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MERGERS & ACQUISITIONS

US Defence Department says climate change threatens national security – so how green is your deal?

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On 12 November 2014, President Barack Obama and Chinese President Xi Jinping issued a joint announcement on climate change and clean energy cooperation, in which the leaders “reaffirmed the importance of strengthening bilateral cooperation on climate change” and pledged to “work together, and with other countries” to adopt a protocol to combat global climate change, which the announcement described as “one of the greatest threats facing humanity”.

Almost a month prior to release of the joint announcement, the United States Department of Defence (DoD) issued a widely publicised report entitled ‘2014 Climate Change: Adaption Roadmap’, which pointedly concludes that climate change will affect national security. In a foreword written well before his announced resignation, Secretary of Defence Chuck Hagel calls climate change a “threat multiplier”, arguing that it “has the potential to exacerbate many of the challenges we are dealing with today – from infectious disease to terrorism”. Secretary Hagel adds that the DoD is “already beginning to see some of these impacts”, and that “a changing climate will have real impacts on



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our military and the way it executes its missions”.

The report makes clear that the DoD sees climate change as a current problem, affecting everything from military readiness to infrastructure planning and maintenance: “As climate change affects the availability of food and water, human migration, and competition for natural resources, the Department’s unique capability to provide logistical, material, and security assistance on a massive scale or in rapid fashion may be called upon with increasing frequency”. The report also notes that climate change can alter the “distribution of disease vectors, including exposure to diseases in regions not routinely encountered, that may have acute and long-term impacts on personnel health and safety”. Only days before the report was made public, the DoD announced that it was dispatching 3000 troops to West Africa to help in the effort to contain the Ebola virus.

The joint announcement and the report may well have significant implications for mergers and acquisitions, particularly in light of the authority of the Committee on Foreign Investment in the United States (CFIUS), a multi-agency panel that reviews foreign acquisitions

of US businesses in order to assess their impact on US national security. Notably, the committee’s jurisdiction may even extend to foreign mergers and acquisitions if the transaction includes US businesses that are owned or controlled by the target.

After CFIUS review, transactions deemed to threaten US security may be blocked by the President. Although presidential vetoes are exceedingly rare – only two have been issued in more than 20 years – it is common for deals to be restructured to address national security concerns. CFIUS may also seek mitigation agreements before clearing transactions. These agreements may provide for divestment of sensitive assets or impose significant controls on post-acquisition governance, lines of supply or the nationality of key personnel, among other constraints. Not surprisingly, some transactions are withdrawn and abandoned when they cannot be restructured to meet national security concerns on terms that are satisfactory to both the buyer and seller.

The law that authorises CFIUS reviews does not define ‘national security’. When it was first created, CFIUS generally limited its reviews to the traditional defence sector – acquisitions of cleared defence

contractors, companies with export-controlled technology and companies engaged in defence programs administered by the US Department of Energy. In 2007, however, following the controversial attempt by Dubai Ports World, a UAE company, to acquire the management business for six major US ports, Congress wrote new legislation to bolster the Committee’s authority to review deals that could result in foreign control of ‘critical infrastructure’ – defined as “systems and assets, whether physical or virtual, so vital to the United States that [their] incapacity or destruction would have a debilitating impact on national security”.

Accordingly, CFIUS is now authorised to consider, among other things: “the potential national security-related effects on United States critical infrastructure, including major energy assets;... the potential national security-related effects on United States critical technologies;... the long-term projection of United States requirements for sources of energy and other critical resources and material; and... *such other factors as the President or the Committee may determine to be appropriate, generally or in connection with a specific review or investigation*” (emphasis added).



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In other words, there are certain things the committee must consider, several of which bear on climate change issues. Additionally, the committee can also consider any other factors deemed appropriate by either itself or the President, taking into account, of course, that the committee's jurisdiction is still limited to the national security impact of a proposed transaction.

Today, CFIUS reviews may also extend to acquisitions of companies that have no defence business whatsoever, but are engaged in, for example, the manufacture, production, design, support, service or repair of critical infrastructure. Acquisitions of firms within the telecommunications, transportation, energy or even food sectors could be and have been subject to CFIUS review. Furthermore, the Committee's reviews may even extend to real estate transactions if the target property is in close proximity to a sensitive national security installation. Notably, the proposed acquisition of the Waldorf Astoria

Hotel by a Chinese buyer reportedly came under CFIUS review recently, as the hotel is the official residence of the US Ambassador to the United Nations.

Against this backdrop, the DoD's report takes on new meaning. If climate change threatens national security, then it is appropriate for CFIUS to consider the environmental impact of a proposed transaction, and it is fair to assume that this inquiry could include the acquirer's record of environmental stewardship outside the US. While a 'deep dive' into a firm's environmental practices is unlikely, the committee may want to assess an acquirer's commitment to environmental rules and regulations if it has a track record of egregious environmental violations. For example, if a foreign manufacturer with a poor environmental record is looking to acquire a US supplier of hazardous materials, CFIUS may want to know how the acquirer plans to protect the environment if the deal is successful, and may impose mitigation measures to make sure that its poor

compliance record will not carry over to the US business. On the other hand, an acquirer with a stellar compliance record may argue that national security will be enhanced if it is cleared to acquire a US business with a record of environmental law violations, since it can then overhaul the target's sorry compliance program. China, a major source of greenhouse gasses, may have improved its standing with the joint announcement, although questions on the country's environmental stewardship may still arise in the future.

Foreign investors looking to acquire US businesses must factor in the prospect of a CFIUS review. Not all deals are candidates for CFIUS review, but many are, and the list keeps getting longer. If a deal is likely to be reviewed by CFIUS, it is important to assess and address the national security risks presented by the transaction. Ten years ago, compliance with environmental laws would not have been a serious factor in that analysis. But today, it may well be. ■