On February 13, 2006, the shareholders of Peninsular & Oriental Steam Navigation Co. of London (P&O) confirmed sale of their company to Dubai Ports World (DP World). Through this act, the management of port operations in five US ports also came under DP World's purview. On March 9, DP World announced that it would divest the US port operations.

The intervening 25 days saw a flurry of activity in the United States with politicians of all shades of opinion, news programs, administration officials, and
assorted experts debating the pros and cons of the deal. The outcome of the deal was seen to have much larger implications than mere port management. It raised issues of national security, the investments of petrodollars around the world, US policy toward foreign investment, political risk, and the attitudes of Americans toward the Arabs.

A Dubai Company

Since 1999, DP World, a Dubai government-owned company, had begun a strategy of aggressive growth. With the acquisition of P&O, it became the world’s third largest port operator, with operations in 13 countries, including China, India, Germany, Australia, the United Kingdom, and the Dominican Republic. The acquisition of P&O was the successful outcome of a bidding war against Singapore’s Temasek Holdings for $6.8 billion. (Being privately owned, DP World’s revenues and profit figures are not publicly accessible.)

Dubai is the second largest of a federation of seven semiautonomous city-states, which became the United Arab Emirates (UAE) in 1971. It has a population of about four million, of whom only about 20% are citizens. Like most of the other countries in the region, Dubai depends on a large number of expatriate workers from South Asia (India, Pakistan, and Bangladesh) to run the country. Its has also attracted a number of British, Australian, and Americans who have come to work or retire.

Dubai attempts to balance the demands on its being a Middle Eastern state with its desire to play a larger role in the world. The UAE is a part of the boycott of Israel called by the Arab League since the early 1990s, although it ignores this in practice. It also does not recognize US sanctions against Iran. As the UAE does not have any direct links with Israel, products are not shipped directly from Israel but are allowed to enter from third countries.

Unlike some of its neighboring states, Dubai gets only a small share of its income from oil and has worked hard over the years to build the country as a business hub and tourism destination. It does not have income taxes. Dubai is a popular shopping center in the region with glitzy malls, extravagant hotels, and amusement parks. All major luxury brands of the world have outlets there. Apart from tourism, it is also the regional headquarters of many of the world’s large financial institutions. Dubai built its port to world-class levels, and it also operates the biggest airline of the area, Emirates Air. More than 500 US companies operate in the UAE.

The Dubai government has been using its oil revenues to make major investments around the world. It has purchased hotels and property in the US and UK. It recently purchased a $1 billion stake in Daimler-Chrysler AG and became the third largest shareholder.1

Given its strategic geographic location and small size, the country has tried to maintain good relations with countries in the region and outside. It stayed neutral during the Iran-Iraq war in the 1980s. The UAE is considered a key ally by the US administration. It cooperates militarily and hosts US naval vessels since its ports are capable of receiving large aircraft carriers and nuclear submarines. It also has an airbase for refueling US military planes.

On the other hand, two of the hijackers who participated in the September 11, 2001, terrorist attacks in the United States were from the UAE. Even before that, it was one of three countries (apart from Pakistan and Saudi Arabia) that officially recognized the Taliban regime in Afghanistan. The UAE was also seen as a transit point for Iran and Pakistan to move contraband nuclear materials, and its banking facilities are believed to be used by terrorist groups. After the terrorist attacks, the country had worked hard to strengthen controls on its financial system.

Investment in US Ports

Through this purchase, the operations by P&O in five ports in the US passed on to DP World’s hands. These included New York/New Jersey, Philadelphia, Baltimore, Miami, and New Orleans. Of these, the New York/New Jersey and Miami terminals are considered the more attractive ones, and in these two, P&O shared ownership with other operators. Apart from the five marine terminal operations, P&O’s operations included cargo handling and cruise ship services in 22 ports in the United States.2

The management of the five ports was not the first venture of DP World in the US. In a previous deal, DP World had purchased the international terminal business of CSX Corp. of Jacksonville, Florida, for $1.15 billion in December 2004.

All foreign investment in the United States needs to be approved by the US Committee on Foreign Investment (CFIUS). The late 1980s saw a lot of debate in the US about increasing Japanese investments. In response, US Congress passed the Omnibus Trade and Competitiveness Act of 1988 (Exon-Florio Amendment) to the Defense Production Act of 1950, which empowered the president to block foreign acquisition proposals on grounds of national security. This role was assigned to CFIUS.

CFIUS comes under the Department of Treasury and is an interagency committee chaired by the department’s Secretary. There are 12 members including the Secretaries of State, Defense, Commerce, and Homeland Security, Attorney General, Director of the Office of Management and Budget, US Trade Representative, Chairman of the Council of Economic Advisers, Assis-

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tant to the President for Economic Policy, Assistant to the President for National Security, and Director of the Office of Science and Technology. On receipt of notification, it undertakes a 30-day review, and in some cases, an additional 45-day period for investigation is allowed, after which it makes a recommendation to the president. The committee since 1988 had reviewed about 1,600 transactions. Of these, only about 25 were investigated further.

In mid-October 2005, even before formally approaching P&O about the acquisition, DP World retained the services of two lawyers in Washington, DC, to informally negotiate with CFIUS and seek its approval. This is normal practice, and often a lot of the work involved in such reviews is undertaken even before a formal application. After completing the deal with P&O and formally announcing the deal, DP World, in mid-November 2005, made its formal application to CFIUS, which was approved on January 16, 2006. At that time, the company also put forward a package of commitments on security, such as allowing US officials to examine company records and check the background of its employees and to separate the port terminal operations from the rest of the country.

When information about the deal appeared in the press, Eller & Co., a stevedoring company in Miami that had a joint venture with P&O, decided it did not want to be an “involuntary partner” of DP World6 pursuant to the acquisition. Therefore, Eller retained the services of a lobbyist in Washington, Mr. Joe Muldoon, who began researching the issues involved in the P&O acquisition and contacted several legislators in February, when they returned from their January recess. One of those senators was Mr. Charles Schumer, Democrat from New York (where one of the ports is situated), who was also on the Banking Committee in the Senate. Meanwhile, the Associated Press also contacted Mr. Schumer and issued a report making a connection between the acquisition, the country of Dubai, terrorists, and the vulnerability of the ports to terrorism.4

Politicians of different hues were quick to react to the deal. Mr. Schumer addressed a press conference along with the families of those who suffered from the terrorist attacks on September 11, 2001, calling the president to step in and prevent the deal. On February 17, Senator Hillary Clinton, the other senator from New York and also a Democrat, said, “Our port security is too important to place in the hands of foreign governments.” Even Republicans (the same party as the president) were opposed to the deal, saying, “Dubai can’t be trusted with our critical infrastructure.” Another said, “It is my intention to lay the foundation to block the deal.” Senator Lindsey Graham (Republican) said, “It’s unbelievably tone-deaf politically . . . four years after 9/11, to entertain the idea of turning port security over to a company based in the UAE, [a country that] vows to destroy Israel.”6

Some political observers felt that the president’s low standing in public opinion polls due to dissatisfaction on the progress in the war in Iraq was making some Republican lawmakers challenge and distance themselves from him in preparation for their own reelection battles in November 2006.

News commentators began to raise alarms about the deal. On the same day that P&O announced its purchase, Lou Dobbs, a business anchor on the CNN News channel said, “a country with ties to the Sept. 11 terrorists could soon be running significant operations at some of our most important and largest seaports with full blessing of the Bush White House.” Mr. Dobbs was known for taking a nationalist position on issues like immigration and outsourcing and the effects on jobs in the United States. Several radio talk shows picked up the story and filled the airwaves with different interpretations. Moreover, many public and security professionals who had been concerned that the government had not been doing enough for port safety and scanning of containers found the ports takeover as another example of a government that was slackening on security.

In an effort to manage the debate around the deal, the administration clarified that it had asked and received additional security commitments from DP World before giving its clearance. An Israeli shipping company, ZIM Integrated Shipping Services Ltd., even sent a letter to US senators stating that they have used the services of DP World at Dubai and have had no concern about their level of security.8

Officials also clarified that security screening was not the responsibility of the commercial port operators but that of US law enforcement agents. However, the misperception that the Middle East company would be responsible for port security persisted in the public impression and was repeated on talk shows.

Ports and Container Operations

Container shipping was pioneered by a US company, Sea Land, in the 1950s. However, during the 1980s, US companies found it difficult to face the competition from companies that were operating under flags of convenience, were thus subject to less stringent tax and regulatory policies, and also used less expensive labor. The shipping industry has been globalized for some time now. None of the major global container shipping companies is US owned. Shipping companies often have subsidiaries to manage terminals to facilitate the cargo they carry.

Most ports are owned by port authorities that are set up by local governments. The authorities lease a terminal to an individual company, which is responsible for port management and operations such as moving the containers from the ships to the warehouses.

Large ports have multiple terminals, and these are operated by different companies. US companies have
exited from this business over time because it requires heavy investment, and returns are seen only over the long term. At the Los Angeles port, the terminals are managed by companies from China, Denmark, Japan, Singapore, and Taiwan. The big ports of the United States—namely, Los Angeles, Long Beach, and Oakland in California and New York/New Jersey—handle about half of all containers that pass through the US. At these ports, about 80% of the container terminals are handled by foreign companies, and some are owned by foreign governments.

Companies that manage terminals were often subsidiaries of shipping companies. About 80% of global cargo was handled by five companies around the world, headquartered in Hong Kong (Hutchison Whampoa), Singapore (PSA), Dubai (DP World), Denmark (A.P. Moller-Maersk Terminals), and Germany (Eurogate).

Security

Regardless of whether a US or a foreign company operates the terminal, security at the ports, including inspection of containers, is the responsibility of federal agencies such as the US Coast Guard and the US Customs and Border Protection. The Coast Guard is also authorized to inspect a vessel at sea or at the harbor entrance. About 26,000 containers arrive at US ports every day, and customs agents inspect about 5% of them. About 37% of containers that leave the ports for the highways are screened. Security in the area surrounding the ports is part of the responsibility of the local police.

There are several areas that can do with strengthening to improve security, and they have very little to do with who manages port operations. There is a voluntary program operated by the US government to protect incoming shipments. Many companies have signed up for this, under which the companies develop voluntary security procedures to protect the shipment from the factory to the port. In return, their cargo is processed at a faster pace at the port. Shipments from companies that don’t take part in the program may not always be inspected. Even for those who do participate, security is not perfect because the cargo may be open to tampering in transit.

About 40 ports around the world ship approximately 80% of the cargo entering the United States. At the port of shipment, the carrier is required to electronically provide the manifest (list of items being shipped) at least 24 hours before loading. This list is analyzed in a screening center in the US, and customs agents who identify any suspicious items can ask their counterparts at the port of dispatch to screen the containers. However, the US Government Accountability Office reports that as of 2005 about one-third of the containers were not being analyzed, and about one-fourth of those identified as high-risk were not being inspected. Scanners and radiation detectors to screen every single container are available, and their use was estimated to add about $20 to the container.

Opposition Gathers Momentum

Faced with rising criticism, DP World also had a crew of lobbyists and attorneys working on its behalf in Washington. Officials of the UAE embassy were also working closely with people like Senator John Warner (Republican) who was in favor of the deal. Legislation was also being planned to permit the deal subject to conditions such as the terminals being operated by US citizens.

When some members of Congress threatened to pass legislation blocking the sale, President George W. Bush responded on February 21 by saying that he would veto it. He also said that he learned about the deal only after it was approved by his administration. Expressing concern about the implications of the deal, he was quoted as saying, “I want those who are questioning to step up and explain why all of a sudden a Middle Eastern company is held to a different standard than a British company. I am trying to say to the people of the world, ‘We’ll treat you fairly.’” 10

By the end of February, a CBS News poll revealed that 70% of participants said that a UAE company should not be permitted to operate US shipping ports. With political objections mounting, DP World on February 26 requested a fresh 45-day review of the deal and offered to hold the American operations separate until the review was completed. The administration agreed to undertake the review.

Although the administration had taken a hard stand initially in supporting the deal, the opposition from within the president’s party was strong. Both the leader of the party in the Senate and the speaker in the House of Representatives were opposed to the president on the issue.

Although the US operations only accounted for about 10% of P&O’s profits, DP World was keen on making the deal work. The US operations of the company were the destination of cargo from its more significant holdings in Asia, and the company wanted this as a foothold to expand its US operations in the future. Its CEO, Mr. Ted Bilkey, told a US news channel, “We’ll do anything possible to make sure this deal goes through.” 11

In keeping with this, the company, on March 7, offered three Republican senators a package of security measures12 titled “Proposed Solution to the DP World Issue.” These proposals, which were in addition to the commitments the company made earlier in January, included:

• Paying for screening devices at all current and future ports the company operates around the world.
• Giving the Department of Homeland Security the right to disapprove the choice of chief executive, board members, security officials, and all senior officers.

• A “supermajority” of the board would be US citizens.

• All records pertaining to its security operations would be maintained on US soil, and these records would be turned over at the request of the US government.

• Its US subsidiary, now managed by a British citizen, would in the future also be headed only by a US or British citizen.

• A Security and Financial Oversight Board would be established, headed by a prominent American who would report annually to the Department of Homeland Security.

Some observers felt that this was truly extraordinary for a foreign company to offer. Although such an offer, if made earlier, may have swayed the debate, by the time it came, positions had already hardened. On March 8, the House Appropriations Committee voted 62 to 2 to block the DP World deal. To make the president’s threat of a veto more difficult, the committee attached this as an amendment to a spending bill for the wars in Iraq and Afghanistan. The next day, the Republican congressional leaders conveyed to the president that Congress would kill the deal.

The Bush administration then conveyed a request to Dubai’s ruler to sever the US operations to allay fears in the US about security. Officials in the UAE saw this as a situation where President Bush was incurring a loss of face in his dealings with Congress. Consequently, DP World on March 9, 2006, offered to divest the US port operations.

Case Discussion Questions

1. From a resource-based view, why was DP World interested in acquiring US ports? What advantages did it have or was interested in acquiring?

2. From an institution-based view, did this acquisition violate any formal laws, rules, and regulations?

3. Also from an institution-based view, what informal rules and norms did this acquisition “violate” that triggered such a strong negative reaction in the United States?

4. Did DP World and its American lawyers and other advisors do enough homework?

5. Combining the institution- and resource-based views, what advantages did Eller have that DP World did not have? Did Eller’s political strategy make sense?

6. If you were CEO of Hong Kong’s Hutchison Whampoa, Singapore’s PSA, Denmark’s Maersk, or Germany’s Eurogate, what lessons would you draw from this case when entertaining the idea of acquiring US port operations?

Notes


