

CFIUS risk grows for Chinese-backed investment in the United States

Investment from China hit a record \$46 billion in 2016 (tripling the previous record of \$15 billion in 2015) and with it has come increased scrutiny from CFIUS both in terms of the number of transactions reviewed and those blocked. Tatman Savio, Christian Davis and Thor Petersen examine current record year for CFIUS and assess the outlook for Chinese investors in the United States.

In recent years, Chinese parties seeking to make investments in the United States have faced heightened scrutiny from the Committee on Foreign Investment in the United States ('CFIUS' or the 'Committee'). This risk has only grown under the Trump administration. In fact, while the early part of this year saw several China-related investments facing and surviving CFIUS review, the latter part of 2017 revealed a series of failed China deals.

Against this backdrop, Congress is in the process of crafting legislation to expand CFIUS authority both generally and in a way that will specifically create a more robust process for reviewing Chinese investments. Moreover, it has been speculated that the Trump administration may be using CFIUS approvals as leverage against China in broader bilateral

negotiations outside of the national security concerns presented by the specific transaction under review. In this regulatory and political climate, it is increasingly important for companies to understand the CFIUS risk associated with a proposed transaction, account for that risk in negotiating deal terms, and develop a strategy for mitigating the risk of an undesirable CFIUS outcome.

Background

CFIUS is an inter-agency committee that conducts national security reviews of mergers, acquisitions, or takeovers of US businesses by non-US persons. CFIUS has the authority to initiate reviews of transactions, impose mitigation measures to address national security concerns, and recommend that the

President block pending transactions or order divestitures of completed transactions. To mitigate CFIUS risk, parties may file a voluntary notice with CFIUS to obtain clearance, known as a 'safe harbor,' with respect to a notified transaction.

CFIUS has jurisdiction to review 'covered transactions', which are defined as transactions that could result in control of a US business by a non-US

owners of the buyer and its parent company. Prior to formally submitting a notice, CFIUS strongly encourages a pre-filing with the Committee to allow for initial comments and feedback from the Committee. Following the formal filing of the notice (which should incorporate feedback from the pre-filing process), CFIUS will begin its formal review, the initial stage of which is a 30-day review period. If CFIUS cannot resolve its

national security concerns during this review, it will commence a subsequent 45-day investigation. At the end of the investigation, CFIUS can clear the transaction, require a mitigation agreement before doing so, or recommend that the President block the transaction, which initiates a 15-day presidential review period.

The review and investigation timelines described in the CFIUS statute and regulations contemplate CFIUS's clearance of transactions within 30, 75 or 90 days. As a matter of practice, in the event that parties learn that CFIUS will recommend to the President the blocking of a proposed transaction, they will typically abandon the deal to avoid negative publicity. In addition, if CFIUS cannot complete its review or reach agreement with parties on mitigation measures in the prescribed review and investigation periods (i.e., 30 days for review, plus 45 days for investigation), the Committee may ask parties to withdraw and re-file their notices to allow more time to assess or address perceived national security risk. As a consequence, CFIUS reviews in complex cases can drag on for many



person. Even if CFIUS has jurisdiction to review a transaction, a filing is not necessarily advisable unless the transaction poses potential US national security concerns. In assessing this risk, CFIUS primarily focuses on the threat posed by the non-US buyer and whether the US business that is the subject of the investment presents a vulnerability in the context of US national security. As discussed further below, Chinese investments in a variety of sectors have triggered national security concerns in recent years.

The CFIUS review process requires parties to submit a joint notice containing detailed information regarding the proposed transaction and the relevant parties, including personal identifier information for officers, directors and

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months beyond the statutory review period.

Trends in CFIUS review and Chinese investment

As a general matter, CFIUS filings have increased dramatically in recent years. While the number of notices reviewed has steadily grown since 2009, CFIUS review surged by over 20% from 2015 to 2016 (from 143 to 172 notices) and is on track to reach 250 notices this year, a potential increase of over 45% or more. This unprecedented workload coincides with concerns that the Committee is understaffed, raising the spectre of costly and frustrating delays for parties to transactions under review.

At the same time, direct investment from China into the United States has skyrocketed. According to the Rhodium Group, investment from China hit a record \$46 billion in 2016 (tripling the previous record of \$15 billion in 2015). While it appears that investment slowed in the first half of 2017, state-owned companies have regained their prominence (accounting for nearly 60% of the total deal value) in Chinese-US deals compared with 2016. In 2016, over 90% of Chinese investment in the United States targeted services and advanced manufacturing, with real estate and hospitality, information and communications technology, entertainment, transport and infrastructure, consumer products, electronics, and financial services standing out.

Given the concurrence of these two trends, it should come as no surprise that Chinese deals have faced increasing scrutiny. From 2012 to 2015, China accounted for the most covered transactions by a foreign country in the CFIUS review process. While CFIUS deliberations and negotiations are confidential, meaningful trends can be extrapolated from public reports of these regulatory reviews.

Recent transactions involving Chinese investors

In the early part of the year, a number of transactions involving Chinese investors cleared CFIUS review. In contrast, since mid-2017, we have seen no public reports of a China-related transaction obtaining CFIUS clearance. In light of this change in CFIUS fortune, we describe below the successful China deals from early 2017, in comparison to the failed and stalled China transactions of late 2017.

The early-in-the-year CFIUS successes

demonstrate that victory for Chinese companies can mean abandoning sensitive technology or relinquishing control rights, as described below.

LEDvance, business unit of Osram Licht AG / IDG Capital Partners, MLS Co., & Yiwu State-Owned Assets Operation Center. In August 2016, a Chinese consortium announced its proposed acquisition of LEDvance, a German LED lighting business. The consortium consisted of (i) IDG Capital Partners, a Chinese investment firm, (ii) MLS Co., a

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Chinese LED manufacturer, and (iii) Yiwu State-Owned Assets Operation Center, a state-owned asset management firm. According to press releases, parts of the LEDvance business are based in the United States, implicating US jurisdiction and the need for CFIUS review. Even though other LED deals did not survive CFIUS review in 2016, Osram announced CFIUS approval of the deal in February 2017. The rationale for this clearance appears to be that this transaction did not involve the transfer of the sensitive types of technology that were at issue in the blocked transactions.

Stillwater Mining Co. / Sibanye Gold Ltd. The buyer in this deal, Sibanye, is an independent mining group incorporated in South Africa with 20% Chinese ownership. At the time of the transaction, Stillwater was headquartered in Colorado and was the only US miner of platinum and palladium – known as platinum group metals ('PGMs'). PGMs have potential national security significance due to the potential military applications of these metals. The parties filed a joint voluntary notice with CFIUS in January 2017 and obtained clearance in April 2017, which would be consistent with a single 30-day review and 45-day investigation by CFIUS. A factor supporting clearance in this transaction was likely that the 20% stake in Sibanye reportedly did not

afford the Chinese investor control over the company.

C.I.T. Leasing / Avolon Holdings Co. (Bohai Capital Holding Co.) Avolon Holdings, a wholly-owned subsidiary of the Chinese Bohai Financial Investment Holding Co., announced an agreement on 6 October 2016 to buy CIT Group's commercial aircraft leasing company for a purchase price of \$10.4 billion. Under the agreement, the parties were to submit a voluntary notice to CFIUS by 30 November 2016. The deal closed in April 2017. Since CFIUS clearance was a closing condition, it appears that the transaction cleared CFIUS review in early 2017. While CFIUS is generally concerned about the transfer of certain aerospace technology to Chinese buyers, the parties were apparently able to resolve any issues that may have existed in relation to the sale of this leasing business.

Following these clearances early in the year, similar reports related to China deals have essentially vanished. Instead, there have been a number of transactions that have been blocked or abandoned, as well as China deals that appear to be stalled in the process. The examples below serve to underscore that CFIUS will not be accommodating in certain sensitive sectors, even for very small minority investments or when parties are willing to propose mitigation.

Lattice Semiconductor / Canyon Bridge On 13 September 2017, in the most high-profile CFIUS case so far this year, President Trump issued an order prohibiting the proposed \$1.3 billion acquisition of Lattice Semiconductor Corporation by Canyon Bridge, a private equity fund with offices in Silicon Valley and Beijing, that reportedly has received significant funding from state-owned investors in China. Despite the parties' two withdrawals and re-files of their CFIUS notice and efforts to propose mitigation measures, the administration determined that the acquisition posed a national security risk related to, among other things, 'the potential transfer of intellectual property to the foreign acquirer, the Chinese government's role in supporting this transaction, the importance of semiconductor supply chain integrity to the US government, and the use of Lattice products by the US government'. Although this was

the second official presidential blocking action in ten months, it was only the fourth time the power had been exercised by a president under the CFIUS statute.

HERE Technologies / NavInfo, Tencent & GIC In late September 2017, HERE Technologies announced that NavInfo Co. Ltd, Tencent Holdings Limited, and GIC Pte Ltd had abandoned an attempt to acquire a 10% stake in the company following CFIUS resistance. HERE, based in Amsterdam and currently controlled by BMW, Daimler, and Volkswagen's Audi unit, is developing detailed three-dimensional maps for location-based services and self-driving vehicles. NavInfo is a Beijing-based digital map provider, while Tencent provides Internet in China and GIC is a Singaporean sovereign wealth fund. In this case, CFIUS apparently scuttled a proposed minority investment by Asian companies in a European-based company. HERE's only identified business in the United States is a development site in Chicago, which was apparently sufficient to qualify NavInfo as a US business for purposes of CFIUS consideration. CFIUS's assertion of jurisdiction in this case may well be connected to its interest in protecting technology related to self-driving vehicles.

Inseego / TCL Industries Novatel Wireless, a subsidiary of Inseego, a Delaware corporation, entered into a stock purchase agreement with T.C.L. Industries Holdings, a wholly-owned subsidiary of the Chinese company TCL Corp., on 21 September 2016. The proposed transaction involved the acquisition of Inseego's MiFi branded hotspots and USB modem product lines. The parties withdrew and refiled their CFIUS notice twice, stating in regulatory filings that they were exploring potential mitigation measures. Regardless, on 7 June 2017, Novatel announced that it had decided to terminate the agreement. While Inseego claimed that the

decision was due to improving business conditions, observers have speculated that CFIUS resistance played a role.

MoneyGram / Ant Financial (Alibaba) Ant Financial, an affiliate of the Alibaba Group Holding, agreed to buy money transfer company, MoneyGram International, for \$1.2 billion on 26 January 2017. After the deal apparently stalled under CFIUS review, Ant Financial refiled with CFIUS for a second time in September 2017, and, at the time of this writing, that notice was still pending with CFIUS. This deal has come under political pressure, which appears to be partly related to US-based Euronet Worldwide's rival bid to acquire Moneygram. The deal has also raised concerns about information possessed by Moneygram pertaining to US citizens, including military personnel. In addition, CFIUS may have concerns regarding Moneygram locations that are in close proximity to, or co-located on, military facilities, a factor which has raised national security concerns in other Chinese investments.

What this means for Chinese investment in the United States

Given the heightened CFIUS scrutiny in 2017, the climate for Chinese investment in the United States has become challenging. Moreover, it remains to be seen whether CFIUS is holding up Chinese investments as leverage or some sort of penalty in connection with broader US-China issues. To the extent that broader trade and bi-lateral issues are affecting clearance of these transactions, parties will face hurdles to completing transactions that may not be as easily addressed through traditional mitigation strategies.

In this context, Senator John Cornyn (R-Texas) and Representative Robert Pittenger (R-N.C.) have floated a draft reform bill that would expand the definition of covered transactions and impose mandatory declarations for certain defined transactions, among other

changes. This bill follows on the heels of ongoing discussions on Capitol Hill that focused on providing more authority to review Chinese investment in the United States, with less emphasis on promoting foreign direct investment

Consistent with the approach and position at the legislative level, numerous members of the Trump administration have criticised the CFIUS review process and called for expansion of its authority and mandate, including Treasury Secretary Steven Mnuchin, Defense Secretary James Mattis, Commerce Secretary Wilbur Ross, and Attorney General Sessions. While it is significant to have the combination of support for CFIUS reform in both the administration and Congress, it remains to be seen whether the bills advanced by Cornyn and Pittenger will be able to muster the necessary majorities in the current political climate. Nevertheless, the draft legislation has the possibility of becoming law and creating additional hurdles for Chinese investors, in particular.

In this challenging investment climate, parties to a transaction must carefully assess the associated CFIUS risks. In this regard, the parties must perform a robust CFIUS analysis and evaluate whether CFIUS has jurisdiction to review transactions, including in minority investment structures and deals that involve multinational targets headquartered outside the United States. In addition, the assessment should involve analysis of potential vulnerabilities presented by the target as well as political concerns that may draw CFIUS scrutiny. After understanding this risk, the parties can make a decision regarding the feasibility of the transaction, mitigation measures that may be needed to proceed, and whether and how to engage with CFIUS. While many transactions involving Chinese investment in the United States may face a rocky road in the current climate, those transactions that do not involve a carefully considered CFIUS strategy are likely to be in peril. ■



Tatman R. Savio is a partner with Akin Gump Strauss Hauer & Feld LLP (a limited liability partnership registered under the laws of Texas, U.S.A.) and a registered foreign lawyer in the firm's Hong Kong office. Christian Davis is counsel and Thor Petersen is a law clerk in Akin Gump's Washington, DC office.

tatman.savio@akingump.com

chdavis@akingump.com

tpetersen@akingump.com