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Chinese Investment in the U.S. – Lessons and Opportunities

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By Tatman Savio, William Leahy, and Alex Conway

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Over the past three years for which such data is available (FY 2012—2014), China has had the most transactions reviewed by CFIUS, with most deals obtaining clearance from the committee. Since the second half of 2015, several proposed Chinese investments have encountered CFIUS challenges. In some cases, CFIUS blocked the proposed transactions, while in others, parties abandoned deals based on scrutiny or potential scrutiny from CFIUS.

At the same time, the political climate in the United States threatens to become increasingly hostile toward Chinese investment. Earlier this year, a member of Congress indicated she would reintroduce a bill to expand the mandate of CFIUS. Furthermore, the presumptive presidential nominees are focusing significant time and energy discussing perceived inequities in the trading relationship with China.

Chinese investors and their potential acquisition targets should take note of these developments, which could imperil Chinese attempts at large-scale acquisitions. However, these dynamics should not obscure recent successes involving Chinese investments in the United States. Despite political and economic hurdles, several large-scale Chinese investments have cleared the CFIUS process and stand as proof that opportunities exist for prudently structured and strategically focused deals.

CFIUS overview

CFIUS has jurisdiction to review "covered transactions" — any transaction that could result in foreign control of a US business — to determine if credible evidence exists that the transaction threatens to impair US national security. The CFIUS process may begin either in response to a voluntary notice by the parties or through self-initiation by CFIUS. To address national security concerns, CFIUS can require a mitigation agreement. CFIUS can also recommend that the president block or suspend proposed transactions, or order divestiture of a completed transaction. Political pressure from lawmakers can influence the CFIUS process, based on express national security concerns and reasons that seemingly fall outside the scope of the statutory basis of CFIUS review.

Recent Chinese deals impacted by CFIUS

Three recent failed Chinese investments in which CFIUS, or the threat of CFIUS interference, played a key role illustrate the committee's impact on Chinese acquisitions.

Blocked by CFIUS: Royal Philips NV (Lumileds)–Go Scale Capital Ltd. (January 2016)

In mid-2015, Royal Philips NV (Philips), a New York Stock Exchange-listed Dutch technology company, announced plans to sell an 80.1 percent interest in its Lumileds light business to a consortium led by Chinese private equity firm Go Scale Capital Ltd. The $3 billion deal stalled in October 2015 and was ultimately blocked by CFIUS in January 2016. Public reports indicate that CFIUS had concerns about Chinese control over dual-use semiconductor technology involved in making LEDs (used in vehicle brake lights, digital cameras, and fiber-optic telecommunications systems) because of the technology's applicability to the development of weapon systems. Philips stated that it and Go Scale Capital made extensive efforts to mitigate CFIUS's national security concerns. Philips has still not divested Lumileds, although reportedly it is engaged with interested parties.

Offer rescinded following CFIUS scrutiny: Western Digital Corp–Unisplendour Corporation Ltd. (February 2016)

In September 2015, Unisplendour Corporation Ltd. (Unisplendour), established as a subsidiary of Chinese conglomerate Tsinghua Unisplendour (Group) Co., offered Western Digital $3.8 billion for a 15 percent stake in the American hard-drive manufacturer. The deal would have made Unisplendour Western Digital's largest shareholder and given Unisplendour a seat on Western Digital's board. According to a Western Digital press release, the parties were notified by CFIUS that it was "undertaking an investigation of the proposed … investment under the Exon-Florio Amendment to the Defense Production Act, triggering a 15-day period during which either Western Digital or [Unisplendour] may terminate the stock purchase agreement." As a result, the parties abandoned the deal.

Offer rejected due to CFIUS concerns, February 2016: Fairchild Semiconductor International Inc.–China Resources Microelectronics Ltd & Hua Capital Management Co Ltd.

In 2015, Fairchild Semiconductor International Inc. – a medium-sized US semiconductor company – entered into an agreement with ON Semiconductor. ON Semiconductor, a US company, offered to acquire the company for $20 per share (or $2.4 billion), but before the deal closed, a Chinese consortium stepped in with a higher offer. The consortium, comprised of China Resources Microelectronics Ltd. and Chinese private equity firm Hua Capital Management Ltd., offered Fairchild $21.70 per share (or $2.46 billion). Fairchild vacillated between the two offers, but ultimately rejected the higher bid to avoid CFIUS and the fight for approval of the Chinese deal. In a statement, Fairchild expressed concern that CFIUS would reject the Chinese deal and the "proposed $108 million CFIUS reverse termination fee would not adequately justify risking the company stockholder premium present in the ON Semiconductor transaction."

Recent Chinese investments surviving CFIUS review

China has had some recent successes in the US market, with a handful of its companies' investments surviving CFIUS review in 2015 and 2016. In March 2016, China's Anbang Insurance Group (Anbang) announced it won approval from CFIUS to buy US annuities and life insurer Fidelity & Guaranty for $1.57 billion. According to public sources, the proposed acquisition received extensive scrutiny due to the amount access Anbang would gain to customer health and financial information.

Anbang also successfully navigated the CFIUS process in 2015 in its $2 billion acquisition of the iconic Waldorf Astoria Hotel in New York. However, in April 2016, following some negative publicity, Anbang and its consortium partners abandoned their unsolicited $14 billion bid for the Starwood hotel chain, citing "various market considerations." Anbang has also agreed to purchase Strategic Hotels & Resorts from Blackstone Group for $6.5 billion. So far, this deal has raised less CFIUS attention than the proposed Starwood acquisition.

In November 2015, CFIUS concluded its review of the purchase of Integrated Silicon Solution Inc. (ISSI), a California-based semiconductor company, by Uphill Investments, an investment vehicle created by a consortium of Chinese investors. At the time, ISSI issued a press statement indicating that CFIUS had found no unresolved national security concerns. That same month, CFIUS cleared the sale by Netherlands-based NXP Semiconductors (NXP) of its RF Power amplifier assets to Beijing Jianguang Asset Management Co. (JAC Capital), the subsidiary of a state-owned investment company. The $1.8 billion sale of RF Power (now known as Ampleon) to JAC Capital was pursuant to a condition of the Federal Trade Commission (FTC) as the result of NXP's merger with Freescale Semiconductor. These two approvals are particularly noteworthy, as Chinese acquisitions of semiconductor companies have historically come under heightened scrutiny.

Political environment

Elected officials in the United States have paid close attention to the increase in Chinese inbound investment. Several members of the Senate recently made public statements in support of expanding the CFIUS mandate, calling for reviews to consider trends and patterns of acquisitions, as well as seeking the inclusion of both the US Department of Agriculture and Food and Drug Administration in the CFIUS review process. In mid-February 2016, Rep. Rosa DeLauro (D-CT) announced she would introduce a bill in the House of Representatives to broaden the mandate of CFIUS. To date, DeLauro has not introduced such a bill; however, according to sources who have seen the leaked text, it would mirror a bill that DeLauro introduced two years ago in response to the Chinese acquisition of Smithfield Foods. Under DeLauro's proposed bill, the mandate of CFIUS would be expanded to include the authority to:

- Review and scrutinize plans for construction of facilities in the United States by a non-American; and
- Evaluate whether a proposed investment would be of "net benefit" to the United States.

The first proposed amendment to CFIUS authority is significant because it would end the exception to CFIUS review for greenfield investments and broaden the committee's jurisdiction. The second proposed amendment introduces a new standard for the assessment of covered transactions beyond national security impact. Specifically, CFIUS, in cooperation with various agencies and departments, would determine net benefit by weighing diverse factors such as the investment's potential effect on US employment, productivity, industrial efficiency, technological development, and public health. The net-benefit test would also weigh "compatibility . . . with [US] industrial, economic, and cultural policies."

The rhetoric emanating from the US presidential race might also fuel a hostile environment toward Chinese investment. Donald Trump has made American competitiveness, and perceived failures and inequities in the bilateral trading relationship with China, a central theme of his candidacy. Trump has consistently expressed his belief that the United States is "losing to China" and has indicated that he would impose a 45 percent tariff on all goods from China. Hillary Clinton has also heightened her criticism of China's trading practices, following a surprising primary loss to Bernie Sanders in Michigan in which Sanders criticized Clinton for her support of NAFTA and other free trade deals. In recent campaign stops, Clinton intensified her rhetoric against China, and called for the use of trade enforcement tools within the bilateral relationship.

What's next?

Proposed Chinese investments in the United States will likely be affected by the CFIUS process. For example, Chongqing Casin Enterprise Group's (the Casin Group) offer to purchase the Chicago Stock Exchange for an unknown amount has provoked action by members of Congress. Forty-six congressmen asked the Treasury Department to review the transaction, expressing concerns about a lack of information on the Casin Group, a private holding company based in Chongqing, China.

The investment environment in the Unites States for Chinese acquirers will remain a challenging one. But it is not without opportunity. The Obama administration has consistently expressed openness to and interest in Chinese investment, as long as any potential national security issues are allayed. While the presidential campaign trail has been marked by tough stances on trade and China, campaign rhetoric does not necessarily translate into tangible policies in a new administration.

In today's environment, it is imperative that companies think strategically about sensitivities with a proposed deal, and how to mitigate economic and political concerns. In anticipating these issues, companies can give themselves a chance to succeed in navigating and surviving CFIUS review.

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