THOUGH CFIUS ALREADY IS SHINING A BRIGHT LIGHT ON CHINESE COVERED TRANSACTIONS, THAT LIGHT LIKELY WILL ONLY INTENSIFY AND BE BRIGHTER WITH THE TRUMP ADMINISTRATION.

Twelve years have passed since publication of the article *Uncle Sam Watches Nervously: Foreign Investment in U.S. Industries* in 2004.¹ That article discussed the review process under the Exon-Florio Amendment delegated to the Committee on Foreign Investment in the United States (CFIUS).² The article highlighted several recent CFIUS reviews, and stressed that the evolving war on terrorism would have implications on U.S. policy governing foreign investment in the United States. The warning was of stricter scrutiny most focused on the individuals and companies making the investment, with more transactions included in CFIUS oversight involving companies engaged in the provision
of critical infrastructure as opposed to just the production and provision of defense-related goods and services. And, as we have seen as recently as the end of 2016, that scrutiny applies to transactions between companies located outside the territorial wall of the United States.

The projections bore out over the years, as the United States Treasury Department soon after issued “new” regulations and guidance on CFIUS that outlined review of critical infrastructure and specific industries. The U.S. Congress motivated by terrorist and other global policy concerns has developed a growing interest in CFIUS. In particular, the rise of China and its economic strength have caused anxiety at the same time China has become the largest growing source of foreign investment in the United States. Since President Trump has taken office, there is a heightened awareness of China’s rise and perhaps a will to curb it not seen in previous U.S. Administrations. The only question is whether investment would be encouraged to bring jobs to the U.S. or discouraged for fear that key industries might be exported.

The article twelve years ago cautioned that change is not always progress, and warned against change toward too tight security over more transactions that could return the United States to an even broader Cold War suppression of foreign investment. That same cautionary bell needs to be struck again, as foreign companies, especially Chinese companies, should be vigilant of CFIUS, but not deterred from pursuing their own goals for U.S. investments. Nor should CFIUS or the U.S. Congress discourage such investment, but rather welcome it (after the appropriate vetting) as the best means of growing and strengthening the U.S. defense industrial base and general economy.

Treasury’s New Guidance
What was “new” guidance in 2008 may not seem so new now in 2017, but it still prevails today. As the CFIUS Chair, Treasury on November 21, 2008 issued new CFIUS regulations, and on December 8, 2008 issued a notice providing guidance on this CFIUS reform and the national security considerations. Initially, the guidance describes that the purpose of CFIUS reviews is to allow CFIUS to identify and address any national security risk that arises as a result of a “covered transaction,” and if necessary to request that the President determine whether to suspend or prohibit a covered transaction or take other action. A “covered transaction” generally is any merger, acquisition, or takeover by or with a foreign person which could result in control of a U.S. business by a foreign person. A U.S. business is not, however, a corporation located in the U.S.; it could be any business, wherever located, that engages in commerce with the U.S. The new
regulations themselves provide several explicit examples of what is and what is not a covered transaction.

The new regulations retained many of the basic features of the earlier regulations, with voluntary notices to CFIUS by parties to transactions, although CFIUS also has the authority to review a transaction that has not been voluntarily notified. The guidance reiterates that the CFIUS review is focused on national security risk, which focuses on the interaction between threat and vulnerability. CFIUS reviews all the national security considerations, though not all such considerations are found to present a national security risk. The guidance makes clear that the review process is voluntary and that, once successfully through the process, a covered transaction receives a “safe harbor” from any future review or challenge. In contrast, any deal that involves a covered transaction remains subject to possible CFIUS review for national security risk (meaning a done deal is not ever really done, and can be undone by the President, if it involves a covered transaction with unacceptable national security risks).

The guidance is most useful in that it provides specific illustrations of the types of covered transactions reviewed. These types are discussed in two broad categories - (1) the nature of the business and (2) the identity of the foreign person.

With respect to the nature of the business, the guidance identifies such national security considerations as foreign control of U.S. businesses that provide products and services (either prime contractors or as subcontractors or suppliers to prime contractors) to U.S. Government agencies and also state and local authorities (and may or may not be sole source or involve access to classified information). As would be expected, the government contracts typically would be in the defense, security, and national security-related law enforcement sectors, and involve industry segments such as weapons and munitions manufacturing, aerospace, and radar systems. In some cases, however, the government contracts might “involve information technology (consulting, hardware, or software), telecommunications, energy, natural resources, industrial products, and a range of goods and services that affect the national security-relevant functions of the U.S. Government agency or create vulnerability to sabotage or espionage.”

Other types of covered transactions with national security considerations based on the nature of the U.S. businesses have no government contracts, but still involve operations, or production or supply of products or services, that may have implications for U.S.
national security. The examples provided include covered transactions in (1) the energy sector at various stages of the value chain ("[t]he exploitation of natural resources, the transportation of these resources (e.g., by pipeline), the conversion of these resources to power, and the provision of power to U.S. Government and civilian customers")$^7$; (2) the U.S. transportation system ("including maritime shipping and port terminal operations and aviation maintenance, repair, and overhaul"]); (3) the U.S. financial system; (4) the advanced technology sector (those technologies useful in defending, or in seeking to impair, U.S. national security, such as the design and production of semiconductors and other equipment or components that have both commercial and military applications or “the production or supply of goods and services involving cryptography, data protection, Internet security, and network intrusion detection"]); (5) research and development, production, or sale of technology, goods, software, or services that are subject to U.S. export controls; and (7) the infrastructure that may constitute U.S. critical infrastructure (including major energy assets). What constitutes “critical infrastructure” is determined on a “case-by-case, depending on the importance of the particular assets involved in the transaction.”$^{10}$

With respect to the identity of the foreign person, the factors identified in the guidance that would be considered “include whether a transaction is a foreign government controlled transaction, and, particularly in the case of foreign government controlled transactions, what the record of the country of the investor is with regard to nonproliferation and other national security-related matters.”$^{11}$ CFIUS also takes into account “the track record or intentions of the foreign person and its personnel with regard to actions that could impair U.S. national security, including whether the foreign person acquiring control of the U.S. business had plans to terminate contracts between the U.S. business and U.S. Government agencies for goods and services relevant to national security.”$^{12}$

As noted in the guidance, the question of whether a covered transaction is a “foreign government-controlled transaction” is one of the national security factors listed in section 721 for consideration by CFIUS.$^{13}$ The new regulations define a foreign government-controlled transaction as “any covered transaction that could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government.”$^{14}$ Such foreign government-controlled transactions can involve control by foreign government agencies, state-owned enterprises, government pension funds, and sovereign wealth funds, among others. The guidance stresses that the fact that a transaction is a foreign government-controlled transaction does not, by itself,
mean that it poses national security risk. CFIUS in its review of foreign government-controlled transaction has considered “the extent to which the basic investment management policies of the investor require investment decisions to be based solely on commercial grounds; the degree to which, in practice, the investor’s management and investment decisions are exercised independently from the controlling government, including whether governance structures are in place to ensure independence; the degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the investor; and the degree to which the investor complies with applicable regulatory and disclosure requirements of the countries in which they invest.”\(^{15}\)

**Growing Congressional Oversight**

The Congressional Research Service (CRS) released a report dated August 12, 2016 detailing the history of CFIUS and the subsequent oversight by Congress.\(^{16}\) This CRS report emphasized that many members of Congress claimed that the economic and national security concerns of the United States needed to change as a result of the September 11, 2001 terrorist attacks, especially with respect to the role of foreign investment in the economy and in the nation’s security. The CRS report summarized the reaction of Congress to several proposed purchases subject to CFIUS review. In particular, the report highlighted the proposed sale by the British-owned Peninsular and Oriental Steam Navigation Company of the commercial port operations in six U.S. ports to Dubai Ports World (DP World). This proposed deal was subject to much Congressional criticism and anxiety over CFIUS reviews. The Congressional and public outcry led to DP World officials announcing that they would sell off the U.S. port operations to a U.S. company (a unit of AIG Global Investment Group, a New York-based asset management company), despite the prior approval of the deal by CFIUS.

Similar Congressional focus and industry objection was brought to bear in 2013 regarding a proposed purchase of U.S. pork producer Smithfield Foods by Hong Kong-based Shuanghui International Holdings, Ltd. U.S. Sen. Debbie Stabenow claimed the deal deserved special scrutiny on the basis that the acquisition threatened the U.S. food supply, a novel addition as a U.S. national security issue. The Senate Agriculture Committee held a hearing on the merger at the direction of its Chairman, Senator Stabenow. Despite the considerable pressure, CFIUS approved the deal and it proceeded as planned. The $4.7 billion takeover was the largest purchase of a U.S. company by a Chinese company at that time.
The application of Congressional pressure likely will continue to be applied to other deals reviewed by CFIUS based on alleged national security concerns, especially Chinese acquisitions. It has been reported that a group of 44 Republican members of Congress and one Democrat sent a letter in February 2016 to the Treasury Department demanding that CFIUS “conduct a full and rigorous investigation” of a bid by a company in Chongqing, China, to acquire the small but historic Chicago Stock Exchange. The fear apparently was that the proposed deal would give China direct access to America’s financial infrastructure.

Most recently the U.S.-China Economic and Security Review Commission (Commission) issued an advisory report to Congress dated November 16, 2016 where it recommended that Congress prohibit U.S. acquisitions by China state owned entities by changing the mandate of CFIUS. According to the Commission, the Chinese Communist Party has used state-backed enterprises as the primary economic tool to advance and achieve its national security objectives. Though only advisory, the Commission’s report adds fuel to the Congressional fire and could lead to legislative efforts to change the law governing CFIUS to restrict approval of investments by both China state-owned companies as well as privately held Chinese companies.

China’s Rise and Fall?
CFIUS released a public version of its most recent classified annual report to Congress on covered transactions in Current Year 2014 on February 19, 2016. The report shows a substantial increase in the number of transactions notified to CFIUS, with both a decline in the percentage of cases taken to a 45-day investigation and in the percentage of cases for which CFIUS imposed mitigation measures. China led all countries represented in CFIUS reviews for the third year in a row, but European investors resurged following a decrease in activity in 2013. These trends are in themselves unremarkable, as Chinese companies have looked to the United States for new investments as the Chinese economy has itself grown, and parties have filed voluntary notices for CFIUS reviews as a prophylactic measure for transactions with minimal national security issues that results in more 30-day decisions.

In all, 24 Chinese investor transactions were reviewed in 2014, an increase from 21 in 2013. Despite this increase in the number of Chinese deals, the actual percentage of Chinese deals as compared to all other countries declined. This decline probably was the result of the significant increase in the total number of reviewed transactions. This trend in Chinese investment and reviews of covered transactions has likely continued since then.
Examples of recent Chinese covered transactions that were reviewed by CFIUS varies both in type, industry, and result. The best-known example is a little stale and did not involve a voluntary notice, but rather a self-initiated review and Presidential action. SANY Group Co., Ltd., which controls Ralls Corp., was blocked for national security reasons in 2010 in the purchase of four wind farms in Oregon. CFIUS ordered Ralls to stop construction of turbines on land close to a U.S. Navy weapons-testing facility. President Obama later ordered Ralls to sell its stake in the wind farms based on security issues. SANY filed an unsuccessful lawsuit against the Obama Administration over the CFIUS decision, which was the first public case decided solely on proximity grounds.\(^{21}\)

In an earlier case in 2009, CFIUS opposed an attempt by China’s Northwest Non Ferrous International Investment to acquire Firstgold Corp., which had property near Fallon Naval Air Station in Nevada; it is reported the Chinese company pulled out of the deal.\(^{22}\) While CFIUS approved the acquisition of the U.S. assets of Canadian energy company Nexen Inc. by Cnooc Ltd., Cnooc was barred from operating oilfields in the Gulf of Mexico under the accord, due to their proximity (around 50 miles) to the U.S. Naval Air Station Joint Reserve Base at Belle Chasse, Louisiana.\(^{23}\)

The most prominent recent China CFIUS review ended successfully. CFIUS approved state-owned China National Chemical Corp.’s takeover bid of Swiss seeds and pesticides group Syngenta AG in August 2016.\(^{24}\) Trumpeted as the “biggest cross-border deal involving a Chinese buyer” that would “mark an acceleration of a shakeup in the global agrochemicals industry,”\(^{25}\) this deal caused considerable anxiety in the financial markets. U.S. interests were particularly piqued that Syngenta earlier had spurned a takeover by Syngenta last year spurned approaches from the U.S.-based seed company, Monsanto. U.S. Representative Michael Conaway, a Texas Republican who chairs the House Agriculture Committee closely monitored the deal.\(^{26}\) Objections tried to be raised that food safety and supply were issues of critical infrastructure and therefore a national security concern, but as with the approval of the Smithfield covered transaction discussed earlier, these concerns have not appeared to take hold with CFIUS.

Generally, it is rare for CFIUS to halt a deal, but in January 2016 it did block the Dutch company Royal Philips NV’s sale of high-end lights to China’s GO Scale Capital, a Chinese-backed private equity firm, based on undisclosed national security concerns.\(^{27}\) This covered transaction highlights the extraterritorial impact of CFIUS, in that it is the “tail wagging the dog” that nixes what essentially is a much larger transaction between companies in foreign countries.
A similar (very recent) covered transaction with extraterritoriality playing a role is the voluntary public takeover offer of Chinese investor Fujian Grand Chip Investment Fund LP (FGC) (part owned by the Chinese government), through its indirect German subsidiary Grand Chip Investment GmbH (GCI), for German chip maker Aixtron SE. CFIUS apparently “informed Grand Chip Investment and Aixtron that there are unresolved US national security concerns and the two companies should abandon the transaction.” Germany also has its own national security concerns with this transaction, which to date is still ongoing. President Obama on December 2, 2016 issued an order barring FGC from buying Aixtron, following CFIUS’ recommendation. The question remains whether the larger part of that deal will still go through.

The targeting of certain industries by Chinese companies may eventually lead to CFIUS looking not only at the national security interest of the particular transaction, but the overall investment takeover in that industry. This broader consideration is most likely to take place in critical infrastructure cases, such as telecommunications, but also in high technology industry sectors, such as semiconductors. The high profile CFIUS review in February, 2016, when Fairchild Semiconductor International turned down an offer by China Resources Microelectronics Ltd. and Hua Capital Management Co. Ltd. allegedly due to the near certainty that CFIUS would not approve the deal. In a similar technology deal shortly after Fairchild, U.S. hard drive maker Western Digital revealed that China state-owned Tsinghua Unisplendour had pulled out of a deal to acquire 15 percent of the company, a transaction valued at $3.78 billion. It is reported that Unisplendour took advantage of an investment agreement provision allowing either party with a 15-day window to walk away from the transaction if, after an initial review, CFIUS determined that it would conduct a formal investigation. As discussed above, prior to these failed technology deals, in the summer of 2015, China Resources, a giant state-owned conglomerate, was forced to rescind its offer for Micron, the U.S. memory chip manufacturer, reportedly because of worries that the deal would not clear CFIUS review.

So from being just an upstart several years ago to becoming the fastest growing investor in the United States, China may now soon drop in the foreign investor race in the United States due to CFIUS concerns. Certainly there will be increased focus and scrutiny by CFIUS on China deals as it exercises what appears to be an extraterritorial oversight of mega foreign party deals with relatively insignificant U.S. interest at play. China state-owned enterprises will cause particular concern for CFIUS, especially in the areas of telecommunications and high technology. Chinese investors need to be aware and active in gaining CFIUS approval before consummating any covered transactions in the United States.
The Trump Administration and Beyond

Though CFIUS already is shining a bright light on Chinese covered transactions, that light likely will only intensify and be brighter with the Trump administration. The press has publicized well President Trump’s intentions to confront China across the board on public policy and commercial matters, especially trade and investment issues. Strongly criticizing China throughout the U.S. election campaign, President Trump made pledges to impose 45 percent tariffs on imported Chinese goods and to label China a currency manipulator. His recent phone call after being elected with president Tsai Ing-wen of Taiwan also may signal his apparent desire to confront China wherever he can.33

For now at least, CFIUS is grounded in legal framework that offsets unfounded hostility to new China investment. While there will be Congressional antagonism to some new China deals, such resistance should not prevail unless there are legitimate national security interest at stake. Regardless, the uncertainty itself have led to warnings to Chinese investors to move more slowly and cautiously in the transitioning to the new environment.34

As discussed above with respect to the 2016 CRS report and the 2016 Commission report, Congress is under pressure from many sources to act more aggressively in repudiating Chinese takeovers of U.S. companies for a variety of reasons. While the Committee’s report as noted is purely advisory, it may be referenced and relied on by President Trump in formulating the new trade and foreign policy agenda. There is no doubt voicing concern and projecting strong opposition to more Chinese investment in the United States will win friends in the Trump Administration. Adding a new Executive opposition to the clearly growing Congressional opposition, may lead to a CFIUS agency oversight that is very hard on any new Chinese investments for years to come.

Endnotes


4. The purpose of this article is not to detail the CFIUS voluntary notice process, which was described in the prior article and remained very similar following the new regulations. The new regulations at 31 C.F.R., Part 800 set forth the process for filing a voluntary notice, and the timing and how that notice will be reviewed by CFIUS.

5. The guidance also clarifies that since “a corporate reorganization normally involves the realignment of a company’s structure to achieve some legal, financial, or other business objective, . . . only in exceptional cases” will a corporate reorganization present national security considerations.” Guidance, 73 Fed. Reg. at 74571. This point remains true “even where a corporate reorganization results in a new foreign person obtaining control over a U.S. business-by becoming, for example, an intermediate parent of the U.S. business” because “that corporate reorganization usually would not result in a change in the ultimate parent of the U.S. business.” Id. The one example give of an exceptional case is where “[c]ontrol of a U.S. business is transferred from Corporation A, a foreign person, to Corporation B, another foreign person, both of which are wholly-owned subsidiaries of Corporation C,” because “[a]lthough Corporation C continues to be the ultimate parent of the U.S. business, the facts and circumstances related to the actions, policies, and personnel of the new intermediate controlling entity, Corporation B, raise national security considerations that were not raised by the facts and circumstances related to control of the U.S. business by Corporation A, the previous intermediate controlling entity.” Id.


7. Id.

8. Id.
9. Id., at 74571.

10. Id., at 74570.

11. Id., at 74571.

12. Id.


14. 31 C.F.R. § 800.214.


Section 721(m) of the Defense Production Act of 1950 (50 U.S.C. App. 2170), as amended by the Foreign Investment and National Security Act of 2007 (Pub. L. No. 110-49), requires the annual report on covered transactions to provide:
A. A list of all notices filed and all reviews or investigations completed during the period, with basic information on each party to the transaction, the nature of the business activities or products of all pertinent persons, along with information about any withdrawal from the process, and any decision or action by the President under this section.

B. Specific, cumulative, and, as appropriate, trend information on the numbers of filings, investigations, withdrawals, and decisions or actions by the President under this section.

C. Cumulative and, as appropriate, trend information on the business sectors involved in the filings which have been made, and the countries from which the investments have originated.

D. Information on whether companies that withdrew notices to the Committee in accordance with subsection (b)(1 )(C)(ii) have later re-filed such notices, or, alternatively, abandoned the transaction.

E. The types of security arrangements and conditions the Committee has used to mitigate national security concerns about a transaction, including a discussion of the methods that the Committee and any lead agency are using to determine compliance with such arrangements or conditions.

F. A detailed discussion of all perceived adverse effects of covered transactions on the national security or critical infrastructure of the United States that the Committee will take into account in its deliberations during the period before delivery of the next report, to the extent possible.

21. Sany apparently made a subsequent and successful investment in a Colorado wind farm after structuring the investment through direct ownership by U.S. citizens and not Chinese. See Ralls CFIUS block alters Sany’s future investment strategy in US, Financial Times (Mar. 1, 2013) http://www.ft.com/intl/cms/s/2/1ff1eb98-82b8-11e2-a3e3-00144feabdc0.html#axzz2MOM6qqB9

23. Id.


28. President Obama to rule on Chinese bid to buy Aixtron, EE Times Europe (Nov. 26, 2016)


elected instead to go forward with U.S.-owned ON Semiconductor, which presented no CFIUS challenge. This case illustrates well how sometimes just the risk of a CFIUS rejection can cause a Chinese party to lose out to a U.S. rival that while reportedly making a less favorable financial offer did not face the regulatory hurdle of a CFIUS review.

