The Great Wall for China

Nearly 14 years have passed since I published with my partner Greg Dorris the article Uncle Sam Watches Nervously: Foreign Investment in U.S. Industries.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.

Today, given the climate for trade, the “America First” policy of the current administration and the concern across Europe regarding protection of its key industries, the scope of review of transactions and industries that receive coverage has expanded widely. At least two transactions in Germany have been abandoned because of concerns raised by CFIUS. An unknown number of others have never progressed beyond early discussions because of the heightened scrutiny of takeovers given by not only the United States but also other western countries. Whether it is truly for national security or a protectionist reaction to the emergence of China as a prolific acquirer of technology to fuel its growth, the expanding level of review given by the United States and European states to transactions involving a wide-range of industries compels any party to a transaction to consider the risk of review by multiple governments. As recently as March 2018, CFIUS review was called upon by Qualcomm to defend itself from a hostile takeover by the Singapore-based Broadcom, a first for takeover defense.

The projections bore out over the years, as the U.S. 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 terrorism 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 United States or discouraged for fear that key industries might be exported.

Our previous article cautioned that change is not always progress, and warned against tightening security over more transactions, which 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. Last year, foreign direct investment from China to the United States fell 35 percent in 2017 to $30 billion, confirming our prior warnings.

Most practitioners believe that the national security concerns sought to be addressed by the CFIUS review fell into three categories:

1. The proposed acquisition would make the United States dependent on a foreign controlled supplier of goods crucial to the functioning of the U.S. economy and that the supplier might delay, or place conditions upon, provision of those goods or services;

2. The proposed acquisition would allow the transfer of technology or other expertise to a foreign-controlled entity that might be deployed by that entity or its government in a harmful manner to the United States; and

3. The proposed acquisition would allow the insertion of some capability for infiltration, surveillance or sabotage into goods and services that are crucial to the functioning of the U.S. economy.

I. 2017 Was a Banner Year for CFIUS

By the end of 2016, CFIUS was undergoing significant changes. President Obama blocked the planned acquisition of the U.S. business of AIXTRON by the Chinese-controlled Grand Chip Investment business. AIXTRON is a German company that makes semiconductor equipment. About a fifth of its sales and 700 of its employees were in the United States. While the CFIUS denial only applied to the U.S. assets, the ruling effectively killed the entire deal. AIXTRON was unusual not only because it caused the failure of an acquisition of a German company, it also required the involvement of President Obama himself. Normally, because the president would be expected to follow the recommendation of CFIUS, presidential action is rare.

During the Obama administration, there was an increased number of refusals, yet most Chinese investments into the United States were approved. When acquisitions involved potentially sensitive information, the transaction succeeded...
by employing mitigation agreements similar to those that have been used for acquisitions by companies in Europe, Japan, Russia, Singapore and Israel as well as other countries.

Enter President Trump. Reading just the headlines in the press, one would think that every Chinese-backed deal met its fate in 2017. In fact, while I am writing this piece on April 13, 2018, the President indicated that Chinese investment in the United States will receive even greater scrutiny. That would be a significant exaggeration. While Chinese companies have experienced the greatest scrutiny, especially when it comes to the acquisition of technology companies or any company that possesses substantial data regarding U.S. citizens, mitigation agreements continue to be the typical solution permitting the transaction to go forward. Although CFIUS will not report its statistics for 2017 until near the end of 2018, it is estimated that 20 deals, mostly involving Chinese buyers, were upended and many more deterred due to fears that CFIUS clearance would not be obtained. Some of those deals were blocked because of fear that China would obtain access to a target company’s technology. That seems to be the case when the German acquiror Infineon sought to acquire Cree.

Some of the recent transactions blocked by the Trump administration seem a bit more logical. Canyon Bridge, a U.S. entity, was stymied in its efforts to acquired Lattice Semiconductor because it was found to be funded by, or otherwise tied to, the Chinese government and by the fact that the Chinese government had a supporting role in the transaction. But China is not the only country for whom an acquisition wall has been constructed. Broadcom, a Singapore-based company, lost out on its bid to acquire Qualcomm because of concerns that Broadcom would cut research and development by Qualcomm on 5G technology, thereby ceding the advantage to Huawei and the Chinese government to be the 5G frontrunner. A well-known example of where CFIUS review has gone beyond what is expected 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.1

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.2 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.3

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 2016.4 Trumpeted as the “biggest cross-border deal involving a Chinese buyer” that would “mark an acceleration of a shakeup in the global agrochemicals industry,”5 this deal caused considerable anxiety in the financial markets. U.S. interests were particularly piqued that Syngenta earlier had spurned a takeover bid by U.S.-based seed company Monsanto. U.S. Representative Michael Conaway, a Texas Republican who chairs the House Agriculture Committee, closely monitored the deal.6 Objections were raised that food safety and supply were issues of critical infrastructure and therefore a national security concern, but these concerns have not appeared to take hold with CFIUS.

In January 2016, CFIUS blocked 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.7 Like the two German transactions discussed above, 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.

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. An example of this is 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.8 In a similar technology deal shortly after Fairchild, U.S. hard drive maker Western Digital revealed that Chinese state-owned Tsinghua Unisplendour had pulled out of a deal to acquire 15 percent of the company, a transaction valued

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5 See Fairchild rejects Chinese offer on U.S. regulatory fears, Reuters (Feb. 16, 2016), http://www.reuters.com/article/us-fairchild-semico-m-a-idUSKCN0VP1O8; Fairchild turns down Chinese group’s acquisition offer, Siliconbeat (Feb. 17, 2016), http://www.siliconbeat.com/2016/02/17/fairchild-turns-down-chinese-offer/. Fairchild elected instead to go forward with U.S.-owned ON Semiconductor, which presented no CFIUS challenge. This case illustrates 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.


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3 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 Rails CFIUS block alters SANY’s future investment strategy in US, Financial Times (Mar. 1, 2013), http://www.ft.com/intl/cms/s/2/1f1e9b98-82b8-11e2-a3e3-00144feabdec0.html#axzz2ZM6M06q8B9.


5 Id.


8 ChemChina, Syngenta to move quickly on U.S. national security review, Reuters (Feb. 4, 2016), http://www.reuters.com/article/us-syngenta-m-a-chemchina-idUSKCN0VD03C.


10 See Fairchild rejects Chinese offer on U.S. regulatory fears, Reuters (Feb. 16, 2016), http://www.reuters.com/article/us-fairchild-semico-m-a-idUSKCN0VP1O8; Fairchild turns down Chinese group’s acquisition offer, Siliconbeat (Feb. 17, 2016), http://www.siliconbeat.com/2016/02/17/fairchild-turns-down-chinese-offer/. Fairchild elected instead to go forward with U.S.-owned ON Semiconductor, which presented no CFIUS challenge. This case illustrates 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.
at $3.78 billion.\textsuperscript{11} It is reported that Unisplendour took advantage of an investment agreement provision allowing either party to walk away from the transaction within a 15-day window if, after an initial review, CFISU determined that it would conduct a formal investigation. As discussed above, before 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 CFISU review.

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 CFISU concerns. Certainly there will be increased focus and scrutiny by CFISU on Chinese deals as it exercises what appears to be an extraterritorial oversight of mega-foreign party deals with relatively insignificant U.S. interest at play. Chinese state-owned enterprises will cause particular concern for CFISU, especially in the areas of telecommunications and high technology. Chinese investors need to be aware of and active in gaining CFISU approval before consummating any covered transactions in the United States.

II. The Trump Administration and Beyond

Though CFISU 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 published well President Trump’s intentions to confront China across the board on public policy and commercial matters, that light likely will only intensify and increase. The press has covered transactions, that light likely will only intensify and increase. Though CFISU 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 published well President Trump’s intentions to confront China across the board on public policy and commercial matters, that light likely will only intensify and increase.

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For now at least, CFISU is grounded in legal framework that offsets unfounded hostility to new Chinese investment. While there will be congressional antagonism to some new Chinese deals, this resistance should not prevail unless there are legitimate national security interests at stake. Regardless, the uncertainty itself has led to warnings to Chinese investors to move more slowly and cautiously in transitioning to the new environment.\textsuperscript{12}

Congress is under pressure from many sources to act more aggressively in repudiating Chinese takeovers of U.S. companies for a variety of reasons. President Trump’s newly formed trade policy with China seems to echo those concerns. There is no doubt that voicing concern and projecting strong opposition to more Chinese investment in the United States will win friends in the Trump administration. President Trump’s “America First” agenda may be the clarion call that any acquisition of a U.S. entity with the remotest connection to national security, technology, data privacy or a government installation could be in peril, even if it is by an acquiror from a long-time ally. While there may not be a Great Wall of America the magnitude of the fortification in China, foreign buyers should strongly consider filing with CFISU before completing a transaction as the barrier may be just as solid.
