



## GLOBAL CONNECTION

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### **China Under the Microscope: The Role of CFIUS in Chinese Acquisitions of U.S. Assets**

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Any foreign investor's plans to acquire U.S. companies, including their technology, strategic natural resources and defense-related assets are subject to review by the Committee on Foreign Investment in the United States (CFIUS or the Committee). At the present time, it is fair to say that there is a particular sensitivity at CFIUS to the *Chinese* acquisition of strategic U.S. assets.

#### **CFIUS Basics**

CFIUS was established by the U.S. Government in 1975, and is now formally authorized by the Foreign Investment and National Security Act of 2007 (FISIA). CFIUS is an inter-

agency body charged with reviewing the effect of foreign mergers and acquisitions on the national security interests of the U.S. The Committee is chaired by the Secretary of the Treasury and includes representatives from 16 different federal agencies and departments, including Defense, Commerce and Homeland Security. Submitting a proposed foreign acquisition for CFIUS review is entirely voluntary; however, the failure to consider a CFIUS filing can result in the blocking of a deal or the later unwinding of a completed deal.

By federal regulation<sup>[1]</sup>, CFIUS has the authority to review any covered transaction, defined as any proposed or pending transaction that could result in the control of a U.S. business by a foreign person. The purpose of a CFIUS review is to identify and address any national security risk that might arise as a result of the covered transaction, including prohibiting the transaction to move forward.

Chinese interests planning the acquisition of a U.S. company or assets must consider the U.S. national security questions raised by the proposed deal and then decide whether or not to have CFIUS review the transaction. The main benefit of voluntarily submitting a proposed transaction for CFIUS review is to best assure that the transaction will not later be overturned. The review also allows the investor an opportunity to address and frame the issues from a proactive and cooperative posture.

The CFIUS review downsides are (1) the costs of providing the required information, (2) possible delays in processing and (3) the possibility that government scrutiny will result in the deal being scrapped or significantly altered.

### **The CFIUS Process (In Brief)**

If the parties to the transaction decide not to file, CFIUS has the power to unilaterally review the deal, which may come to their attention in a variety of ways and ultimately block or unwind the transaction. Suffice it to say that it is generally not good news if CFIUS decides to review a deal on its own initiative.

Prior to filing a review notice with CFIUS, the parties to a covered transaction have the opportunity to consult with the Committee and/or file a draft notice describing the transaction. This process is generally informal, confidential and affords the parties to the transaction a sense of the Committee's views and concerns.

The information for a formal filing relates to the U.S. business being acquired, including information about market share, technologies, government contracting and any defense involvement. Information about the foreign party to the transaction involves details about the identities of the owners, foreign government control and plans for the U.S. enterprise. CFIUS also requires that the filing be certified (both at the beginning and end

of the proceeding). False certification carries a penalty of up to \$250,000.

Once a complete and sufficient notice is filed (both electronically and in hard-copy), CFIUS begins a 30-day review period. Most CFIUS reviews are completed and cleared within this 30-day initial review period. At its discretion, CFIUS may initiate an additional 45-day investigation of the proposed acquisition. At the conclusion of CFIUS investigation, the president has an additional 15 days to take appropriate action concerning the proposed transaction. Barring presidential intervention, if CFIUS approves the proposed deal, either at the end of the 30-day or additional 45-day period, the parties will be given "safe harbor" from any subsequent CFIUS objection.

### **China's Recent History at CFIUS**

In 2004, IBM agreed to sell its PC division to the Lenovo Group (partially owned by the Chinese government) for \$1.7 billion. There were concerns that the Chinese government would have access to cutting edge PC development and technology to the possible detriment of U.S. security interests. Issues concerning reciprocity and protection of intellectual property (or more to the point, the lack thereof), were also raised in objection to the deal. Interestingly, these issues would seem to have little relation to national security. However, CFIUS ultimately approved the acquisition and the deal went through.

In 2005, the China National Offshore Oil Corporation (CNOOC) tried to purchase Unocal, a U.S. oil company. Objections were raised at the prospect of a company partially owned by the Chinese government having access to oil, necessary to critical U.S. strategic interests. The CNOOC-Unocal deal was withdrawn prior to CFIUS review, but it is likely that the prospect of a negative CFIUS experience played an important role in the deal's collapse.

In 2009, a Chinese mining firm, Northwest Non-Ferrous International Company, Ltd. tried to acquire a majority interest in Firstgold Corp. a U.S. mining company. The parties submitted their \$26 million deal for review before CFIUS. The issue before CFIUS turned on the close proximity of the Firstgold mining fields to Fallon Naval Air Station and other nearby U.S. military assets. CFIUS refused to approve the acquisition and the deal failed to close (The Firstgold fields were more than 50 miles from the naval air station). There has been speculation that besides the location of the property, CFIUS had real concerns about any Chinese acquisition of U.S. mineral reserves.

In June 2010, Tangshan Caofeidian Investment Corp. and Emcore Corporation withdrew their joint CFIUS filing of a proposed sale of an interest in Emcore's fibre optics business to the Chinese. CFIUS made it clear to both companies that they would have serious concerns about the proposed acquisition.

In February 2011, CFIUS informed Huawei Technologies Co. (Huawei) that it should unwind its \$2 million asset purchase of 3Leaf Systems, a California-based cloud computing company. This was a case in which the merger partners mistakenly failed to submit the proposed deal (which closed in July 2010) to CFIUS and later bore the consequences of divestiture. The U.S. government has long-held concerns about the ownership of Huawei believing it to be connected to the Chinese Army.

While the U.S. is publicly amenable to Chinese investment in the U.S., such investments may be subject to special scrutiny. Any proposed acquisition of U.S. defense-related assets by the Chinese will not be permitted. Further, CFIUS will not favor the purchase of any advanced technologies that, while civilian in nature, may have military application. These policies are in line with current U.S. export control regimes administered by the State and Commerce Departments. In other words, if you can't export certain products or technology to China, it is unlikely that you can sell the Chinese your business in the U.S., which includes such assets.

When evaluating foreign mergers and acquisitions, it is important for U.S. businesses to understand the impact of CFIUS, the recent history of proposed Chinese direct investment and plan accordingly to minimize any impact on an otherwise beneficial deal.

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**Notes:**

<sup>[1]</sup> 31 CFR part 800

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