

## *China and Regulatory Practices*

# Spring 2018 CFIUS Briefing

### *“Dozens of Transactions Were Cleared”*

Contrary to popular belief, most China-U.S. deals are still getting done. Even the Trump Administration recognizes CFIUS should not close the door to investment from China. The Treasury Department recently testified before Congress:

“How do we do [CFIUS] right versus having people say we’re not even going to pursue any discussion with a Chinese firm? We’re clearly making ourselves more attractive to build investment in the United States. Last year, even from a country like China, dozens of transactions were in fact cleared through CFIUS.”<sup>1</sup>

Following a recently released report by the Office of the United States Trade Representative (USTR) in connection with a “Section 301” investigation, President Trump has directed the U.S. Government to propose possible restrictions on Chinese investment in U.S. companies. At this time, the nature and scope of potential restrictions are unknown though there could be significant impacts on proposed or pending investments from Chinese acquirers, especially state-owned enterprises. These foreign investment restrictions may be accompanied by other executive action, such as tariff increases (25%) for certain products, as well as initiating a World Trade Organization (“WTO”) dispute to address China’s allegedly discriminatory licensing practices.

Against this backdrop, how can parties help CFIUS say “yes?” The key is to begin with the data, identify problems early, and approach CFIUS proactively. Our Spring 2018 Briefing describes the current climate, lays out the Trump-era data, and outlines a proactive approach to getting a transaction closed in the United States.

## The Climate

The U.S. policy approach to international investment traditionally has been to establish and support an open and rules-based system that is in line with U.S. economic and national security interests. For deals notified to CFIUS, each transaction must be viewed individually in light of the specific facts and circumstances at play to determine whether there are any national security concerns that cannot be appropriately mitigated by the Committee. As an inter-agency committee, different U.S. Government components may have competing viewpoints as to whether a transaction poses an unresolvable national security concern. For example, while certain U.S. Government agencies, such as the Department of Defense (DOD) and Department of Homeland Security (DHS) may strongly advocate against foreign investment to protect a particular national security concern, other agencies committed to promoting open cross-border investment with limited government intervention would argue in support of economic investment in U.S. companies.

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<sup>1</sup> Testimony of Heath P. Tarbert, assistant secretary of the Treasury for International Markets and Investment, before the U.S. Senate Banking Committee, January 25, 2018.

In some cases, there may be particular U.S. businesses or assets where there is no possibility of mitigating a national security concern. This often emerges when examining “proximity” issues, meaning where a U.S. business may have certain assets located near sensitive U.S. Government facilities or other critical infrastructure. Here, the possibility of surveillance or other actions by certain foreign actors may pose an unresolvable national security concern. More recently, the U.S. Department of Defense (DOD) in particular has expressed a growing concern over certain types of Chinese investment in the U.S. technology sector. In particular, DOD seeks to strengthen protections on “sensitive” technologies in order to decrease the risk of technology transfers that would directly enable key means of foreign military advantage and/or displace the United States’ current technological edge. Highlighted emerging technology sectors include artificial intelligence, virtual reality, robotics, and financial technology.

Still, many investments either do not present a national security concern or if so, can be mitigated through a national security agreement with CFIUS. As the CFIUS review process is strictly confidential, there are undoubtedly many transactions involving Chinese acquirers that have cleared CFIUS with little fanfare. In the public domain, there have been several transactions cleared during the Trump Administration that continue to demonstrate the U.S. is not completely closed off to Chinese investment. For example, in 2017 Zhengzhou Coal Mining Machinery Group Ltd. (Zhengzhou) and Zhongan Zhaoshang Equity Investment LLP (controlled by China Renaissance Capital Investment) received CFIUS clearance in connection with acquisition of Robert Bosch Starter Motors Generators Holding GmbH, which included a U.S. business and manufactures starter motors and generators for cars. In November 2017, CFIUS reviewed and cleared Bison Capital’s 20 million share investment in Cinedigm Corp., a media content distributor. Finally, in December 2017, Naura Microelectronics Equipment Co. Ltd. received CFIUS clearance in connection with a deal to buy U.S. semiconductor manufacturing equipment company Akrion Systems LLC.

The above demonstrates that where there is no “show stopper” issue, transactions continue to be reviewed and cleared CFIUS, even where a Chinese entity is involved. However, it remains critical to properly review and assess a transaction from both the buyer and seller perspective, and be prepared to address potential concerns. Moreover, we have found that a lack of transparency can often stall or potentially lead to the downfall of particular transactions. Accordingly, it is essential that both the buyer and seller provide CFIUS with complete, accurate, and comprehensive information in order to resolve a national security concern.

## The Data and the Strategy

### The Data

Analysis of the data since the Trump Inauguration indicates what transactions can be done, and what approaches have and have not worked.

*Most deals are not submitted.* It is important to note that half to two-thirds of China-U.S. transaction likely are never submitted to CFIUS. The Rhodium group tracked 141 Chinese direct investment deals in the U.S. in 2017—virtually all of them M&A transactions. Our data identifies fewer than 40 before CFIUS during that period. CFIUS retains jurisdiction to require an application even after a deal closes; in at least two recent deals this occurred, and clearance was given. Our recommendation, however, is to proceed only when a transaction appears manageable, and in those cases, file a CFIUS application.

*Our analysis is conservative.* Information about China transactions before CFIUS is not publicly available, and CFIUS is almost completely leak-free. We have identified 37 China-related transactions before CFIUS during the Trump Administration. Of those, 15 were cleared; 12 were not cleared; the remainder are pending.<sup>2</sup> The government’s testimony before Congress suggests there were more deals than this actually cleared by CFIUS, so our analysis must be seen as conservative.

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<sup>2</sup> The data is as of March 1, 2018.

*Analysis of China-U.S. deals under Trump.* Of 36 China-related deals we have identified as being before CFIUS during the Trump Administration, 27 appear to have completed the review process, with about half clearing:<sup>3</sup>

| Status       | Count     |
|--------------|-----------|
| Cleared      | 15        |
| Failed       | 12        |
| Pending      | 9         |
| <b>Total</b> | <b>36</b> |

The same ratio applies to technology deals, with the numbers smaller and therefore the ratios less reliable in other sectors:<sup>4</sup>

| Sector           | Cleared   | Failed    | Pending  | Total     |
|------------------|-----------|-----------|----------|-----------|
| Semiconductors   | 2         | 3         | 1        | <b>6</b>  |
| Other technology | 6         | 4         | 1        | <b>11</b> |
| Media            | 2         | 1         | 1        | <b>4</b>  |
| Financial        | 3         | 2         | 2        | <b>7</b>  |
| Pharma           | 1         | 0         | 0        | <b>1</b>  |
| Real Estate      | 1         | 0         | 0        | <b>1</b>  |
| Energy           | 0         | 1         | 1        | <b>2</b>  |
| Other            | 0         | 1         | 3        | <b>4</b>  |
| <b>Total</b>     | <b>15</b> | <b>12</b> | <b>9</b> | <b>36</b> |

It is important to analyze why the deals that failed were unsuccessful. Looking at the 12 deals that failed, there seem to have been obvious concerns in half of them. Importantly, in the six deals where the concerns are evident, one probably failed because of government and military sales, two probably failed for lack of transparency on the buy side, and three probably were victims of concerns over personal identifier information (PII).

- *Xcerra* – concerns over sales to military and U.S. government
- *Lattice* – lack of transparency regarding ownership of buyer (similar to HNA deals)
- *MoneyGram* – concerns over PII (a previous acquisition by Ant Financial was cleared under Trump – EyeVerify, in August 2017)
- *Applovin* – concerns over PII

<sup>3</sup> A 37<sup>th</sup> deal was HNA Group’s acquisition of Ness Technology Holdings, which was broken off before CFIUS could act. Ness Technologies has sued HNA.

<sup>4</sup> The six semiconductor deals were Akzion and Nexperia (cleared); Xcerra, Global Communications and Lattice (failed) and Anaren (pending).

- *Cowen, Inc.* – concerns over PII
- Global Eagle – withdrawn by HNA; CFIUS has signaled it will not approve any HNA deal until its shareholding is satisfactorily explained

## **Risk Assessment**

We recommend bringing your CFIUS analysis forward at the same time as your business analysis. There is no reason to avoid U.S. deals altogether. If a transaction is attractive as a business proposition, our Risk Assessment can tell you if a deal will be *easy, manageable, or problematical*. If a deal is problematical, you may want to reconsider. If it is manageable, a proactive approach should allow the deal to clear CFIUS review.

CFIUS reviews each transaction on a case-by-case basis, examining both the foreign acquirer and the U.S. business at issue. While a “voluntary” process, it is often prudent for the parties to submit a notification to CFIUS where the transaction is “covered” and could pose a national security risk. Our Risk Assessment program looks at a range of issues which our experience and the data shows CFIUS will examine.

### *Initial Considerations*

- *Is the Transaction Covered?* Currently, covered transactions include where a foreign person acquires “control” of a U.S. business. While there is a carve-out for passive investments of 10% or less, this analysis can become quite complex. Additional considerations should be given to convertible interests, as well as lending transactions where the lender acquires certain rights.
- *Is there a U.S. business?* This means any activities in U.S. interstate commerce, no matter where the entity is located. Thus, acquisitions of non-U.S. companies can still be subject to CFIUS.
- *Is there a foreign person?* Complex questions can arise where there are multiple parties and/or foreign entities owned by U.S. nationals, requiring persons include an intricate examination of the particular deal.

### *Analysis of the U.S. Business*

- *U.S. Government Nexus.* This includes direct and indirect sales to the U.S. Government, as well as U.S. Government funding for research and development.
- *Controlled Technologies.* Export controls are an important factor, though CFIUS is also concerned with certain emerging technologies that may not otherwise be controlled.
- *“Proximity” Concerns.* It is especially important to review whether there are any U.S. assets located in or near sensitive U.S. Government facilities and/or U.S. critical infrastructure.
- *Personal Identifier Information.* Consider whether the company possesses sensitive personal identifier information on U.S. Government employees and/or U.S. citizens more broadly.

### *Analysis of the Foreign Acquirer*

- *Home country.* Is the buyer from a country posing a national security concern?
- *Foreign-government ownership.* CFIUS will more closely scrutinize transactions involved acquirers owned by a foreign government.

- *Foreign acquirer's link to foreign military.* Such a link could pose an increased risk of technology transfer or other actions posing a security threat.

#### *Evaluation of “national security” risk factors*

The mandate of CFIUS is to examine potential transactions for potential “national security” risks. While there are certain statutory factors to consider, CFIUS has broad discretion in determining what constitutes a national security risk and the Committee’s focus changes over time. Based on our experience and the data, we know that at least the following areas will be of concern to CFIUS in addition to those mentioned above. Our Risk Assessment takes these into account, both to analyze the potential risk and to consider possible mitigation efforts.

- Target’s access to classified or sensitive information, personnel or facilities
- Target’s involvement in government contracts or funding, especially with the U.S. military
- Whether the transaction affects critical infrastructure (such as roads, harbors, ports, power generation, etc.)
- Whether the buyer’s home country has a bad “track record” in the industry concerned – in the case of China, the most common concerns are “leakage” of technology to the PRC government and especially the military, and sales from China to countries subject to comprehensive sanctions, such as North Korea or Iran
- Whether the buyer itself is disfavored – some Chinese buyers have placed themselves at a long-term disadvantage with CFIUS by not being transparent in their applications; others have acquired a negative reputation for other reasons; these buyers will have a difficult time getting a transaction approved

In addition to the more straightforward determination of whether a proposed investment is feasible, the Risk Assessment will guide the parties through the subsequent deal negotiation and drafting phase. For example, the U.S. target may insist on a reverse termination fee tied to CFIUS. In addition, the parties may seek to incorporate detailed terms in deal documents specifying what the foreign business may or may not agree to in order to obtain CFIUS clearance. Ultimately, the Risk Assessment proves to be a valuable tool in helping companies analyze issues before it’s too late.

#### **Proactive Approach**

We recommend a custom-designed, proactive approach to CFIUS. This can include informal consultations and even early clearance of a deals based on a non-binding letter of intent. During the application process itself, we anticipate and work with U.S. government officials to answer their concerns and make it possible for them to say “yes.”

*Preparing for the approach.* The Risk Assessment process should have given the parties a thorough understanding of the issues that are likely to arise when the transaction is put before CFIUS. It is critical that the parties are fully transparent with counsel in this process and that they alert counsel to any changes in either the business being acquired or the makeup of the buyer. Both these key elements must be “locked down” before approaching CFIUS.

*Confidentiality.* Communications with CFIUS are entirely confidential. As a matter of experience, neither we nor other practitioners are aware of any significant, or even minor, breaches of this confidentiality by the U.S. government. Parties can have a high degree of confidence that any communications, and any applications made with CFIUS, will not be made public unless the parties themselves do so.

*Informal consultations.* Once the parties are close to agreement on the basic terms of a deal, and certainly by the time they sign a letter of intent, it is possible to confer informally with CFIUS. At that meeting, the buyer will describe itself, including most importantly its controlling stakeholders and any relationship, formal or informal, with the PRC government. Any

financing sources should be described (financial institutions, private lenders, government funding) and specifically identified if possible. On the target side, the business to be acquired, including any technology or sensitive aspects of the business, must be fully understood and described. An informal meeting with CFIUS will not result in “pre-approval,” but can provide important, early guidance as to whether the transaction is manageable or—for some reason not known to the parties—will be problematical.

*Early clearance.* It is possible to make a formal CFIUS filing on the basis of a non-binding letter of intent, binding letter of intent, or other document that is short of the definitive transaction agreement. We have cleared several transactions in this manner. The advantage is that parties can complete the entire CFIUS process and remove this element of risk, before investing the time and money required to negotiate definitive agreements, and in most cases before any public announcement of the transaction is made. Parties should be highly confident that the transaction will in fact proceed, assuming CFIUS clearance, since CFIUS will have limited patience with having done the work to clear a deal only to have the parties walk away from it. This could hamper any future CFIUS application by either of the parties.

*Proactive, collaborative approach.* The government officials involved in the CFIUS process are all dedicated public servants who take seriously their responsibility to protect the national security of the United States. They are all expert in their fields, from financial and trade experts, to economists, engineers and scientists. They are not, however, businesspeople and they obviously know only as much about how the business at issue operates as the parties tell them. The best approach is to anticipate the national security concerns CFIUS will have, and present possible solutions when making the application. If new concerns are raised, the parties are advised not to challenge validity of the Committee’s concerns, but rather work openly and collaboratively with the government to solve its concerns. The parties themselves are in the best position to propose creative solutions to whatever concerns are raised, and therefore in the best position to help CFIUS say “yes.”

*Be open to structural changes.* Sometimes parties will proceed with a CFIUS application even when the Risk Assessment has identified the transaction as “problematical.” Occasionally—although very rarely in our experience—a transaction that appeared manageable will be blocked by CFIUS for unexpected reasons. In those situations, the parties may want to have a “Plan B” for their business relationship that will not require CFIUS review. Various debt structures, joint ventures, and licensing transactions, are all outside the scope of CFIUS review and may achieve the parties’ objectives, either as an end in themselves or as a temporary measure pending a change in the regulatory climate.

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*Pillsbury’s China and Regulatory Practices represent dozens of companies engaged in transactions between or involving the United States and the People’s Republic of China. For additional information, please contact:*

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## CFIUS - CHINA TRACKING SHEET - TRUMP ADMINISTRATION

Date: The "date" column uses the most recent date on which a CFIUS-related event occurred

Terms: "Cleared" includes deals that were before CFIUS and later closed; "Failed" includes deals withdrawn before final rejection



| Date    | PRC Buyer   | Target   | Industry                                  | \$M  | CFIUS     | Comments   |
|---------|---|--|---|------|-----------|--|
| 2018-02 | BlueFocus International Limited   | Cogint Inc.  | Technology - IT                           | 100  | Failed    | Withdrawn Feb 2018, reportedly because of inability to obtain CFIUS clearance.   |
| 2018-02 | Unic Capital Management Co., Ltd; China Integrated Circuit Industry Investment Fund Co., Ltd. | Xcerra Corporation   | Semiconductor                             | 580  | Failed    | Withdrawn in Dec 2017. Press release that deal was being abandoned in Feb 2018. Reuters reported CFIUS blocked the deal (Feb 2018). Cowen may have been the financial advisor. Concerns were over participation in supply chain to USG and military, per Reuters.  |
| 2018-02 | Harbin Pharmaceutical Group Holdings Co.  | GNC, Inc.  | Other: U.S. health and wellness products  | 300  | Pending   | Deal announced Feb 2018. CFIUS application pending   |
| 2018-02 | China Oceanwide Holdings Group Co., Ltd.  | Genworth Financial   | Financial - insurance                     | 2700 | Pending   | Parties withdrew and re-filed several times, including in April 2017 and Feb 2018. Parties say they are pressing on.   |
| 2018-02 | SDIC Fund Management  | Maxwell Technologies   | Energy                                    | 47   | Failed    | Abandoned Feb 2018   |
| 2018-01 | SOE   | U.S. real estate company                                       | Real Estate                               | 2000 | Cleared   | Cleared within 75-day period   |
| 2018-01 | GSR Capital   | Automotive Energy Supply Corp. (Nissan car battery operations) | Technology - electric car batteries       | 1000 | Cleared   | News reports announced deal; not clear if it proceeded. Jan 2018 reports suggest the deal closed.  |
| 2018-01 | Naura Microelectronics  | Akrion Systems LLC   | Semiconductor                             | 15   | Cleared   | Cleared January 2018   |
| 2018-01 | Creat Group Corporation (China)   | Biotest AG   | Pharma                                    |      | Cleared   | Cleared January 2018   |
| 2018-01 | HNA Innovation Finance Group Co.  | Glencore   | Other - commodities storage and logistics |      | Pending   | Non-U.S. portions of deal closed; CFIUS filing reportedly made in Jan 2018. HNA may be blacklisted.  |
| 2018-01 | HNA Group   | Skybridge Capital II LLC                                       | Financial                                 | 200  | Pending   | Sale of majority stake; this is Anthony Scaramucci's firm. Reuters reported in Jan 2018 that CFIUS will not approve any HNA deals until it receives adequate information on its shareholders   |
| 2018-01 | Ant Financial   | Moneygram  | Financial                                 | 800  | Failed    | PII and proximity issues   |
| 2018-01 | General International Holdings, Inc.  | Lightbridge Corporation  | Energy - nuclear                          | 3    | Pending   | Minority investment. According to SEC filings, in April 2017, General International had raised its holdings to 9.8%. Lightbridge's 8-K reflects a Securities Purchase Agreement dated Jan 2018 to buy non-voting shares, pending approval by CFIUS ( <a href="https://seekingalpha.com/filing/3835447">https://seekingalpha.com/filing/3835447</a> ) |
| 2018-01 | Zhengzhou Coal Mining Machinery Group Co., Ltd.   | Robert Bosch Motors Generators LLC                             | Technology                                |      | Cleared   | Cleared early 2018.  |
| 2017-12 | T.C.L. Industries Holdings (Hong Kong)  | Novatel Wireless, Inc. / Inseego                               | Technology - wireless communications      | 50   | Failed    |  |
| 2017-12 | TTM Technologies, Inc.  | Anaren Holding Corp.   | Semiconductor                             |      | Pending   | Deal signed 12/1/17. Target is a key supplier to USG and has facilities clearances. Buyer is an offshore company with a 9.6% Chinese stockholder. Pending as of 2/12/18  |
| 2017-11 | HNA Group; Pactera Technology International Limited   | Ness Technologies; Jersey Holdings Corp.                       | Technology - software and IT services     | 325  | Abandoned | Target sued buyer claiming lack of transparency in the CFIUS filing could not be resolved; deal terminated by target. The final CFIUS filing was in November 2017. Reuters reported Ness alleged that HNA did not pursue CFIUS with good faith.  |
| 2017-11 | Orient Hontai Capital   | Applovin   | Technology - adtech                       | 1400 | Failed    | Parties restructuring in a way that is intended to avoid CFIUS review.   |
| 2017-11 | Bison Capital (Hong Kong)   | Cinedigm   | Media-Entertainment                       | 30   | Cleared   | Post-closing clearance.  |
| 2017-11 | HNA Group   | OM Asset Management  | Financial - insurance                     | 446  | Cleared   | Acquiring 24.95% of England/Wales entity, which has U.S. subsidiary. News reports indicate the deal closed in November 2017.   |
| 2017-11 | China Energy Company Limited  | Cowen, Inc.  | Financial                                 | 100  | Failed    | Withdrawn in Nov 2017  |
| 2017-10 | NetPosa Technologies (Chongqing) Ltd.   | Arecont Vision, LLC  | Technology - surveillance cameras         |      | Cleared   | According to reliable sources, CFIUS was about to clear the transaction when NetPosa allegedly backed out; target has sued.  |
| 2017-09 | Beijing Jianguang Asset Management Co., Ltd. (China)  | RJR Technologies, Inc.   | Technology - electronics packaging        |      | Unknown   | Announcement of joint venture in September 2017; parties stated they planned to make a CFIUS filing; not clear if a filing was ever made   |
| 2017-09 | China National Heavy Duty Truck Group   | UQM Technologies, Inc.   | Technology - electric motors              | 5    | Cleared   | "Stage II" closing not cleared   |

|         |  |                               |                               |        |                |   |
|---------|--|-------------------------------|-------------------------------|--------|----------------|---|
| 2017-09 | NavInfo; Tencent; GIC  | HERE                          | Technology - mapping Services |        | <b>Failed</b>  | Deal abandoned Sept 2017  |
| 2017-09 | Canyon Bridge Capital Partners (Limited partners mainly from China Reform Fund)  | Lattice Semiconductor         | Semiconductor                 | 1300   | <b>Failed</b>  | Probably due to lack of transparency. Case study info at PF10255.   |
| 2017-08 | Zhongwang USA LLC (investment company majority-owned by Liu Zhongtian through Zhongwang International Group Ltd., parent company of China Zhongwang) | Aleris Corporation            | Other - aluminum              | 2330   | <b>Failed</b>  | Withdrawn in Aug 2017, per Bloomberg, but parties are still talking.  |
| 2017-08 | Ant Financial Services Group   | EyeVerify                     | Financial                     |        | <b>Cleared</b> | Cleared August 2017   |
| 2017-06 | COSCO Shipping Holdings Co.,Ltd.   | Orient Overseas (Int'l) Ltd.  | Other - shipping              | 6300   | <b>Pending</b> | Deal announced June 2016. CFIUS review pending as of Jan 2018.  |
| 2017-05 | HNA Group (via affiliate, Beijing Shareco Technologies Co., Ltd.)  | Global Eagle Entertainment    | Media-Entertainment           | 416    | <b>Failed</b>  | Deal abandoned in July 2017   |
| 2017-04 | Automated Systems Holding Limited (ASL) (affiliate of Beijing Teamsun)   | Grid Dynamics International   | Technology - IT               | 118    | <b>Cleared</b> | Completion announced April 2017   |
| 2017-04 | Avolon (Owned by Bohai Capital, a fund controlled by HNA Group)  | CIT Group, Inc.               | Financial - aircraft leasing  | 10,000 | <b>Cleared</b> | Deal closed in April 2017   |
| 2017-03 | China Oceanwide Holdings Group Co., Ltd.; IDG Capital  | International Data Group      | Media-Entertainment           |        | <b>Cleared</b> | Cleared and closed March 2017   |
| 2017-02 | Consortium (MLS, Yiwu State-owned Assets Operation Center, IDG Capital Partners)   | Osram Licht AG unit: LEDvance | Technology - LED Lighting     | 442    | <b>Cleared</b> | Cleared in approximately Feb 2017.  |
| 2017-02 | Beijing JianGuang Asset Management Co., Ltd. (China); Wise Road Capital LTD  | Nexperia Holdco Netherlands   | Semiconductor                 | 2750   | <b>Cleared</b> | Cleared Feb 2017  |
| 2017-02 | Dalian Wanda Group Co., Ltd  | Dick Clark Productions        | Media-Entertainment           | 1000   | <b>Pending</b> | Not clear whether the deal was abandoned due to CFIUS issues or PRC foreign exchange problems; the WSJ and Reuters in Feb 2017 said it was problems in Beijing but Wanda said the deal was not dead. CFIUS filing status unknown. |

2017-01 TRUMP INAUGURATION