Chinese Investment in the U.S. and U.S. National Security Regulations

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Trends in Chinese Investment and CFIUS Matters

- Increase in major M&A activity – CNOOC-Nexen, Wanda-AMC, ILFC, Wanxiang-A123, Shuanghui-Smithfield
  - Smaller-to-mid size transactions continue (e.g., Enstrom Helicopter), but larger deals are increasing in number
  - Transactions may be truly global, with U.S. representing only one piece – e.g., CNOOC, ICBC-Bank of East Asia

- Areas of focus:
  - Natural resources – CNOOC-Nexen, Sinopec-Chesapeake, Sinochem-Pioneer
  - Clean tech – Wanxiang, Three Gorges, Ralls
  - Aviation – AVIC, Enstrom
  - Auto
  - Industrial
Trends in Chinese Investment and CFIUS Matters

- Investment is increasing; security concerns rising
  - Intelligence community assessment that Chinese are using M&A activity to target critical technologies – 2012 CFIUS report to Congress
  - Heightened attention and concerns over cybersecurity and state-sponsored theft of IP – Mandiant report
  - Concerns over “persistent co-location” – connections between Fallon Naval Air Station (Procon-Lincoln Mining) and Boardman Naval Air Station (Ralls)

- Emphasis on “non-notified” transactions

- Overall, majority of cases are being approved by CFIUS, but several failures within the last year
  - CFIUS remains key focus for Chinese investors considering US investment
Background on CFIUS

• Authority of the Committee on Foreign Investment in the United States ("CFIUS")
  – to review a foreign investment into an existing U.S. business to determine whether the investment “threatens to impair” U.S. national security
  – only triggered if a foreign person acquires control over a US business and there is a nexus to US national security

• Under Section 721 of the Defense Production Act, CFIUS has authority to take action to mitigate a threat posed by a transaction, but only the President can actually prohibit or unwind a transaction
  – Incentive for CFIUS to find a solution, if possible, to avoid a presidential decision

• CFIUS applies only to a minority of transactions
  – “Greenfield” investments are not covered
  – Debt transactions are not covered
Composition of CFIUS
CFIUS Jurisdictional Flow Chart

How to Identify Whether a Transaction Might be Subject to CFIUS Review

**STEP 1:** Is a foreign person considering an investment or an acquisition of a U.S. business?

- “Foreign person” defined broadly to include any entity controlled by a foreign national, foreign government or foreign entity
  - “Foreign entity” means any business organized outside the US or whose stock is principally traded outside US
- “U.S. business” defined broadly -- can include asset acquisitions (e.g., facilities, employees, customer contracts and lists, intellectual property)
- JVs may be subject to review if the U.S. contribution is a business or line of business

**STEP 2:** Will the transaction result in control, directly or indirectly, over that U.S. business?

- “Control” is defined very broadly to mean an ability to determine, direct, take, reach, or cause decisions of the U.S. business
- Even small minority investments can be “controlling” if other factors are present, such as ability to appoint directors or approval rights over certain decisions of the business

**STEP 3:** If there may be control over a U.S. business, then consult with counsel on whether any U.S. national security issues could arise.

- “National security” is broadly defined and can encompass many factors
What is National Security?
何谓“国家安全”？

• Not precisely defined, but there are factors listed in law and regulations:
没有精确定义，但有列入法律法规的考虑因素：
  – Securing defense industrial base
    保护国防工业基地的安全
  – Protecting critical technologies
    保护关键技术
  – Protecting critical infrastructure (including energy assets)
    保护关键基础设施（包括能源资产）
  – Assuring the government and defense supply chain
    保障政府和国防供应渠道
  – Compliance with important U.S. national security policies
    (counter-terrorism, nonproliferation, export controls)
    遵守美国重要的国家安全政策（反恐、不扩散、出口管制）
  – Government ownership
    政府所有权
What is National Security? (cont’d)
何谓“国家安全”？（续）

- Additional factors in practice:
  实践中考虑的其它因素：
  - USG customers and/or access to USG systems
    美国政府是否为其用户和/或是否能进入美国政府电脑系统
  - Classified contracts 保密合同
  - Industry and assets (e.g., critical infrastructure)
    行业及资产（例如：关键的基础设施）
  - Supply chain security 供应链安全
  - Information assurance/cyber security 信息保证/信息安全
  - Law enforcement interests (e.g., in data or telecom networks)
    执法利益（如：数据或电信网络）
  - Competition (other sources of supply)
    竞争（其它可获得的供应渠道）
  - Compliance record of U.S. company 美国公司的合规记录
  - Reputation of home country 所在国的声誉
  - Investor’s reputation, including for compliance 投资者的信誉，包括合规记录
  - Management, including current or past ties to foreign military
    管理层现在或以前与外国军方的关系
  - Commitment/ties to U.S. market 对美国市场的承诺/与美国市场的联系
  - Business in other countries (e.g., Iran)
    与其他国家的生意往来（例如：伊朗）
  - Financing 融资
Conditions for CFIUS Approval: Mitigation Agreements

- If CFIUS concludes there is a threat to national security, it considers whether threat can be mitigated through agreement with the parties.

- Such agreements are conditions to approval; vary from one-page letters to 50-page contracts with commitments and penalties.

- Potential elements:
  - Governance requirements – e.g., U.S. citizen officers or directors; appointment of a “security officer” for the company.
  - Security requirements or commitments – e.g., maintenance of security measures or participation in security programs.
  - Administrative processes – recordkeeping and reporting obligations.
  - Compliance checks/monitoring – e.g., government inspection or third-party audit.

- Important issue in transactional negotiations: What level of mitigation must the investor accept and still be required to complete the transaction?
Trends in CFIUS Filings and Investigations

CFIUS申报和调查趋势

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Covington
Managing Political and Public Affairs

• Investors need strategies for both Congress and Executive Branch, as well as managing public affairs
  – Understanding the political and public landscape, as well as the Executive Branch regulatory approval process, is critical to success

• Recognize that there may be many stakeholders that can be helpful or that can stir controversy
  – Employees – union relationships
  – Local officials – state and local governments
  – Congressional Committees
  – Third parties
    • Think tanks
    • Rivals
    • Other interest groups
Sensitivity of Target /并购目标的敏感度

High/

Political Sensitivity
政治敏感度

Low/

High/

Low/

National Security Sensitivity
国家安全敏感度

Energy (Oil, Gas, Services, Electric, LNG)
能源 (石油, 天然气, 服务, 电气, 液化石油气)

Aerospace
航天

IT Security/ IT
IT安全

Defense
国防

Energy (Nuclear)
能源 (核能)

Telecom
电信

Transportation (ports/airports/shipping)
交通 (港口/机场/海运)

IT (non-security related)
IT (与安全无关的)

Biomed, iodefense
生物医药, 生物国防

Real Estate
房地产

Systems integration
系统集成

Energy (Nuclear)
能源 (核能)

Chemicals/化学品

Transportation (roads, rail)
交通 (公路, 铁路)

Water/water treatment
水/水处理

Banking/银行

Entertainment
娱乐

Agriculture
农业

IT Security/ IT
IT安全

Insurance
保险

Biomed, iodefense
生物医药, 生物国防

Healthcare
医疗

Pharma/制药

Retail
零售

Transportation (roads, rail)
交通 (公路, 铁路)

Protection
保护

Low/

Low/
Comparison of CNOOC-Nexen and Wanxiang America-A123 Systems
对比中海油-尼克森和万向美国-A123 案件

• **Similarities:**
  相似点:
  - Reputational risk for each buyer.
    每位收购方的声誉风险
  - Each deal offered patient capital and important investment to the U.S. with the potential to save or grow jobs.
    每一交易均可为美国提供长期资本和重要投资，并有可能保留或增加就业机会
  - Both transactions faced some opposition within DOD.
    两桩交易均在一定程度上遭到国防部的反对
  - CFIUS administrative challenges.
    CFIUS行政挑战
Comparison of CNOOC-Nexen and Wanxiang America-A123 Systems

• Differences:

不同点：

– Wanxiang faced stronger political obstacles – competitive bid situation with rival actively seeking to interfere in CFIUS and in Congress; sensitivities over DOE grants

万向面临更强的政治障碍—竞争性招标，且对手公司积极努力干预CFIUS和国会决定；能源部的拨款具有敏感性

• Nexen – modest letter-writing from small number of Congressional members.

尼克森——来自少数国会议员的保守意见

– Wanxiang faced deeper security concerns

万向面临更深层次的安全隐患

• Wanxiang – sensitive assets ultimately carved out of transaction that was reviewed by CFIUS; no proximity concerns.

万向——经CFIUS审查，敏感资产最终从交易中剥离；不存在临近性担忧

– Wanxiang was able to anticipate and address security issues in deal structure

万向能够在交易结构中预见到并处理好安全问题

• CNOOC-Nexen struck deal focusing largely on other jurisdiction (e.g., Canada), not U.S.

中海油-尼克森达成了着重于其他司法辖区（如加拿大）的交易，而非美国
Contrasting Cases: Lenovo vs. Huawei

• IBM/Lenovo (2005)
  IBM/联想(2005)
  - Engaged CFIUS counsel months before final deal
    在最终签署协议前几个月就开始接触CFIUS律师
  - Consulted CFIUS informally to identify security concerns
    CFIUS非正式咨询,了解安全方面的担忧
  - U.S. party took public lead
    美国卖家在媒体面前很主动
  - Parties briefed CFIUS and Congress extensively in secret prior to announcing transaction
    买卖双方在正式公布交易之前,向CFIUS和国会分别广泛而又秘密地说明情况
  - Parties anticipated CFIUS concerns and offered mitigation proposals
    买卖双方事先预料到CFIUS的担忧,主动提出缓和措施建议

• Huawei/3Com (2008)
  华为/3Com(2008)
  - Engaged CFIUS counsel after deal went public
    交易公布之后才向有经验的CFIUS律师咨询
  - No advance consultations with CFIUS
    事先没有与CFIUS沟通咨询
  - Huawei was very vocal in press and made light of CFIUS concerns
    华为在媒体上很强势，而且不重视CFIUS提出的担忧问题
  - Parties surprised CFIUS, Congress with no advance briefing
    由于没有事先沟通，买卖双方让CFIUS和国会都很意外
  - Parties were surprised at CFIUS mitigation demands
    买卖双方对CFIUS提出的缓和措施要求也很意外
Ralls Transaction
Ralls交易

- On September 28, President Obama issued an Executive Order prohibiting a transaction – only the second such formal order in history.

Transaction details:
交易详情：
- In March 2012, Ralls indirectly acquired four Oregon wind farm projects.
- Wind farm was located near restricted air space at Naval Weapons Systems Training Facility.
Ralls Transaction
Ralls交易

• Parties did not file with CFIUS and closed the transaction
  双方没有向CFIUS申报，即进行了交割
• CFIUS required filing after transaction closed and ordered certain interim protections to protect national security:
  CFIUS要求在交易完成后申报，并命令采取特定临时性保护措施以保护国家安全：
  – Prevented further construction and required demolition of existing construction
    阻止进一步施工并要求拆除现有建筑
  – Removal of stockpiled assets 移除堆放的资产
  – Prevent transfer of ownership until removal of stockpile was complete
    阻止所有权转让直至完成移除堆放的资产
• President’s Order codified protections required by CFIUS and ordered divestment within 90 days 总统命令使得CFIUS要求的保护入法，并命令在90天内出售资产
  – Ralls sued CFIUS and President – recent judicial rulings in USG’s favor
    Ralls起诉了CFIUS和总统-近期做出了有利于美国政府的司法判决
Lessons from Case Studies
案例分析总结

• Careful planning
  - Anticipate and address issues – critically important for the parties to anticipate and solve problems
    事先预料并处理问题 - 预料到并解决好相关问题对双方均极其重要
  - Informal briefings with key agencies to prepare CFIUS for filing and solicit potential questions
    向主要部门进行非正式汇报，让CFIUS对申报有所准备，并征询可能提出的问题

• Proactive engagement of regulators to obtain level of comfort in connection with filing
  主动接触监管部门，以便对申报心中有数
  - Both parties must cooperate and work together to address questions
    买卖双方必须通力合作，共同应对问题

• Active management of Congressional dynamic
  及时掌握国会的动态

• Significant benefits of not having rival bidders
  没有竞价对手是很大优势

• U.S. seller can use its relationships to help give comfort to U.S. government officials and political actors
  美国卖家可以利用他们的关系宽慰美国政府和政客们

• Key items to avoid:
  需要避免的重要事项：
  - ITAR prohibition / ITAR 禁令
  - Proximity to sensitive government facilities / 靠近敏感的政府设施
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