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CFIUS's Concerns With Chinese Investments and Acquisitions in the U.S.

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On January 2, 2018, the Committee on Foreign Investment in the United States (CFIUS) rejected Ant Financial's plan to acquire U.S. money transfer company MoneyGram International over national security concerns. According to Reuters' report, CFIUS rejected the deal due to concerns over the safety of data that can be used to identify U.S. citizens. The companies have already undergone the CFIUS process three times and proposed safeguard measures, but these efforts did not clear CFIUS's concerns. The companies decided to terminate their deal after CFIUS rejected their proposal. Ant Financial needs to pay MoneyGram a $30 million termination fee for the deal's collapse.

This is the latest planned Chinese acquisition of a U.S. company that has failed to clear CFIUS. There have been a number of proposed Chinese acquisitions of U.S. companies that have been rejected by CFIUS. A high-profile deal that was recently blocked by President Donald Trump was Canyon Bridge Capital Partners Inc.'s planned $1.3 billion acquisition of chipmaker Lattice Semiconductor Corp. on September 13, 2017, in which the president sided with CFIUS's decision that the involvement of Chinese investors presents a national security concern. This is the fourth time in the past 30 years that a U.S. president has blocked foreign companies' acquisitions in the United States due to national security concerns. All four deals have involved investors from China with three of the deals having occurred in the past five years.

President George Bush blocked China Aero Technology Import & Export Co.'s acquisition of a Washington-based aerospace manufactory company, MAMCO Manufacturing, Inc. President Barack Obama blocked SANY Heavy Industry Co., Ltd-backed Ralls Corp.'s investment in building a wind power plant in Oregon because the plant was too close to a U.S. Navy base. President Barack Obama also blocked a Chinese company's acquisition of a German semiconductor company, AIXTRON SE, because the acquisition would have also included the company's U.S. subsidiary and assets in California.

CFIUS has opposed many investments and acquisitions from various countries during the last three decades; most investors withdrew the deals like Ant Financial without escalating the issue to the White House. CFIUS Chairman Steven Mnuchin commented in May 2017 that CFIUS investigation does not specifically target investors from China or any particular country and that CFIUS would not block any foreign investments without there being a threat to U.S. national security.

CFIUS was established by President Gerald Ford in 1975. It was first exercised to supervise foreign direct investments in the United States. Its jurisdiction had since expanded, and its process was changed to review any national security concerns related to foreign companies investing in and taking control of U.S. companies. Currently, CFIUS is composed of the heads of the Department of the Treasury, Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, Department of Energy, the Office of the U.S. Trade Representative and Office of Science & Technology Policy. The Secretary of the Treasury is the Chairperson of CFIUS.

CFIUS review is based on voluntary submission by the parties of the deal. Only transactions that involve foreign control that raise national security concerns need to be filed by both the parties with CFIUS. Parties need to carefully examine whether the deal involves a threat to U.S. national security, which would then need to be approved by CFIUS. If the parties do not voluntarily submit the deal to CFIUS, and CFIUS still considers the deal to be a threat to national security, CFIUS would then require parties to terminate the deal or change terms to eliminate any cause for national security concerns. Therefore, parties should carefully review the deal for any cause for national security concerns and then submit it to CFIUS to obtain approval before entering a substantial phase of the transaction, and to avoid amending the terms or being terminated. Many deals that are generally not considered a threat to national security do not need to be submitted to CFIUS for review. In such cases, these deals can proceed to completing its transactions.

CFIUS maintains that it can only investigate foreign investments if there is a cause for national security concerns. But in recent years, the interpretation of national security concern has broadened. For example, Lattice does not make military products nor does it supply semiconductor products to the U.S. military. The semiconductor products are used on cars, computers and civilian products. CFIUS blocked the investment because of the potential transfer of intellectual property to the foreign acquirer, the Chinese government's role in supporting this transaction, the importance of semiconductor supply chain integrity to the U.S. government, and the use of Lattice products by the U.S. government. As a result, CFIUS's interpretation of national security concerns posed by foreign investment has expanded, especially with investments involving semiconductor and/or state-owned Chinese companies. For example, in January 2016, CFIUS advised to block GSR Ventures and Nanchang Industry Holding Group Co.'s $3.3 billion acquisition of Lumileds, a subsidiary of Royal Dutch Philips Electronics Ltd. that manufactures LED (includes semiconductors). The parties then dropped the deal. In February 2016, a U.S. semiconductor manufactory company Fairchild Semiconductor International rejected China Resources Microelectronics and CRE Investment's $2.49 billion acquisition due to CFIUS concerns.

In the meantime, Chinese deals awaiting approval include: China Oceanwide Holdings Group Co Ltd.'s $2.7 billion acquisition of U.S. insurer Genworth Financial Inc.; HNA Group Co's acquisition of hedge fund-of-funds firm SkyBridge Capital LLC from Anthony Scaramucci, the

Trump administration's former communications director; and a significant technology deal – Unic Capital Management's $580 million acquisition of U.S. semiconductor testing company Xcerra Corp. Xcerra designs and manufactures products that test semiconductors and PCB. Xcerra said in December 2017 that it would resubmit its deal to give CFIUS more time to review the transaction for national security concerns.

Currently, Chinese investment and acquisition in the United States remain high. According to Rhodim Group's reports on Chinese oversea investment, Chinese companies had 117 direct investments in the United States in 2013, 167 in 2014, 169 in 2015 and 178 in 2016. During the first half of 2017, despite the stricter foreign exchange control, there were still 83 Chinese direct investments in the United States – an increase from the same period in 2016, which saw a total of 77.

While Chinese companies' foreign investments have increased rapidly as of late, China issued a policy about Chinese foreign investments on August 4, 2017. It listed the encouraged, restricted and prohibited target categories. A few of the six encouraged categories include: foreign investments that a Chinese company has strengths in production capacity, equipment and technology; high-tech intellectual property and energy companies.

Some of the deals in the encouraged categories will undergo CFIUS review. If Chinese investors want to acquire and control these companies, they need to examine whether the investment will cause U.S. national security concerns, especially in light of CFIUS's broader interpretation of national security concern in its latest case. Investors also need to review their capital structure and determine whether the company is privately-owned, state-owned, or is a publicly traded company. According to the rules, state-owned companies' investments and acquisitions in the United States would undergo a more thorough and rigorous review (an investigation rather than initial review), unless CFIUS considers the deal absent of any national security concern after the initial review and drops the investigation. On the other hand, with Chinese companies' interest in acquiring U.S. companies that have distribution channels or goodwill to expand sales, the risk of CFIUS investment may be lower than investment in high-tech or energy companies. The latest case above shows that CFIUS expanded the interpretation of national security concern again to include cyber security and the integrity of personal data which are not traditionally associated with national security, such as financial and internet services.

Overall, CFIUS's rejection ratio of foreign investments is still relatively low. According to CFIUS's data, it had rejected only five of the 172 deals that were filed for review – lower than 3 percent. The ratio in 2015 was 2 percent and a little higher than 1 percent in 2014. In conclusion, Chinese investors should not entirely abandon acquisitions of U.S. high-tech or energy companies. The key is to conduct a thorough investigation about the target company, its technology, intellectual property, productivity, market share, whether it provides goods and/or services to the U.S. government, whether the company is located near U.S. military base, whether the deal involves cyber security or personal data and so on. Investors also need to understand the scope and rules of national security concerns, and then choose the appropriate target and complete the acquisition.

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Tags: CFIUS, CFIUS investigation, Chinese Investment, Chinese investors, Committee on Foreign Investment in the United States, foreign direct investments, national security concern, President Trump