

# How Chinese Companies Can Successfully Invest in the United States

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Chinese investment in the US market has increased significantly in recent years and is expected to continue rising. Despite some heightened sensitivity with Chinese transactions, which has been most evident in the context of Committee on Foreign Investment in the United States (CFIUS) reviews, it is clear that the US market is not closed off to Chinese investment. In order for Chinese investors to succeed in the US market, parties and their counsel must carefully consider the myriad of factors that can impact a transaction and develop an effective, deal-specific CFIUS strategy.

As background, CFIUS is a committee composed of US government agencies, including the Departments of Treasury (which chairs CFIUS), Defense, Homeland Security, Justice, State, Energy and Commerce. CFIUS conducts national security reviews of transactions that can result in a non-US entity or person (including US companies that are owned by non-US persons) having control of a US business. The CFIUS regulations define “control” broadly—and CFIUS similarly interprets its jurisdiction broadly.

CFIUS review is ostensibly a voluntary process, but CFIUS actively monitors transactions and has not been hesitant about “inviting” parties to submit CFIUS filings for transactions it determines should have been notified. The vast majority of cases notified to CFIUS are approved without conditions, but CFIUS may impose mitigation requirements on a transaction—which can be difficult to predict and significantly impact the investor’s involvement with the US company—or recommend that the president block a transaction. As a practical matter, transactions rarely reach a presidential review; more commonly, if CFIUS advises parties that it will recommend divestment, parties will abandon the transaction.

When a Chinese investor wants to invest in a US company—or acquire a foreign company that has US operations—it is critical to assess potential national security considerations associated

with the transaction, determine whether to submit a CFIUS filing and develop an appropriate strategy to ensure the best chances for success.

Once the parties have determined they want to proceed with a transaction that they believe is subject to CFIUS jurisdiction, they must next conduct CFIUS-related due diligence. In completing its national security risk analysis, CFIUS considers both the “threat” posed by the foreign investor and the “vulnerability” exposed by the US business. Accordingly, CFIUS due diligence should begin by examining the parties to the transaction.

In assessing the potential vulnerability associated with the US target, the parties must have a complete understanding of the nature of the US target’s business. The CFIUS statute and regulations deliberately do not define “national security” since national security concerns can arise in a wide array of fields and transactions. For example, CFIUS has taken interest in transactions involving companies engaged in the US defense industry, government contracting (at the federal, state and local levels), critical infrastructure, aerospace-related activities, identity authentication, manufacturing, energy, information technology, communications, cyber security, food production, mining, ports, transportation and the financial sector, among others, as well as companies with products, technology or services controlled under US export control laws. There can also be national security implications if the US company holds a significant share of the market for its business, so parties should consider potential concerns associated with Chinese control over a substantial portion of a US market sector.

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CFIUS is likely to view transactions with a nexus to the US government with heightened sensitivity, particularly if the US company is a defense contractor. Similarly, due to the US arms embargo with respect to China, a Chinese company likely will not be permitted to acquire a US business that produces or trades in items or services controlled under the International Traffic in Arms Regulations (ITAR), including classified articles or information. Accordingly, if a Chinese investor wants to acquire a US company that holds security clearances, has ITAR-controlled assets or is otherwise contracting with the US government in a manner that may be sensitive, it may be advisable to structure the transaction so that it does not include those sensitive assets.

This type of strategy has been successful in a variety of transactions involving investors from China, as well as from other countries. For example, Chinese auto-parts company Wanxiang Group successfully acquired US lithium-ion battery maker A123 Systems in 2013, but the transaction was structured so that A123 Systems’ government business and battery technology for military applications were sold to a US buyer prior to closing. It is not uncommon for a US target to be appealing to investors due to factors unrelated to military technology or US

government contracts. In such cases, structuring the transaction to include only the less sensitive business may prove to be the best strategy.

Since the CFIUS risk analysis considers both the US company and the investor, the parties also must assess national security considerations that may arise in connection with the buyer. One element that can impact the national security analysis is whether the Chinese investor is government owned or controlled. Although government ownership may increase sensitivity regarding the transaction, it is not determinative. Indeed, some transactions involving Chinese government ownership have succeeded while some others involving private Chinese companies have not.

An investor's history with CFIUS can also be relevant. While prior history is no guarantee of an outcome in a given case, it can nevertheless be valuable since it means the foreign investor is both better known to CFIUS and has a record of treatment by CFIUS. For this same reason, a buyer's history of compliance and candor with CFIUS may bolster the buyer's credibility before CFIUS.

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Another key due diligence consideration is whether there are any additional sensitivities with the Chinese investor, its management or affiliates. Inclusion on one of the US government's prohibited parties lists, for example, is a likely indicator that CFIUS will view the investor with heightened scrutiny.

In addition to assessing the parties themselves, the parties and their CFIUS counsel should analyze potential national security concerns that may arise from external factors. Several Chinese transactions have failed because the targeted US companies were located in close proximity to sensitive US government assets. For example, Procon Resource's acquisition of Lincoln Mining Corporation, Far East Golden Resources Group's acquisition of Nevada Gold Holdings and Ralls Corporation's acquisition of several wind farm projects all resulted in completed transactions effectively being unwound (or, in the case of Ralls Corporation, divestment being ordered by the US president). In each of these cases, the parties failed to notify CFIUS voluntarily of the transaction and CFIUS requested a filing after the deal had closed. Ultimately, CFIUS's objection to these transactions did not necessarily appear to be related to the substance of the transaction itself, but rather to the physical location of the US assets that had been acquired. These cases emphasize the necessity of considering potential close-proximity concerns in all cases of Chinese investment, regardless of the nature of the US company's business. Moreover, these cases highlight that the size of a transaction is not determinative of

sensitivities: the Lincoln Mining and Nevada Gold Holdings transactions were each valued at less than \$5 million.

Additionally, the parties and their CFIUS counsel must be aware of, and potentially adapt the CFIUS strategy to account for, the evolving political climate and relationship between China and the United States. For example, developments like the US government's recent indictment of five Chinese military officers for alleged cyber crimes could affect how CFIUS views certain potential Chinese investments.

Competitors opposed to a transaction often engage in public relations and lobbying efforts to try to stop the transaction. For example, Shuanghui International Holdings Ltd's \$4.7 billion acquisition of Smithfield Foods, Inc. faced significant political opposition. Despite such efforts, however, CFIUS approved the transaction because it did not have national security objections. Even though political opposition may not ultimately drive the outcome of a given review, parties to a transaction that is likely to face opposition should develop a public and government relations strategy to try to preempt such objections and establish publicly why the transaction is beneficial for both the parties and the United States.

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Following completion of the initial CFIUS due diligence, the parties and their counsel should develop a strategy to yield the greatest chance of success given the specific circumstances of the deal. Such a strategy should include negotiation of purchase agreement terms that best protect the Chinese investor, allocation of sufficient time for the CFIUS process to be completed prior to closing, preparation of the CFIUS filing and careful assessment of whether and how best to engage government officials in connection with the process.

In general, when in doubt, the prudent course is to complete the CFIUS process prior to closing. CFIUS does not issue advisory opinions or provide informal guidance on potential transactions, so the most effective way to avoid CFIUS risk is to complete the CFIUS review process. Moreover, not filing carries significant risks for parties since CFIUS may ultimately request a filing and require mitigation measures the investor finds unacceptable, or recommend that the president order divestment. Given the current political climate, it is particularly important for Chinese investors to consider CFIUS risks in planning deals. By completing the CFIUS process prior to closing the transaction, parties are better positioned to react to any CFIUS resistance to the deal, rather than being forced to accept requirements CFIUS imposes after the transaction has been completed.

Allocation of CFIUS risk is a key point to be addressed in deal negotiations. As a practical matter, the CFIUS risk is more significant for the investor than the US company. If mitigation is required, it is likely to increase costs for the investor and/or impact the investor's ability to manage the US business as contemplated. By assessing the likelihood of potential mitigation—and trying to anticipate the forms it may take based on the facts in a given deal—Chinese investors can tailor conditions precedent to closing to ensure that they are only obligated to complete the transaction if it will continue to satisfy the business rationale on which the deal is based.

As part of planning, the parties must ensure that sufficient time is allowed to complete the CFIUS process. CFIUS requests that the parties submit a “prefiling”—or draft filing—at least five business days before formally beginning the CFIUS process. Following the prefiling period, the parties formally submit their CFIUS filing, after which a 30-calendar-day initial review period begins. At the end of the initial review, CFIUS can conclude its process or proceed into a 45-calendar-day investigation period. Approximately 40% of all CFIUS cases move into investigation, so parties should plan for a full 75-day formal CFIUS process.

The parties, however, may also need to account for additional time. If CFIUS intends to condition its approval on mitigation requirements, it often does not advise the parties of the mitigation measures until well into the 75-day process. Since mitigation terms can be complex, parties may need additional time to review, consider and negotiate the terms. In such cases, parties often withdraw and then resubmit their CFIUS filing, which restarts the initial 30-day review process. Most cases involving mitigation can be resolved within two 75-day CFIUS cycles, but some cases have required a third cycle. Thus, particularly with respect to higher-profile or otherwise sensitive transactions, it is important to build in sufficient timing flexibility.

Once the parties are ready to proceed with the CFIUS filing, they should carefully prepare their notification to fully disclose the information required under the CFIUS regulations. Parties can also use the CFIUS filing preemptively to address anticipated issues upfront. Depending on the nature of the transaction, it may be advisable to request a meeting with CFIUS, which can provide the US government officials an opportunity to meet with the parties and ask any questions directly. Such meetings are not always necessary, but can be helpful in some cases, particularly where there are expected sensitivities. If there are parallel processes related to a transaction—such as the Team Telecom review process associated with certain telecommunications transactions—the parties should also consider engaging those relevant US government officials as part of the strategic planning process.

If CFIUS does ultimately require mitigation measures, the parties and their counsel should carefully consider the implications of implementing the measures and try to work with CFIUS to ensure that the requirements will be workable in practice. Although CFIUS mitigation can vary widely and accordingly be difficult to predict, trying to anticipate potential mitigation following CFIUS due diligence can be quite valuable. The Chinese investor can obtain a significant

strategic advantage by considering and accounting for likely forms of CFIUS mitigation prior to starting the CFIUS process.

Perhaps the most important advice for Chinese investors looking to expand into the US market is to carefully plan for CFIUS considerations when contemplating transactions. The US government is certainly sensitive to Chinese investment, but Chinese investors clearly can find ways to succeed in the American market. The worst outcomes for Chinese investors have typically involved insufficient planning with respect to the CFIUS process. Whether a given transaction will be approved outright, conditioned on certain mitigation requirements or ultimately proven unworkable, Chinese investors can afford themselves the best chances of success and maximum protection by working with experienced counsel and carefully planning their CFIUS strategy.

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