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Addressing National Security Concerns

In February 2008, China's Huawei Technologies and Bain Capital abandoned a proposed venture to acquire 3Com in the face of an adverse decision by the Committee on Foreign Investment in the United States (CFIUS or the Committee), which reviews foreign acquisitions of U.S. companies for national security implications.

In late December 2009, CFIUS sank the proposed acquisition of Firstgold Corp., a U.S. mining company, by a large Chinese mining firm.

In the last week of June 2010, CFIUS was blamed for scuttling a proposed U.S.-Chinese joint venture between U.S.-based Emcore Corp., a manufacturer of fiber optics and solar panels, and China's Tangshan Caofeidian Investment Corp. Amid rumors that CFIUS was prepared to recommend U.S. President Barack Obama to block the deal, the companies abandoned the venture.

And in July 2010, 50 lawmakers representing the Congressional Steel Caucus urged CFIUS to scrutinize a joint venture between U.S.-based Steel Development Co. and China's fourth-largest

steelmaker, Anshan Iron & Steel Group, causing the Chinese firm to review its investment strategy.

These cases illustrate at least two potential roadblocks Chinese companies can encounter investing in or acquiring U.S. targets: (1) CFIUS-raised concerns about national security and (2) political concerns raised by Congress. Recognizing and preparing for these concerns can help increase the success rate of Chinese companies investing in or acquiring American targets.

Navigating CFIUS

Chaired by the Department of Treasury, CFIUS is comprised of various agencies with security-focused and trade-focused missions. At weekly in-person interagency discussions of each case pending before CFIUS, representatives from security-related agencies, such as the Departments of Homeland Security, Justice and Defense discuss deals that have the potential to raise concerns about national security. These discussions are held with representatives from U.S. trade agencies

Careful planning and understanding of potential roadblocks to investment in the U.S. can help Chinese investors navigate CFIUS.



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that include the U.S. Trade Representative and the Department of Commerce.

CFIUS operates on the presumption that foreign direct investment and free trade generally are in the national interest. While CFIUS members rigorously scrutinize each acquisition for potential threats to national security, the Committee in practice approves almost all investments or acquisitions it reviews – typically between 100 and 200 each year.

CFIUS generally is required to make a decision within 30 days from the time it receives a formal filing unless the Committee affirmatively decides to utilize extension mechanisms. If approved, a deal is largely insulated from challenges on national security grounds. While the President has statutory authority to block or unwind a foreign acquisition over concerns of national security, CFIUS approval ensures that this authority will not be exercised. For that reason, even though a CFIUS review generally is voluntary for the transacting parties, most parties file with the Committee if they believe that the acquisition touches national security or critical assets.

If the Committee becomes aware of a deal that has not been filed but which touches on national security, CFIUS has the authority to compel a filing. Committee personnel routinely review the press and trade journals for reports on transactions that have not been filed.

Security analysis

The analytical inquiry assesses the threat, vulnerability and consequence of a foreign acquisition of an American target. Discussions generally focus on the acquirer’s intent and ability to cause harm (the threat), whether and how the target assets might be exploited to breach national security (the vulnerability) and the consequences of a successful exploitation of American resources (the consequence). These factors guide the Committee’s efforts to protect against espionage, illicit acquisitions of sensitive technology and the risk of mass casualties, among other concerns.

The Emcore-Tangshan deal likely raised concerns because of the role of Emcore’s fiber optics products in highly strategic and espionage-vulnerable U.S. communications systems. This deal is the third

Chinese investment in less than three years that has been abandoned publicly because of CFIUS. Some of the concerns the CFIUS review raised can be attributed to widespread publicity over alleged Chinese hacking of U.S. networks, raising deep suspicions about espionage.

Congressional concerns

When the Congressional Steel Caucus urged CFIUS to examine the deal between Steel Development Co. and Anshan Iron & Steel Group in July, the U.S. lawmakers expressed concerns about the effect of Chinese investment on U.S. steel markets and Chinese access to American steel production technologies.

In a letter urging CFIUS to review the joint venture, the Congressional Steel Caucus referenced national security as a reason for the request. The letter also referred to concerns about whether Chinese investment in the U.S. steel industry will cause a loss of domestic manufacturing jobs. That latter concern, rather than national security, seems to be the driving force behind the actions of the Congressional Steel Caucus.

These concerns are reminiscent of the Chinese National Offshore Oil Co.’s (CNOOC) failed attempt to acquire American oil giant Unocal, then the ninth-largest oil company in the world. That deal was vociferously opposed by U.S. oil interests, particularly competing bidder Chevron. After a political firestorm, CNOOC dropped its bid in August 2005, allowing Chevron to ultimately acquire Unocal’s assets.

In both cases, the motivations behind the resistance to CNOOC’s and Anshan’s investments seemed to have less to do with national security and more to do with domestic and corporate politics.


Preparing for success

While some high-profile Chinese investments in the United States have faced hurdles, many have been successful, including some that faced hurdles initially. In general, the political concerns that prompt strong congressional reactions to Chinese investments have declined. This decline

seems at least partially attributable to efforts to educate Congress on the potentially constructive role of Chinese investment in the United States – especially in terms of domestic job creation.

But for the foreseeable future, Chinese investment in strategic American sectors will continue to be scrutinized. Chinese investors and U.S. target companies accordingly need a communications plan that addresses these concerns. It would be wise, for example, to craft a media plan that promotes the job-creating benefits of the investment. That message needs to be honed and targeted to the right audiences.

Chinese investments that can be construed as creating espionage opportunities will likely continue to raise CFIUS skepticism. Sometimes that skepticism can be overcome through risk mitigation agreements, whereby transacting parties agree to take certain security measures to win CFIUS approval. Such measures often have included the appointment of a security officer, the creation of a written security plan, security screening for certain employees, the periodic

provision to the U.S. government of customer lists, access to company books and records, audit rights to confirm compliance with all required security measures and other provisions. These so-called risk mitigation agreements are less commonly used today, because legislation enacted in 2007 requires a consensus among all of the CFIUS agencies as to the need for (and details of) such an agreement, and such consensus often is illusive. But Chinese investors and U.S. target companies should think through risk mitigation strategies, particularly if acquisition of the target company creates espionage opportunities. 

Stewart Baker and Stephen Heifetz were, respectively, Assistant Secretary for Policy and Deputy Assistant Secretary for Policy Development at the Department of Homeland Security, where they reviewed CFIUS cases, negotiated risk mitigation agreements and helped revise CFIUS laws and policies. They now are partners in the Washington office of Steptoe & Johnson LLP.

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