

Committee on Foreign Investment in the United States Rejects Huawei Deal; Third Recent Chinese Transaction Scuttled by National Security Review

In mid-February, the U.S. committee charged with examining national security implications of foreign acquisitions of U.S. businesses determined that Huawei Technologies Co. ("**Huawei**") should be required to unwind its recent purchase of certain assets of 3Leaf Systems ("**3Leaf**"), a California-based company which provides technology for cloud computing. According to news reports, after conducting a 30-day review and a follow-on 45-day investigation of the acquisition pursuant to the "Exon-Florio" statute,¹ the interagency Committee on Foreign Investment in the United States ("**CFIUS**") informed Huawei that it would have to divest the assets or CFIUS would recommend to the U.S. President that the acquisition be unwound. Huawei reportedly decided initially to wait for the President's decision, required by law to be made within 15 days, but subsequently agreed to divest the assets. Huawei's decision spared President Obama what might have been a controversial and difficult determination.

Filings with CFIUS are not mandatory, and Huawei and 3Leaf did not notify CFIUS before the acquisition in May and July 2010. Huawei reportedly acquired intellectual property and key personnel from 3Leaf, but no equity or physical assets, and the parties concluded that the transaction was not covered because Huawei did not acquire all of the target's assets. According to press reports, last fall CFIUS asked Huawei to seek approval for the completed transaction, worth approximately \$2 million, and the company voluntarily filed in November.

The U.S. government has long been concerned about Huawei. In 2008, Huawei's proposed acquisition of 16% of 3Com Corp., in a deal with Bain Capital Partners, fell through because CFIUS signaled that it would recommend that the transaction be rejected. More recently, in late 2010, Huawei was reportedly removed from consideration for a major equipment contract with Sprint Nextel Corp. ("**Sprint**") after the U.S. Commerce Secretary called Sprint's chief executive officer to express concerns. In August 2010, eight Republican senators had sent a letter to several U.S. government officials, including the Secretary of the Treasury, also expressing national security concerns about the possible supply contract. It stated that Huawei has a "concerning history," citing reports that Huawei had sold technology to Saddam Hussein's regime and supplied the Taliban before its fall, and noting its "leading presence in Iran, especially with military industries," including a "close relationship with the Islamic Revolutionary Guard Corps." The senators also expressed concern about the often-reported links of Huawei with China's People's Liberation Army (the "**PLA**"). Ren Zhengfei, the company's founder and current chief executive officer, was a member of the PLA. Huawei has denied having ties to the Chinese military or government.

Only once in the history of Exon-Florio has a U.S. President ordered divestiture. In 1990, President George H.W. Bush ordered China National Aero-Technology Import & Export Corporation to divest itself of a U.S. aircraft parts manufacturer, Mamco Manufacturing Co. Typically, if a potential foreign acquirer is advised by CFIUS that the committee intends to recommend that the President prohibit the consummation of a transaction, the acquirer will abandon the transaction or voluntarily divest the U.S. business.

¹ Section 721 of the U.S. Defense Production Act of 1950, as amended, including most recently by the Financial Investment and National Security Act of 2007, 50 App. U.S.C.A. § 2170 (2010).

The failed Huawei transaction is the third proposed or completed acquisition by a Chinese buyer that CFIUS has declined to approve since late 2009. In December 2009, CFIUS was poised to block a proposed 51% investment by a Chinese government-controlled company, Northwest Ferrous International Investment Company, in a Nevada gold mining company, Firstgold Corp., allegedly due to the proximity of the target's mining facilities to a naval air station and other nearby sensitive military installations and assets. The parties withdrew the CFIUS notice on the day the transaction was to be referred to the President. In June 2010, New Mexico-based EMCORE Corporation and Chinese investment company Tangshan Caofeidian Investment Corporation ("**TCIC**") withdrew their joint CFIUS filing with respect to EMCORE's proposed sale of a 60% interest in its fiber optics business to TCIC, because of "certain regulatory concerns" expressed by CFIUS.

These recent setbacks for particular deals do not mean that the U.S. is always closed to Chinese investment, although parties to such deals should be prepared for additional scrutiny. According to press reports, a spokesperson for the Treasury Department stated after Huawei's withdrawal of its notice, "We strongly support the longstanding bipartisan U.S. commitment to welcoming foreign investment, consistent with national security. This includes investment from China." There have been several recent high-profile investments in or acquisitions of U.S. companies by Chinese entities, as well as some smaller deals. For example, in late 2010 and earlier this month, CNOOC Limited, majority-owned by China's state-controlled oil company, purchased 33.3% interests in two of Chesapeake Energy Corporation's oil and natural gas projects, the first in South Texas and the second in Colorado and Wyoming. In early 2010, China Investment Corporation purchased a 15% stake in AES Corporation, a U.S. power generating company, for \$1.58 billion after receiving CFIUS clearance. The Chinese company BGP Inc. entered into a land seismic equipment joint venture with Texas-based ION Geophysical Corporation, to which the U.S. company contributed various assets and businesses, after CFIUS cleared the deal in March 2010. Last summer, Ford Motor Company completed the sale of its Volvo unit to Zhejiang Geely Holding Group Co. Ltd., a Chinese automobile manufacturer, for \$1.8 billion. In addition, the Chinese company Pacific Century Motors acquired a subsidiary of General Motors Co., Nexteer Automotive, which manufactures advanced steering and related technology, in November 2010.

It should be noted that the Huawei transaction is not the only one that CFIUS has recently decided to review after the closing. After being contacted by CFIUS, AOL Inc. ("**AOL**") and Russian company Mail.ru Group Limited ("**Mail.ru**"), voluntarily submitted a joint filing to the committee, commencing a review of the sale of AOL's ICQ operations to Mail.ru, which closed in July 2010. ICQ is a leading instant messaging service in Russia and other international markets. AOL reports that the parties to the transaction are working with CFIUS to address the committee's concerns, and that it is likely that AOL will agree to provide certain network infrastructure and other operational services to Mail.ru beyond its contractual obligations.

These two recent post-closing requests by CFIUS that the parties file a notice with the committee should be a cautionary reminder for sellers and foreign buyers of U.S. businesses that filing with CFIUS *before* an acquisition is consummated would be wise if there is any possibility that it could raise national security concerns.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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