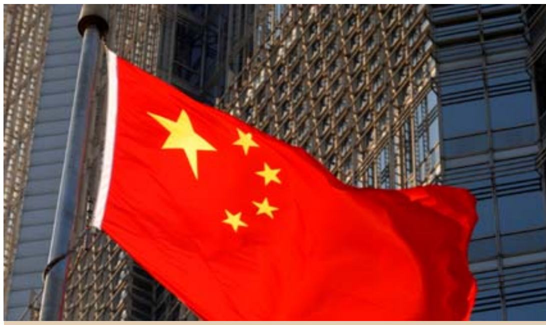

White and Williams LLP

China News Alert, February 2010 www.whiteandwilliams.com

DEVELOPMENTS IN CHINA SET STAGE FOR INCREASE IN INVESTMENT IN THE UNITED STATES

By: Gary P. Biehn, Esquire and Merritt A. Cole, Esquire

CHINESE ECONOMIC GROWTH BRINGS M&A OPPORTUNITIES

Since joining the World Trade Organization in late 2001, China has experienced unprecedented economic growth. In 2009, despite the global economic downturn, the Chinese economy grew at an 8.7% rate, outpacing other economic powers by a significant margin. As reported by the Chinese National Bureau of Statistics, the growth was broad-based, with retail sales rising by 17.5% in December 2009 and industrial production increasing by 18.5%.

While global merger and acquisition activity in 2009 remained less robust as compared to the years leading up to the financial crisis, M&A activity in China remains significant. In 2009, according to Smith Street Solutions M&A, there were a total of 135 announced "inbound transactions" into China, with aggregate deal value of $10.6 billion. Private equity funds and U.S. investors participating in China-based M&A need to remain mindful of the changing legal and regulatory climate in China. The movement in China to "westernize" its legal system has yielded extraordinary and comprehensive modifications to the M&A regulatory landscape, including the overhaul of the employment law in 2008, adoption of the Anti-Monopoly provisions in 2009, and recently adopted Transitional Measures for the Implementation of the Amended PRC Patent Law.

China is now slowly turning its attention to "outbound" investment, with a primary focus being the U.S. Historically, acquisitions and investments by Chinese firms outside of their country have been minimal due to cultural and regulatory restraints, but the pace of deal making is picking up and should accelerate over the coming decade. Significant recent developments include the late 2009 bid by Zhejiang Geely for Ford Motor Company's Volvo subsidiary, Beijing West Industries' $90 million acquisition of Delphi Corporation's global suspension and brakes business in November 2009, and the pending sale of GM's Hummer brand to Sichuan Tengzhong Heavy Industrial Machinery Company. Still, questions remain as to how Chinese investment will be received in the U.S. and whether U.S. policy will embrace or resist this emerging chapter in trade relations.

CHINESE GOVERNMENT ENCOURAGES CHINESE COMPANIES TO INVEST OVERSEAS

The Chinese government continues to adopt economic policies that encourage Chinese investment abroad. In September 2009, the China Industrial Overseas Development and Planning Association reported that, for the first time, China's outbound investments surpassed inbound investments. More dramatically, the $150 billion of outbound investment from China in 2009, reported by the Chinese government, is nearly three times greater than the amount recorded the previous year.

In June 2009, China's State Administration of Foreign Exchange (SAFE) significantly relaxed its control on outbound investment procedures. Some of the significant features of the new SAFE procedures include:

- **Expanded sources of capital.** Chinese companies can engage in outbound direct investments using self-owned foreign exchange, foreign exchange borrowed onshore or purchased with RMB, tangible and intangible assets, overseas profits, or other sources of funds approved by SAFE. Profits generated from outbound investments can be retained offshore for further investment.
- **Pre-approval of funding sources not required.** The source of funds for outbound direct investment no longer needs to

be reviewed by SAFE prior to the overseas investment.

- **Replacement of approval regime for outbound remittance by registration system.** Prior approval by SAFE for the outbound remittance of capital is no longer required. Chinese companies only need to complete a registration form with SAFE for outbound remittance.
- **Commercial loans to overseas entities permitted**. Chinese companies can provide commercial loans to overseas entities in which they invest, provided that the requirements of the relevant foreign exchange regulations are met.

Historically, Chinese companies have often been challenged in branding or marketing products to the satisfaction of American consumers. In addition, Chinese firms traditionally have placed greater value on manufacturing than on brands, customer relationships, and distribution, and so have tended (especially in asset light industries) to elect not to proceed after due diligence or to submit relatively low offers when evaluating potential acquisitions. With increasing numbers of U.S.-educated Chinese guiding both Chinese companies and government policies, there is a greater expectation that Chinese companies can more successfully position their products, marketing, and acquisition strategies for success in the U.S. marketplace, though that shift will continue to evolve gradually.

Currently, much of the market penetration into the U.S. is from multi-national Chinese companies, such as Haier and LG Electronics. Also, joint ventures, partnerships, and alliances are common means for entering the U.S. market. These vehicles enable a Chinese company to overcome the barrier of developing its own distribution and retail network and provide more flexibility to make direct investments. Under the new SAFE procedures, increased M&A activity in the U.S. from China's larger enterprises ultimately is likely.

Many Chinese companies that desire to acquire businesses and raise capital in the U.S. have entered the U.S. securities markets, most commonly through reverse mergers with shell companies that have public shareholders. As a result of the reverse merger, the U.S. company effectively becomes a holding company for the operating Chinese company, with the goal being to list on the NASDAQ or the New York Amex. A small number of large, well-established Chinese companies have completed IPOs in the United States by selling securities to investors in traditional, public underwritten offerings.

WILL THE UNITED STATES WELCOME THIS EMERGING WAVE OF INVESTMENTS FROM CHINA?

A critical question for this new decade is the manner in which potential business partners and government policy in the U.S. will respond to growing inbound investment from China.

Recently, commercial and political tension has dominated the relationship between the countries. For example, certain actions by the Obama administration in its first year in office were viewed in China as a less than enthusiastic signal of the administration's view toward Chinese investment in, and trade with, the U.S. In September 2009, President Obama signed an order imposing a new 35% duty on imports of Chinese tires on top of the existing 4% tariff, following pressure exerted by the United Steelworkers Union. The President's action was permitted under a "special safeguard" provision in the World Trade Organization's rules that dates back to 2001 and is specifically targeted at Chinese imports. President Obama's action is the first time that a U.S. president has taken such action. It is notable that this special safeguard provision is set to expire at the end of 2012.

Other specific restrictive actions include the December 2009 action under FINSA relating to a proposed investment in a Nevada mining company and actions in early February 2010 on countervailing duties on exported metal fasteners. More recently, in the President's 2010 State of the Union address, the President, in commenting on a recent Supreme Court decision regarding election financing, expressed concern regarding the potential influence of "special interests - including foreign corporations - to spend without limit in our elections . . ." The President's comment, coupled with recent more direct actions by his administration and suggestions by U.S. senators about revoking the bi-lateral trade agreements with China, have elevated the already serious concerns in China that Chinese investment in the U.S. is not welcomed.

U.S. RESTRICTIONS ON CHINESE COMPANIES

Chinese investments in the U.S. have often been cautiously received by U.S. companies and government officials. These concerns have been prompted by the role of the Chinese government in the investments, which are often made by entities that are either subsidized or wholly-owned by the Chinese government. Concerns also have been expressed as to the potential of Chinese influence in the U.S. economy, alleging that Chinese investment will limit American autonomy, injure domestic industry, or, in the most extreme case, harm national security. For example, an announcement by the Chinese government that it would invest $3 billion in the Blackstone Group in 2007 prompted speculation of a "master plan" by China to control Wall Street, although those fears have largely subsided.

China's economic motivations to invest in the U.S. are manifold, including establishing a partnership with U.S. companies and investors that can lead to opportunities for brand and technology transfer to the Chinese market. Additionally, as one of the largest holders of U.S. Treasury notes and bonds, China and its policy makers are aware of the advantages of diversifying China's U.S. investment portfolio.

In 2007, the Foreign Investment and National Security Act (FINSA) was enacted to grant to the President of the U.S. the authority to "suspend or prohibit any foreign acquisition, merger or takeover of a U.S. corporation that is determined to threaten the national security of the United States." FINSA is administered by the Committee on Foreign Investment in the U.S. (CFIUS). Although the CFIUS review is not mandatory, many foreign companies have voluntarily submitted to a CFIUS review to avoid government intervention at a later date. Among many factors, the CFIUS process considers whether the investing entity is state-owned and the proximity of the investment to vital U.S. national security interests.

CFIUS review has been used to prevent Chinese companies, many of which are partly state-owned, from acquiring or investing in U.S. corporations. Notably, in 2005, the prospect of a political fallout over a CFIUS recommendation prompted China National Offshore Oil Co. to withdraw its bid for Unocal, a U.S. oil company. Most recently, in December 2009, CFIUS concluded that a China-based company, Northwest Non Ferrous International Investment, should be barred from investing in Firstgold Corp., a Nevada mining company.

CONCLUSION

The unprecedented growth of the Chinese economy has emboldened Chinese companies to invest in the U.S. Outward investment from China is both economically beneficial for its companies and a central part of its government's economic strategy. As Chinese companies continue to investigate investment opportunities and understand the U.S. economy with greater sophistication, U.S. companies that are aware of the differences in both cultures and legal frameworks often are better positioned to benefit from in-bound investment by Chinese companies.

A version of this article first appeared in the "1st Quarter 2010 Middle Market Update" published by Bryant Park Capital.

CONTRIBUTORS

GARY P. BIEHN

Gary Biehn is chair of the Business Department and the China Business Practice Group.

For more information, please contact Gary at 215.864.7007 or email him at biehng@whiteandwilliams.com.

MERRITT A. COLE

Merrit Cole is a partner in the Business Department and chair of the Securities Law Practice Group.

For more information, please contact Merritt at 215.864.7018 or email him at colem@whiteandwilliams.com

OFFICE LOCATIONS

Berwyn, PA | Boston, MA | Center Valley, PA | Cherry Hill, NJ | Conshohocken, PA
New York, NY | Paramus, NJ | Philadelphia, PA | Pittsburgh, PA | Wilmington, DE