

A123/Wanxiang: CFIUS mitigation labeled a 'technical fiction' by advocacy group

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Chinese auto parts company **Wanxiang's** attempt to assuage national security concerns over its acquisition of bankrupt battery manufacturer **A123 Systems** by divesting the latter's military contracts is a "technical fiction" and should not calm those worried about the deal, according to Jeffery Green, executive director of the Strategic Minerals Advisory Council -- an advocacy group focused on the supply of key materials to the US military.

Before filing for bankruptcy in October 2012, A123 was a leader in the manufacture of lithium-ion batteries used by the US military in unmanned aerial vehicles, micro-grids, underwater propulsion and spy satellites, and the inter-agency Committee on Foreign Investment in the United States (CFIUS) is currently reviewing the transaction for possible national security concerns.

Even though Wanxiang sold A123's military contracts to Michigan-based Navitas Systems, Green said Navitas does not manufacture the electrodes and cells that are the key components in these batteries and will simply package them for its new military clients.

"Every bit of that ... process, equipment and technology will be owned by the Chinese. That's the fiction. The government says I'm buying this battery from Navitas but if you look inside there's a [Wanxiang] manufactured electrode and cell," Green told PaRR.

Green also questioned whether Navitas could stand on its own if Wanxiang stopped supplying it with these components and thus, he said, the possible transfer of such cutting-edge manufacturing capability to China constitutes a national security risk.

Members of Congress also have attempted to apply political pressure on CFIUS to block the deal, since A123 has received nearly USD 250m in government grants. Several senators and House members have written to Treasury Secretary and CFIUS chairman Timothy Geithner -- as well the secretaries of the departments of Defense, Energy and Homeland Security -- voicing concerns over the transaction, since it involves equipment currently used by the US military.

"Certainly anything that's currently in use is something that the Defense Department will latch on to as a possible concern. That raises some serious, serious challenges," Thad McBride, a partner with Sheppard Mullin in Washington, DC told PaRR. "Unquestionably that will have raised some national security issues."

A second DC-based attorney also said CFIUS will be prompted to carefully review the transaction, since the transaction involves "current and tangible" national security concerns.

Export controls

Any final decision by CFIUS could also be affected by an ongoing arms embargo against China.

"Not only are these products subject to US export laws, but the company's research is also subject to the International Traffic in Arms Regulations (ITAR), which prohibits its dissemination to restricted foreign parties," the letter from the senators on the A123 deal said.

And when it comes to export controls, technical data can be just as important as the sale of physical goods.

"The US controls not only export of the actual goods but the technology related to the goods as well," McBride said.

McBride pointed out that even a foreign national touring a facility where ITAR-controlled products are manufactured could constitute an export control violation.

And in this case, concerns may not arise simply because A123 is being sold to a foreign company. "China is under an arms embargo and as such a Chinese acquirer is different from a company from a close ally such as the UK or Australia," the second attorney said.

Moreover, when it comes to export controls, China is a particular concern.

"The EAR [Export Administration Regulations] is staggered; the more sophisticated an item, the more destinations to which it is controlled. There are destinations more tightly controlled than China, but there aren't a lot," McBride said, who added that the embargo on China is not likely to be lessened any time soon.

Substitution concerns

In addition, national security concerns have also been raised by Johnson Controls (NYSE:JCI) – a US company that also tried to acquire A123.

Despite this public opposition, factors such as China’s broader industrial policy and its use of acquisitions to gain strategic capability in certain sectors is not likely to be the key factor in any CFIUS decision.

As PaRR previously reported, broad technology transfer issues generally are not key concerns of CFIUS officials, who tend to focus on specific national security threats.

Therefore, a decisive factor in this transaction could likely be whether the US military believes it can obtain these batteries from companies other than A123.

“Li-Ion battery technology for automotive and other highly engineered applications (i.e. stationary, military) is specialized and in most cases, customized for a customer or specific application,” a spokesperson for Johnson Controls told PaRR in an email.

“Standards around chemistry, cell format, system design and controls are just forming and as result, backward compatibility or interchangeability is not possible,” the spokesperson said.

“With the bankruptcy of A123 systems, Johnson Controls will be one of the last standing American companies competing in and building this US advanced battery industry,” the spokesperson added.

Wanxiang had not responded for comment by the time of this story’s publication.

by Raymond Barrett in Washington DC

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