

**Testimony Before the U.S.-China Economic and Security Review
Commission
Chinese Investment in the United States: Impacts and Issues for
Policymakers**

Patrick Jenevein
CEO, Tang Energy Group
Chairman, WattStock LLC
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Thank you for the opportunity to testify today on issues that are vital to U.S. economic interests and rule of law. In our testimony today, we will provide a frontline business perspective of the real financial, political, and legal imbalances U.S. firms face when working with, and resolving disputes against, Chinese firms—notably national-level Chinese state owned enterprises (SOEs)—in the United States.

Dallas-based Tang Energy Group (“Tang”) invests in and develops clean energy projects around the world and has been active in China since 1996. For over two decades, Tang has cultivated deep, strong, and lasting relationships with Chinese business and government leaders. These relationships, combined with our business management capabilities, have been vital to Tang’s commercial successes in China.

Tang has participated in the financing and development of energy projects in Xinjiang, Gansu, Hebei, and Shanxi provinces. Our project partners have ranged from provincial Chinese government entities to large Chinese SOEs, including the China National Petroleum Corporation (CNPC) and the Aviation Industry Corporation of China (AVIC).¹

In 2008, after years of success in China, Tang and AVIC established U.S.-based Soaring Wind Energy (“Soaring Wind”) to identify, finance, market and develop wind energy projects worldwide. AVIC committed to providing \$600 million in financing to the venture.

However, after launching Soaring Wind, Tang discovered that AVIC was establishing separate companies to develop wind energy projects around the world in contravention of the exclusivity provisions within the Soaring Wind joint venture agreement (“Soaring Wind Agreement”). After numerous attempts to resolve AVIC’s wrongful conduct failed, Tang was forced to initiate arbitration proceedings in June 2014 (the “Tang Case”). In December 2015, a panel from the American Arbitration Association’s International Centre for Dispute

¹ Following the practice of official Chinese sources, which are careful to designate the “Group” company when referring to the top-level organization of national-level Chinese SOEs, the apex organization of AVIC will be referred to as “AVIC Group HQ.” To avert confusion, AVIC Group’s subordinate “business units” will be referred to as “AVIC subsidiaries” or, when appropriate, by their full company name. “AVIC” will be used to refer to AVIC Group HQ and its subsidiaries collectively.

Resolution found in favor of Tang and Soaring Wind, awarding them substantial monetary relief approximating \$70 million.²

Tang’s ongoing experience underscores key challenges U.S. companies face litigating against Chinese firms in the U.S. This includes navigating opaque and complex multinational corporate structures that limit liability, obfuscate ownership, and add degrees of separation between a Chinese firm’s U.S. subsidiaries and its ultimate controlling parent, which is almost always based in China. In some cases, including the Tang Case, Chinese SOEs have refused to recognize the jurisdiction of U.S. courts and arbitrators, even asserting sovereign immunity.

Establishing *Alter-Ego* and the Singularity of Chinese SOEs

A key challenge when litigating against Chinese companies in the U.S., especially SOEs, is establishing the interconnectivity amongst corporate entities involved in the dispute. The concept in U.S. law known as *alter ego* provides the rigorous principles required for determining this interconnectivity, which often focuses on the relationship between a parent company and its subsidiaries.³

In Tang’s case, nine jurists determined that AVIC Group HQ and its related subsidiaries⁴ operated as a single entity and that it used its control over its subsidiaries to commit a fraud and work an injustice on Tang. U.S. litigants must meet the *alter ego* requirements to determine what entity or entities are liable for damages.

Complex Multinational Corporate Structures

Chinese firms investing in the U.S. often use a complex web of multinational corporate structures that obfuscate ownership and enable evasion of U.S. legal and regulatory reach. Chinese secrecy laws and the government’s mixed interpretation of its obligations under the Hague Convention makes obtaining evidence and serving legal documents against offshore Chinese firms and their executives, especially SOEs, nearly impossible.⁵ In the

² The Final Award from the International Centre for Dispute Resolution, International Arbitration Tribunal is publicly available as a filing with the United States District Court for the Northern District of Texas as part of *Soaring Wind Energy LLC et al v. Catic USA Inc et al*. Also, see Matt Miller, *China’s AVIC ordered to pay \$70 million to U.S. wind firm*, Reuters, 22 December 2015, <http://www.reuters.com/article/us-usa-aviation-ind-idUSKBN0U5oGZ20151222>

³ The determination of whether one entity is the alter ego of another is a complex and multi-faceted undertaking that can be highly fact specific. Under federal common law, alter ego can be shown based upon a finding that (1) the non-signatory exercised complete control over the signatory with respect to the transaction at issue, and (2) such control was used to commit a fraud or wrong that injured the claimants. *Bridas S.A.P.I.C. v. Gov’t of Turkmenistan*, 345 F.3d 347, 359 (5th Cir. 2003) (*Bridas I*). Delaware law is substantially similar.

⁴ The AVIC subsidiaries named in the Tang Case (collectively referred to as the “Respondents”), include the Aviation Industry Corporation of China, CATIC USA, Inc., A/K/A AVIC International USA, Inc., AVIC International Holding Corp., China Aviation Industry General Aircraft Co., Ltd., AVIC International Renewable Energy Corp., Ascendant Renewable Energy Corp., and AVIC International Trade & Economic Development.

⁵ For a more in-depth overview of the hurdles U.S. companies face serving Chinese firms through the Hague Convention and the Chinese government’s interpretation of its obligations see Kevin Rosier, “*China’s Great Legal Firewall: Extraterritoriality of Chinese Firms in the United State*,” The US-China Economic and Security Review Commission, May 5, 2015.

Tang Case, initial efforts to serve AVIC and its China-based subsidiaries through The Hague Convention were rejected by Chinese authorities who claimed the Chinese translations of the U.S. legal documents were not “good enough.” These factors combine to hinder U.S. firms’ attempts to obtain justice while reducing the potential recovery of damages.

Cascading Command and Control Structure

Although U.S. firms may face substantial difficulties in proving the existence of *alter ego* relationships between or among Chinese subsidiaries and their ultimate parents, our working knowledge and experience with Chinese laws and practice demonstrates that this relationship is fundamental to the Chinese system. For instance, Chinese law governing the overseas investments of national-level SOEs (e.g. *The Interim Measures for the Supervision and Administration of the Outbound Investments by Central State-owned Enterprises*) requires the ultimate parent or group company, along with the State-owned Assets Supervision and Administration Commission (SASAC), to be in charge of supervising and administering SOEs’ overseas investments.⁶

The corporate structure of China’s national-level SOEs reflect the centrally controlled, top-down Chinese Party-state system.⁷ Following Party directives, SOEs design corporate structures to place all significant revenue-earning activities under first level or Tier 1 subsidiaries with the Group holding company sitting at the apex exercising direct control and oversight of its subsidiaries. Ownership allows control; enabling Chinese SOE parent companies to direct the subsidiaries’ commercial strategy, personnel appointments, and business operations.

- This top-down corporate structure replicates itself in the interaction between Tier 1 SOE enterprises and their own respective subsidiaries, including those in the U.S.

Within this construct, the U.S.-based Chinese SOE is oftentimes a shell company with little to no assets, even though this entity, more often than not, serves as the legally binding signatory in U.S. commercial ventures. Thus, when a dispute arises, the U.S. partner faces the additional legal obstacle of establishing *alter ego* between the signatory and the non-signatory SOE parent, which approved the transaction as required under Chinese law, to obtain relief.

http://origin.www.uscc.gov/sites/default/files/Research/Extraterritoriality%20of%20Chinese%20Firms_Research%20Report_o.pdf

⁶ For more information on SASAC’s regulations governing the overseas investments of central level SOEs see “China issues new rules on outbound investments by centrally administered state-owned enterprises,” Hogan Lovells, April 25, 2012. <http://www.lexology.com/library/detail.aspx?g=994616a7-3296-4f93-8eb1-670ca18708fa> and “New regulations for SOEs’ overseas deals,” Global Times, January 18, 2017. <http://www.globaltimes.cn/content/1029539.shtml>

⁷ The hierarchal leadership structures within and across Chinese SOEs come into focus when one considers the role of the Chinese Communist Party (CCP) within SOEs. For additional information on the role of the CCP in Chinese SOEs see Jonathan G. S. Koppell, “Political Control for China’s State-Owned Enterprises: Lessons from America’s Experience with Hybrid Organizations,” *Governance: An International Journal of Policy, Administration, and Institutions*, Vol. 20, No.2, April 2007. <http://onlinelibrary.wiley.com/doi/10.1111/j.1468-0491.2007.00356.x/abstract>

Tang confronted this scenario when initiating legal proceedings against AVIC in mid-2014. Ultimately, after significant expenditure of time and resources, including hiring experts to work with our legal team to uncover evidence regarding AVIC subsidiaries and activities, Tang established—per the findings of the arbitration tribunal—that AVIC Group HQ and its subsidiaries involved in the case were *alter egos* of one another. In its Final Award, the arbitration panel concluded that:

- AVIC Group HQ “exercises such complete dominion and control over the other AVIC Respondents that they all operate as a single economic entity” and that AVIC Group HQ “used its control over its subsidiaries to commit a fraud and work an injustice” against Tang and its affiliates, including creating “additional subsidiaries in an attempt to get around its promises made” in the Soaring Wind Agreement.⁸
- AVIC’s U.S. subsidiaries readily and repeatedly acknowledge that they are agents of AVIC Group HQ. For example, China Aviation Industry General Aircraft (CAIGA), the parent company of Minnesota-based Cirrus Aircraft, publicly reports that it operates “under the strategic guidance of AVIC,” and that it is controlled by its majority shareholder, AVIC Group HQ.

The Foreign Sovereign Immunities Act (FSIA)

Though undeniably engaged in commercial activities within the United States, Chinese SOEs attempt to wield the FSIA, in many cases, as a tool to skirt their legal responsibilities and delay legal proceedings. The FSIA provides the basis for obtaining jurisdiction over a foreign state and includes a commercial “carve out” or exception.⁹

Noah Feldman, a professor of constitutional and international law at Harvard University, describes how Chinese companies exploit the FSIA to their benefit.¹⁰ According to Feldman, this misuse exists because of “the innovative way the Chinese government organizes its state-owned enterprises” and their complex, opaque operating posture.

In the Tang Case, AVIC Group HQ and its subsidiary, CAIGA, are asserting immunity from suit under the FSIA.¹¹ Chinese SOEs, including AVIC have made similar claims in other recent commercial cases in U.S. courts, including:

⁸ It is highly likely that AVIC Group HQ’s International Department exercises administrative responsibility over AVIC International and other selected entities with an overseas presence. The AVIC International Department trains personnel assigned overseas, including providing instruction on AVIC Group’s internationalization strategy ((国际化发展战略), overseas management structure (外机构职责要求), overseas “social security” (境外社会安全), and overseas organizational secrecy management (境外机构保密管理). “中航工业组织境外派驻人员集中培训,” China Aviation News, May 12, 2015. <http://www.cannews.com.cn/2015/0512/125887.shtml>

⁹ For a legal definition see 28 U.S. Code § 1605 – General exceptions to the jurisdictional immunity of a foreign state. <https://www.law.cornell.edu/uscode/text/28/1605>

¹⁰ Noah Feldman, “Gap in U.S. law helps Chinese companies, for now,” Bloomberg View, May 15, 2016. <http://origin-www.bloombergvew.com/articles/2016-05-15/gap-in-u-s-law-helps-chinese-companies-for-now>

¹¹ Matthew Miller and Michael Martina, “Chinese state entities argue they have ‘sovereign immunity’ in U.S. courts,” Reuters, May 11, 2016. <http://www.reuters.com/article/us-china-usa-companies-lawsuits-idUSKCN0Y2131>

- **Global Technology, Inc. v. Yubei (XinXiang) Power Steering System Co. (“Yubei XinXiang”)**¹²— A 2012 breach of contract dispute against AVIC subsidiary Yubei XinXiang relating to its acquisition of Nexteer Automotive.¹³ The case settled privately in August 2016.
- **Chinese Manufactured Drywall Products Liability Litigation MDL 2047 (“Chinese Drywall Case”)**¹⁴—China National Building Materials Group Corp. is arguing that it is immune from U.S. courts in the Chinese Drywall Case.¹⁵

Describing the “real-life” impact of the FSIA on U.S. legal proceedings illuminates its attractiveness and utility to foreign state-owned commercial entities. The simple act of “asserting” sovereign immunity in U.S. court proceedings initiates a mandatory and time consuming back-and-forth legal process to determine the FSIA’s applicability. In fact, once a defendant asserts sovereign immunity “the burden shifts to the party opposing immunity to present evidence that one of the exceptions to immunity applies.”¹⁶

In the words of Victoria A. Valentine, an attorney who represented Global Technology Inc. in its lawsuit against AVIC Group HQ and its subsidiary Yubei XinXiang, “this strenuous mandatory determination of litigating whether a foreign sovereign’s or foreign state’s activity was legally commercial, even when the actions are undeniably commercial, is often accompanied by the halting of discovery during the appeal process. Delay, together with the prolonged and increased cost of litigation, has a chilling effect on pursuing a plaintiff’s legal rights.”¹⁷

Parent Company and Government Support in Legal Cases

When Chinese SOEs are involved, the financial and political resources at the SOEs disposal makes the material impact to a U.S. company’s legal case, especially small and medium sized firms, all the more disproportionate. For example, during the Tang Case, Tang discovered that AVIC Group HQ was providing material support to AVIC International USA, including directing its U.S. attorney to draft AVIC International USA’s legal motions. AVIC Group HQ provided this support while claiming it was not participating in the proceedings despite being a named party.

¹² See United States Court of Appeals for the Sixth Circuit, *Global Technology, Inc. v. Yubei (XinXiang) Power Steering System Co., Ltd., a People’s Republic of China corporation et al*, December 7, 2015.

<http://www.opn.ca6.uscourts.gov/opinions.pdf/15a0287p-06.pdf>

¹³ See *Global Technology, Inc. v. Yubei (XinXiang) Power Steering System Co., Ltd., a People’s Republic of China corporation et al*, United States Court of Appeals for the Sixth Circuit, December 7, 2015.

<http://www.opn.ca6.uscourts.gov/opinions.pdf/15a0287p-06.pdf>

¹⁴ Related case developments can be found on the United State District Court for the Eastern District of Louisiana website at <http://www.laed.uscourts.gov/case-information/mdl-mass-class-action/drywall>

¹⁵ See Sindhu Sundar, “Chinese Co. Fights to Duck Claims in Drywall MDL,” *Law360*, December 8, 2015.

<https://www.law360.com/articles/73534/chinese-co-fights-to-duck-claims-in-drywall-mdl>

¹⁶ See *Kelly v. Syria Shell Petroleum Dev. B.V.*, 213 F. 3d 841, 847 (5th Cir. 2000).

¹⁷ See Victoria A. Valentine et al, *The Foreign Sovereign Immunities Act’s Crippling Effect on United States Businesses*, *Michigan State International Law Review*, Vol. 24, Issue 3 (2015).

<http://digitalcommons.law.msu.edu/cgi/viewcontent.cgi?article=1196&context=ilr>

The Chinese government has also attempted to exert political pressure to influence U.S. judicial proceedings against Chinese SOEs. In October 2015, China's Ministry of Foreign Affairs (MOFA) submitted a letter to the U.S. Department of State expressing its "strong discontent" and "resolute objection" to the courts acceptance of the Chinese Drywall Case. The MOFA letter concludes that it expects "a statement of interest be issued to the court to stop the abuse of judicial procedures, so as to avoid any disruption or damage to the U.S.-China Relationship, as well as the economic and trade ties between the two nations."¹⁸

Asymmetric "Lawfare"

Throughout the course of the Tang Case, AVIC has executed a coordinated campaign to exert financial pressure on Tang and its affiliates through legal and commercial actions that others have described as "lawfare." These ongoing actions range from lawsuits to the transfer of assets and the obstruction of normal business activities within AVIC-Tang joint ventures in China. As a result, AVIC has exponentially increased Tang's time and expense to exercise its legal rights and erased the value of its investment holdings in China.

- **Attempts to Delegitimize Arbitration Proceedings**—AVIC and its attorneys sought to undermine the arbitration proceedings by alleging that the panel, constituted in accordance with the Soaring Wind Agreement AVIC signed, amounted to a "stacked deck" against it.¹⁹ AVIC International and its subsidiaries also claimed that the arbitration panel engaged in misconduct.
 - In addition, AVIC subsidiaries in China refused to produce evidence and contravened orders from the nine-member American Arbitration Association panel acting under the International Center for Dispute Resolution.
 - AVIC's actions turned what should have been a speedy arbitration process into an 18-month ordeal.
- **Asymmetric Lawsuits**—AVIC, through its U.S. attorneys, is pursuing litigation against Tang's CEO in both Delaware and California.
 - In California, AVIC initiated a suit against Tang's CEO personally alleging invasion of privacy.

¹⁸ See United States District Court for the Eastern District of Louisiana, *In re: Chinese Manufactured Drywall Products Liability Litigation*, Document 19965, Filed on January 12, 2016.

¹⁹ For more information on AVIC's legal arguments regarding the composition of the arbitration panel and subsequent court rulings on the matter see Christopher S. Moore, "District Court Rejects Pre-Award 'Stacked Deck' Challenge to Arbitrator Selection Process," American Bar Association, February 26, 2015. <http://www.americanbar.org/publications/litigation-committees/alternative-dispute-resolution/practice/2015/district-court-rejects-pre-award-stacked-deck-challenge-to-arbitrator-selection-process.html>

and Jacob Fischler, "Court Can't Step into \$2B Row's Arbitration, 5th Circ. Says," Law360, August 26, 2015. <https://www.law360.com/aerospace/articles/695465/court-can-t-step-into-2b-row-s-arbitration-5th-circ-says>

- In Delaware, AVIC is alleging that Tang’s CEO breached his fiduciary duties to Soaring Wind by initiating the arbitration claims that will substantially benefit Soaring Wind when the arbitration award is collected.
- **Destroying the Value of Tang Interests in China**—In retaliation for Tang’s initiating legal action, AVIC is transferring or withholding assets from two China-based joint venture companies in which Tang owns minority stakes.
 - Since initiating arbitration proceedings, executives at AVIC-Tang joint venture AVIC HT Blade have refused to comply with requests by Tang or its legal representatives for corporate information, including financial documents and business contracts. AVIC HT Blade is also liquidating and transferring company assets to other AVIC-owned entities.
 - In 2009, Guoxin Securities reported AVIC HT Blade’s market value at \$1.8 billion, placing Tang’s 25 percent interest at \$450 million. Since then, AVIC has valued Tang’s interest at 1 RMB (USD 15 cents).
 - Since mid-2015, deliberate inaction by AVIC subsidiaries has obstructed the sale of Tang’s minority interest in Shanxi Zhonghang Tengjin Energy Co., a Tang-AVIC joint venture company. This includes preventing Tang legal representatives from signing sale-closing documents and alleging that Tang’s CEO must personally travel to Shanxi to finalize the sale. AVIC reports the current value of Tang’s interest in the venture is \$3 million.

Key Recommendations

With the rapid uptick in Chinese investment in the U.S., disputes between Chinese and U.S. firms in U.S. courts will likely rise. U.S. companies are already beginning to seek protections in commercial agreements in response to growing legal and commercial risks posed by Chinese firms. This includes requiring Chinese acquirers to provide sovereign immunity waivers.²⁰ Congress should consider implementing practical measures that ensure a level playing field between U.S. and Chinese companies in the United States. Key recommendations include:

- Requiring all majority-owned or controlled Chinese companies, especially SOEs, operating in the United States to waive claims of sovereign immunity in U.S. courts and establish an agent for the receipt of legal service. This should be required as part of Committee on Foreign Investment in the United States (“CFIUS”) reviews.

²⁰ Fairchild Semiconductor International Inc.’s December 2015 Schedule 14D-9 filing with the U.S. Securities and Exchange Commission includes a provision that its proposed Chinese acquirers, China Resources Holdings Limited and Hua Capital Management, provide “a waiver of sovereign immunity and establish a process agent in the U.S. for the receipt of legal service.” The filing can be accessed at <https://www.sec.gov/Archives/edgar/data/1036960/000119312516463934/d22910dsc14d9a.htm>

- Establishing a pathway for U.S. plaintiffs to receive support from the U.S. government once an SOE claims sovereign immunity in U.S. legal proceedings. Given recent public pronouncements by Chinese leaders that SOEs should implement decisions of the CCP, including defense and intelligence directives,²¹ this pathway may best be established within the Department of Justice, the National Security Council, or the recently announced National Trade Council.
- Advising CFIUS to assess and consider the legal risks posed to U.S. consumers and companies in its review of Chinese transactions.
- Establishing a protocol for CFIUS to periodically re-review approved Chinese transactions to ensure the acquired entities activities do not present new national security risks.

We hope that other U.S. firms will benefit from Tang's experiences and that these recommendations provide lawmakers a practical basis for implementing regulations that protect U.S. businesses and consumers, while ensuring the U.S. remains open to Chinese investment.

²¹ See "Xi stresses CPC leadership of state-owned enterprises," Xinhua News Agency, October 11, 2016. http://news.xinhuanet.com/english/2016-10/11/c_135746608.htm