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Jurisdiction in the Spotlight

China

China and Israel – the Next Phase

"Israeli technology, Israeli technology, and Israeli technology" – the three things in which China is interested, according to Israeli Prime Minister Benjamin Netanyahu after his visit to China in 2013. The relationship has long since expanded to cover trade, investment, construction, educational partnerships, scientific cooperation, tourism and more, and this November, negotiating teams will meet for a further round of talks on finalizing a free trade agreement between Israel and China.

And the two countries share more in common than one might think. *"The modern Chinese economy and the Israeli innovative economy are today, more than ever, complimentary and synergetic,"* adds Ilan Maor, Vice Chairman, Israel – China and Hong Kong Chamber of Commerce. According to the data released by China's Ministry of Commerce, the volume of trade between the countries stood at USD13.9 billion in 2018, a 6.1% increase from 2017.

At the heart of the relationship has been China's unquenchable hunger for innovation and interest in advanced technology. For Israel, China, its second largest export market after the U.S., is a vast source of potential funding and appeals to many Israeli companies, especially those interested in software, semiconductors, IT, biotech, and agriculture.

Since 2013, the two countries have signed bilateral and business agreements valued at over USD 25 billion; there are annual meetings of the Israel-China Joint Committee on Innovation Cooperation (JCIC), the last one attended by China's Vice President Wang Qishan in October 2018; and many senior executives from China are also visiting Israel. *"This is true of leading Chinese business groups, including Alibaba, Fosun, DJI, and many others, but also for other mid-scale and large-scale companies, while more Israeli SME's executives are invited and traveling to various activities and events in China,"* adds Maor.

"China is hosting some of the largest, most prominent and popular events worldwide. Semicon China and CMEF are based in Shanghai, while others, such as World IOT are based in less well-known cities like Wuxi, in Jiangsu province," Maor points out. In Shandong province, the 3rd largest by GDP (USD 1.1 trillion), over 100 Israeli start-ups attended this year's GoforIsrael conference, spotlighting greentech, water technology, renewable energy, life sciences, AI and many other sectors. China also looks to Israeli technology in defense, security, and counterterrorism as a means of addressing China's security needs, while Israel's achievements in agricultural technology, medical technology, water technology are also highly relevant to China's domestic agenda.

Chinese Investment Continues to Grow

As such, Chinese investment in Israel continues to grow. Over the past five years, according to an *IVC Research Center* report, around USD 1.5 billion from China was invested in around 300 Israeli companies. IVC also reported that over the past two years the average number of direct Chinese investments in Israeli companies each quarter grew from 15 to 20. All in all, in 2018, Chinese investors have been involved in 12% of the financing round by Israeli start-ups, compared to 7.5-9% during 2015-2017. In 2018, the Chinese also participated in six of the 17 large financing rounds (USD 50 million or more), also a higher proportion than previously.

"More Chinese investment is directed at Israeli tech start-ups (with around 80-90 investments conducted annually), driven by both investing companies, as strategic investments, as well as by corporate funds, private equity and venture capital funds – such as Alibaba, Fosun, Horizons Ventures, CEIIF, Grit, Radiant and others," adds Maor.

The opportunities for Israeli companies are 'almost endless'

"A large share of the large Israeli tech companies are already active in China and we now see a growing number of SME companies and even startups making their way. The opportunities are almost endless. China is in many ways the new 'land of unlimited opportunities.' The main sectors of interest for Chinese companies - for cooperation and investment alike - are advanced manufacturing, microelectronics & IC, IOT solutions, medical device, smart and autonomous automotive, and agri-tech." says Maor.

Sungbo Shim, Managing Partner in the Beijing office of Squire Patton Boggs ("SPB") agrees. *"Chinese companies are mainly attracted by the technologies in software, semiconductors, telecommunications, medical, agriculture, and financial sectors. These are viewed as the strongest areas and are expected to remain so for some years. Most Chinese companies invest in these sectors to get technologies to support their business in China and strengthen their patent portfolio to compete with their competitors."*

Simon Weintraub, Co-head of the China practice at Yigal Arnon & Co., adds *"Chinese companies for a long time have also been interested in Israeli healthcare innovation including medical devices and digital health companies. Most of our investment work representing Chinese companies investing in Israel have been in this space. Auto-tech and agri-tech are other areas that are very hot and of great interest to Chinese companies coming to Israel today.*

The agriculture and technology sectors had typically accounted for most of the total Chinese investment in Israel. In recent years, ChemChina acquired Adama, an Israeli crop protection company, for USD 2.8 billion. China Bright Food Group took over Israel's Tnuva Food Industries. In the ever-evolving healthcare sector, Israeli cannabis company, iCAN: Israel-Cannabis is teaming up with a Thalys Medical Technology, a Chinese healthcare conglomerate, to focus on medical marijuana. China looks to Israel as a model in greentech, with Chinese telecom giant Huawei, typically known for smartphones, entering the Israeli solar power market to sell inverters, which help to convert solar power into energy for the electricity grid. China-based consumer electronics company Haier Group Corporation is dipping its toes in the Israeli petrochemical sector by partnering with Israeli oil refining and petrochemicals company, Bazan Group – and these are just the recent tip of the iceberg.

Close ties brings challenges and risks

While there are simmering tensions between China and the U.S., Israel's principal ally, there are opportunities for Israel, if companies do their homework. *"Chinese investments in Silicon Valley have slowed down,"* said Shim. *"Chinese investments in high-tech start-ups in the U.S. face strict restrictions and are subject to approval under CFIUS ("Committee on Foreign Investment in the United States"). As a result, Chinese investors who previously focused on U.S. based technology companies have to look for targets elsewhere. Israel, with relatively lenient policy on foreign investments in high-tech companies, significantly lower costs of investment and operation than Silicon Valley, has become an attractive target for Chinese investors looking for cutting-edge technologies."*

"Any Israeli company with a U.S. subsidiary and /or U.S. activities needs to be concerned about CFIUS today when considering an investment from a Chinese investor," agrees Weintraub. *"We have seen potential investments and acquisitions of Israeli companies fail as of late because following a CIFIUS analysis it was determined that there was a great risk that the U.S. regulators would veto such a transaction. This is a major concern today for our clients. There are structures that can be created to mitigate the risk, and this requires strong guidance and expertise."*

Israeli companies need to consider possible ramifications of Chinese backing, especially if operating in fields with national security and data privacy implications, including cybersecurity, energy and mobility, *"Companies operating in such domains may find their ability to do business with certain American partners, especially government entities diminished if they have Chinese backers,* "former U.S. ambassador to Israel, Daniel Shapiro said in a recent interview with financial newspaper Calcalist.

China has a published index of recommended industries

In addition to potential tension in the relationship with the U.S., there are vital regulatory issues. *"With the current overseas direct investment (ODI) policies in place in China, an investment / M&A deal that involves foreign currency investment outside China requires regulatory approval. Moreover, the various sectors have been categorized based on whether the Chinese government wishes to encourage, allow or prohibit them,"* points out Maor. For example, *"investments by a Chinese company in an Israeli semiconductor or advanced manufacturing company is considered and encouraged and therefore there is a high probability that it will be approved and in a relatively short time."*

Jeremy Bressman, a Tel Aviv lawyer at Kobre & Kim, experts in cross-border litigation, confirms: *"The Chinese government welcomes foreign investors, but only in certain industries and sectors, and at the end of June 2019, China's National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") announced they would publish an index of recommended industries where foreign investment is encouraged, as well as publishing two "negative lists" of industries in which foreign investment is either prohibited or restricted. In particular, China seeks investment in the logistics industry, and in particular hi-tech solutions to the distribution of products in rural areas, the cryogenic distribution of fresh produce, and the spread of technical services across China."*

One potential complication relates to funding investments. *"Many Chinese companies and investors do not have the ability today to transfer funds outside of China and while it is possible to receive the applicable regulatory approvals in China, in our experience this process can last a very long time and is an issue of many months and not weeks,"* says Weintraub. *"When an Israeli company is negotiating an investment from a Chinese investor, it is critical to get an understanding as to where is the source of funds and the regulatory hurdles, if any, required to obtain such funds."*

Where there is cross-border M&A or investment, it is also important to be clear about goals. "Israeli companies tend to be interested in selling to the Chinese market and even granting license rights to the Chinese market but Chinese companies on the other hand are often looking to buy the technology outright and transfer to China which can often lead to a disconnect in the negotiation," adds Weintraub.

Chinese role infrastructure projects bring more challenges

The sensitive issue around technology is particularly striking with regards to the participation of Chinese companies in massive infrastructure projects in Israel. As part of its Belt Road Initiative, Chinese construction is focused on transportation infrastructure, including ports, tunnels and railway lines, raising the risk of surveillance and social/political influence. China Communications Construction Company and subsidiaries, such as China Harbour Engineering Company, are involved in the expansion of Ashdod port and Shanghai International Port Group is involved in the partial construction and 25-year operation of a new container terminal at the Haifa port. Ashdod port is near Israel's national electricity company and refineries, while Haifa is a frequent port of call for the U.S. Sixth Fleet and serves as the base for Israel's submarines. *"This has raised substantial concerns in Washington, and the U.S. has been urging Israel to establish CFIUS-like laws to impose higher scrutiny on China investments. Given the importance the U.S. in Israel's national security, it is difficult to tell if Israel will do so in the next few years,"* added Shim. Other infrastructure projects in which Chinese companies are involved include the construction and operation of the Tel Aviv Light Rail; the July acquisition by a consortium including China Harbor of the Alon Tavor electricity power plant; the excavation and construction of the Carmel Tunnels; the excavation of the tunnels on the Akko-Karmiel train line; and the not-yet-approved Eilat-Ashdod train construction project, also known as the "Red-Med" railway.

Close Scrutiny

Increased scrutiny is not new, and widely practiced elsewhere. Chinese companies have been turned back before when trying to buy the Israeli insurance companies Phoenix and Clal, but that was the initiative of the capital markets regulators, who expressed concern over Chinese control of hundreds of billions of shekels in Israeli pension savings. The plan with some of these other sectors is for a panel to be chaired by the Finance Minister (and including other ministers from defense, public security and justice, as well as the head of Israel's National Cyber Authority) to examine deals by businesses involved in critical technology, national infrastructure, telecommunications, financial services and defense.

Regulating foreign involvement in major infrastructure projects and adopting concrete plans to properly screen foreign investments will go some way towards resolving the issue, and expert counsel from experienced lawyers can also do their part to ensure that the Israel/China relationship remains strong.

Five Key Points to Take Away

Ilan Maor, Vice Chairman, Israel – China and Hong Kong Chamber of Commerce

01 Give priority to segments that are strongly encouraged by the Chinese government, which includes advanced manufacturing & industry 4.0, semiconductors & microelectronics, advanced medical devices, new energy vehicles, and so on.

02 Remember that alongside with considering the first lines cities, such as Shanghai and Beijing, there are many other cities that are eager to attract Israeli companies and worth considering, if to mention a few: Nanjing, Wuxi & Changzhou (Jiangsu Province), Hefei (Anhui Province), Hangzhou & Ningbo (Zhejiang Province), Chengdu (Sichuan Province), and others.

03 Carefully study the relevant business and competitive environment and consider the technology and commercial advantage which will enable the company to strive in a challenging market.

04 Make sure that the company has the needed management attention and resources for the long road ahead. Doing business in China is a marathon.

05 Plan how to establish presence on the ground, whether independently or with / via other entity (representative, partner, etc).

Key Bodies to Be Aware Of

The **Israeli Embassy in Beijing** and the **Consulates General of Israel** in **Shanghai, Guangzhou, Chengdu, and Hong Kong**, are very active in supporting in assisting both Israeli and Chinese companies in guidance and active support, and should be on the "homework" list of every company as part of its preparatory work. The same goes for the Chinese Embassy in Tel Aviv who is active and eagerly aiming to support the enhancement of economic and business cooperation.

The Israeli Export and International Cooperation is actively promoting activities aiming at supporting exchange between Israeli and Chinese companies, from training program to delegation and expos, as well as company guidance.

The Israeli Innovation Authority and its counterparts, the Ministry of Science and Technology of China and its Provincial and Municipal levels are playing an important role in supporting technological R&D cooperation, in a very wide scope and paths, between the countries. Companies interested in such activities may approach them directly for guidance and support.

The Foreign Investments and Industrial Cooperation Authority of Israel is an integrative body in the Israeli Government dealing with the promotion of foreign investment and management of offset in Israel, and can consult Chinese companies coming to Israel, as well as their Israeli counterpart.

The Israel – China & Hong Kong Chamber of Commerce is a non-profit organization, whose sole purpose is to support Israeli & Chinese companies in engaging, providing guidance and support based on the vast experience of its management and members, as well as its network in China.

Ministry of Commerce of the People's Republic of China ("MOFCOM") is responsible for China's foreign economic cooperation efforts by creating policies with regard to foreign trade, investments, consumer protection, and market competition. MOFCOM is also in charge of negotiating bilateral and multilateral trade agreements. China's new Foreign Investment Law requires foreign investors to periodically disclose certain information to MOFCOM and the Ministry of Commerce and State Administration of Market Regulation.

National Development and Reform Commission ("NDRC") functions to "formulate and implement strategies of national economic and social development" by developing plans for economic growth and monitoring business developments. The NDRC approves, authorizes, and reviews foreign funded projects, investment projects for overseas development, and projects utilizing significant foreign exchanges. The NDRC further provides guidance by proposing plans for foreign capital utilization and overseas investment.

China Securities Regulatory Commission ("CSRC") is the regulatory body that oversees the country's securities and futures exchanges (equivalent to the U.S. SEC). The CSRC is comprised of 36 regulatory bureaus, and is tasked with creating and enforcing laws and regulations for China's securities market and providing oversight, including the supervision of foreign securities trading firms in China.