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CFIUS Continues to Present an Obstacle to Chinese Acquisitions

On September 13, 2017, President Donald Trump issued an Executive Order blocking investment firm, Canyon Bridge Capital Partners Inc. (“Canyon”), from acquiring Lattice Semiconductor Corporation (“Lattice”). President Trump’s decision to block the transaction marked only the fourth time over the last thirty years that a U.S. President has blocked a transaction out of concerns for national security. Notably, all four examples involved Chinese investors, and three occurred within the last five years.¹

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Although presidential intervention to block a planned acquisition is relatively rare, President Trump’s action was not especially surprising in light of recent precedent and public statements by the President and members of his Administration regarding China. In recent years, the Committee on Foreign Investment in the United States (“CFIUS” or the “Committee”), an inter-agency committee with broad authority to review transactions that could result in control of a U.S. business by a foreign person, has closely scrutinized transactions involving prospective Chinese investors. And while CFIUS’s cautious approach to such transactions predates the Trump Administration, President Trump’s public statements regarding China, both before and after his election, have suggested skepticism regarding—and potential increased scrutiny of—active Chinese participation in the U.S. economy. Against this backdrop, the Lattice decision confirms what practitioners and prospective Chinese investors already suspected: transactions involving Chinese acquirers will continue to be subject to rigorous scrutiny under the Trump Administration.

I. The Lattice Transaction

Lattice is a publicly traded semiconductor company based in Portland, Oregon. Lattice manufactures non-military-grade programmable chips for use in vehicles, computers, mobile phones, and other similar devices. Lattice advertises that its products can be used to support numerous cutting-edge technologies, including virtual reality, intelligent automation, and advanced computing.

In November 2016, Lattice and Canyon, a firm based in Palo Alto but backed by Chinese investors, announced that they had reached a definitive agreement whereby Canyon would acquire the entire outstanding equity of Lattice for \$1.3 billion, or \$8.30 per share. The November 2016 announcement stated that the proposed acquisition would require approval from CFIUS, which it acknowledged had previously “prevented some Chinese takeovers of U.S. technology companies in the past year.”² Approximately one month after the proposed acquisition was announced, a bipartisan group of 22 members of the U.S. House of Representatives submitted a letter to then-U.S. Secretary of the Treasury Jack Lew objecting to the proposed transaction, asserting that “the deal could disrupt the U.S. military

¹ In 1990, President George H. W. Bush intervened to prevent China National Aero-Technology Import and Export Corp. from acquiring MAMCO Manufacturing, Inc., an aerospace and aircraft parts manufacturer. In 2012, President Barack Obama blocked Chinese-owned Ralls Corp. from developing wind farm sites near a naval base in Oregon. In 2016, President Obama blocked the proposed sale of AIXTRON SE, a German semi-conductor equipment supplier, to China-based Grand Chip Investment GmbH.

² Don Clark, [Lattice Semiconductor to Sell Itself to Canyon Bridge for \\$1.3 Billion](#), WALL STREET J. (Nov. 3, 2016).

supply chain and possibly lead to a reliance on foreign-sourced technologies for many critical U.S. Defense Department programs.”³

Although the CFIUS review process is confidential, based on publicly available information, the Committee appears to have engaged in a thorough and lengthy analysis of the proposed acquisition. The parties filed an initial joint request for CFIUS approval in January 2017 and, after failing to obtain pre-clearance, refiled their request twice (in March and June 2017).⁴ In a September 1, 2017 filing with the U.S. Securities and Exchange Commission, Lattice announced that the parties had been unable to resolve certain concerns expressed by CFIUS regarding the proposed acquisition. According to public reports, CFIUS submitted a package of information to President Trump that included “a full record of the committee’s review, including information exchanged between the companies and the panel, and its assessment of the risks from the takeover” and recommended that the President block the proposed acquisition.⁵

On September 13, President Trump issued an Executive Order blocking the contemplated acquisition. A White House press release stated that “[t]he national-security risk posed by the transaction relates to, among other things, the potential transfer of intellectual property to the foreign acquirer, the Chinese government’s role in supporting this transaction, the importance of semiconductor supply chain integrity to the United States Government, and the use of Lattice products by the United States Government.”⁶

II. Overview of the CFIUS Review Process

CFIUS was established by President Gerald Ford in 1975 to monitor foreign direct investment in the United States. The Committee was delegated authority to review foreign transactions by President Ronald Reagan in 1988, following passage of the Exon-Florio Amendment, 50 U.S.C. § 2170, which amended Section 721 of the Defense Production Act of 1950 and granted the President authority to block foreign investment in the United States when “the transaction threatens to impair the national security of the United States.” 50 U.S.C. § 4565(b)(2)(B)(i)(I).

Pursuant to Treasury Department regulations, CFIUS has the authority to review any “covered transaction,” defined to mean “any transaction . . . by or with any foreign person, which could result in control of a U.S. business by a foreign person.” 31 C.F.R. § 800.207. CFIUS construes the terms “foreign national” and “U.S. business” broadly. The term “foreign national” includes foreign governments and foreign entities, as well as entities controlled by foreign governments and foreign entities,⁷ 31 C.F.R. § 800.216, while the term “U.S. business” includes “any entity, irrespective of the nationality of the persons that control it, engaged in interstate commerce in the United States.” *Id.* § 800.226. CFIUS has the authority to block a covered transaction, or to impose mitigation measures, if the transaction poses a threat to U.S. national security, a concept that the Committee construes very broadly.

The CFIUS review process is a voluntary filing regime, meaning that parties to a covered transaction are not required to seek CFIUS pre-clearance before proceeding with the transaction. However, there may be strong incentives to file with CFIUS. Where parties to a covered transaction elect not to seek CFIUS pre-clearance, the Committee may initiate its own review of the planned transaction and impose mitigating measures (or recommend that the President block the transaction). Importantly, CFIUS’s authority to review covered transactions is not time-limited—the Committee may review a transaction and recommend mitigating measures (including, potentially, unwinding of a transaction) at any time after closing.

³ Greg Roumeliotis, [Lawmakers ask U.S. to block Chinese takeover of Lattice Semiconductor](#), REUTERS (Dec. 5, 2016).

⁴ Liana Baker & Greg Roumeliotis, [Exclusive: China-backed fund in third bid for U.S. to approve chip deal – sources](#), REUTERS (June 11, 2017).

⁵ David McLaughlin, [Trump to Weigh Security Risk of Chinese Bid for Chipmaker](#), BLOOMBERG POLITICS (Sept. 1, 2017).

⁶ Press Release, [The White House, Statement from the Press Secretary on President Donald J. Trump’s Decision Regarding Lattice Semiconductor Corporation](#) (Sept. 13, 2017) [hereinafter “White House Press Release”].

⁷ Canyon, a newly formed firm based in Palo Alto, qualified as a “foreign national” because its funding came from Chinese investors.

The CFIUS review process begins when the parties to a covered transaction make a voluntary filing to CFIUS or CFIUS otherwise becomes aware of a covered transaction. *Id.* § 800.401(a), (b). Once the process is initiated, the parties to a covered transaction must make a detailed submission to CFIUS, including (1) information about the transaction, including its nature and value; (2) detailed corporate information about the acquiring and target entities, including any information about the relationship between the acquirer and foreign governments; (3) detailed information about the nature of the target entity's products, particularly whether the products are export-controlled; and (4) information about the acquiring entity's plans to alter or change the target entity's business moving forward. *See id.* § 800.402(c). Frequently, parties to a covered transaction will submit a draft joint voluntary notice to CFIUS, which will be updated and resubmitted as a final joint voluntary notice upon receipt of preliminary feedback from the Committee.

The parties' submission of a final joint voluntary notice triggers an initial, 30-day review period, upon completion of which CFIUS may (1) clear the proposed transaction or (2) proceed to a more detailed, 45-day follow-up investigation. *Id.* § 800.502. In the latter scenario, at the conclusion of the 45-day follow-up investigation, CFIUS may (1) clear the proposed transaction or (2) provide a recommendation to the President, who then has 15 days to determine whether to clear or block the proposed transaction. *Id.* § 800.506. Throughout the review process, CFIUS may submit questions and information requests to the parties, which generally must be answered within three business days (or CFIUS may reject the parties' voluntary notice). *Id.* § 800.403(a)(3). In addition, at any point during the process, CFIUS may request that the parties to a covered transaction refile their request for pre-clearance, which effectively restarts the entire process.

III. Recent Activity Involving Chinese Investors

Over the past several years, CFIUS has reviewed an increasing number of transactions, reflecting an expanding view of the scope of U.S. national security. CFIUS reviewed a record number of transactions (approximately 170) in 2016, and the Committee appears to be on pace to review an even greater number of cases this year.⁸

As noted above, CFIUS appears to be exercising particular scrutiny over covered transactions involving prospective Chinese acquirers. For example, in January 2016, CFIUS blocked Dutch company Philips NV's proposed \$3.3 billion sale of Lumileds, a manufacturer of lighting components and LEDs, to a consortium that included several Chinese firms (e.g., GSR Ventures and Nanchang Industrial Group).⁹ The deal would have resulted in the sale of an 80% stake in the Lumileds division, which is based in California.¹⁰ Observers speculated that CFIUS was concerned about the prospect of a Chinese company acquiring advanced technologies to make LED lights, which are a type of semiconductor.¹¹ CFIUS's decision to block the Lumileds transaction appears to have been a significant factor in parties' decisions to abandon other, similar transactions. For example, in February 2016, Fairchild Semiconductor International, a U.S.-based semiconductor chip manufacturer, rejected a \$2.49 billion acquisition offer from China Resources Microelectronics Ltd and Hua Capital Management Co Ltd due to CFIUS concerns.¹²

In December 2016, CFIUS recommended that the parties scrap a proposed \$715 million sale of AIXTRON SE, a German semi-conductor equipment supplier, to Grand Chip Investment GmbH, a Chinese company.¹³ Although neither the buyer nor the seller was a U.S. company at the time, AIXTRON had a U.S. subsidiary and employed around 100 people in the United States (which accounted for approximately 20% of the company's sales).¹⁴ The

⁸ Kate O'Keefe and Julie Steinberg, [U.S. Message to China: Hands Off Our Companies](#), WALL ST. J. (July 21, 2017).

⁹ Toby Sterling, [U.S. blocks Philips' \\$3.3 billion sale of Lumileds to Asian buyers](#), REUTERS (Jan. 22, 2016).

¹⁰ *Id.*

¹¹ *Id.*; see also Baker & Roumeliotis, *supra* note 4 ("The semiconductor industry has long been seen as one of the most sensitive sectors from a U.S. national security perspective, because it provides chips for a plethora of applications and devices, from smartphones and satellites to missiles and power grids.").

¹² Diane Bartz & Liana Baker, [Fairchild rejects Chinese offer on U.S. regulatory fears](#), REUTERS (Feb. 16, 2016).

¹³ David McLaughlin, [Obama Blocks Chinese Takeover of Aixtron as U.S. Security Risk](#), BLOOMBERG MARKETS (Dec. 2, 2016).

¹⁴ *Id.*

parties elected not to follow CFIUS's recommendation, and President Obama ultimately rejected the proposed sale for national security reasons.

In June 2017, U.S. electronics maker Inseego Corp. abandoned a proposed \$50 million sale of its MiFi business to TCL Industries Holdings, a Chinese smartphone manufacturer.¹⁵ Similarly, in July 2017, Chinese conglomerate HNA Group Co Ltd abandoned a proposed \$416 million investment in Global Eagle Entertainment Inc., a U.S.-based in-flight services company, citing delays obtaining CFIUS pre-clearance.¹⁶

Notably, CFIUS's recent scrutiny of transactions involving Chinese purchasers has not been limited to cases that would result in Chinese companies acquiring control of advanced technology. For example, in October 2016, Blackstone sought to sell a real estate trust (Strategic Hotels and Resorts), comprised of 16 U.S.-based hotels and resorts, to Chinese investment firm Anbang Insurance Group Co.¹⁷ CFIUS reviewed the proposed transaction and, in connection with that review, a California-based hotel, Hotel del Coronado, was excluded from the transaction. The Hotel del Coronado is located on a California peninsula in proximity of a U.S. naval base that operates as a training ground for U.S. Navy SEAL teams (among other military functions).¹⁸ The above examples are in addition to numerous transactions currently pending before CFIUS.

IV. Looking Ahead

a. Continued Scrutiny of Chinese Investments

At the most fundamental level, the Lattice decision underscores that the U.S. government is committed to carefully scrutinizing prospective transactions that would result in a Chinese investor acquiring control of a U.S. business. As outlined above, in recent years, the CFIUS review process has resulted in the blocking—or abandonment—of numerous transactions involving Chinese purchasers, a trend that may escalate under the Trump Administration. The dead deal costs associated with such transactions undoubtedly have affected—and will continue to affect—investment decisions by Chinese firms.

b. National Security Is A Broad And, At Times, Elusive Concept

Historically, CFIUS has exercised its authority to review transactions with clear implications for U.S. national security. In recent years, however, CFIUS appears to be construing the concept of national security more broadly, in response to an ever-increasing array of non-traditional security threats (e.g., cyber threats, food and agriculture supply chain threats, threats to the financial industry, etc.).

CFIUS apparently believed that the acquisition of Lattice by Canyon presented national security concerns because Lattice is in the semiconductor industry, despite the fact that Lattice does not sell its programmable chips to the U.S. military. For its part, the White House claimed that the acquisition presented national security concerns for reasons including (1) the potential transfer of intellectual property to the foreign acquirer; (2) the Chinese government's role in supporting the transaction; (3) the importance of semiconductor supply chain integrity to the U.S. government; and (4) the use of Lattice products by the U.S. government.¹⁹ Going forward, CFIUS's increasingly expansive view of U.S. national security will require prospective foreign investors, and their counsel, to think broadly (and creatively) regarding potential national security implications of contemplated investments and acquisitions.

c. The CFIUS Review Process Can Be Lengthy (And Expensive)

¹⁵ Press Release, Inseego Corp., [Inseego Announces Termination of Transaction with TCL, Leadership Changes, and Company-Wide Restructuring](#) (June 7, 2017).

¹⁶ Sumeet Chatterjee & Diane Bartz, [U.S. regulatory scrutiny scuppers deal for unit of China's HNA](#), REUTERS (July 26, 2017).

¹⁷ Hui-yong Yu & David McLaughlin, [Blackstone Ends Plan to Sell Landmark Hotel to China's Anbang After U.S. Opposition](#), BLOOMBERG (Oct. 21, 2016).

¹⁸ *Id.*

¹⁹ White House Press Release, *supra* note 6.

Prospective foreign investors in U.S. businesses frequently inquire about the length of the CFIUS review process. Pursuant to Treasury Department regulations, the process should take between 30 and 75 days, depending on whether CFIUS determines that a 45-day follow-up investigation is warranted. However, this time frame does not account for the time required to gather the detailed information that must be included in the parties' joint voluntary notice. In addition, as illustrated by the examples discussed above, CFIUS can—and regularly does—request that parties to a covered transaction refile their request for pre-clearance, which effectively restarts the 75-day clock. As a result, it can be difficult to predict the time and costs (*e.g.*, legal costs; management distraction) associated with obtaining CFIUS pre-clearance with any certainty.

By way of example, CFIUS requested the parties to refile their request for pre-clearance in connection with the Inseego and Lattice transactions. As a result, the CFIUS review process for each transaction stretched over many months—Inseego (7 months) and Lattice (9 months)—which can present a variety of commercial and practical challenges.

d. Foreign Acquirers Face Financial Risks

The decision whether to seek CFIUS pre-clearance of a covered transaction requires an especially fact- and transaction-specific analysis. Non-U.S. investors participating in a competitive bidding process that includes U.S. investors may feel compelled to not seek CFIUS pre-clearance in order to present a more competitive offer. Regardless of the competitiveness of the investment process, however, all non-U.S. investors considering whether to seek CFIUS pre-clearance must assess the likelihood that CFIUS will independently learn about—and initiate its own review of—the contemplated transaction.

By not seeking CFIUS pre-clearance, non-U.S. investors expose themselves to risk that CFIUS may initiate a review of the transaction at any time during the duration of the investment. While CFIUS review costs may be shared between both parties, the consequences of an adverse CFIUS decision are far greater for the non-U.S. investor. At worst, a non-U.S. investor may be ordered to unwind a transaction post-closing, likely at a “fire sale” price.

e. Legislation May Grant CFIUS Greater Power

In parallel to CFIUS's increasingly aggressive posture, legislative efforts are underway to formally expand the Committee's authority to review transactions involving foreign investors. Senator John Cornyn of Texas, the second-ranking Republican in the United States Senate, said he plans to introduce a reform bill called the Foreign Investment Risk Review Modernization Act, or FIRRMA, to “modernize the CFIUS process to prepare [the United States] to meet the 21st-century threats.”²⁰ As described by Senator Cornyn, FIRRMA would, among other things, grant CFIUS greater power to review (1) non-control transactions where a foreign investor will gain access to certain technologies; and (2) joint ventures operating overseas.²¹ Senator Cornyn has opined that “China's investments have the potential to degrade [U.S.] military superiority” and that, while FIRRMA would not seek to “ban foreign investment in the United States, including investment from China,” it would seek to give CFIUS greater power to combat China's investment strategy.²² If FIRRMA or other similar legislation were enacted, CFIUS's scrutiny of transactions involving foreign investors could expand significantly.

V. Conclusion

The Lattice decision is the latest in a series of actions by the U.S. government to regulate investments in U.S. businesses by Chinese businesses. Although President Trump's action is consistent with recent precedent and his own public statements, the Lattice case is a useful data point for practitioners and prospective investors who are seeking to map CFIUS's expanding views of its jurisdiction and the scope of U.S. national security interests.

²⁰ [Foreign Investments and National Security: A Conversation With Senator John Cornyn](#), COUNCIL ON FOREIGN RELATIONS (June 22, 2017).

²¹ *Id.*

²² *Id.*