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MERGERS AND ACQUISITIONS

CFIUS After Lattice: What Boards, Investors, and Bankers Need to Know Now



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It has been a challenging year for the Committee on Foreign Investment in the United States (“CFIUS”). The number of transactions notified to CFIUS is on pace to set a record. Transactions are taking longer to receive clearance, as delays in appointments of senior governmental officials with CFIUS responsibilities have slowed CFIUS’ reviews and investigations. Complex transaction structures and ownership chains have prompted requests for additional disclosure from trans-

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action parties as well as, in some acquisitions involving private equity sponsors, limited partners. And, the scope of CFIUS’ concerns is widening: national security questions are increasingly being raised with regard to industries and sectors that have not historically been considered “sensitive.”

In light of these circumstances, boards, investors, and bankers alike must consider how CFIUS may be relevant to a transaction at the earliest possible opportunity. Whether a transaction may warrant notification to CFIUS will inform not only deal feasibility, but also certainty, timing, and financial and other costs. But, while CFIUS tends to be opaque, it is not a black box, and it is not binary. With careful advance preparation, decisions about whether and when to file with CFIUS can be nested within the deal strategy process, and properly account for both deal-specific considerations as well as enterprise investment goals.

We summarize below the top five things about the CFIUS climate that boards, investors, and bankers need to know now.

1. Any direct or indirect China nexus elevates deal risk.

Transactions involving Chinese buyers have encountered particularly challenging headwinds in the CFIUS process in the past year—and in particular, within the past three months.

On Sept. 13, President Donald Trump blocked the \$1.3 billion acquisition of Lattice Semiconductor Corp., a U.S. manufacturer of programmable logic chips, by Canyon Bridge, a fund headquartered in Silicon Valley and backed by a Chinese state-owned investment manager.

The Lattice transaction ran into trouble well before President Trump’s decision. According to public filings, the parties met with CFIUS officials in advance of signing to socialize the transaction and seek CFIUS’ reaction to Canyon Bridge’s participation. However, shortly after the deal was announced in November 2016, 22 members of Congress signed a letter to the Secretary of the Treasury, Chair of CFIUS, calling for CFIUS to reject the acquisition in light of factors including Canyon

Bridge's financial ties to the Chinese government and the Chinese government's pursuit of semiconductor technology through sequential acquisitions of U.S. semiconductor businesses. In the intervening months, the parties pulled and refiled their notice to CFIUS twice before deciding to elevate the transaction for President Trump's final decision.

A press release from the Department of Treasury explained that sources of national security risk in the transaction that could not be mitigated included:

- transfer of IP to Canyon Bridge;
- the Chinese government's involvement in the transaction;
- "the importance of semiconductor supply chain integrity to the U.S. government"; and
- the U.S. government's use of Lattice products.

A Presidential decision to block a transaction after CFIUS review is rare, and has occurred on only three other occasions in CFIUS' history. In each such transaction, the acquiring party has been Chinese. However, a number of other transactions involving prospective Chinese buyers have been abandoned following CFIUS' notification to the parties that CFIUS would recommend that the President prohibit the transaction.

Recent examples of failed deals include:

- On July 26, Global Eagle Entertainment Inc. ("GEE") walked away from a \$416 million investment by an affiliate of HNA Group, a Chinese conglomerate, after failure to obtain CFIUS clearance.
 - The deal contemplated the acquisition of up to 34.9 percent of GEE, and the formation of a joint venture in China.
- On June 7, Inseego Corp. terminated a \$50 million sale of its MiFi mobile hotspot business to TCL Industries Holdings (H.K.) Ltd., after having notified the transaction to CFIUS three times without success.

According to public information, at least ten other deals involving Chinese acquirers or minority investors are currently pending before CFIUS, many of which have been filed to CFIUS more than once.

Importantly, CFIUS risk may arise not only from direct Chinese acquisitions of U.S. businesses, but also from:

- participation by Chinese limited partners in an investment opportunity involving U.S. assets;
- pre- or post-closing syndication to Chinese investors; and
- Chinese sources of financing for a transaction (e.g., state-backed banks).

2. New and different national security themes are becoming more prominent in CFIUS reviews.

These include:

- **Bleeding-Edge Technology:** CFIUS has devoted increasing attention to the potential transfer of new and different "bleeding-edge" technology to foreign persons that could exploit such technology to the detriment of U.S. national security.

o In certain cases, the foreign buyer and the U.S. business may not fully recognize the potential array of applications of the technology at issue, or appreciate the extent to which such technology is utilized by the U.S. government or by commercial customers that may indirectly supply U.S. government customers or otherwise contribute to U.S. national security.

- **Potential Vulnerabilities of Lower-Tech Products:** On the other hand, a U.S. target company's business may be vulnerable even in the absence of "sensitive" technology, particularly if the business manufactures or deals in products that are widely used by U.S. government customers or sensitive commercial customers.

- **Big Data:** The U.S. government is increasingly concerned about transactions that may result in foreign access to large amounts of data, especially when such data may include U.S. citizens' personal identifying information.

3. Key U.S. government stakeholders have raised concerns regarding national security considerations presented in minority investments, joint ventures, and other transaction structures.

- At a Senate Banking Committee hearing on CFIUS on Sept. 14, Sen. Sherrod Brown (D-Ohio) noted, "We have seen an increase in smaller private investments to obtain access to new technological know-how."

- Secretary of Commerce Wilbur Ross and Secretary of the Treasury Steven Mnuchin have voiced concerns regarding CFIUS' ability to address national security risk that may arise from joint ventures.

- A Senate Committee report on potential enhancements to foreign investment review in the 2018 National Defense Authorization Act suggested an imperative to scrutinize "foreign use of investment tools and methods that work around existing vetting processes to gain access to critical technology or intellectual property."

4. CFIUS' jurisdictional ambit may expand in the near term, making certain non-control transactions subject to closer scrutiny and different types of transactions newly subject to CFIUS' jurisdiction.

Sen. John Cornyn (R-Texas) has indicated that he intends to propose a bill that would reform and strengthen CFIUS, with a specific focus on imposing more stringent criteria for Chinese acquisitions of U.S. technology companies. The bill would expand CFIUS' jurisdiction to enhance scrutiny of joint ventures and certain types of minority investments, permit CFIUS to undertake reviews of licensing transactions, and require CFIUS to devote additional scrutiny to transactions involving "countries of concern" (e.g., China, Russia).

If Sen. Cornyn's bill or other legislation incorporating these concepts becomes law, boards and management teams of U.S. companies (or foreign companies with U.S. assets) will need to plan for longer transaction review timelines in negotiating sales to foreign buyers whose acquisitions would fall within the scope of the new law. Foreign acquiring parties to such transactions

will likewise need to account for any competitive disadvantages posed by higher standards of review.

5. CFIUS reviews must be closely coordinated with other foreign investment reviews.

For reasons similar to those driving U.S. stakeholder interest in strengthening CFIUS, other countries have begun to adopt CFIUS analogues to screen foreign direct investment.

- In the EU, European Commission President Jean-Claude Juncker set forth a proposed framework for an EU foreign investment clearance regime, which would be implemented at the member state level.

- o The EU proposal would not require EU member states to adopt a foreign investment screening process. However, for those member states that currently undertake foreign investment screening, the proposal would provide standardized criteria for considering the impact of an acquisition of an EU company on national security, with specific focus on effects relating to technology and infrastructure.

- In July, Germany implemented a new directive to enhance the German government's ability to review acquisitions and public takeovers of German companies on national security grounds. Timetables for transactions that contemplate national security reviews by CFIUS and other countries' regulators must be carefully coordinated to avoid timing complications and other deal risks.

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Looking forward to the fourth quarter and beyond, deal professionals should address CFIUS strategy and tactics as early as practicable in the deal process. CFIUS' decisional metabolism in the Trump administration is continuing to work itself out, and a transaction party's prior smooth reviews may not predict future clearances. Each case that goes before the Committee for review is unique, and must be carefully evaluated in light of U.S. national security and foreign policy priorities.