

Report from Washington

President Trump Blocks Sale of Lattice Semiconductor to Private Equity Fund with Ties to Chinese State-Owned Enterprises, Underscoring Uniquely Difficult Environment for Obtaining CFIUS Approval of Semiconductor Transactions Involving Chinese Investors

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On September 13, 2017, President Trump issued an Executive Order blocking the proposed \$1.3 billion sale of Lattice Semiconductor to Canyon Bridge Capital Partners, a private equity firm managed by United States nationals and backed by funds from several Chinese state-owned entities. The Order states that Canyon Bridge and its Chinese affiliates, “through exercising control of [Lattice], might take action that threatens to impair the national security of the United States.” The decision marked the first opportunity for President Trump to invoke his formal authority under the Defense Production Act of 1950 to block a foreign investment in the U.S. on national security grounds. By accepting a recommendation from the Committee on Foreign Investment in the United States (“CFIUS”) to block the acquisition, President Trump rejected arguments presented by Lattice Semiconductor and Canyon Bridge that the transaction would create American jobs and boost the U.S. economy.

Prior to the President’s decision, Canyon Bridge and Lattice publicly asserted that the transaction would offer significant benefits to the U.S. economy. In particular, Lattice issued a pledge to use the investment to double its American workforce from 350 to 700. The Lattice CEO described it as “[g]rowing U.S. jobs with someone else’s money.” But as evidenced by his decision, the Trump Administration was not persuaded that these purported economic benefits were sufficient to overcome the national security concerns identified by CFIUS.

Although President Trump’s Executive Order is sparse on details, U.S. Secretary of the Treasury Steven T. Mnuchin, who chairs CFIUS, issued a press release that discusses the Committee’s rationale for its recommendation to block the Lattice transaction. According to

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the release, “[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 U.S. government, and the use of Lattice products by the U.S. government.”

The Lattice transaction was partly controversial because of the way it was structured. From public reports, the parties employed a typical private equity structure involving an asset manager (Canyon Bridge) for a limited partnership backed by funds from Chinese state-owned enterprises. Canyon Bridge itself was said to be owned and managed by U.S. nationals. Because ultimate control of Lattice would have been in U.S. hands, the parties evidently adopted the structure to make it more difficult for CFIUS to conclude that a “foreign” investor would acquire control over Lattice. But it was clear by the time the parties filed with CFIUS for the second time that the Committee had found it had jurisdiction over the acquisition, most likely because the Chinese state-owned enterprises would have been entitled to substantially all of the economics of the deal and therefore may have been seen by the Committee as acquiring meaningful or decisive practical influence over Canyon Bridge and therefore Lattice itself.

Lattice designs and develops semiconductor products with a focus on programmable logic devices (“PLDs”), chips that are incorporated into mobile and consumer products, commercial communications and computing solutions, and industrial and automotive applications. While Lattice is involved in the design and distribution of semiconductors, it does not own or operate semiconductor foundry or manufacturing facilities.

Semiconductor supply and technology has long been a focus of CFIUS, which has historically expressed national security concerns over efforts by both Chinese and non-Chinese entities to acquire semiconductor-related assets. Scrutiny of semiconductor transactions has ratcheted up to unprecedented levels in the past two years. Late in 2016, President Obama blocked the sale of the U.S. assets of German semiconductor manufacturer Aixtron SE to a Chinese investor on national security grounds. And earlier in 2016, Chinese investors led by GO Scale Capital abandoned their attempt to purchase Royal Philips’ Lumileds business after CFIUS concluded that the deal posed unresolvable national security risks. It has been widely speculated that CFIUS’s concerns about both transactions were driven by the targets’ semiconductor process technologies and capabilities and the potential for transfer of sensitive technology to China. In particular, both Aixtron and Lumileds were involved in Metal-Organic Chemical Vapor Deposition (MOCVD) systems, a highly complex manufacturing process used to produce, among other things, Gallium Nitride (GaN)

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semiconductors. GaN semiconductors have been around for some time for commercial applications and are increasingly being used in military applications, such as radar transmitters and electronic jamming equipment.

In addition to China’s efforts to become self-sufficient in its capabilities in high-end semiconductors, CFIUS’s concerns with foreign investment in the semiconductor industry have extended to non-Chinese acquirers. For example, in February 2017, the German chip maker Infineon Technologies abandoned its proposed acquisition of Wolfspeed Power from Cree in light of CFIUS’s conclusion that the transaction posed national security concerns (although Infineon’s commercial relationships with China may have played a role in CFIUS’s refusal to approve the proposed sale).

CFIUS’s review of the Lattice transaction is also noteworthy because it represents a growing trend of extended timetables for CFIUS investigations, particularly those with Chinese investors. Ordinarily, the Committee has 30 days to review a transaction for national security concerns once the parties provide it with notice of the deal, which can extend another 45 days (i.e., for a total of 75 days) if CFIUS opens an investigation. But this timeline can be elongated in practice. If the Committee and the parties to the transaction are not able to agree to mitigation terms prior to the conclusion of the initial investigation period, the parties with CFIUS’s permission can withdraw and refile their notice with the Committee—effectively restarting the 75-day clock. Although the practice of withdrawing and refiling is not new, there has been a marked expansion in its use during the Trump Administration. Ultimately, the Lattice transaction underwent three of these cycles before the parties sought a formal decision from the President, and public disclosures indicate that numerous other deals involving China have proceeded into second or third cycles. Moreover, we believe this new phenomenon has not been limited to deals involving Chinese acquirers.

While there are likely many reasons for the increase in protracted reviews, including key vacancies in positions held by political appointees in the Trump Administration that would typically oversee the CFIUS process, broader geo-political and trade issues appear to be at play. White House officials have publicly expressed security concerns related to increased Chinese and other foreign investment in the United States, and the Administration has launched formal investigations into alleged intellectual property trade violations by China—as well as purported steel dumping and other Chinese trade practices considered detrimental to the U.S. steel industry. More recently, diplomatic tensions involving North Korea have prompted top U.S. Treasury officials to threaten economic sanctions against Chinese financial institutions facilitating transactions with the rogue state, which hints at the possibility of a growing trade war between China and the United States. Indeed, one recent

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tweet by President Trump went so far as to threaten to cut off trade with China altogether in light of the North Korean provocations: “The United States is considering, in addition to other options, stopping all trade with any country doing business with North Korea.”

In sum, President Trump’s decision to block the Lattice transaction shows that transactions involving semiconductor technologies have never been subject to greater scrutiny by CFIUS than at present. At the same time, the Trump Administration’s willingness to adopt the Committee’s findings on national security, even in the face of arguable substantial economic benefits to the United States, affirms the central role that national security issues increasingly play in foreign investment screening. In the past, so-called economic agencies of CFIUS such as Treasury, Commerce and the Special Trade Representative were stronger proponents of the benefits of foreign direct investment into the United States. Their voices appear to be stifled, at least in the current environment, which seems very shortsighted in terms of the U.S. economy. Going forward, parties to foreign investments in the semiconductor industry can continue to expect heightened scrutiny and protracted reviews. An open question is whether, in the current environment and for the foreseeable future, it will be possible for any Chinese investor to acquire a semiconductor company with U.S. operations.

To learn more about the CFIUS process and how to navigate it effectively, please contact any of the following:

WASHINGTON, D.C.

Peter Thomas

+1-202-636-5535
pthomas@stblaw.com

* * * * *

David Shogren

+1-202-636-5562
dshogren@stblaw.com

Nicholas Barker

+1-202-636-5822
nicholas.barker@stblaw.com

Nicholas Ridley

+1-202-636-5824
nicholas.ridley@stblaw.com

Andrew Hasty

+1-202-636-5829
andrew.hasty@stblaw.com

Mark Skerry

+1-202-636-5523
mark.skerry@stblaw.com

Alexandra Saper

+1-202-636-5850
alexandra.saper@stblaw.com

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Simpson
Thacher
Worldwide



UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000