Report from Washington

CFIUS Update: President Obama Issues Rare Executive Order Blocking an Acquisition While Potentially Significant Changes to Foreign Investment Review by the United States Government Are on the Horizon

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On December 2, 2016, President Obama issued an executive order blocking the sale of the U.S. assets of a German semiconductor manufacturer, Aixtron SE, to a Chinese investor, Fujian Grand Chip Investment Fund. Although proposed acquisitions in the semiconductor space have been abandoned for national security reasons, a Presidential order (as opposed to the threat of one) is a rare example of executive intervention that confirms the growing scrutiny of Chinese and other foreign investments in U.S. businesses.

Every year, numerous foreign acquisitions of U.S. businesses are conditioned on mitigation agreements imposed by the Committee on Foreign Investment in the United States ("CFIUS" or the "Committee"), the inter-agency committee charged with reviewing foreign investments in U.S. businesses for potential national security issues. There were nine such mitigation agreements in 2014, the latest year for which information is publicly available. It would be unsurprising if the number of such agreements increased in 2015 and this year. In those instances where CFIUS determines that a deal presents unresolvable national security concerns, most parties choose to abandon their deal rather than necessitate Presidential intervention. President Obama's order on Aixtron is only the third time that a formal executive action has been used to halt foreign investment in a U.S. business since the Committee's creation during President Ford's administration. The order also provides visibility into the extent to which the CFIUS process can have extra-territorial effects. The announced prohibition extends to assets beyond U.S. borders if those assets are "used in, or owned for the use in or benefit of, the activities in interstate commerce in the United States."

Neither the President or CFIUS is required to disclose publicly the specific nature of any national security concerns raised by a transaction, but CFIUS has long considered semiconductors a critical technology demanding close scrutiny, and an accompanying statement from the U.S. Department of Treasury, which chairs CFIUS, provides some clues. While sparse on details, the Treasury Department's statement reveals that Grand Chip was "ultimately owned by investors in China some of whom have Chinese government ownership," and that "the military applications of the overall technical body of knowledge and experience of Aixtron" pose a risk to U.S. national security, specifically noting that Aixtron uses "Metal-Organic Chemical Vapor Deposition (MOCVD) systems to build semiconductor materials." MOCVD is a highly complex manufacturing process used to produce Gallium Nitride (GaN) semiconductors, which are increasingly used in military applications of products like radar transmitters and electronic jamming equipment. Earlier this year, a consortium of Chinese investors led by GO Scale Capital announced their decision to abandon the consortium's purchase of Royal Philips' Lumileds business after CFIUS determined that the deal posed unresolvable national security concerns. While neither CFIUS nor the Treasury Department have publicly commented on the Lumileds transaction, it was widely speculated at the time that their concerns were driven by Lumileds' use of MOCVD technology to manufacture GaN semiconductors used in Lumileds' end product, LED lights.

The Aixtron transaction does not reflect a shift in the Committee's focus, especially in light of its conclusion in the Lumileds transaction, but there are signs that additional scrutiny and consideration of factors outside the realm of traditional national security may be on the horizon. Last month, the U.S.-China Economic and Security Review Commission—a congressional panel that monitors trade and security issues between the United States and China—called on Congress to require CFIUS to bar all Chinese state-owned enterprises from gaining effective control of U.S. companies. A month earlier, in September, a group of Congressional representatives issued a public letter calling for the Government Accountability Office to evaluate CFIUS's effectiveness in the wake of several recent U.S.-bound Chinese investments. In addition to calling for a report, the letter lobbied for expansive changes to CFIUS's mandate—such as considering agriculture and media businesses as part of the country's critical infrastructure, and adding additional government agencies to CFIUS's membership—to resolve concerns over food security and censorship. Echoing prior recommendations from the U.S.-China Economic and Security Review Commission, the letter also advocated for changes requiring CFIUS to broadly employ a net economic benefit test and to consider reciprocal foreign regulatory treatment as part of its national security reviews, blocking investments in industries by foreign companies whose government prohibits investment in that same industry by U.S. companies.

Although many of the reforms described above have been suggested before and failed to gain traction in Congress or the Executive Branch, there are signs that President-elect Trump and his Administration may be more receptive. Throughout the campaign, much of President-elect Trump's rhetoric advanced protectionist trade policies. Many of the advisors tapped by the incoming President to lead CFIUS's member agencies have expressed security concerns related to increased Chinese and other foreign investment in the United States, which probably spells tougher scrutiny for foreign investors independent of any structural reforms to CFIUS. Some of the suggested reforms, even if enacted, are unlikely to materially alter CFIUS's existing review process. CFIUS already can and does draw from the expertise of non-member U.S. government agencies, for example relying on the U.S. Department of Agriculture to help evaluate Shuanghui International's acquisition of Smithfield Foods in 2013 and ChemChina's proposed acquisition of Syngenta earlier this year. Other contemplated reforms, however, could vastly expand the scope of CFIUS's review to include economic considerations beyond their impact on national security. For example, requiring CFIUS to evaluate the net economic benefits of a proposed transaction, or to consider reciprocal foreign regulatory treatment, could add considerable uncertainty to foreign investment screening. A reciprocity test could effectively prohibit many transactions involving Chinese investors, particularly by state-owned enterprises. Acquisitive foreign businesses, U.S. acquisition targets, and investment funds seeking foreign co-investors should closely monitor CFIUS, including key political appointees overseeing the Committee, and any CFIUS reform legislation, for impacts on transaction risk and regulatory clearance timelines.

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

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

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

Elliot Weingarten
+1-202-636-5553
elliot.weingarten@stblaw.com

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

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

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

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