

Client Alert

Corporate Practice Group

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President Trump Blocks Acquisition of US Chipmaker by Chinese-Backed Private Equity Fund Amid CFIUS Concerns

Order sends strong signal that Washington will continue to oppose deals with Chinese acquirers involving technologies with potential military applications.

On September 13, 2017, President Trump issued an Executive Order prohibiting Canyon Bridge Capital Partners, Inc.'s ("Canyon Bridge") proposed acquisition of Lattice Semiconductor Corporation ("Lattice"). This is in line with the recommendation by the Committee on Foreign Investment in the United States ("CFIUS") that the transaction be prohibited due to national security concerns.

Background

In November 2016, Canyon Bridge announced the entry into a definitive agreement to acquire Lattice for approximately \$1.3 billion, inclusive of Lattice's net debt, which represented a 30% premium to Lattice's trading price at the time.

Canyon Bridge is a newly formed private equity fund backed by China Venture Capital Fund Corporation Limited, a Chinese corporation owned by Chinese state-owned entities that manages industrial investments and venture capital. Lattice, Oregon's largest technology company, manufactures computer chips known as field-programmable gate arrays, which are dual use items, having both commercial and military applications.

After an extended campaign by Canyon Bridge and Lattice to obtain government approval, CFIUS recommended in early September 2017 that President Trump block the transaction, citing potential risks "to the national security of the United States that cannot be resolved through mitigation."¹

The Order

Notwithstanding the CFIUS recommendation, Canyon Bridge and Lattice hoped that President Trump would clear the transaction, asserting that the "proposed transaction does not raise any national security concerns that

For more information, contact:

Raymond E. Baltz, Jr.
+1 404 572 4715
rbaltz@kslaw.com

Eleanor J. Hill
+1 202 626 2955
ehill@kslaw.com

Christine E. Savage
+1 202 626 5541
csavage@kslaw.com

Spencer A. Stockdale
+1 404 572 4718
sstockdale@kslaw.com

Betre M. Gizaw
+1 202 626 8974
bgizaw@kslaw.com

King & Spalding Atlanta

1180 Peachtree Street
Atlanta, GA 30309
Tel: +1 404 572 4600
Fax: +1 404 572 5100

Washington, D.C.

1700 Pennsylvania Avenue, NW
Washington, D.C. 20006
Tel: +1 202 737 0500
Fax: +1 202 626 3737

www.kslaw.com

cannot be addressed by comprehensive mitigation measures that Lattice and Canyon Bridge have proposed to implement.”² The direct appeal to the president in these situations is unusual, as the parties involved typically agree to walk-away following indications from CFIUS that it will not approve the deal. There have been only three other CFIUS determinations submitted to the president since 1990 (each of which involved Chinese investors) where the parties to a transaction have not withdrawn their CFIUS notice once CFIUS has made such a recommendation. In each, the president has decided to block the transaction.

Under the Executive Order, Canyon Bridge and Lattice have 30 days to “take all steps necessary to fully and permanently abandon the proposed transaction.”³

Intellectual Property Transfers to China

In a statement issued on September 13, 2017, Steven T. Mnuchin, Secretary of the Treasury and chair of CFIUS, indicated that the national security risk at hand in the proposed Canyon Bridge/Lattice transaction related to “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 use of Lattice products by the U.S. government.”⁴

Mr. Mnuchin’s statement highlights an increasing U.S. government concern related to the transfer of intellectual property to the Chinese government. This same concern was outlined in a Department of Defense commissioned report (the “Report”) obtained and released by journalists in July 2017. The Report concluded that China is executing a long-term strategy to transfer technological know-how from the U.S. to China through a variety of means, including through the acquisition of critical technologies. In particular, the Report notes that China has significantly increased its investments in early venture start-up companies working on technologies that will likely be foundational to future innovation in the United States, such as: (i) artificial intelligence, (ii) autonomous vehicles, (iii) augmented/ virtual reality, (iv) robotics, and (v) block chain technology. Notably, many of these technologies require the use of semiconductors.

The Report identified the CFIUS process as one of the primary tools available to the U.S. government to prevent such intellectual property transfers, and concluded that the interagency group should be given additional authorities to strengthen its ability to prevent such deals. Such recommendations included: (i) expanding CFIUS jurisdiction to review all technology transfers, including those involving joint ventures (even if such joint ventures are located abroad), reverse mergers, and assets purchased from bankruptcies, (ii) instituting mandatory reporting requirements of foreign investors for all transactions valued at more than \$1 million, (iii) extending the CFIUS period to allow for closer review of complex transactions, and (iv) minimizing the use of mitigation agreements unless they can be derived from a to be developed standardized template.

In addition, over the past several months, various senators have introduced, or announced their intention to introduce, bills designed to implement changes to the CFIUS process. For example, Senator John Cornyn (R-TX) announced he is preparing a bill that will seek to expand CFIUS jurisdiction to permit review of non-controlling investments in technology by Chinese investors, including foreign joint ventures that involve a transfer of U.S. technology. A bill introduced by Senators Debbie Stabenow (D-MI) and Chuck Grassley (R-IA) sought to direct CFIUS to consider matters of food security when reviewing a transaction. While none of these proposed changes have gained the necessary support to indicate imminent passage, there appears to be bipartisan agreement that the CFIUS process should be strengthened. In the meantime, CFIUS and the president seem to have decided to use the tools at hand to influence, and now, outright block transactions involving China.

Parties engaging in transactions involving China, especially where such a transaction would involve the transfer of intellectual property to China, should be sure to take CFIUS risks into account during negotiations.

Merger Agreement/Negotiations

It appears the parties did consider CFIUS here. As shown by the background section of Lattice's proxy statement, Canyon Bridge and Lattice clearly entered the negotiations anticipating that a CFIUS review and clearance would be an important issue in the transaction.⁵ The merger agreement entered into between Canyon Bridge and Lattice contained detailed covenants related to CFIUS approval, including that Canyon Bridge would agree to certain mitigation conditions imposed by CFIUS so long as they would not reasonably be expected to:

1. Require Canyon Bridge's control of Lattice to be passive or otherwise restricted (including pursuant to a Special Security Arrangement, appointment of a proxy, or requirement to elect one or more independent directors to the board of directors);
2. Require Canyon Bridge to divest, exclusively license, hold separate, or otherwise relinquish ownership rights with respect to one or more business units, product lines or technologies meeting certain aggregate revenue thresholds; or
3. Materially and adversely affect the operation or management of Lattice going forward.

Ultimately, the mitigation plan proposed by Canyon Bridge and Lattice was unsuccessful in alleviating the U.S. government's concerns about the transaction.

Importantly, while Lattice clearly began negotiations focused on having a meaningful termination fee payable in the event CFIUS approval was not obtained, this point had been negotiated away prior to the signing of the merger agreement. As such, it appears at this point that Lattice will walk away from the transaction empty handed.

Takeaways

President Trump's decision with respect to the Canyon Bridge/Lattice acquisition evidences the U.S. government's increasing scrutiny of investments giving China access to certain key technologies as discussed above. At least two other Chinese deals have fallen apart this year after failing to obtain CFIUS approval.⁶ It also raises substantial doubts for other Chinese deals awaiting approval, including ANT Financial's purchase of MoneyGram International Inc., China Oceanwide Holdings Group Co Ltd's acquisition of Genworth Financial Inc., and Unic Capital Management's acquisition of Xcerra Corp. (a U.S. semiconductor testing company).

This Executive Order also emphasizes the need to fully understand and appreciate potential CFIUS or other regulatory risks in deals involving foreign investors, especially Chinese backed investors. In analyzing, negotiating and consummating a transaction involving CFIUS review, it is extremely important to go in with a fulsome understanding of the risks and challenges, including (i) developing and implementing a proactive communication and messaging plan with the applicable regulators and (ii) ensuring that the regulatory risk be properly allocated in the deal documentation, including through appropriate covenants, protections and regulatory break fees.

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¹ U.S. Department of the Treasury, *Statement On The President's Decision Regarding Lattice Semiconductor Corporation* (September 13, 2017).

² Lattice Semiconductor Corporation, Current Report (Form 10-K) (September 1, 2017).

³ The White House, *Order Regarding the Proposed Acquisition of Lattice Semiconductor Corporation by China Venture Capital Fund Corporation Limited* (September 13, 2017).

⁴ U.S. Department of the Treasury, *Statement On The President's Decision Regarding Lattice Semiconductor Corporation*, September 13, 2017.

⁵ Lattice Semiconductor Corporation, Proxy Statement (Schedule 14A) (January 27, 2017).

⁶ HNA Group's proposed investment in Global Eagle Entertainment Inc. and T.C.L. Industries Holdings' proposed purchase of Inseego Corp.'s mobile-broadband business.