

## COVINGTON

# PRESIDENT TRUMP BARS ACQUISITION OF U.S. SEMICONDUCTOR COMPANY AS CONGRESS CONDUCTS FIRST HEARING ON POTENTIAL CFIUS REFORM

September 14, 2017

CFIUS

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We are writing to provide our perspective on two significant developments involving the Committee on Foreign Investment in the United States (“CFIUS”).

On September 13, President Trump prohibited the proposed acquisition of Lattice Semiconductor Corporation (“Lattice”) by a Chinese acquirer — marking only the second time a President has used his authorities to proactively block a transaction at the recommendation of CFIUS, and only the fourth Presidential order in history arising out of a CFIUS review (with the other two orders directing a divestiture of consummated transactions). The President’s decision reflects the significant challenges in the current environment in Washington for China-related investments, particularly those in the semiconductor industry. (We have previously addressed some of the emerging challenges in CFIUS and Washington for China-related semiconductor deals [here](#) and [here](#).)

Then, earlier today, the Senate Committee on Banking, Housing, and Urban Affairs — which is the committee with jurisdiction over CFIUS — held an open hearing entitled “*Examining the Committee on Foreign Investment in the United States.*” This was the first hearing by the committee to meaningfully address CFIUS in a decade.

Both of these developments occurred as Congress is expected to consider legislation to reform CFIUS proposed by Senator John Cornyn (R-TX), which we previously analyzed in a June 23, 2017 Covington Alert entitled “*Update on CFIUS Developments: Proposed Legislation and Reflections on CFIUS Under the Trump Administration.*”

## **President Trump Blocks Acquisition of Lattice Semiconductor**

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Acting on the recommendation of CFIUS, President Donald J. Trump issued an [Executive Order](#) on Wednesday, September 14, prohibiting the acquisition of Lattice by China Venture Capital Fund Corporation Limited (“CVCF”).

Both the White House and the Department of the Treasury, which chairs the CFIUS review process, issued statements regarding the transaction. The White House statement noted at least four national security considerations that underlay the President’s order: namely, “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.”

The Treasury statement, issued by Secretary Steven T. Mnuchin, offered additional detail relating to the basis for the Administration's action. Regarding the "Chinese government's role" in the transaction, Treasury observed that "CVCF is a Chinese corporation owned by Chinese state-owned entities that manages industrial investments and venture capital." CVCF is a limited partner in a private equity fund organized by Canyon Bridge Capital Partners, a U.S.-based firm primarily owned and managed by U.S. citizens. Neither the White House nor Treasury statements addressed the U.S. ownership character of Canyon Bridge or, for that matter, referenced any concerns with Canyon Bridge.

With respect to the U.S. business itself, the Treasury statement commented that "Lattice is a publicly traded company headquartered in Oregon that manufactures semiconductors for the consumer, communications, and industrial markets. Lattice's primary semiconductor product lines are programmable logic devices, which are general purpose semiconductors that customers can program to provide functionality similar to chips that are designed and produced for specific applications." The Treasury statement, however, did not explain how Chinese ownership of a U.S. company producing "general purpose semiconductors" might threaten the U.S. government's supply chain integrity or use of such semiconductors.

We have discussed in previous client alerts the fact that CFIUS is carefully examining foreign investments in sensitive U.S. industries, including the semiconductor sector, particularly when the investment comes from China. In December, we [reported](#) that President Obama had blocked the acquisition of Aixtron SE — a manufacturer of metal-organic chemical vapor deposition (MOCVD) systems used to build compound semiconductor materials — by a Chinese acquirer. At the time, we cautioned that we expected CFIUS to remain increasingly vigilant in matters involving investments in critical technology areas such as semiconductors and transactions generally involving investment from China. This included U.S. businesses involved in the design and production of leading-edge equipment related to semiconductor manufacturing, such as MOCVD systems.

That said, the Lattice transaction is notable in part because the company's principal products are field-programmable gate arrays (FPGAs), an older form of integrated circuit introduced more than 35 years ago. FPGAs are designed to be configured and customized by or for a customer after manufacturing. Because FPGAs are not preconfigured to perform certain tasks, some industry observers consider them to be considerably more benign than other semiconductors that theoretically could be configured with malicious code, backdoors or other threats. The Lattice matter was also distinguished by recent public comments of the company's CEO, who stated that the parties had submitted a substantial mitigation proposal to CFIUS intended to address potential national security concerns.

The foregoing aspects of the Lattice transaction raise new questions regarding the preparedness of CFIUS and the Trump Administration to prohibit transactions only as a last resort when no mitigation solution can fully resolve CFIUS's national security concerns. To the extent that the Lattice matter indicates that CFIUS is closely scrutinizing technology-related transactions and is declining to utilize its mitigation authority to address national security issues, transaction parties will need to be alert to the possibility that even seemingly benign investments may face serious hurdles in the months ahead.

## **Reflections on the Committee's Hearing on CFIUS**

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As noted above, the Senate Committee on Banking, Housing, and Urban Affairs this morning held a hearing on potential CFIUS reform. Members who participated in today's hearing included Chairman Michael Crapo (R-ID), Ranking Member Sherrod Brown (D-OH), and

Senators Tim Scott (R-SC), Mike Rounds (R-SD), David Perdue (R-GA), Thom Tillis (R-NC), John Kennedy (R-LA), Elizabeth Warren (D-MA), Joe Donnelly (D-IN), and Chris Van Hollen (D-MD).

The three hearing witnesses who testified before the Committee were:

- **The Honorable Clay Lowery**, Managing Director, Rock Creek Global Advisors; former Assistant Secretary for International Affairs, U.S. Department of the Treasury
- **The Honorable Kevin J. Wolf**, Partner, Akin Gump Strauss Hauer & Feld LLP; former Assistant Secretary for Export Administration, U.S. Department of Commerce
- **Mr. James Lewis**, Senior Vice President, Center for Strategic and International Studies

The hearing focused on two primary issues: (1) The evolving nature of the global environment as it relates to foreign direct investment (“FDI”) and U.S. national security; and (2) whether CFIUS reform is needed to address those potential threats by enlarging the Committee’s jurisdiction and revising its processes.

Most members of the Committee appear to believe that FDI benefits U.S. economic growth and job creation, but there clearly are concerns among Committee members that China is circumventing CFIUS in some instances in order to acquire U.S. technology and “know-how”:

- Chairman Crapo, Ranking Member Brown, and Senator Scott all expressly recognized the importance of FDI to the U.S. economy and the need to maintain the United States’ reputation of being open to foreign investment. They and others seemed to be striving to determine how to ensure that CFIUS can fulfill its dual mandates of protecting national security and promoting foreign investment. At the same time, there appeared to be bipartisan agreement that China is pursuing alternative investment strategies that do not trigger CFIUS jurisdiction to obtain U.S. technology and “know-how” — particularly in the areas of artificial intelligence, robotics, and biotechnologies.
- Messrs. Lowery and Wolf testified that existing U.S. export control regimes possess a greater capability and flexibility to restrict continuously evolving technologies from particular destinations of concern, including “greenfield” or startup investment. To the extent that these regimes are falling short, both witnesses suggested that it is preferable to update the regimes rather than to expand CFIUS’ authority.
- While some members of the Committee — Senators Warren and Scott in particular — seem to view expanding CFIUS’ jurisdiction and the consideration of a “net benefit” or “reciprocity” test as preferable solutions, the witnesses were in agreement that CFIUS should maintain its focus and analysis on national security threats rather than purely economic factors. Senator Tillis expressed his concern about expanding CFIUS’ authority and the detriment such an expansion would have on investments that are often mutually beneficial to both the foreign investor and the U.S. company. Mr. Lowery also cautioned against the politicization of CFIUS review.

The witnesses and the Committee also addressed specific solutions for increasing CFIUS’ efficiency and effectiveness:

- There appeared to be bipartisan support for ensuring that CFIUS has the personnel, budgetary, and information resources necessary to achieve its statutory function in an era in which the number of transactions of potential CFIUS interest has grown dramatically. In furtherance of that goal, all three witnesses stressed the importance of increased resources for the ongoing monitoring of mitigation agreements, which effectively allow CFIUS to simultaneously pursue the policy objectives of promoting FDI while also mitigating any national security risks.

- Chairman Crapo and Senator Perdue voiced concern over the slow pace of Senate confirmation of political appointees and its effect on CFIUS, and Mr. Lowery underscored the important complementary role of political appointees to civil servants. Senator Warren urged the Administration to accelerate the submission of additional nominees.

In sum, today's hearing — which is anticipated to be the first of several hearings on CFIUS reform — reflected a bipartisan recognition among most members of the Committee, as well as all three witnesses, that any adjustments to CFIUS should be only one part of a broader, multifaceted solution to protect U.S. national security and promote foreign investment. It remains to be seen whether and how these considerations will be taken into account when the Congress begins to debate the expected CFIUS reform legislation in the months ahead.

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We hope that you find this analysis useful. Please do not hesitate to contact the following members of our CFIUS Practice Group if you would like to discuss any aspect of the foregoing in further detail:

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