President Obama Blocks Chinese Acquisition of Semiconductor Manufacturer Aixtron

On December 2, 2016, President Obama issued an Executive Order blocking the acquisition of the U.S. business of German semiconductor company Aixtron SE (“Aixtron”) by Chinese investor Fujian Grand Chip Investment Fund LP (“FGC”). The Executive Order directs the parties to abandon the acquisition of Aixtron’s U.S. subsidiary, Aixtron, Inc., in the next 30 days. This marks only the third time that a U.S. President has ordered a transaction blocked or unwound due to national security concerns. The Committee on Foreign Investment in the United States (“CFIUS”) investigated the transaction and found that the national security risk presented by the transaction could not be addressed by mitigation measures and recommended that the President prohibit the transaction.

This development highlights certain salient features and trends in the CFIUS review process. First, CFIUS has jurisdiction to review the acquisition of a non-U.S. company if it involves a U.S. subsidiary or other U.S. business. Second, CFIUS remains focused on investments in the high-tech sector – and semiconductors in particular – especially when the company’s technology has military applications. Third, CFIUS scrutiny is heightened in the case of Chinese investments, as all three presidential actions under CFIUS have involved Chinese acquirors. We expect these trends to continue in the next administration, and that CFIUS’ jurisdiction and activity may even expand.

We summarize below the main aspects of this development, as well as key takeaways.

History of Presidential Intervention in Transactions for National Security Reasons

Under the CFIUS statute, the President has the authority to block or unwind a foreign investment transaction based on national security factors. This action is only the third time that a U.S. President has intervened in a transaction as a result of the CFIUS national security review process. However, it is the first time that a U.S. President has prohibited a transaction that had not yet closed. Previously, in 1990, President George H. W. Bush ordered that China National Aero-Technology Import and Export Corp. divest its interest in MAMCO Manufacturing, Inc., a U.S. supplier of parts to the aerospace industry. In 2012, President Obama ordered Ralls Corp., a U.S. company owned by two Chinese nationals, to divest the wind farm companies it had acquired due to the wind farms’ proximity to a sensitive U.S. Navy base. We previously reported on the Ralls case, including the litigation surrounding whether Ralls was deprived of its due process by CFIUS. We note that CFIUS also occasionally informally blocks transactions, and in most cases the parties voluntarily withdraw their CFIUS notice and abandon the transaction rather than have CFIUS publicly recommend that the President formally block the transaction.
The Aixtron Case and Chinese Investment in the U.S. Semiconductor Industry

The FGC/Aixtron transaction was announced in May 2016 for the price of $752 million. Both German and U.S. national security authorities reviewed the transaction, with the U.S. involved because of Aixtron’s U.S. subsidiary, Aixtron, Inc. The German Federal Ministry for Economic Affairs and Energy granted preliminary approval in September 2016, but withdrew its approval the next month, citing new information (as we previously reported). The German national security review remains ongoing. On November 21, 2016, Aixtron issued a press release stating that CFIUS had informed the parties of unresolved U.S. national security concerns regarding the proposed transaction. CFIUS advised the parties that if they did not withdraw their CFIUS notice and abandon the transaction, CFIUS would refer the case to President Obama with a recommendation that he prohibit the transaction with respect to Aixtron, Inc.

The Chinese acquisition of Aixtron is another example of the increased level of Chinese investment in the U.S. and Western technology sectors. Chinese interest in the U.S. semiconductor industry, in particular, has increased in recent years, as China seeks to develop its own capacity in this area. The pattern of Chinese investments in this sector has drawn CFIUS scrutiny. For example, Royal Philips abandoned its plans to sell a controlling interest in its U.S. subsidiary Lumileds due to an apparent threat by CFIUS to refer the transaction to the President and recommend that he block the deal. CFIUS did not issue a statement as to the reason for withholding clearance, but media reports indicated that Lumileds produces a material, gallium nitride, that is suitable for use in semiconductors with advanced military applications. Fairchild Semiconductor International rejected an acquisition offer from Chinese investors because of what it said was an "unacceptable level of risk" that CFIUS would reject the deal.

CFIUS does not typically publicly issue rationales for its decisions, and President Obama’s Executive Order does not elaborate on specific national security concerns. However, the U.S. Department of the Treasury issued a statement remarking that the “national security risk posed by the transaction relates, among other things, to the military applications of the overall technical body of knowledge and experience of Aixtron, a producer and innovator of semiconductor manufacturing equipment and technology, and the contribution of Aixtron’s U.S. business to that body of knowledge and experience.” The statement also referred to Aixtron’s business as manufacturing “Metal-Organic Chemical Vapor Deposition (MOCVD) systems used to build compound semiconductor materials.” Aixtron, like Lumileds, manufactures gallium nitride, and CFIUS may be concerned with the transfer of this production know-how (with its military applications) to China.

CFIUS Jurisdiction in the Aixtron Case and Looking Forward

CFIUS exercised jurisdiction in this case of a German company because of the inclusion of Aixtron, Inc. The CFIUS regulations provide jurisdiction over U.S. businesses, even if they are foreign-owned. However, while President Obama’s Executive Order is focused on the U.S. business, it potentially goes beyond the strict CFIUS jurisdictional parameters. It requires the party to “fully and permanently abandon the proposed acquisition” of not just the U.S. business, Aixtron Inc., but also “any asset of Aixtron or AIXTRON, Inc. used in, or owned for the use in or benefit of, the activities in interstate commerce in the United States of AIXTRON, Inc., including without limitation any interest in any patents issued by, and any interest in any patent applications pending with, the United States Patent and Trademark Office.” This includes any assets of Aixtron that are not owned by the U.S. business but that may be within the United States, and could include assets outside the United States that are used in the U.S. business’s activities. This order does not affect the parties’ ability to conclude the transaction if the U.S. business and related assets are carved out, although the German review process is still pending.
This decision shows that CFIUS takes a wide view of its jurisdiction and is likely to continue to do so going forward. Moreover, CFIUS is responsible for deciding on its own jurisdiction in a particular case, and its findings are not subject to judicial review. Parties to a transaction between non-U.S. companies may need to consider CFIUS unless the target company has no presence in the United States. Furthermore, transactions involving U.S. manufacturers of potentially sensitive technology, especially semiconductors, should be prepared for increased CFIUS scrutiny, particularly when the transaction would result in Chinese control.

Members of both political parties in the United States have recently advocated for an expansion of CFIUS’s power and jurisdiction. President-elect Trump has not publicly taken a position on CFIUS, although his campaign focused on trade issues and the role of China in the U.S. economy. It is a safe assumption that CFIUS under the Trump administration will be at least as inquisitive and thorough regarding Chinese investment and investment in sensitive areas, and potentially will have an even greater involvement in these types of transactions.

If you have any questions regarding CFIUS or how it may affect your business, please reach out to the contacts listed below.

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