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Broadcom-Qualcomm Blocked Deal Shows Expanding CFIUS Reach in High-Tech Sector

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March 19, 2018 – President Trump’s March 12 decision to block the proposed takeover of California-based semiconductor manufacturer Qualcomm by Singapore-based Broadcom Limited¹ demonstrates the expanding CFIUS reach in the high-tech sector. If this \$117 billion takeover had gone through, it would have been the largest technology merger in history. The President determined that there was “credible evidence” that Broadcom, after gaining control of Qualcomm, might “take action that threatens to impair the national security of the United States.”² The Executive Order prohibited not only the proposed acquisition but also any “substantially equivalent” transaction and disqualified all individuals proposed by Broadcom from standing for Qualcomm’s board election.³

The March 12 decision and similar recent Presidential decisions demonstrate that the U.S. government is increasingly aggressive in deciding the fate of transactions involving foreign parties that relate to emerging technologies and that have some direct, or even indirect, nexus to China. The Broadcom-Qualcomm matter also shows that the Administration is focusing on economic and competition factors as a basis for raising national security concerns in such transactions. For future deals, U.S. companies in the tech sector can use the lessons from the thwarted Broadcom-Qualcomm deal to fend off hostile takeovers by foreign firms.

CFIUS Review of Broadcom’s Proposed Takeover

President Trump’s decision followed a review by the Committee on Foreign Investment in the United States (“CFIUS”). CFIUS is an interagency group chaired by the Secretary of the Treasury, which is authorized to review transactions that could result in control of a U.S. business by a foreign person. CFIUS may require mitigation measures or recommend that the President block a transaction that threatens to impair the national security of the United States.⁴

Qualcomm, in what appears to be an effort to fend off a hostile takeover by Broadcom, filed a unilateral notice to CFIUS in January. In early March, two days before the originally scheduled date of Qualcomm's annual stockholders meeting, CFIUS issued an interim order that Qualcomm postpone the meeting by 30 days, delaying a board election that would have given Broadcom majority control over Qualcomm's board while CFIUS continued its investigation.⁵ According to a publicly released letter from Treasury to lawyers for Qualcomm and Broadcom,⁶ CFIUS's interim measures were necessary to mitigate the potential national security risks "associated with Broadcom's relationships with third party foreign entities and the national security effects of Broadcom's business intentions with respect to Qualcomm." In the letter, which was issued a day after CFIUS's interim order, the Treasury Department expressed concern that an acquisition by Singapore's Broadcom could reduce Qualcomm's long-term investment in high-speed 5G wireless technology and weaken Qualcomm's technological competitiveness – which "would leave an opening for China" to take the lead in developing the next-generation technology.⁷ The letter specifically cited Huawei as one of the Chinese companies vying for dominance in 5G. The Treasury Department also posited that the proposed acquisition could limit or eliminate an important U.S. supplier of telecommunications equipment to U.S. federal defense agencies and hamper its partnership with the U.S. government addressing cybersecurity.

After the letter was released, Broadcom made a public statement⁸ and sent a letter to Congress,⁹ expressing a commitment to make the United States a global leader in 5G, and pledging \$1.5 billion toward training and educating the next generation of wireless technology engineers in the United States. Broadcom also emphasized that it is "in every important respect an American company" – in terms of its origin, the makeup of its executive team, board of directors, and shareholders, and its substantial operations in the United States – also pointing out that the company was in the final stages of moving its legal domicile back to the United States. The headquarters shift had played a key role in garnering the CFIUS clearance for Broadcom's acquisition of California-based Brocade Communications last November. This time, however, neither the imminent headquarters shift nor Broadcom's plan to employ more than 25,000 workers in the United States was enough to persuade President Trump to allow the deal to proceed.

Stricter Scrutiny for High-Tech Companies with Any Potential Nexus to China

President Trump's March 12 decision was a departure from the CFIUS trend, in that the prohibited transaction did not involve a Chinese party. Presidential blocking of transactions is rare. This is only the fifth time a President has blocked a transaction under the CFIUS statute, and the past four all involved a Chinese acquirer. The fact that CFIUS was apparently concerned about the "risks associated with Broadcom's relationship with third party foreign entities" – speculated to be referring to Huawei – indicates that the current administration is expanding CFIUS's focus to transactions with an indirect nexus to China or the Chinese companies. As the Treasury Department's letter indicates, even the possibility that a foreign buyer could later make a business decision that might have the effect of boosting China's competitive position vis-à-vis a critical technology was a concern.

Transaction parties should expect heightened sensitivity when it comes to advanced technology, in particular relating to the defense, semiconductor, digital communications, and network security industries. Treasury Secretary Steven Mnuchin said, regarding the President's recent decision to block the acquisition of Lattice Semiconductor Corp. by a Chinese-funded private equity fund, that national security risks are raised by "the importance of semiconductor supply chain integrity to the U.S. government, and the use of Lattice products by the U.S. government."¹⁰ While CFIUS, in January, did approve Beijing-based Naura Microelectronics Equipment Co. Ltd.'s acquisition of a U.S.-based semiconductor manufacturing equipment producer, Akzion Systems LLC, that may be because the acquisition target makes equipment that processes and prepares semiconductors for use but does not manufacture semiconductors itself.

Proposed Legislation May Further Increase Scrutiny over High-Tech Transactions

A bill introduced in Congress last November – the Foreign Investment Risk Review Modernization Act of 2017 (“FIRRMA”) – proposes to expand CFIUS’s jurisdiction and the scope of what constitutes a national security risk. If enacted, FIRRMA would bring within the scope of CFIUS certain real estate transactions, for instance buildings close to U.S. military facilities. FIRRMA would also expand CFIUS’s jurisdiction to high-tech joint ventures and minority-position investments providing access to any non-public information, which could include non-U.S. technology transfers. The legislation also would give CFIUS greater ability to prevent companies from restructuring their investments to evade review. If the bill becomes law, we can expect to see a substantial rise in CFIUS’s workload and possibly an increased number of transactions hindered by CFIUS mitigation measures or blocked by the President. Moreover, the perception of heightened CFIUS scrutiny may have a general chilling effect on cross-border transactions.

Takeaway

The Broadcom-Qualcomm matter provides valuable insights for potential M&A transactions involving foreign buyers:

- President Trump’s order blocking the Broadcom-Qualcomm deal indicates that parties to transactions involving emerging technologies (especially in the semiconductor industry) should be prepared to face increasing levels of scrutiny – regardless of the nationality of the foreign investor.
- That said, any potential nexus to China, even an indirect nexus, such as the possibility that a transaction might have the effect of expanding Chinese global market share, could trigger heightened national security concerns in CFIUS proceedings.
- Finally, this is an unusual case, in how quickly CFIUS acted, and in the detailed information provided by the U.S. government regarding its national security concerns. That may be due to the fact that Qualcomm unilaterally notified CFIUS in what appears to be a defensive measure against a hostile takeover, whereas typically both parties cooperate to seek CFIUS approval and to keep the proceedings confidential. The possibility of a contentious CFIUS review is an important consideration for foreign buyers considering a hostile takeover.

¹ Executive Office of the President, “Presidential Order Regarding the Proposed Takeover of Qualcomm Incorporated by Broadcom Limited” (Mar. 12, 2018), 83 Fed. Reg. 11631 (Mar. 15, 2018), available at <https://www.whitehouse.gov/presidential-actions/presidential-order-regarding-proposed-takeover-qualcomm-incorporated-broadcom-limited>.

² Id.

³ Id.

⁴ Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007, codified at 50 U.S.C. App. 2170.

⁵ U.S. Department of the Treasury, “Statement on CFIUS Action” (Mar. 4, 2018), available at <https://home.treasury.gov/news/press-releases/sm0303>.

⁶ Available at https://www.sec.gov/Archives/edgar/data/804328/000110465918015036/a18-7296_7ex99d1.htm.

⁷ Id.

⁸ Broadcom, “Broadcom Pledges to Make the U.S. the Global Leader in 5G” (Mar. 7, 2018), available at <http://investors.broadcom.com/phoenix.zhtml?c=203541&p=irol-newsArticle&ID=2336707>.

⁹ See Broadcom, “In Letter to Congress, Broadcom Pledges to Make the U.S. the Global Leader in 5G” (Mar. 9, 2018), available at <http://investors.broadcom.com/phoenix.zhtml?c=203541&p=irol-newsArticle&ID=2337280>.

¹⁰ Id.

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