

CLIENT MEMORANDUM

President Obama Blocks Chinese Investment Fund's Acquisition of Aixtron under the CFIUS Process

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On December 2, 2016, President Barack Obama, invoking a rarely used Presidential authority under the “Exon-Florio” law, issued an [order](#) blocking China’s Fujian Grand Chip Investment GmbH’s (“Grand Chip”) proposed \$752 million takeover of German chip-equipment maker Aixtron SE’s U.S. subsidiary. The order directs Grand Chip and Aixtron to take all steps necessary to fully and permanently abandon the proposed acquisition of Aixtron’s U.S. business not later than 30 days after the date of the order. This is the third time that a U.S. President has halted a transaction because of national security concerns raised by the Committee on Foreign Investment in the United States (“CFIUS”) review process provided for in the Exon-Florio law.

Aixtron manufactures metalorganic chemical vapour deposition equipment (“MOCVD”) for clients in the semiconductor industry and employs about 100 people in a production unit in California, which is responsible for one-fifth of its revenues and is a U.S. military contractor. The company specifically makes devices that produce crystalline layers based on gallium nitride and are used as semiconductors in weapon systems.

The Treasury Department, which chairs CFIUS, explained in a statement that the proposed Aixtron transaction was against U.S. national security interests because of the military applications of the overall technical body of knowledge and experience of Aixtron. Treasury further stated that the national security concerns could not be resolved through mitigation

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provisions. The partial funding that would have been provided to Grand Chip from a Chinese-government supported industrial investment fund also likely played a significant role in blocking the transaction.

Aixtron had issued a press release on November 21, 2016 stating that CFIUS informed it of unresolved U.S. national security concerns. CFIUS advised the two parties that if they did not withdraw their CFIUS notice and abandon the transaction, it would refer the case to President Obama with a recommendation that he prohibit the transaction. Notably, by allowing the transaction to go to President Obama with a negative recommendation, Grand Chip challenged CFIUS (and the President) to formally and publicly block the transaction.

In reaction to the President's Order, Chinese Foreign Ministry spokesman Lu Kang said that "China opposed politicizing normal business behavior or political interference. We hope the U.S. side can stop making groundless accusations against Chinese companies and provide a fair environment and good conditions to Chinese investments." Treasury's statement included the responsive comment that "the President's decision is specific to this transaction and is not a determination with regard to any other foreign direct investment from China or any other country."

This outcome highlights the extraterritorial reach of the Exon-Florio law and its potentially dramatic impact on international acquisitions with a significant U.S. component, as well as particular U.S. concerns about China's efforts to advance its technological competitiveness through foreign acquisitions. The other two transactions blocked by Presidential order under the CFIUS process also involved foreign investment from China. In 1990, President George H.W. Bush ordered the China National Aero-Technology Import and Export Corporation to divest its interests in MAMCO Manufacturing, Inc., a U.S. parts supplier to the aerospace industry. In 2012, President Obama ordered Ralls Corporation, a U.S. company owned by two Chinese nationals, to divest its acquisition of a U.S. wind farm company because of its wind turbines' proximity to a sensitive U.S. Navy facility. Such formal rejections are rare because the parties usually abandon such a transaction before it's referred to the President and after CFIUS informs them that U.S. national security concerns either cannot be mitigated or the measures demanded for such mitigation are unacceptable to the parties.

The rejection of this transaction, while ostensibly based on its particular facts and circumstances, reflects general concerns about Chinese acquisitions among government officials and U.S. critics. A recent report of the U.S.-China Economic Security Review Commission, a group of U.S. industrial and labor representatives tasked by Congress with identifying China-specific national security concerns, urged Congress to investigate the extent to which "large-scale out-sourcing of manufacturing activities to China is leading to the hollowing out of the U.S. defense industrial base." The Commission included in its reference to "out-sourcing" the acquisition of strategic U.S. business enterprises and listed possible impacts on food safety, biotechnology-derived drugs, biologics, agriculture products and technology, the environment, and labor and employment conditions. The Commission recommended further study of restrictions on Chinese acquisitions based on China's claimed lack of reciprocity in allowing U.S. acquisitions of Chinese companies, and a blanket requirement that CFIUS investigate every proposed acquisition by a Chinese state-owned enterprise.

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While these recommendations are extreme and not likely to be adopted by Congress or the Trump Administration, they are indicative of the pressure currently being put on CFIUS to very aggressively scrutinize China-based transactions. While CFIUS seeks to insulate itself and its process from political influence, and has been notably successful in doing so, the prospect of heightened tension with China over trade, economic, and technological issues means that what can already be a challenging process will continue, and could potentially increase in difficulty. For businesses considering transactions that could potentially be affected, this only further emphasizes the need to consider the CFIUS process as a major regulatory component for which parties should prepare through early and careful analysis of issues, strategic planning regarding the CFIUS notice and process, attention to detail, cooperation both internally and with CFIUS, respect for the process, and flexibility in dealing with government authorities.

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