Analysis of Executive Order Prohibiting Broadcom's Acquisition of Qualcomm

Skadden

03 / 19 / 18

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

President Donald Trump's recent executive order blocking Broadcom Limited's acquisition of chipmaker Qualcomm, Inc. (the Order) is the latest in a series of significant actions and statements regarding the national security implications of trade policy. In December 2017, the president released his National Security Strategy, emphasizing economic security as a key component of national security, and specifically focusing on the regulation of international trade and foreign investment as a way to secure U.S. military and technological superiority. On March 12, 2018, President Trump issued the Order, citing national security concerns raised by Broadcom's potential acquisition of Qualcomm.

These actions, coupled with recently announced tariffs on steel and aluminum as well as a Section 301 investigation into China's intellectual property practices, illustrate that economic and trade issues are at the forefront of the Trump administration's national security policy. They also indicate that the president is willing to use the significant power he possesses to police foreign investment, primarily in the form of the Committee on Foreign Investment in the United States (CFIUS), to advance the economic aspects of his national security policy.

The December 2017 National Security Strategy

In the newly released National Security Strategy, the Trump administration identified the three main challenges to U.S. national security as "the revisionist powers of China and Russia, the rogue states of Iran and North Korea, and transnational threat organizations, particularly jihadist terrorist groups." The National Security Strategy is a congressional mandate derived from the Goldwater-Nichols Act, which requires the White House to produce an annual report to Congress on the country's "worldwide interests, goals, and objectives" and propose short- and long-term uses of the "political, economic, military, and other elements of the national power." The strategy must also communicate the U.S. defense capabilities necessary to deter aggression and the adequacy of such capabilities. Although the Goldwater-Nichols Act originally required annual reports to Congress, recent presidential administrations have produced such strategies on only a periodic basis.

The December 2017 strategy cautioned that "American prosperity and security are challenged by ... economic competition." The strategy focused heavily on China's theft and exploitation of intellectual property, though it also acknowledged that "some actors use largely legitimate, legal transfers and relationships to gain access to fields, experts, and trusted foundries that fill their capability gaps." This was possibly an allusion to gaps in the jurisdiction of CFIUS, the interagency committee tasked with reviewing the national security implications of cross-border transactions. The Trump administration also expressed concern as to the potential exploitation of U.S. personal data, stating that China is determined "to control information and data" by gathering data on an unrivaled scale.

In order to mitigate the perceived threats, the strategy signals that the administration intends to work with Congress to strengthen CFIUS while maintaining an investor-friendly climate.[1] Additionally, the strategy indicates that the administration will explore new legal and regulatory regimes to prevent and prosecute intellectual property violations, including establishing procedures to reduce "economic theft by non-traditional intelligence collectors." Evidence of such measures include the recent initiation of trade investigations into Chinese practices as they relate to technology transfer, intellectual property and innovation, and the increasing complexity of CFIUS investigations involving Chinese entities.

[1] For additional information about administration efforts concerning CFIUS reform, see the Skadden client alerts "Legislation Proposes Sweeping New Foreign Investment Review Authorities" and "Reform Proposes Sweeping Changes to CFIUS Reviews."

Analysis of Executive Order Prohibiting Broadcom's Acquisition of Qualcomm

Broadcom's Bid for Qualcomm

Broadcom, with a market capitalization of roughly $107 billion, is the eighth-largest chipmaker in the world. The company, formerly named Avago, is the product of numerous acquisitions — most notably its $37 billion acquisition of California-based Broadcom in 2016, from which it gained its current name. Avago began life as an independent, Singapore-incorporated public company when it was spun out of U.S.-based Agilent (itself earlier spun out of Hewlett-Packard) in 2005. At the time, and since, Avago had little connection to Singapore other than its jurisdiction of incorporation, and the majority of its personnel and facilities remained in the United States. On November 2, 2017, Broadcom CEO Hock Tan — alongside President Trump, in the Oval Office — announced Broadcom's plan to redomicile in the United States from Singapore.

Within days of its redomiciling announcement, Broadcom disclosed its hostile bid for Qualcomm. Qualcomm developed 2G and 3G wireless technology and is currently a leader in the development of 5G technology. Qualcomm resisted Broadcom's bid, which resulted in Broadcom revising its bid on two separate occasions, for a final announced value of $117 billion. As part of its takeover bid, Broadcom initiated a proxy solicitation designed to elect six new directors selected by Broadcom to Qualcomm's board. If all were elected, they would have represented a majority of Qualcomm's board.

CFIUS Intervenes

On January 29, 2018, Qualcomm submitted a unilateral CFIUS notice requesting review of Broadcom's actions aimed at electing a majority of directors at Qualcomm. CFIUS proceeded to review the proposed transaction and solicited information through phone calls, emails and meetings with both parties. On February 21, 2018, and March 2, 2018, Broadcom submitted letters to CFIUS with information relevant to the review.

Broadcom's bid also faced political opposition. Sen. John Cornyn, R-Texas, one of the key sponsors of CFIUS reform, and Rep. Duncan Hunter, R-Calif., wrote letters urging the treasury secretary to review the proposed transaction ahead of an important Qualcomm shareholder vote scheduled for March 6, 2018. Notably, Sen. Cornyn's letter argued that Broadcom would drastically cut Qualcomm's investment in 5G wireless technology research and development, creating a market opening for China's Huawei to move into a dominant position, potentially threatening U.S. national security.

On March 4, 2018, CFIUS filed an agency notice to broaden the scope of its review to cover the proposed hostile takeover itself. CFIUS also issued an interim order to the parties directing that Qualcomm's annual stockholder meeting scheduled for March 6, 2018, be adjourned for 30 days to allow for further investigation by CFIUS. The interim order stipulated that Broadcom provide five business days' notice before taking any action to relocate to the United States.

In a March 5, 2018, letter addressed to the parties, CFIUS enumerated several concerns with the transaction that it believed warranted a full investigation. These concerns included: (1) Broadcom's reputation for reducing research and development, and the national security risk if China dominates the 5G space; (2) the amount of debt financing — $106 billion, the largest corporate acquisition loan on record — driving pressure for short-term profits; and (3) a potential disruption in supply to critical Department of Defense and other government contracts. In addition, the letter highlighted the ways in which CFIUS viewed Qualcomm as a preferred partner and provider of technology for U.S. infrastructure.

On March 8, 2018, CFIUS informed Broadcom that certain actions it had taken in furtherance of its efforts to relocate to the United States violated the five-business-day notice requirement from the interim order (*e.g.*, participation in a Singapore court hearing and a filing to convene a Broadcom shareholder vote on the redomiciliation on March 23, 2018).

On March 10, 2018, Broadcom authored an open letter to the U.S. Congress promising to: (1) invest $1.5 billion in training and education for U.S. engineers; (2) not sell any critical national security assets to foreign buyers; (3) annually invest $3 billion in research and engineering after relocation; and (4) annually invest $6 billion in manufacturing from its future U.S. location. The letter highlighted Broadcom's strong ties to the United States, including: (1) management by a board and executives, a majority of whom are U.S. citizens; (2) ownership by shareholders, 90 percent of whom are in the United States and are largely the same as Qualcomm shareholders; and (3) employment of a workforce, with more than half of its employees already located in the United States. The letter also indicated Broadcom was in the final stages of relocating its domicile to the United States with an expected completion date of May 6, 2018.

Analysis of Executive Order Prohibiting Broadcom's Acquisition of Qualcomm

On March 11, 2018, the Treasury Department sent the parties a letter updating them on the status of the CFIUS investigation. The letter listed alleged violations to the CFIUS interim order, including Broadcom's filing and dissemination of a definitive proxy statement with the Securities and Exchange Commission on March 9, 2018. CFIUS thus required the parties to provide all responsive information relating to its concerns set forth in its March 5, 2018, letter by noon on March 12, 2018. Finally, CFIUS noted that "[i]n absence of information that changes CFIUS' assessment of the national security risks posed by this transaction, CFIUS would consider taking further action, including but not limited to referring the transaction to the President for decision."

The President's Order

On March 12, 2018, after CFIUS had met with Broadcom, the president issued the order blocking the transaction. Specifically, the Order stated that "[Broadcom] and Qualcomm shall immediately and permanently abandon the proposed takeover." The Order also stipulated that all 15 individuals listed on the proxy card filed by Broadcom were disqualified from standing for election as directors of Qualcomm and that Qualcomm was prohibited from accepting nominations or votes for any of those candidates.

Analysis

Unprecedented Action Spurred by Jurisdictional Challenge?

A presidential order blocking a transaction is unusual, with only five occurring in CFIUS' history. In this case, the Order was truly unprecedented, marking the first time in CFIUS' history that a transaction was blocked before an acquisition agreement was even signed. Although CFIUS does not explain its jurisdictional theory, it is likely that it viewed the impending election of Broadcom-sponsored directors as potentially giving Broadcom influence or control over Qualcomm and thus provided sufficient justification for its intervention.

Moreover, CFIUS was undoubtedly aware of the impending limits of its jurisdiction based on Broadcom's announced — and then accelerated — redomiciling to the United States. CFIUS' authorizing statute empowers CFIUS and the president to act in investments made by foreign parties; given the totality of circumstances, it would be exceedingly difficult for CFIUS to claim Broadcom as a foreign party once it redomiciled in the United States. Thus, CFIUS likely believed it faced a do-or-die moment: block the transaction at an early stage or potentially lose all ability to influence the outcome of the transaction. It recommended the former, and the president acted accordingly.

Expanding Scope of CFIUS' Concerns Regarding China

Although many in the press — undoubtedly in part because of CFIUS' explicit reference — have characterized the president's action as being motivated by concerns over China, Broadcom is not a Chinese entity and, to a great extent, its apparent ties to China look much like Qualcomm's and many other non-Chinese global technology companies'. In this regard, CFIUS' action highlights how its current view of concerns regarding China is expanding and may encompass a wide range of companies that — even if not Chinese — do business with or in China and hence, in CFIUS' view, may be susceptible to Chinese influence in a manner that is detrimental to U.S. national security.

CFIUS: A Powerful but Narrow Tool

The Order also illustrates how CFIUS' inherent characteristics could make it an attractive trade policy tool during periods of heightened trade and national security tensions. Unlike many other trade authorities, CFIUS is a relatively speedy, case-by-case authority with little precedent of judicial review. It is also far more efficient than other governmental trade authorities. The remarkable speed with which CFIUS advanced this matter to the president, and his correspondingly rapid action blocking the transaction, provides a degree of policy responsiveness that is largely absent across the rest of the U.S. government.

This case, however, also illustrates CFIUS' inherent limitations to address broader concerns over domestic capabilities and capacity. Much of the justification found in CFIUS' statements, as well as the argument included in congressional letters concerning the risks of the transaction, would apply equally to a purely domestic acquisition of Qualcomm by a U.S. company. Were a U.S. company to acquire Qualcomm with a "private equity-style direction" — as phrased by CFIUS — or purchase Qualcomm with an eye to radically reduce research and development spending, CFIUS would have no recourse. Thus, although in this case CFIUS was well-positioned to address perceived concerns, it is clearly insufficient to address the broader set of concerns identified in the December 2017 National Security Strategy and implicated by the United States' declining technology edge in key areas of national security.

A New Paradigm?

We believe the Order is reflective of a significant change in CFIUS' perspective on the national security risk of foreign investment in the United States and the use of CFIUS to advance the economic aspects of the administration's national security policy. Others, however, have a legitimate belief that a variety of specific factors demonstrate that the Order does not represent a radical change for CFIUS. For example, Broadcom's move to redomicile added significant complexity to the CFIUS-related issues and undoubtedly led to a hurried consideration of the substantive outcome of CFIUS' response. In addition, the technology involved has long been central to CFIUS and broader U.S. government concerns, as is in part illustrated by recent White House contemplation of a larger U.S. government role in 5G networks and technology, and Obama-era reports regarding the importance of the semiconductor industry to national security. It has also been noted in the media that Qualcomm had a close and long-standing relationship with the U.S. government. As 2018 progresses, we will continue to further assess the impact of the president's action as it relates to, or is reflected in reviews of, other transactions.

Conclusion

The president's blocking of the Broadcom/Qualcomm transaction should be seen as part of the Trump administration's heightened effort to guard against perceived national security concerns emanating from trade. Consistent with the December 2017 National Security Strategy and as evidenced by the Order, we expect that CFIUS reviews will increasingly reflect the positions set forth in the president's policy. Consequently, more than ever, cross-border transactions require careful and early-stage diligence and analysis to understand fully how CFIUS may view national security issues.

Contacts

Michael E. Leiter
Partner / Washington, D.C.
202.371.7540
michael.leiter@skadden.com

Ivan A. Schlager
Partner / Washington, D.C.
202.371.7810
ivan.schlager@skadden.com

Donald L. Vieira
Partner / Washington, D.C.
202.371.7124
donald.vieira@skadden.com

Joe Molosky
Associate / Chicago
312.407.0512
joe.molosky@skadden.com

Michelle A. Weinbaum
Associate / Washington, D.C.
202.371.7113
michelle.weinbaum@skadden.com