

# Why CFIUS Intervened In Broadcom's Bid For Qualcomm

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Since late 2017, Singapore-based semiconductor company Broadcom Ltd. has been pursuing a \$117 billion hostile takeover bid for Qualcomm Inc., its U.S.-based rival whose chips are omnipresent in U.S. telecommunications infrastructure, including consumer devices like smartphones and tablets. As part of its hostile bid, Broadcom nominated its own slate of six directors who were to be voted on at Qualcomm's annual stockholders meeting, originally scheduled for March 6th.

However, the Committee on Foreign Investment in the United States announced last week that it "issued an interim order to Qualcomm directing it to postpone its annual stockholders meeting and election of directors by 30 days. This measure will afford CFIUS the ability to investigate fully Broadcom's proposed acquisition of Qualcomm."

## Background: CFIUS Involvement in the Proposed Broadcom Takeover

As revealed by CFIUS, Qualcomm unilaterally submitted a voluntary notice to CFIUS in January 2018 seeking review of Broadcom's solicitation of proxies to elect a majority of Qualcomm's board of directors. It is highly unusual for a party to unilaterally submit a CFIUS notice without the knowledge of the other party; it is even more unusual for CFIUS to then intervene in the election of a public company's board of directors based on the potential that those directors will vote to approve a future transaction.

In light of this unprecedented series of events, perhaps the most interesting development is that CFIUS sent a letter to Broadcom and Qualcomm — made publicly available by Qualcomm in an SEC filing — explaining the reasons underpinning its initial conclusion that a hostile takeover of Qualcomm and potential merger with Broadcom "could pose a risk to the national security of the United States."

## CFIUS Outlines Its Concerns

Although the proposed transaction remains subject to a full CFIUS investigation, the correspondence from CFIUS notes that CFIUS' (unclassified) concerns lie in "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."

Unpacking that broad statement reveals twin concerns that have been featured prominently in many CFIUS reviews during the last few years: namely, China's growing technological ambitions (including the means used to achieve such ambitions) and the

potential vulnerability of U.S. network infrastructure, especially as mobile platforms and technologies converge and the race to deploy 5G networks accelerates.

Noting Qualcomm's large research and development expenditures and historical position as a driver of 2G, 3G and 4G LTE technologies, the CFIUS letter reveals an acute concern that prior statements of Broadcom's management — questioning the wisdom of Qualcomm's current business model — Broadcom's past M&A activity and the significant debt financing necessary to acquire Qualcomm suggest Broadcom could reduce Qualcomm's R&D expenditures in favor of short-term profitability.

CFIUS speculated that such changes to Qualcomm's business model could leave a void in the standard-settings space that "China would likely compete robustly to fill." Unsurprisingly, CFIUS also expressed concern that Qualcomm's ability to supply the U.S. government with its products — including sole source classified prime contracts with DOD — could be compromised.

In many ways, it is somewhat astonishing to read such a detailed critique of a potential transaction by CFIUS staff. CFIUS is not required to explain how it assesses the potential impacts of a transaction on U.S. national security, nor are such statements and explanations typically made public. However, the letter to Broadcom and Qualcomm constitutes a de facto advisory opinion that can offer some key insights for companies who are or may become subject to a CFIUS review.

**Practical Guidance: What Are the Key Takeaways from CFIUS' Involvement in the Potential Broadcom-Qualcomm Transaction?**

Although most CFIUS practitioners are still in the process of digesting this highly unusual course of events, there are at least five key takeaways from CFIUS' ongoing review of the potential Broadcom-Qualcomm transaction that companies should consider going forward.

**Continued concern with China-related investments**

Although CFIUS' interest in transactions with Chinese buyers is well-established, companies should be aware that even in transactions where the buyer is not Chinese, CFIUS will often scrutinize a buyer's key strategic relationships. Sources have reported that Broadcom earns more than half of its revenue from China and has major Chinese customers.

In addition, companies can expect CFIUS to analyze the potential downstream benefits that may accrue to China if a proposed transaction is cleared. In other words, a cross-border transaction that does not involve a Chinese buyer could still face close scrutiny from CFIUS based on China-related concerns.

**Increased focus on potential threats to U.S. technological leadership**

As a manufacturer whose chips are found in many different kinds of consumer devices and network equipment — including devices and equipment supplied under classified contracts with the U.S. government — it is unsurprising that CFIUS identified Qualcomm as a “trusted” company. Clearly, that level of trust does not extend to Broadcom.

Similarly, CFIUS’ concern with ensuring that Qualcomm retain its current leadership position with respect to 5G standard setting demonstrates an implicit acknowledgement that CFIUS is not only aware of the race towards 5G, but intends for the U.S. to win such race.

#### CFIUS as a defensive weapon against hostile takeover attempts

Although traditional takeover defenses such as the poison pill and white knight have long histories in the corporate M&A world, it is possible we are seeing now for the first time the (potentially successful) use of CFIUS as a takeover defense against a hostile offer.

For example, Broadcom described Qualcomm’s filing of a voluntary CFIUS notice as a “blatant, desperate act.” In the future, it will be interesting to see if other companies choose to pursue a similar strategy against a hostile foreign buyer.

#### Expansion of CFIUS’ jurisdiction beyond traditional parameters

Although statutorily bound to only review transactions that impact U.S. national security, CFIUS continues to interpret that standard to cover transactions whose facial relationship to national security may seem tenuous.

Here, CFIUS, prompted by a unilateral notice, successfully delayed the annual meeting of a U.S. company because its stockholders might have elected six directors who then might have voted for an acquisition offer. Companies should keep in mind the long tentacles of CFIUS when structuring cross-border transactions.

#### Use of CFIUS as a tool to effectuate U.S. trade policy

In light of the “America First” trade policy being implemented by the Trump administration, it is not surprising to see CFIUS act quickly and decisively to protect critical U.S. network infrastructure and express skepticism about the intentions of a foreign buyer.

Companies should expect CFIUS to be keenly aware of any threats presented by a transaction to U.S. leadership in particularly important industries such as technology, infrastructure and finance.