THE CAPITOL FORUM
Vol. 7 No. 177 May 22, 2019

SAMR Policy: Huawei Sanctions Create Behavioral Remedy Challenges for U.S. Tech Transactions, Practitioners Say

The Trump administration's move to prevent U.S. firms from supplying Chinese telecom giant Huawei could affect SAMR's willingness to clear U.S. tech deals subject to behavioral conditions, local antitrust practitioners said.

SAMR, China's antitrust authority, and its predecessor Mofcom have traditionally approved U.S. tech transactions conditioned on extensive conduct remedies, including the merged entity's commitment to maintain current sales practices and supply to the Chinese market.

But the Trump administration last week placed Huawei—a key Chinese customer for many U.S. tech companies—on a banned entity list, in effect preventing U.S. firms from selling to the company. And U.S. companies' new inability to supply a strategically important Chinese customer could render merger-related supply conditions ineffective, the antitrust practitioners said.

As a result, the Huawei ban could impact SAMR's approach to U.S. tech mergers, including pending reviews of II-VI's (IIVI) acquisition of Finisar (FNSR) and Nvidia's (NVDA) buyout of Mellanox (MLNX), the antitrust practitioners said.

An II-VI spokesperson told *The Capitol Forum* that the company does not expect the Huawei ban "to affect the merits of the merger with Finisar, which is still expected to complete mid calendar year 2019." Nvidia, Mellanox, and Finisar did not respond to requests for comment. SAMR doesn't comment on ongoing merger reviews.

Repercussions. In response to the Trump administration's May 15 ban, a number of U.S. companies—including Google (GOOGL)—immediately announced plans to stop supplying Huawei.

However, on Monday the administration granted a 90-day exemption allowing some U.S. firms to wind down their supply operations to the Chinese telecom giant. The reprieve is set to expire August 19.

Google is under a supply commitment in China due to Mofcom's 2012 approval of its $12.5 billion Motorola acquisition.

"The act by U.S. companies like Google to cut off supply to Huawei poses a dilemma for SAMR, particularly with respect to imposing behavioral conditions for approvals, such as maintaining a continuous supply of certain products or services," said Zhaofeng Zhou, a managing partner at Fieldfisher in China.

He said while those companies need to comply with the U.S. laws, such compliance may violate SAMR-imposed conditions and the Chinese Antimonopoly Law (AML).

"This situation has emerged neither prior to nor throughout the AML's 11 years of enforcement history, so it would be interesting to see how this dilemma will be resolved," he said.

Google is not the only U.S. tech firm currently subject to supply commitments in China. For example, KLA-Tencor (KLAC) agreed to supply the Chinese market on fair, reasonable and non-discriminatory terms in exchange for SAMR's February clearance of its $3.4 billion Orbotech buy.

Broadcom (AVGO) likewise agreed to maintain existing terms of sale in China for fibre channel host bus adapters in return for Mofcom's 2017 clearance of its $5.5 billion acquisition of Brocade.

The Huawei ban is already causing confusion on how to enforce this remedy, a source close to the monitoring trustee of the Broadcom/Brocade commitments said.

SAMR approach. Ongoing tensions between the U.S. and China have created some uncertainty around whether SAMR could use its reviews of U.S. deals as a lever in the broader trade dispute between the two nations.

That said—with the exception of Qualcomm's (QCOM) scuttled 2018 acquisition of NXP (NXPI)—Chinese antitrust enforcers have proven reluctant to block U.S. tech deals outright, instead opting to use the merger clearance process to obtain behavioral conditions geared toward protecting Chinese firms.

But the Huawei supply issue represents a direct challenge to this approach, leaving SAMR the option to either accept supply remedies that exclude a key Chinese customer, or instead pursue a different course, the antitrust practitioners said.

In fact, Huawei may not be the only Chinese customer facing a near-term U.S. blacklist—*Bloomberg* reported yesterday that the Trump administration is considering banning additional Chinese companies from buying U.S. products, including Hangzhou Hikvision Digital Technology Co. and Zheijang Dahua Technology Co.

Expanding the list of Chinese customers precluded from purchasing U.S. components would further weaken merger-related supply commitments, the antitrust practitioners said.

Finisar, Mellanox deals. How and whether the Huawei issue affects SAMR's disposition toward U.S. tech deals may become clear in the agency's approach to two pending acquisitions involving Huawei suppliers.

The first involves U.S. chipmaker Nvidia Corp's $6.8 billion purchase of Mellanox Technologies. Although the deal doesn't raise noticeable horizontal competition concerns, the merging parties' dominance in adjacent, strategically-important markets could drive a lengthy SAMR process.

The companies filed their notification in recent weeks, but SAMR hasn't yet officially accepted the case for review, sources familiar with the matter said. Nvidia has said it expects the deal to close by the end of calendar year 2019.

Nvidia is a supplier to Huawei, although sales to the Chinese company represent a low single digit percentage of Nvidia's revenues. Mellanox also works with Huawei, including in 2017 partnering with the company on a high performance computing cloud platform.

Nvidia CEO Jen-Hsun Huang said on a May 17 earnings call that trade tensions wouldn't affect SAMR's review of the Mellanox tie-up. "This [deal] is good for customers and it's great for customers in China," he said.

A second U.S. tech deal under SAMR review is II-VI's $3.2 billion acquisition of optical communications firm Finisar. The transaction is currently in SAMR's Phase 2 review process, and is likely to extend into Phase 3, sources familiar with the matter said.

Relative to Nvidia and Mellanox, sales to Huawei represent a significant percentage of the merging parties' revenues.

Huawei is a key customer for II-VI's laser solutions and photonics segments, and sales to the company represent about 8 percent of II-VI's revenue, according to a Goldman Sachs report.

However, the company said in a statement to *The Capitol Forum* that the Huawei ban's effects on its sales and prospects would be "minimal."

Huawei is an even more significant customer for Finisar—the Chinese telecom giant accounted for 11 percent of Finisar's 2017 revenues, according to the company's 2018 annual report.