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CFIUS Newsletter

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What's Inside

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The TikTok Saga Summary

<u>August 24, 2020</u> - TikTok and ByteDance filed a complaint against President Donald J Trump, Wilbur Ross, and the U.S. Department of Commerce in the U.S. Central District of California, Western Division

The legal team at Covington & Burling LLP, led by DC-based partner Beth Brinkmann is representing TikTok and ByteDance. Brinkmann is the co-chair of the Appellate and Supreme Court Litigation Group and served as the Deputy Assistant Attorney General in the United States Department of Justice Civil Division.

The nexus of the lawsuit is as follows:

The executive order and, necessarily, any implementing regulations are unlawful and unconstitutional for a number of independent reasons:

- By banning TikTok with no notice or opportunity to be heard (whether before or after the fact), the executive order violates the due process protections of the Fifth Amendment.
- The order is ultra vires because it is not based on a bona fide national emergency and authorizes the prohibition of activities that have not been found to pose "an unusual and extraordinary threat."
- The order is ultra vires because its prohibitions sweep broadly to prohibit any transactions with ByteDance, although the purported threat justifying the order is limited to TikTok, just one of ByteDance's businesses.
- The order is ultra vires because it restricts personal communications and the transmission of informational materials, in direct violation of the IEEPA (International Emergency Economic Powers Act).
- IEEPA lacks any intelligible principle to guide or constrain the President's action and thereby violates the non-delegation doctrine, as the President's overbroad and unjustified claim of authority in this matter confirms.
- By demanding that Plaintiffs make a payment to the U.S. Treasury as a condition for the sale of TikTok, the President has taken Plaintiffs' property without compensation in violation of the Fifth Amendment.
- By preventing TikTok Inc. from operating in the United States the executive order violates TikTok Inc.'s First Amendment rights in its code, an expressive means of communication.

Accordingly, ByteDance and TikTok Inc. seek a declaratory judgment and order, invalidating and enjoining the executive order and any implementing regulations issued by the Department of Commerce.

<u>What Prompted This</u>? – On August 14th, President Trump issued an Executive Order citing the existence of credible evidence that ByteDance, Ltd.'s (ByteDance) 2017 acquisition of Musical.ly "threatens to impair the national security of the United States", ordering ByteDance to divest all of its interests in the mobile application TikTok within 90 days. [1]

<u>The Executive Order has been heavily critiqued in the private sector raising the following points</u>:

- The Committee on Foreign Investment in the United States (CFIUS) mandate is to ensure that foreign persons do not acquire U.S. assets that are critical to national defense or national security.
- The CFIUS Order appears to go beyond CFIUS's historical scope in order to reach assets outside the United States, a significant extraterritorial expansion of CFIUS review.
- Normally, a presidential order prohibiting an acquisition of a foreign company under the authority of CFIUS is expected to bar only the acquisition of assets and subsidiaries in the United States.
- The CFIUS Order appears to reach well beyond the acquired assets of Musical.ly in the United States, requiring ByteDance to divest "any tangible or intangible assets or property, wherever located, used to enable or support ByteDance's operation of the TikTok application in the United States, as determined by the Committee."
- The CFIUS Order explicitly appears to reach assets located outside the United States used to support services provided inside the United States (which might include servers, research and development, etc.), which traditionally has been thought to be outside CFIUS's jurisdiction.
- If the CFIUS Order in fact reaches assets outside the United States used to provide services to U.S. persons and assets that were not in fact acquired from Musical.ly, that would be a significant expansion of CFIUS's asserted jurisdiction with potentially far-reaching implications for overseas transactions involving companies with U.S. customers.

Source: Cleary Gottlieb

<u>The Tech Problem</u>

- TikTok is functionally and technically similar to ByteDance-owned Douyin, which is available only in China, and shares technical resources with it and other ByteDance-owned properties.
- While the code for the app, which determines the look and feel of TikTok, has been separated from Douyin, the server code is still partially shared across other ByteDance products.
- The server code provides basic app functionality such as data storage, algorithms for moderating and recommending content, and the management of user profiles.
- To ensure uninterrupted TikTok service, any buyer would likely need to rely on ByteDance's code while it reviews and revises the code, and moves to a new back-end infrastructure to serve users; however, any continuing technical or operational reliance of the U.S. business on the Chinese company after the sale generally would have been unacceptable to the CFIUS.
- Another challenge a buyer faces is how it will transfer what is viewed as TikTok's secret sauce, the recommendation engine that keeps users glued to their screens.
    - Algorithms are not worth anything without the user data.

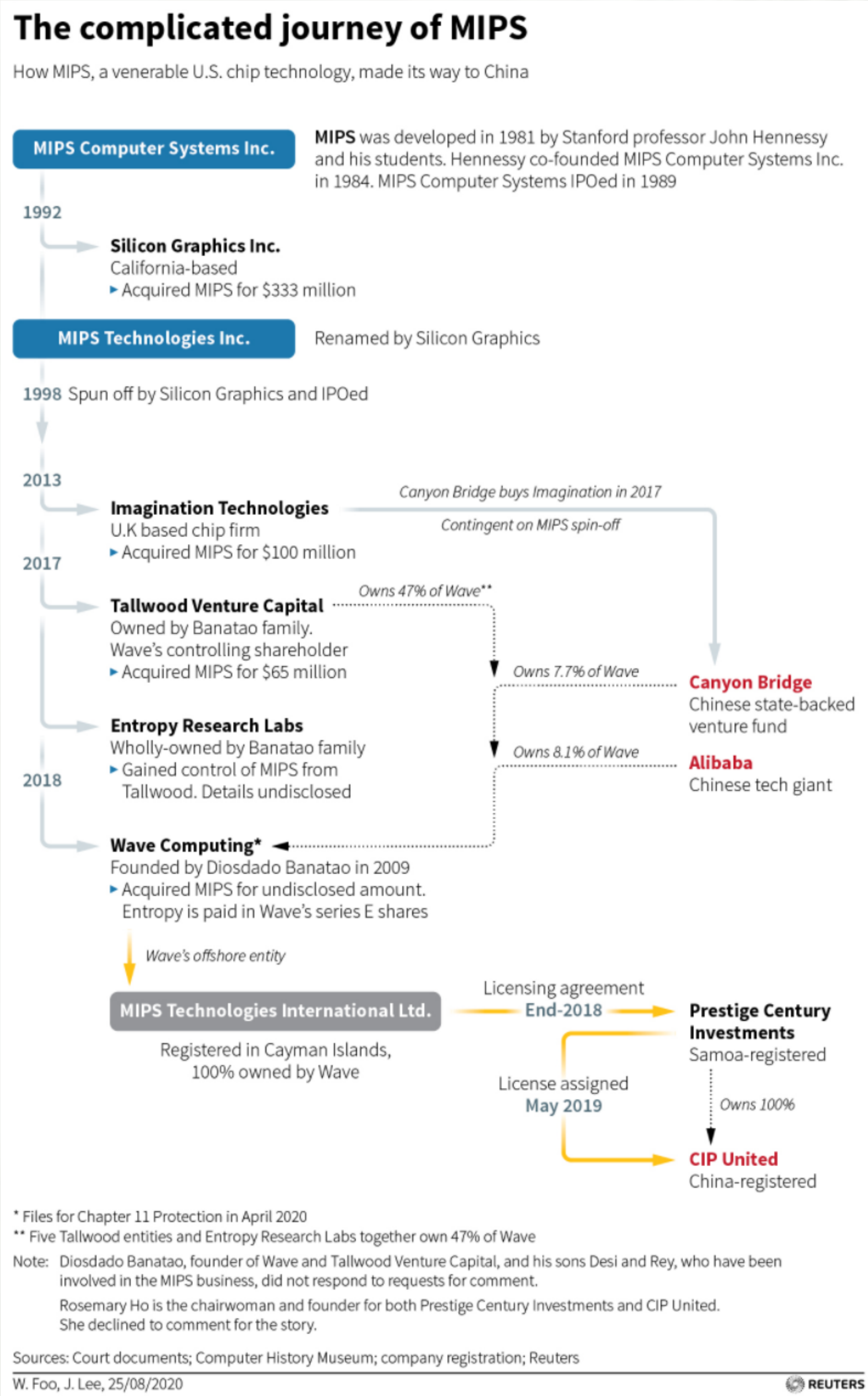
Source: Reuters and other news outlets

[1] https://home.treasury.gov/system/files/136/EO-on-TikTok-8-14-20.pdf

How a Silicon Valley Chip Pioneer Landed in China

Reporting by: https://www.channelnewsasia.com/news/business/tech-war-chronicles--how-a-silicon-valley-chip-pioneer-landed-in-china------13051742

- MIPS Computer Systems Inc developed a new approach to chip architectures that remains in wide use. MIPS was co-founded over 35 years ago by John Hennessy, Stanford University professor and Chairman of Alphabet Inc.
- In late 2018 and 2019, as the U.S.-China tech trade war was in full swing, the core technology of MIPS was licensed to a Shanghai-based firm, CIP United Co Ltd, via a complex series of transactions involving companies in the Cayman Islands and Samoa.
- The details of the MIPS licensing deal and the transactions that preceded it - revealed in U.S. bankruptcy proceedings involving MIPS' parent company, Wave Computing Inc, and interviews with nearly two dozen people - offer a rare glimpse into how foreign firms were able to gain access to one strategically important American technology.
- The MIPS license promises to provide "core technology" that will help China "implement the ambitious goal of Made in China 2025," the presentation stated, referring to a government program to achieve self-sufficiency in strategic industries.
- The path to sending the MIPS core technology to China started out with a maneuver to help ease U.S. concerns about technology transfer.
    - Canyon Bridge, an investment firm which Reuters has reported was founded partly with Chinese government funds, announced in September 2017 that it was buying Imagination Technologies, a UK-based graphics chip company that was then the owner of MIPS.
    - Acquiring MIPS would have subjected the transaction to a review by CFIUS. The deal was ultimately made contingent on completing a reorganization “to separate MIPS from the remainder of the group,” according to an Imagination press release dated September 22, 2017 announcing the MIPS sale.
    - Imagination’s chief executive Ray Bingham, who is also a partner of Canyon Bridge, did not reply to requests for comment.
    - From the Imagination spin-off, MIPS changed hands multiple times before ending up inside Wave Computing, a company that counts Canyon Bridge and China's Alibaba Investments Limited as minority investors.
    - The Alibaba and Canyon Bridge investments in Wave did not require a CFIUS filing because their investments were passive and below the 10 percent threshold that would require such a filing, according to CFIUS experts.
    - Two former CFIUS members, who declined to be named, said they would have looked into the Wave investments to determine if the investments were in the purview of CFIUS’ scope. CFIUS had already denied Canyon Bridge’s takeover of U.S. chip maker Lattice Semiconductor; Canyon Bridge was backed by the Chinese government.


The complicated journey of MIPS
How MIPS, a venerable U.S. chip technology, made its way to China
MIPS Computer Systems Inc.
MIPS was developed in 1981 by Stanford professor John Hennessy and his students. Hennessy co-founded MIPS Computer Systems Inc. in 1984. MIPS Computer Systems IPOed in 1989
1992
Silicon Graphics Inc.
California-based
Acquired MIPS for $333 million
MIPS Technologies Inc.
Renamed by Silicon Graphics
1998 Spun off by Silicon Graphics and IPOed
2013
Imagination Technologies
U.K based chip firm
Acquired MIPS for $100 million
Canyon Bridge buys Imagination in 2017
Contingent on MIPS spin-off
2017
Tallwood Venture Capital
Owned by Banatao family.
Wave's controlling shareholder
Acquired MIPS for $65 million
Owns 47% of Wave**
Owns 7.7% of Wave
Canyon Bridge
Chinese state-backed venture fund
Entropy Research Labs
Wholly-owned by Banatao family
Gained control of MIPS from Tallwood. Details undisclosed
Owns 8.1% of Wave
Alibaba
Chinese tech giant
2018
Wave Computing*
Founded by Diosdado Banatao in 2009
Acquired MIPS for undisclosed amount. Entropy is paid in Wave's series E shares
Wave's offshore entity
MIPS Technologies International Ltd.
Registered in Cayman Islands, 100% owned by Wave
Licensing agreement
End-2018
Prestige Century Investments
Samoa-registered
License assigned
May 2019
Owns 100%
CIP United
China-registered
* Files for Chapter 11 Protection in April 2020
** Five Tallwood entities and Entropy Research Labs together own 47% of Wave
Note: Diosdado Banatao, founder of Wave and Tallwood Venture Capital, and his sons Desi and Rey, who have been involved in the MIPS business, did not respond to requests for comment.
Rosemary Ho is the chairwoman and founder for both Prestige Century Investments and CIP United. She declined to comment for the story.
Sources: Court documents; Computer History Museum; company registration; Reuters
W. Foo, J. Lee, 25/08/2020
REUTERS

Did China re-acquire Grindr?

Reporting by: https://foreignpolicy.com/2020/08/24/chinese-acquisitions-of-western-firms-threaten-national-security/ and https://www.reuters.com/article/us-grindr-m-a-sanvicente-exclusive/exclusive-winning-bidder-for-grindr-has-ties-to-chinese-owner-idUSKBN2391AI

- In May 2019, CFIUS reportedly forced Beijing Kunlun Tech Co. Ltd. ("Kunlun") to divest Grindr LLC ("Grindr"), the dating app Kunlun acquired in 2016.
  - Grindr collects and maintains location and other behavioral data on its more than 27 million users, including over 3.3 million daily users. This data can be used to ascertain the behavioral trends of U.S. citizens, including, for example, the behavior of military or intelligence personnel in the United States.
  - Grindr's datasets also include highly sensitive and highly personal information, including records of chats and photos exchanged between users. These datasets could be used to blackmail users, including those with security clearances or access to sensitive military or intelligence information. Grindr has previously been the subject of congressional scrutiny due to its treatment of users' data, including users' HIV status and other personal details.
  - China's National Intelligence Law, enacted in 2017, compels Chinese entities to provide access for or cooperate with the government's intelligence-gathering activities. Thus, CFIUS may be concerned about Beijing's ability to compel Kunlun to provide the People's Republic of China (PRC) access to Grindr's datasets.
- The new owner, a completely new Delaware-based investment group jointly led by a former executive at the Chinese search engine Baidu (BIDU.O) and a Singapore-based businessman, has close links to Kunlun. When CFIUS ordered Kunlun to sell Grindr last year, the two businessmen advised Kunlun. They then founded the firm that bought the app, Reuters reported. Grindr has, in other words, barely left Kunlun.
- Kunlun disclosed in June 2020 that the CFIUS had cleared the sale of Grindr to San Vicente Acquisition LLC for more than $600 million, but did not give details about the investor group.
  - A Reuters review of confidential fundraising documents and interviews with two sources familiar with the deal show that a close business associate of Kunlun's founder tried to raise money for a fund to buy Grindr. Two of the partners in that fund eventually became part of San Vicente.
    - Kunlun also offered financing support to San Vicente that it didn't extend to two other groups
  - CFIUS declined to comment on the deal, including on whether it was aware of the links between Kunlun and San Vicente, which have not been previously reported.
  - James Lu, a former executive at Chinese internet search engine Baidu Inc, and George Raymond Zage, the chief executive of family office Tiga Investments Pte Ltd, alongside U.S. basketball team Atlanta Hawks co-owner Michael Gearon, are the main owners of the San Vicente consortium that agreed to acquire Grindr.
  - A regulatory filing shows San Vicente was incorporated in Delaware on February 19th, just weeks before the deal with Kunlun. The company is named after the Los Angeles street where Grindr is headquartered.

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