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National Security Review of Foreign Mergers and Acquisitions of Domestic Companies in China and the United States

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NATIONAL SECURITY REVIEW OF FOREIGN MERGERS AND ACQUISITIONS OF DOMESTIC COMPANIES IN CHINA AND THE UNITED STATES

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ABSTRACT

China's recently enacted Anti-Monopoly Law has received much academic attention. In particular, many articles and comments have been written about Article 31 of the Anti-Monopoly Law, a provision on national security review of foreign mergers and acquisitions of domestic companies. The provision has often been labelled as draconian and protectionist. This paper argues that Article 31 is not necessarily so. Article 31 is actually, to a large extent, in line with the national security provisions found in liberal economies. By taking a comparative approach, this paper will demonstrate the similarities between the national security laws in China and the United States, challenging common misconceptions.

I. INTRODUCTION

The recent enactment of China's Anti-Monopoly Law (the "Anti-Monopoly Law") has provided a source of discussion for many academics and journalists. In particular, the national security review provision under the Anti Monopoly Law has received

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much attention. Under Article 31, foreign mergers and acquisitions of domestic enterprises are subject to both national security and anti-monopoly reviews. Some commentators such as Anu Bradford have labelled Article 31 as a protectionist measure designed to protect domestic companies from foreign investors. [1] They also assert that the vagueness and uncertainty surrounding the concept of national security in Article 31 allows room for abuse and protectionist policies. This paper argues that the concept of a national security review in China is not new. The review of foreign mergers and acquisitions of domestic companies has already been in operation since 2006 under the Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the "2006 Provisions").[2] Contrary to popular belief, both Article 31 of the Anti-Monopoly Law and the 2006 Provisions are not outright protectionist measures in a comparative context. In fact, it echoes national security review laws found in free market economies, such as the United States.

II. AIMS OF THIS PAPER

The aim of this paper is to argue against labelling China's national security laws on foreign mergers and acquisitions of domestic companies (the "national security laws") as protectionist. To demonstrate this point, this paper will embark on a comparative approach to show that China's national security laws are actually in line with corresponding laws in free market countries. Given that the United States is often regarded as the prime free market example, this paper will compare the national

[1] Anu Bradford, *Chinese Antitrust Law: The New Face of Protectionism?*, THE HUFFINGTON POST August 1 2008. See also Dale Oesterle, *China gets tough on foreign investmen*t, BUSINESS LAW PROFESSOR BLOG, August 30 2006

[2] Steve Dickinson, *National Security Review Under China's New Anti-Monopoly Law*, CHINA LAW BLOG, August 29 2008

security laws of China and the United States. It will be argued that the laws in China and the United States are in fact substantially similar. Accordingly, China's policies are not necessarily more protectionist than those in a free market economy. Hence, Bradford's candid and unqualified argument must be wrong.

For the purposes of this paper, the national security laws discussed will be limited to the rules on foreign mergers, acquisitions and takeovers of domestic enterprises. In this paper the terms merger, acquisition and takeover will be used synonymously. The focus will be on transactions where one company (itself or through its wholly owned subsidiaries) purchases a majority of the shares or substantial assets of another company. The target company then ceases to exist. Although the Anti-Monopoly Law and the 2006 Provisions also cover other forms of foreign investments in domestic enterprises, these rules will not be taken into account.

Part III of this paper introduces the legislative development behind China's national security laws. Part IV explains the review process for proposed foreign acquisitions of domestic companies. Since the review process does not hinder foreign mergers and acquisitions *per se*, such discussion will be brief. Parts V and VI examine the scope of the national security laws in China and the United States and demonstrate their similarities. Part VII compares the remedies available to the state in China and the United States and demonstrates their similarities. Finally Part VIII examines the decision making procedure in both countries.

III. LEGISLATIVE HISTORY OF CHINA'S NATIONAL SECURITY LAWS

Foreign direct investment in China has grown at an alarming rate in the past ten years. In particular, foreign mergers and acquisitions of domestic companies, as a percentage of China's total foreign direct investment, grew from 5 percent in 2003 to 20 percent in 2005.[3] The Fair Trade Bureau in 2004 published a report accounting that foreign companies such as Microsoft and Tetra Pak have monopolized their respective markets in China. [4] These developments put pressure on China's government to control and protect its economy from foreign control.[5] As an interim response, the Ministry of Foreign Trade and Economic Cooperation (now the Ministry of Commerce), the State Administration for Industry and Commerce, the State Administration of Taxation and the State Administration of Foreign Exchange jointly promulgated the Provisional Rules on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (the "2003 Provisional Rules").

Despite the 2003 Provisional Rules, mergers and acquisitions of domestic enterprises by foreign investors continued to rise. In between June 2005 and 2006, foreign purchasers acquired over 250 domestic enterprises worth more than US$14 billion.[6] Further, of the 21 acquisitions in the first six months of 2006, 18 involved foreign companies acquiring domestic companies and only 3 involved the acquisition of

[3] See *Anti-Monopoly Law Seeks to Regulate Foreign Acquisitions*, MINISTRY OF COMMERCE NEWS RELEASE, July 5 2007

[4] See *The Competition Restriction Behaviour of Multinational Companies in China Countermeasures*, FAIR TRADE BUREAU, May 2004

[5] Wang Xiaoye, *Report: Anti-monopoly Law Vital*, CHINA DAILY, August 22 2004

[6] See *UK spent $3.5 billion in China M&A takeaway*, GRANT THORNTON, August 15 2006. See the Grant Thornton website at http://www.grant-thornton.co.uk

foreign companies.[7] Rising concern over the loss of state-owned assets combined with Carlyle Group's attempt to purchase a subsidiary of Xugong Group, China's construction and machinery giant, prompted further state intervention.[8] Eventually, in August 2006, six PRC authorities, the Ministry of Commerce ("MOFCOM"), the State-owned Assets Supervision and Administration Commission of the State Council, the State Administration for Industry and Commerce, the State Administration of Taxation, the China Securities Regulatory Commission and the State Administration of Foreign Exchange jointly promulgated the 2006 Provisions.[9] The 2006 Provisions expanded the scope of national security and offered more comprehensive guidelines regarding the review procedure.

Recently, the Standing Committee of the 10th National People's Congress ("NPC") adopted the Anti-Monopoly Law, which came into force on August 1 2008. The national security provision of the Anti-Monopoly Law, Article 31, states that "where a foreign investor mergers and acquires a domestic enterprise …, if state security is involved, besides the examination on the concentration in accordance with this Law, the examination on national security shall also be conducted in accordance with the relevant State provisions." Contrary to popular belief, Article 31 does not in fact add anything new. Article 31 reiterates the applicability of existing national security laws

[7] See interview of Sun Xiaohua, CHINA BUSINESS NEWS, July 17 2006

[8] See *China to revise regulation on foreign mergers and acquisitions*, MINISTRY OF COMMERCE NEWS RELEASE, July 18 2006

[9] Decree of the Ministry of Commerce, State-owned Assets Supervision and Administration Commission of the State Council, the State Administration of Taxation, the State Administration for Industry and Commerce, Securities Regulatory Commission of China, and the State Administration of Foreign Exchange No. 10

rather than adding new provisions. As such, the more detailed 2006 Provisions remains as legal authority on foreign takeovers of domestic companies.[10]

The historical development of United States national security laws is by large similar to the development of Chinese national security laws. It was also triggered by increasing foreign direct investment and acquisition of domestic companies. In the late 1970s, Congress became concerned with the rapid increase in Organization of the Petroleum Exporting Countries ("OPEC") investments in American portfolio assets.[11] As a result, President Gerald Ford created the Committee of Foreign Investment in the United States ("CFIUS") in 1975 to placate Congress.[12] CFIUS, at the time, was tasked with monitoring the impact of foreign investments in the United States.[13] Subsequently in the late 1980's, increasing acquisition of United States firms by Japanese firms led to the passage of the Exon-Florio provision by Congress.[14] The Exon-Florio provision granted the President authority to block foreign acquisitions of persons engaged in United States interstate commerce.[15] Through Executive Order 12,661, President Ronald Reagan then delegated power to CFIUS, transforming it from an administrative body to a Committee that could investigate, review and make

[10] Dickinson, *National Security Review Under China's New Anti-Monopoly Law*

[11] U.S. Congress. House. Committee on Government Operations. Subcommittee on Commerce, Consumer, and Monetary Affairs. The Operations of Federal Agencies in Monitoring, *Reporting on, and Analyzing Foreign Investments in the United States*. Hearings. 96th Cong., 1st sess., Part 3, July 30, 1979. Washington, U.S. Govt. Print. Off., 1979, at pp.334-335

[12] Matthew R. Byrne, *Protecting National Security and Promoting Foreign Investment: Maintain the Exon-Florio Balance*, 67 OHIO STATE LAW JOURNAL 849 (2006)

[13] Executive Order No. 11,858, 3 C.F.R. 159 (1976)

[14] U.S. Congress. House. Committee on Energy and Commerce. Subcommittee on Commerce, Consumer Protection, and Competitiveness. Foreign Takeovers and National Security. Hearings on Section 905 of H.R.3. 100th Cong., 1st sess., October 20, 1987. *Testimony of David C. Mulford*. Washington, U.S. Govt., Print., Off., 1988, at pp. 21-22.

[15] Omnibus Trade and Competitivness Act §5021

recommendations.[16] The Exon-Florio provision has since been amended again in response to the acquisition of LTV Steel's missile division, a United States company, by Thomson CTF, a company owned by the French government.[17] The Byrd Amendment added a section requiring mandatory investigation by CFIUS if a United States company is being acquired by a foreign state owned enterprise.

IV. REVIEW PROCESS

Under Article 12 of the 2006 Provisions, the burden on initiating the review process is on the foreign investor. If the acquisition "involves any critical industry, affects or may affect the security of national economy, or causes transference of actual control over the domestic enterprise who possesses a resound trademark or China's time-honored brand," then foreign investors must make an application to MOFCOM. Although there are some precedents to aid foreign investors in their judgment, it remains difficult for foreign investors to second-guess MOFCOM.[18] In practice, foreign investors will take a cautious approach in assessing whether they should make an application.[19]

To apply for a security review under the 2006 Provisions, the foreign investor must submit a list of documents including the target company's shareholders resolution, an application for a merged company to be established as a foreign investment enterprise,

[16] Executive Order No. 12,661, 3 C.F.R. 618 (1989)

[17] Byrne, *Protecting National Security and Promoting Foreign Investment: Maintain the Exon-Florio Balance*

[18] Ibid.

[19] Dickinson, *National Security Review Under China's New Anti-Monopoly Law*

the Articles of Association of the foreign investment enterprise established after the merger and any other relevant government permits to the approving authority. [20] Under the 2006 Provisions, MOFCOM has been assigned as the approving authority.[21] Upon receipt of all the required documents, MOFCOM has thirty days to decide whether or not to grant the approval.[22] If MOFCOM decides to grant the approval, it shall then issue a certificate of approval.

Under the Exon-Florio provision, a review is triggered by either party, by the President or a member of the CFIUS requesting CFIUS to commence a review.[23] A further 45 day investigation is necessary if the acquiring firm is "controlled by or acting on behalf of a foreign government" and the transaction could result in control of a United States company affecting national security. [24] Subsequent to the investigation, CFIUS then produces an opinion for the President, who then has 15 days to consider whether to approve the transaction.[25]

V. SCOPE OF THE NATIONAL SECURITY REVIEW

The scope of the national security laws in China and in the United States are relatively similar. Article 31 of the Anti-Monopoly Law covers situations where a "foreign investor mergers and acquires a domestic enterprise" resulting in actual

[20] Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Article 21

[21] Ibid., Article 10

[22] Ibid., Article 25

[23] 50 U.S.C.§2170(a)

[24] 50 U.S.C.§2170(b)

[25] 50 U.S.C. §2170(d)

control of the domestic enterprise.[26] The Exon-Florio provision, although worded differently, contains a similar concept. Under the provision, investigations by CFIUS may only be made where there are "mergers, acquisitions and takeovers … by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States."[27] In the following section, the key elements defining the scope of national security reviews in China and the United States will be compared. The discussion on the definition of "national security" will be left to Part VI.

(a) Foreign investor

The term foreign investor is undefined in the 2006 Provisions. The Law of the People's Republic of China on Foreign Capital Enterprises (the "Foreign Capital Laws"), however, provides some guidance. Foreign investors are defined as foreign enterprises or individuals, with the litmus test being the nationality of the enterprise or individual.[28] In addition, the 2006 Provisions provide two further situations where the acquiring entity is defined as a foreign investor. Firstly, the 2006 Provisions also applies to foreign invested enterprises; enterprises with 25 percent of its equities held by foreign investors that are of an investment nature.[29] Secondly, a special purpose

[26] Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Article 12

[27] 50 U.S.C. §2170(a); Also note that such investigations are compulsory under the Byrd amendment if "an entity controlled by or acting on behalf of a foreign government seeks to engage in any merger, acquisition, or takeover which could result in the control of a person engaged in interstate commerce in the United States that could affect the national security of the United States," 50 U.S.C. app. §2170(b)

[28] Law of the People's Republic of China on Foreign Capital Enterprises, Article 1

[29] Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Article 55

vehicle, meaning an overseas company directly or indirectly controlled by a domestic company or a natural person, may also fall under the 2006 Provisions.[30]

This definition is relatively similar to the corresponding definition under the Exon-Florio provision. The Code of Federal Regulations (the "Regulations") also uses a nationality test to delineate a foreign person. A foreign person is defined as "any foreign national or any entity over which control is exercised or exercisable by foreign interest."[31] Like the 2006 Provisions, this definition covers acquisitions by foreign companies incorporated abroad. In addition, it also covers acquisitions by domestic companies under the control of a foreign national or entity. Given that "control" is given a broad definition under the Regulations, it includes situations where a shareholder has a minority interest but much actual influence. As such a company like a foreign invested enterprise, with 25 percent of its shares held by foreign investors, can be a foreign person if there is control. In fact, the Exon-Florio test is potentially wider than the 2006 Provisions. By using the concept of "control", a company with less than 25 percent of its shares held by a foreign investor can become a foreign person.

(b) Domestic enterprise

The biggest difference between the scope of the Chinese and the United States national security review process is the definition of a target company. Under the 2006 Provisions, a target company is defined as a domestic enterprise with "no foreign

[30] Ibid., Article 39

[31] 31 C.F.R. §800.213

investment."[32] Although the language here suggests of a Chinese entity with no foreign investment at all, the definition seems to be wider when applied. A domestic enterprise has been interpreted by academics to mean a non foreign invested enterprise (an entity with less than 25 percent of its ordinary shares held by a foreign entity). [33]

In contrast, the definition of a target company is much wider in the United States. The target can be any "person engaged in interstate commerce."[34] The target does not have to be a domestic company. A far-reaching consequence of this definition is that the target entity does not require a particularly strong connection with the United States. All that is required is that the person conducts business in the United States. An example can be seen in the proposed acquisition of Peninsular and Oriental Steam Navigation Company ("P&O"), a British company, by Dubai Ports World ("DPW"), a state owned company in the United Arab Emirates.[35] The issue here was that P&O operated and managed terminals at five United States ports. Since P&O managed port facilities in multiple states, including New York, New Jersey, Philadelphia, Baltimore and New Orleans, the deal fell within review jurisdiction – even though P&O was not a United States company. This example, if anything, suggests that the Exon-Florio review process is more stringent and more protectionist than the 2006 Provisions. With the 2006 Provisions, the national security rules can only be invoked if a domestic company is invoked.

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[32] Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Article 2

[33] Peter Neumann and Tony Zhang, *China's new foreign funded M&A provisions: greater legal protection or legalized protectionism?*, 20 CHINA LAW AND PRACTICE 8, 2006

[34] A person means any natural person or entity under 31 C.F.R. §800.217

[35] David E. Sanger and Eric Lipton, *Bush Would Veto Any Bill Halting Dubai Port Deal*, N.Y. TIMES, February 22 2006

VI. DEFINITION OF "NATIONAL SECURITY"

Article 31 of the Anti-Monopoly Act articulates that a review is required when "national security" is involved. The article does not elaborate further on what national security means and how it is to be applied. It seems that the Anti-Monopoly Act follows the 2006 Provisions for the definition of national security. Article 12 of the 2006 Provisions provides that mergers and acquisitions that (1) involves any critical industry, (2) affects or may affect the security of national economy, or (3) causes transference of actual control over the domestic enterprise which possesses a resound trademark or China's time-honored brand is subject to review.

In contrast, the Exon-Florio provision takes a different emphasis. The President may only intervene in a transaction if he believes "that the foreign interest exercising control might take action that threatens to impair the national security" and that other provisions of law do not provide adequate and appropriate authority to protect the national security in the matter.[36] There are twelve factors that the President must consider when deciding to block a foreign acquisition.[37] The factors cited mostly revolve around the issue of national security. Thus, unlike the 2006 Provisions, none

[36] 50 U.S.C. §2170(e)

[37] The factors include: (1) domestic production needed for projected national defense requirements; (2) the capability and capacity of domestic industries to meet national defense requirements; (3) control of domestic industries by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of nationals security; (4) potential effects of the proposed or pending transaction … identified by the Secretary of Defense as posing a military threat to the interests of the United States; (5) the potential effects of the transaction on United States technological leadership in areas affecting U.S. national security; (6) whether the transaction has a security related impact on critical infrastructure in the United States; (7) the potential effects on United States critical infrastructure, including major energy assets; (8) the potential effects on United States critical technologies; (9) whether the transaction is a foreign government controlled transaction; …. (11) the long term projection of the United States requirements for sources of energy and other critical resources and materials; and (12) such other factors as the President or the Committee determine to be appropriate.

of the factors make explicit reference to "critical industries" or "national economic security." As Steve Dickinson points out, the main difference between the security provisions of both countries is that one focuses on the economy while the other focuses on national security.[38]

While in theory, the Chinese national security laws are aligned with the concepts of economic and industrial security, the disparity is not as big as it first seems. In practice, the 2006 Provisions and the Exon-Florio provision produce the same result. A closer examination of the key provisions suggests that they are applied in the same way.

(a) Critical industry

The notion of "critical industry" in China has in fact been applied in a way that covers national security. Although the concept of critical industry is undefined in the Anti-Monopoly Law and the 2006 Provisions, the State Assets Supervision and Administration Commission ("SASAC") has in the past highlighted several key sectors critical to the national industry. They are the armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation and shipping industries. [39] It is unsurprising that these industries are listed. These industries are the backbone of China's economy and livelihood. Since China is heavily based on natural resources and industrial production, these industries are the ones that will have most bearing on its national security and will be protected most.

[38] Dickinson, *National Security Review Under China's New Anti-Monopoly Law*

[39] Zhao Huanxin, *China names key industries for absolute state control*, CHINA DAILY, December 19 2006

An example of this is the protection of the steel industry from foreigners. Arcelor Mittal's attempt to acquire Laiwu Iron and Steel Corporation in 2006 was blocked for a year and a half because of the National and Development Reform Commission's objection. The Commission expressed that it was concerned with the deal's pricing and the steel market's development. Apart from being in SASAC's defined categories, an additional factor seems to be necessary for state intervention. For example, Singapore Airlines' bid for China Eastern Airlines in 2006 clearly fell into the aviation category. Despite the deal ultimately falling through because of commercial reasons, the transaction was actually given support by MOFCOM and other government authorities. This suggests that a national security test is implicit in the critical industry test; reinforcing similarities with the Exon-Florio provision.

In practice, the only major difference between the application of the Exon-Florio provision and the 2006 Provisions is where the emphasis of protection lies. While China focuses on primary industries like manufacturing and natural resources, the United States focuses on defense and technology.[40] The reason for this is that the economic structure of the United States is different from China's, with a greater emphasis on information and technology. A recent example of this is Hutchison Whampoa Limited's offer for Global Crossing, a fiber optic network. CFIUS' concern about the security of United States data transmissions and the ability of United States law enforcement's ability to access the network for wiretap led to the

[40] Edward M. Graham and David M. Marchick, *U.S. National Security and Foreign Direct Investment*, (Washington: Institute for International Economics, 2006) at p. 54

initiation of an extended 45 day investigation. Seeing this as a negative sign, Hutchison Whampoa Limited withdrew its offer.[41]

(b) Security of national economy

Despite denials by officials, the concept of national economic security is actually incorporated into the United States national security laws. In theory, national economic security and national security cannot be distinct from one another. National economic security is a subset of national security. A country's economy will undoubtedly have a major influence in its foreign relations, trade, development and defence spending. It follows then that the Exon-Florio national security test must at least incorporate some economic elements into its analysis. The factors listed under the Regulations provide traces of this. For instance, the factors cite that the acquisition of major assets in the energy sector may be of national concern. The leading transaction for this was the proposed acquisition of Union Oil Corporation of California by the Chinese National Offshore Oil Corporation ("CNOOC"), a state owned company in 2005. CNOOC, under political pressure, pulled out of the deal before a CFIUS review as there was wide consensus that CFIUS would come to a negative outcome. Various lobbyists have argued that the deal would impact on the United States' oil dependence.[42]

[41] It also depends on whether the national security element can be alleviated. The acquisition of Tyco International, another fiber optical company, by Videsh Sanchar Nigram Ltd (an Indian company) in 2005 was approved because VSNL was able to alleviate national security fears by entering into a data security arrangement.

[42] See *Testimony of Guy Cariso*, before the Commission on US-China Economic and Security Review hearing on China's Energy Needs and Strategies, October 30 2003

Another factor that seems to include economic considerations in the Exon-Florio provision is the critical infrastructure factor. A transaction that has a security related impact on critical infrastructure may be subject to review. Critical infrastructure has been referred to and includes economic sectors such as aircraft, telecommunications, financial services, water and transportation.[43] This interpretation has been further expanded by the Department of Homeland Security through a series of Directives.[44] The widening definition of critical infrastructure implies that the Exon-Florio provision has the capability to consider economic matters.[45] It seems then, that the Exon-Florio provision covers the same matters, if not more, than the 2006 Provisions.

(c) Resound trademark or time-honored brand

Many critics have also commentated that the inclusion of "resound trademark or China's time-honored brand" as a ground of refusal to be protectionist.[46] This view is misguided. Undeniably, the time-honored brand ground is found nowhere in the Exon-Florio provision, but its application is so narrow that its effect is negligible in practice. The threshold to establish a resound trademark or a time-honored brand is very high. An example of this can be seen in the Coca Cola's pending US$2.4 billion takeover of China Huiyuan Juice Group Limited ("Huiyuan"). Although there were

[43] 42 U.S.C. §5195c(b)(2)

[44] Sectors include (1) Agriculture and Food; (2) Defense Industrial Base; (3) Energy; (4) Public Health and Healthcare; (5) National Monuments and Icons; (6) Banking and Finance; (7) Drinking Water and Water Treatment Systems; (8) Chemical; (9) Commercial Facilities; (10) Dams; (11) Emergency Services; (12) Commercial Nuclear Reactors, Materials and Waste; (13) Information Technology; (14) Telecommunications; (15) Postal and Shipping; (16) Transportation Systems; and (17) Government Facilities

[45] James K. Jackson, *Foreign Investment, CFIUS, and Homeland Security: An Overview*, CRS REPORT FOR CONGRESS, April 17 2008

[46] Peter Neumann and Tony Zhang, *China's new foreign funded M&A provisions: greater legal protection or legalized protectionism?*

rumours of a national security review, the deal was instead postponed for an anti-monopoly review. This implicitly suggests that Huiyuan did not qualify as a resound trademark or a time-honored brand despite being dubbed the "leading brand in China's beverage industry" and winning titles such as the "China Famous Trademark.[47]" It seems that the standard has been set so high that few domestic companies, if any, will be treated as having a resound trademark or a time-honored brand.[48]

The absence of a similar provision in the Exon-Florio provision can be seen in Lenovo Group's acquisition of International Business Machines ("IBM") for $1.25 billion in 2005 and InBev's acquisition of Anheuser-Busch for $52 billion in 2008. The popularity of the IBM and Anheuser-Busch brand in the United States, for producing well-known computers and beers respectively, did not have any influence in the review by CFIUS. The more difficult question however is what will happen if IBM and Anheuser-Busch were both Chinese companies and these transactions occurred in China. Theoretically, of course, the resound trademark or time-honored brand provision can be used to block the deals. But in practice, given the Huiyuan precedent, it becomes more difficult to give a firm conclusion. The similarities of the Anheuser-Busch and Huiyuan deals, both are well known brands acquired by a foreign competitor, may indicate that such hypothetical Anheuser-Busch deal will produce the same result. As such, the inclusion of a time-honored brand provision in the Chinese national security law does not actually create a substantial difference when compared with the Exon-Florio provision.

[47] For information on the Huiyuan Group see http://www.huiyuan.com.cn/en/about/

[48] Andrew Ross Sorkin, *Coca Cola's Chinese Deal Seen as Litmus Test for M&A*, THE DEAL BOOK, September 29 2008

VII. REMEDIES

Despite being labelled "draconian", the Chinese national security law remedies are actually similar with the Exon-Florio provision remedies. Where the parties have filed an application for security review, MOFCOM and the relevant authorities decides whether or not to grant the approval.[49] If the parties fail to make an application, "the Ministry of Commerce may, together with other competent authorities, request the parties to stop the transaction, assign relevant equity or assets, or take any other effective actions, to eliminate the affect of the merger on the security of national economy."[50] Thus, even if the parties do not file, the government can still intervene by blocking the deal or issuing a divestiture order if the transaction has been completed.

Essentially, this is same as the corresponding Exon-Florio remedy. If a transaction is reported to the President, the President then has the authority to take no action or block the transaction. If a transaction is unreported, the President can still block the deal or make a divestiture order, epitomizing Article 12 of the 2006 Provisions. An example can be seen in China International Trust and Investment Corporation's ("CATIC") acquisition of MAMCO Manufacturing, an American aircraft parts manufacturer based in Seattle, in 1990. Although a voluntary notice was filed with CFIUS, the transaction was completed before CFIUS finished its review. In the end, President George H.W. Bush, upon the recommendation of CFIUS, ordered the divestiture of MAMCO by CATIC on the ground that CATIC's strong ties with the

[49] Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Article 25

[50] Ibid., Article 12

People's Liberation Army of the People's Republic of China threatened national security.[51]

The Exon-Florio provision has an additional limitation to the President's powers. The President must be satisfied that "all other means, including the International Emergency Economic Powers Act, must be exhausted" or the Exon-Florio provision is appropriate for protecting the nation's security.[52] This limitation must not be overstated. In practice, this limitation only requires the President to choose the best option in light of the circumstances. Thus, Article 25 of the 2006 Provisions actually corresponds to the Exon-Florio limitation. Article 25 gives the state wide discretion to "take any other effective action" it thinks fit. If there are alternative measures that are more appropriate, the Chinese authorities will undoubtedly pursue those.

There is, however, a development that has marked a difference in the two regimes. In an increasing number of cases, CFIUS has reached "mitigation agreements" with the parties either before or during the review process. Although informal agreements are not a new concept, the conditions, which CFIUS has imposed on the parties have become more innovative. An example of the terms imposed can be seen in the acquisition of Lucent Technologies Inc by the French based Alcatel SA in December 2006. Before the transaction was approved by CFIUS, Alcaltel Lucent was required to agree to a special security arrangement that restricts Alcaltel's access to sensitive work done by Lucents research arm, Bell Labs. Potentially, this allows CFIUS to reopen a review of the deal and overturn its approval if CFIUS believes the

[51] See *PRC Acquisition of U.S. Technology*, THE U.S. HOUSE OF REPRESENTATIVES SELECT COMMITTEE ON U.S. NATIONAL SECURITY, 1999, at pp.44-45

[52] 50 U.SC. §2170(e)

companies "materially failed to comply" with the arrangement terms. What this means is that CFIUS determination is not longer final. The review process may be continuous and perpetual. Compared to the traditional remedies discussed above, this continual monitoring condition seems to be even more onerous and protectionist.[53]

VIII. DECISION MAKING IN THE REVIEW PROCESS

Although MOFCOM is the government authority which grants the certificate of approval, the decision on security review applications and remedies lie within an inter agency committee. A recent statement issued by the National Development and Reform Commission has indicated that MOFCOM will have the primary responsibility of processing and responding applications and the interagency review committee will be responsible for considering whether such applications raise national security concerns. Where the national security concerns are major, a ministry level interagency committee will consider the application. The interagency review committee referred to will consist of the six government bodies that promulgated the 2006 Provisions. That is, MOFCOM, the State-owned Assets Supervision and Administration Commission of the State Council, the State Administration for Industry and Commerce, the State Administration of Taxation, the China Securities Regulatory Commission and the State Administration of Foreign Exchange. In practice, it has been suggested, that unanimous approval is required to grant a certificate of approval.[54]

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[53] Stephanie Kirchgaessner, *US Threat to Reopen Terms of Lucent and Alcatel Deal Mergers*, THE FINANCIAL TIMES, December 1 2006

[54] Peter Neumann and Tony Zhang, *China's new foreign funded M&A provisions: greater legal protection or legalized protectionism?*

The decision making process under the Exon-Florio provision is fundamentally different. At the end of an investigation, CFIUS produces an opinion on whether there is credible evidence to believe that the foreign interest exercising control might take action that threatens to impair the national security and whether other provisions of law may provide relief.[55] Its report and opinion to the President is non-binding.[56] The President then has 15 days to consider the opinion and "take such action … as the President considers appropriate to suspend or prohibit any acquisition, merger, or takeover, of a person engaged in interstate commerce in the United States." [57] In practice, CFIUS has initiated little investigations. Of the 1,593 investigations it has received since 1988, CFIUS has only proceeded to make 25 investigations.[58] The reason for this is that the parties mostly reach a mitigation agreement with CFIUS before the investigation.[59] Nonetheless, such data must be used cautiously. Many transactions were abandoned after informal negotiations led the parties to conclude that there would be no CFIUS approval.[60]

Comparing the two decision-making processes, the following conclusion can be drawn. The process is more bureaucratic under the 2006 Provisions, requiring the

[55] 50 U.S.C. §2170(e)

[56] Apart from the nine members, The Secretary of Labor and the Director of National Intelligence also serve as ex officio members of the Committee. In addition, the Director of the Office of Management and Budget, the Chairman of the Council of Economic Advisors, the Assistant to the President for National Security Affairs, the Assistant to the President for Economic Policy and the Assistant to the President for Homeland Security and Counter terrorism may observe, participate and report to the President

[57] 50 U.S.C. §2170(d) ; 31 C.F.R. §800.601

[58] Edward M. Graham and David M. Marchick, *U.S. National Security and Foreign Direct Investment*, at p. 57

[59] Ibid., at p. 58

[60] Ibid., at p. 57

consensus of six governmental agencies. This makes it difficult for a transaction to be approved. An example can be seen in the proposed merger between Carlyle Group and a subsidiary of the Xugong Group. Carlyle made three separate attempts to merge with the company but refused was approval each time. The difficulty in negotiating with numerous administrative bodies and the delays eventually forced Carlyle to pull out of the deal. In contrast, historical data seems to suggest that it is easier for a transaction to be approved in the United States. The greater use of informal agreements along with a more efficient negotiation process (negotiation with only one government body) allows parties to satisfy CFIUS demands more easily.

IV. CONCLUSION

China's national security laws do not differ greatly with the United States national security laws. In terms of substantive law, there are considerable similarities in the definition of "national security" and the remedies available. In fact, the scope of review seems to be wider under the Exon-Florio provision than the 2006 Provisions. Under the Exon-Florio provision, the definition of the target entity is not limited to domestic companies and extends to any entity engaging in interstate commerce. It is therefore wrong to argue that China's substantive rules are more protectionist than those in free market countries such as the United States. The only protectionist feature of China's national security law is its decision making procedure. The requirement of unanimous approval and the difficulty in negotiating with all six government departments makes it harder for a deal to be approved. Despite this, China's national

security law is not as "draconian" as some commentators have suggested. [61] It is simply inaccurate to candidly label China's national security laws as protectionist in a comparative context.

[61] *See* Ed Morissey, *Is China now more capitalist than the US?*, HOT AIR, December 11 2008