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Regulatory Hurdles Facing Mergers With Chinese State-Owned Enterprises in the United States and the European Union

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This article explores the potential stumbling blocks for transactions with Chinese state-owned enterprises (“SOEs”) imposed by the merger review rules of the US Hart-Scott-Rodino Antitrust Improvements Act (“HSR Act”) and the European Union Merger Regulation (“EUMR”), as well as the reviews of the Committee on Foreign Investment in the United States. It begins by providing background on SOEs generally and Chinese SOEs in particular, and a brief history of investments made by such enterprises in the United States and in Europe. The paper then discusses the regulatory framework and the hurdles transactions by and with SOEs face in the United States (“US”) and Europe, as well as the practical considerations that entities engaging in such transactions should keep in mind.

1. INTRODUCTION

Acquisitions by Chinese state-owned enterprises (“SOEs”) of companies in the United States (“US”) and European Union (“EU”) have grown in recent years. Trade and cross-border investment has increased and Chinese SOEs have extended their reach beyond their domestic market. Those acquisitions, together with joint ventures between Western companies and Chinese SOEs, have attracted substantial attention from the general public and from scholars. Transactions with Chinese companies often generate headlines and attract political attention. Transactions with Chinese SOEs tend to attract even greater scrutiny, and often face special merger control and foreign investment rules. Those rules have been subject to recent changes as Western governments have increasingly confronted such deals. Chinese SOEs and the companies considering entering into mergers with them should be prepared for the regulatory hurdles such transactions face.

The present article explores the potential stumbling blocks for transactions with Chinese SOEs imposed by the merger review rules of the US Hart-Scott-Rodino Antitrust Improvements Act (“HSR Act”)¹ and the European Union Merger Regulation (“EUMR”)², as well as the reviews of the Committee on Foreign Investment in the United States (“CFIUS”). It

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¹ Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a.

² Council Regulation (EC) 139/2004 on the Control of Concentrations between Undertakings, 2004 O.J. (L 24) 1. It replaced the original merger regulation, Council Regulation (EEC) 4064/89, 1989 O.J. (L 395) 1, as

begins by providing background on SOEs generally (Part 2) and Chinese SOEs in particular (Part 3), and a brief history of the investments made by such enterprises in the US and Europe. The paper then discusses the regulatory framework and the hurdles transactions by and with SOEs face in the US under HSR (Part 4), with special emphasis on the reviews of the CFIUS (Part 5), and in Europe (Part 6), as well as the practical considerations that entities engaging in such transactions should keep in mind (Part 7).

2. THE ROLE OF STATE-OWNED ENTERPRISES IN THE GLOBAL ECONOMY

SOEs, also known as public enterprises, are entities owned by the State rather than by private actors.³ According to the World Bank, SOEs are “government-owned or government-controlled economic entities that generate the bulk of their revenues from selling goods and services.”⁴ SOEs may take different forms, which range from statutory corporations which are part of a government department, to fully incorporated, state-controlled enterprises, to publicly listed companies with a minority of shares traded on the stock market.⁵ SOEs differ from privately-held entities in a number of significant ways, including the following aspects: they are typically tasked with promoting specific non-commercial, public-policy objectives; they often enjoy privileges and immunities that are not available to privately-owned companies, such as cash infusions, cheap financing and tax and regulatory exemptions, which may reduce the demands of fiscal efficiency imposed on privately-held entities; and they are often shielded from potential takeovers.⁶

The reasons behind a government’s decision to establish an SOE vary widely.⁷ In some instances, the motivation may be political and ideological. That is, nationalization may be used to ensure that the State maintains a significant presence and facilitates the distribution of societal wealth and power.⁸ In other instances, governments use SOEs to control strategic resources. Social and economic reasons also drive use of SOEs where, for instance, government bailouts of private firms are used to preserve jobs, prevent industrial unrest, or preserve a domestic industry.⁹ Governments sometimes establish SOEs to spur economic growth and development particularly in sectors where short-term costs of investment are

amended by Council Regulation (EC) 1310/97, 1997 O.J. (L 180) 1; corrigendum, 1998 O.J. (L 40) 17.

³ OECD, POLICY ROUNDTABLE, STATE OWNED ENTERPRISES AND THE PRINCIPLE OF COMPETITIVE NEUTRALITY, 26 (2009).

⁴ WORLD BANK, BUREAUCRATS IN BUSINESS: THE ECONOMICS AND POLITICS OF GOVERNMENT OWNERSHIP (1995). See also A. Capobianco and H. Christensen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options* (OECD Corporate Governance, Working Papers No. 1, 2011).

⁵ OECD POLICY ROUNDTABLE, *supra* at 27.

⁶ *Id.* 26–27.

⁷ OECD, STATE-OWNED ENTERPRISE GOVERNANCE: A STOCKTAKING OF GOVERNMENT RATIONALES FOR ENTERPRISE OWNERSHIP (2015).

⁸ See generally, THE RISE AND FALL OF STATE-OWNED ENTERPRISE IN THE WESTERN WORLD (P. Toninelli ed., Cambridge University Press 2000).

⁹ M. Boycko, A. Shleifer and R. Vishny, *A Theory of Privatization*, 106 ECON. J. 309 (1996).

significant. Finally, setting up a government entity may be preferred over attempting to regulate a natural monopoly or allowing a private firm to charge monopoly prices.¹⁰

SOEs have played a more modest role in the US than they have in most other countries, consistent with the US political belief in limited government intervention and a market-based economy. But while US federal, state, and local government involvement in commercial activities is limited, the federal government does own and operate some businesses, including Amtrak (which provides passenger rail service), the Tennessee Valley Authority (a public utility), and the US Postal Service, which handles physical mail delivery. There are also federal government-sponsored enterprises created by the US Congress, such as the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), whose purpose is to expand the secondary mortgage market by securitizing mortgages. State and local governments play a role in sectors such as transportation, energy (electricity production and distribution), education (community colleges and universities), hospitals, and distribution of alcohol.¹¹

Despite privatization programs in the 1980s and 1990s, SOEs have survived around the world. Indeed, the financial crisis of recent years drove countries to resort to industrial bail-outs to save entities on the brink of collapse, increasing state-ownership.¹² The US government, for instance, bailed out General Motors in 2009, which gave the US government a sixty percent stake in the company, which it reduced over time, selling its last shares in 2013.¹³

Studies estimate that worldwide SOEs account for eight to ten percent of GDP in industrialized countries and fifteen percent of GDP in countries with lower incomes.¹⁴ Percentages may be even higher in less developed countries, with an OECD study estimating that SOEs account for approximately ten to twenty percent of GDP and employment in India and a third in Russia and China.¹⁵

¹⁰ N. Kaldor, *Public or Private Enterprises: The Issues to be Considered in PUBLIC AND PRIVATE ENTERPRISES IN A MIXED ECONOMY* (W.J. Baumol ed., 1980).

¹¹ OCED POLICY ROUNDTABLE, at 225–230.

¹² N. Bellini, *The Decline of State-Owned Enterprise and the New Foundations of the State-Industry Relationship*, in *THE RISE AND FALL OF STATE-OWNED ENTERPRISE IN THE WESTERN WORLD*, (Toninelli eds., Cambridge University Press 2000); *BUREAUCRATS IN BUSINESS: THE ECONOMICS AND POLITICS OF GOVERNMENT OWNERSHIP* (World Bank 1995).

¹³ B. Vlasic and A. Lowrey, *US Ends Bailout of G.M., Selling Last Shares of Stock*, NEW YORK TIMES, 9 December 2013, available at http://dealbook.nytimes.com/2013/12/09/u-s-sells-remaining-stake-in-gm/?_r=0.

¹⁴ S. Kikeri and A. Kolo, *State Enterprises*, WORLD BANK NOTE 304, (2006).

¹⁵ OECD, *THE ROLE OF STATE-OWNED ENTERPRISES IN THE ECONOMY: AN INITIAL REVIEW OF THE EVIDENCE* (2008).

3. THE SPECIFIC CHARACTERISTICS OF CHINESE STATE-OWNED ENTERPRISES

3.1 HISTORICAL OVERVIEW, ORGANIZATION AND RESTRUCTURING OF CHINESE STATE-OWNED ENTERPRISES

SOEs have a long history in China. When, following a long period of war and underdevelopment, the People's Republic of China ("PRC") was established in 1949, the country had limited infrastructure, industrial capability, education, healthcare or social security. The Chinese government thus took on the task of re-building the nation through "state enterprises."¹⁶ Such companies were first entirely state-owned, and effectively operated as government units under the direct control of line ministries. They were required to meet output targets set by state planners and sell products at prices set by the government. These enterprises were the bedrock of the Chinese economy for many years, employing large swathes of society.¹⁷ In the late 1970s, China's system began to shift towards a socialist market economy. The central government engaged in a revamp of the SOE structure in 2003, giving managers autonomy to run businesses, reducing the level of governmental ownership and control, and essentially separating ownership from management.¹⁸ The first step was to set up investors to act on behalf of the Chinese government. It was with this aim that the State-Owned Assets Supervision and Administration Commission ("SASAC") of the Chinese State Council, and Central Huijin Ltd, were established. Ownership of many SOEs shifted from line ministries to these investors, and has remained in their hands since then. Industrial SOEs are indirectly owned by the government through SASAC, and financial institutions through Central Huijin. These entities were given substantial powers to oversee the activities of SOEs, but they are not involved in day-to-day business activities. There are also provincial, municipal and county level SASACs, which act in parallel to the central SASAC, overseeing local SOEs. A few SOEs do, however, remain under the direct control of national ministries, including the Ministry of Agriculture, Ministry of Education, Ministry of Finance, and the Ministry of Industry and Information Technology.¹⁹

Since 2005, the pace of Chinese SOE restructuring has sped up. That year, the PRC launched a pilot program to establish boards of directors, with external directors. In 2008, the government launched yet another pilot program which allowed the boards of directors of some SOEs to recruit and nominate top executives to run the company. These programs were subsequently expanded, and by early 2012, no less than forty-two central SOEs had boards of directors, with external directors making up more than fifty-two percent of the seats.²⁰

¹⁶ F. Gang and N. Hope, *The Role of State-Owned Enterprises in the Chinese Economy* 2, 5, in US-CHINA 2022: ECONOMIC RELATIONS IN THE NEXT 10 YEARS (2013).

¹⁷ *Id.* at 5.

¹⁸ *Id.*

¹⁹ *Id.* at 6.

²⁰ WORLD TRADE ORGANIZATION, TRADE POLICY REVIEW: REPORT BY CHINA 2012, 15 (2012). Note,

Chinese SOEs have also been listed on the Shanghai and Shenzhen stock markets in order to “realize diversification of investors.”²¹ Private investment in SOEs has been facilitated through an initial public offering (“IPO”) process, which operates in the following manner: the holding companies controlled by SASAC and Central Huijin carve out their most lucrative businesses to create a separately financially solid company that meets exchange listing requirements; thereafter, a percentage of the shares of the company are allocated for sale to the public, with the relevant holding company maintaining a controlling stake. As a consequence of the public listing, SOEs are required to disclose information relating to, *inter alia*, their finances and operations. This disclosure provides transparency to the SOE’s activities. While reliable data on the proportion of Chinese SOE assets that are publicly listed are scarce, reports indicate that, as of April 2015, there were 277 such entities listed on the Shanghai and Shenzhen stock exchanges.²²

Over time, and in response to external pressure, China has worked to decrease the overall number of SOEs and their impact on the Chinese economy.²³ The number of SOEs for which SASAC has continued to perform investor responsibilities is said to have declined to 106.²⁴ Still, SOEs continue to play a vital role in China, accounting for approximately twenty percent of China’s total economic output, according to IMF officials,²⁵ approximately seventeen percent of urban employment, twenty-two percent of industrial income and thirty-eight percent of China’s industrial assets, according to JPMorgan Chase.²⁶ Other estimations calculate that SOEs still make up nearly forty percent of China’s GDP.²⁷ Indeed, the ten most valued companies on the Shanghai Composite Index are all SOEs.²⁸ Moreover, of the Chinese companies on Fortune’s Global 500 list, the top twelve are all SOEs, and together account for approximately USD 4.6 trillion in revenue.²⁹

however, that “SASAC and the Central Organization Department (“COD”) of the Chinese Communist Party still appoint the majority of senior managers in central level SOEs.” Gang and Hope, *supra* at 6.

²¹ *Id.* at 14.

²² W. Leutert, *Challenges Ahead in China’s Reform of State-Owned Enterprises*, 21 ASIA POLICY 83, 96 note 30 (April 2016); *see also* Gang and Hope, *supra* at 6; WTO REPORT BY CHINA 2012 at 15; A. de Jonge, *China’s Grip Still Tight on State-Owned Enterprises*, THE CONVERSATION (17 September 2015).

²³ WORLD TRADE ORGANIZATION, TRADE POLICY REVIEW: REPORT BY CHINA 2016 13 (2016).

²⁴ *Id.* at 15.

²⁵ D. Lipton, *Rebalancing China: International Lessons in Corporate Debt*, China Economic Society Conference on Sustainable Development in China and the World (11 June 2016).

²⁶ E. Curran, *State Companies: Back on China’s To-Do List*, BLOOMBERG BUSINESS, 30 July 2015, available at <http://www.bloomberg.com/news/articles/2015-07-30/china-s-state-owned-companies-may-face-reform>.

²⁷ M. Lelyveld, *China Lags on SOE Reform Goal*, RADIO FREE ASIA, 10 December 2015, available at <http://www.statecraft.org.uk/research/dealing-chinese-investment-wave-overhauling-western-response-0>.

²⁸ S. Cendrowski, *Here’s What You May Not Know about the Chinese Stock Market*, FORTUNE, 2 September 2015, available at <http://fortune.com/2015/09/02/heres-what-you-may-not-know-about-the-chinese-stock-market/>; S. Cendrowski, *China’s Global 500 companies are bigger than ever—and mostly state owned*, FORTUNE, 22 July 2015, available at <http://fortune.com/2015/07/22/china-global-500-government-owned/>.

²⁹ P. Hubbard, *China’s Shifting Economic Realities and Implications for the United States*, Testimony before the US–China Economic and Security Review Commission, (24 February 2016).

3.2 GLOBAL ACTIVITY OF CHINESE STATE-OWNED ENTERPRISES

Cross-border investment into and out of China has increased dramatically over the last twenty-five years. The collapse of communism brought an influx of Western capital into China starting in the 1990s. China's ascension to the World Trade Organization ("WTO") in 2001 brought with it significant optimism regarding the future of Chinese-Western relations.³⁰ As a result, foreign firms have expanded in China and have partnered with Chinese enterprises, including SOEs.³¹ The Chinese government has encouraged outbound investment since at least 2002, when the Communist Party openly encouraged companies to "go global."³² Early investments focused on developing countries and emerging markets in regions such as Africa and primarily targeted land, energy and other natural resources.³³

In recent years, the Chinese government has reiterated its call to go global, and Chinese SOEs have responded by acquiring Western companies. The surge in such transactions has been attributed to a structural shift in the Chinese economy from an export-driven model to a consumption and service-oriented economy and an effort to upgrade the low-end manufacturing economy into a high value-added economy, raising the international competitiveness of Chinese products.³⁴ Others argue that after two decades of explosive growth, the Chinese market is slowing and Chinese companies are searching for growth opportunities abroad, with the financial support from the Chinese government.³⁵ In addition and as a result of the global financial crisis, Western assets dropped in value and could be purchased more cheaply. External investment also fits with strategic objectives to further develop the Chinese economy, which requires access to Western markets, supply chains, international brands, marketing know-how and high technology.³⁶

The wave of Chinese investments can be traced back to Lenovo's USD 1.25 billion acquisition of IBM's personal computer business in 2008, which was the earliest sizeable Chinese acquisition of a Western target.³⁷ Since then, the number of transactions and

³⁰ D. Shea, *Evaluating the Financial Risks of China*, Testimony before the US Senate Committee on Banking, Housing, and Urban Affairs, (14 July 2016).

³¹ J. Ma, *State-Owned Enterprises: Partners and Competitors*, CHINA BUSINESS REVIEW, 1 January 2012, available at <http://www.chinabusinessreview.com/state-owned-enterprises-partners-and-competitors/>.

³² A. Riley, *Dealing with the Chinese Investment Wave: Overhauling the Western Response*, THE INSTITUTE FOR STATECRAFT, 24 March 2016, available at <http://www.statecraft.org.uk/research/dealing-chinese-investment-wave-overhauling-western-response-0>.

³³ *Id.*

³⁴ Y. Fu-Tomlinson and A. Chou, *China's Buying Spree: Is it Real and Sustainable?*, LAW360, 25 August 2016, available at <http://www.law360.com/articles/832955/china-s-buying-spree-is-it-real-and-sustainable>.

³⁵ *China's Foreign Acquisitions Surge in 2016*, ASIA TIMES, 4 February 2016, available at <http://www.atimes.com/article/chinas-foreign-acquisitions-surge-in-2016/>; K. Chu and J. Steinberg, *Chinese Companies are Shopping Abroad at Record Pace*, WALL STREET JOURNAL, 3 February 2016, available at <http://www.wsj.com/articles/chinese-companies-shopping-abroad-at-record-pace-1454506310>.

³⁶ A. Riley, *supra* note 32.

³⁷ *Id.*

corresponding deal value has been increasing exponentially.³⁸ The focus of investment has also shifted from energy and commodities in developing countries to assets further up the value chain in developed countries. The involvement of Chinese SOEs in these acquisition activities has grown along with the overall increase in transactions. The following chart highlights recent large transactions.

FIGURE 1: RECENT TRANSACTIONS INVOLVING CHINESE STATE-OWNED ENTERPRISES AS ACQUIRERS

Acquiring Party	Acquired Party	Transaction Value	Year
China National Chemical Corp.	Syngenta AG	USD 43 billion	2016
China General Nuclear Power Corporation	Electricité de France S.A.	USD 9.3 billion Joint Venture	2016
China National Tire and Rubber Company	Pirelli & C. SpA	USD 7.7 billion	2015
China National Chemical Corp (consortium)	KraussMaffei Group	USD 1 billion	2015
Yanfeng Automotive Trim Systems Co., Ltd.	Johnson Controls, Inc.	USD 8.5 billion Joint Venture	2015
Bright Food Co. Ltd.	MIquel ALimentació	USD 123.52 million	2015
Dongfeng Motor Group Co.	Dongfeng Motor Group Co.	USD 1.1 billion	2014
Bright Food Co. Ltd.	Salov Group	Undisclosed	2014
Bright Food Co. Ltd.	Weetabix Food Co.	Undisclosed	2014
China National Offshore Oil Corporation	Nexen Inc.	USD 15.1 billion	2013
China National BlueStar	Elkem	USD 2 billion	2011
SinoChem Group	DSM N.V.	Joint Venture	2011
Sinopec Group	Addax Petroleum Corp AXC.TO	USD 7.24 billion	2009

Source: authors' own elaboration based on news reports

Chinese acquisitions are being met with mixed reactions around the globe from financial markets, foreign governments and legislators, target companies and even private individuals.³⁹ In spite of this, projections suggest that investments by Chinese SOEs will continue and grow as much as fifty percent annually in the coming years.⁴⁰

³⁸ See *China's Foreign Investments Surge in 2016*, *supra* note 35.

³⁹ E.g., P. Crowe, *China is Buying up American Companies Fast, and It's Freaking People Out*, BUSINESS INSIDER, 21 February 2016, available at <http://www.businessinsider.com/chinese-outbound-acquisitions-concerns-2016-2>; M. Schuman, *Wake Up America, the Chinese (Investors) Are Coming! But There's No Reason to be Afraid*, TIME, 16 January 2014, available at <http://business.time.com/2014/01/16/wake-up-america-the-chinese-investors-are-coming/>; M. Büge et al, *State-owned Enterprises in the Global Economy: Reason for Concern?*, VOX, 2 May 2013, available at <http://voxeu.org/article/state-owned-enterprises-global-economy-reason-concern>.

⁴⁰ K. Chu and J. Steinberg, *supra*.

4 THE APPLICATION OF US MERGER CONTROL TO TRANSACTIONS WITH CHINESE STATE-OWNED ENTERPRISES

In the United States, the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (“HSR Act”) requires parties to significant transactions to notify the US Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) before consummation.⁴¹ There are unique rules under the HSR Act applicable to transactions with SOEs of which Chinese SOEs and companies considering transactions with such SOE should be aware. They are summarized in this section of the paper.

The pre-merger notification and review process established under the HSR Act was created to avoid the difficulties and expense of the agencies challenging anticompetitive acquisitions after they have occurred, when it may be impossible to restore lost competition in the market.⁴² While both federal antitrust agencies in the US—the DOJ and FTC—share antitrust enforcement authority, only one will investigate any given transaction, since the agencies follow a “clearance” agreement to allocate reviews between them based on expertise in the product or service involved.⁴³

After filing a notification under the HSR Act, parties must wait a specified period of time, normally thirty days, while the antitrust agencies review the proposed transaction to determine whether it may “substantially lessen competition.” That waiting period may be terminated early, if the agencies conclude that a transaction does not present antitrust issues, or extended through a request for additional materials and information, known as a “Second Request.” Issuance of a Second Requests by the DOJ or FTC prevents consummation until after the parties provide requested documents and information, often delaying consummation for six months to a year.⁴⁴ Thereafter, unless the parties agree to address competitive concerns through divestiture or other form of relief, or abandon the proposed transaction, the reviewing agency must go to court and prove that the transaction is likely to lessen competition.⁴⁵

⁴¹ 15 U.S.C. § 18a.

⁴² FTC, HSR INTRODUCTORY GUIDE: WHAT IS THE PREMERGER NOTIFICATION PROGRAM? 1, (March 2009), available at <https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf>.

⁴³ J. Kay, *Clearance: The Back Story and Looking Forward*, ANTITRUST SOURCE (August 2012), available at http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/aug12_kay_7_31f.authcheckdam.pdf.

⁴⁴ P. Boberg and A. Dick, *Findings from the Second Request Compliance Burden Survey*, THE THRESHOLD (Summer 2014), available at <https://www.crai.com/sites/default/files/publications/Threshold-Summer-2014-Issue.pdf>.

⁴⁵ FTC, HSR INTRODUCTORY GUIDE: WHAT IS THE PREMERGER NOTIFICATION PROGRAM?, 13–14 (March 2009).

4.1 THE UNITED STATES PRE-MERGER NOTIFICATION PROGRAM—DETERMINING REPORTABILITY

The HSR Act applies to mergers, consolidations, tender offers, acquisitions of voting securities and non-corporate interests, acquisition of assets, exclusive licenses, and to the formation of joint ventures that meet jurisdictional thresholds. Whether or not a transaction must be reported depends on whether it meets three jurisdictional thresholds: (i) a so-called commerce test; (ii) a size-of-transaction test, and (iii) a size-of-person test.⁴⁶ The specific dollar figures associated with the thresholds are adjusted annually for changes in gross national product (“GNP”).

With regard to the first test, the US commerce requirement requires only that one of the parties to the proposed transaction, either “the acquiring person, or the person whose voting securities or assets are being acquired,” be “engaged in commerce or in any activity affecting commerce” in the US.⁴⁷ As a practical matter, given how broadly these terms have been defined, this test is rarely seriously in question.

The size-of-transaction test requires that a transaction be valued at more than USD 80.8 million currently, or USD 323 million if the size-of-person test is not met. The threshold is based on the value of the voting securities, non-corporate interests or assets that will be “held as a result of the acquisition” and the HSR rules sometimes require aggregation of transactions, complicating the analysis.⁴⁸

The size-of-person test requires that the parties to a transaction meet minimum annual sales and asset criteria.⁴⁹ The test, which is based not only on the size of the entity involved in the transaction but on the Ultimate Parent Entity (“UPE”) and any other entities the UPE controls,⁵⁰ is met if one party has at least USD 16.2 million in annual net sales or total assets and the other party has at least USD 161.5 million in annual net sales or total assets.⁵¹ These tests are based on global sales and assets of all entities within the same UPE, not just US sales or assets.

The HSR rules generally define control to mean: holding fifty percent or more of the outstanding voting securities; or having a contractual right to designate fifty percent or more of the board of directors of a corporation; or having the right to fifty percent or more of the profits or assets upon dissolution of a partnership, limited liability company or other

⁴⁶ See generally FTC, TO FILE OR NOT TO FILE: WHEN YOU MUST FILE A PREMERGER NOTIFICATION REPORT FORM (September 2008), available at <https://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide2.pdf>.

⁴⁷ 15 U.S.C. § 18a(1).

⁴⁸ See 15 C.F.R. §§ 801.10, 801.12, 801.13, 801.14, and 801.15.

⁴⁹ 16 C.F.R. § 801.11.

⁵⁰ *Id.* § 801.1(a)(1).

⁵¹ If the acquired party is not engaged in manufacturing, the acquired party must have USD 15.6 million in assets or USD 312.6 million in annual net sales.

non-corporate interests.⁵² Notably, the HSR Act and agency rules exempt certain transactions from filing, even if the jurisdictional thresholds are met.⁵³

4.2 THE NEED TO REPORT A TRANSACTION INVOLVING CHINESE STATE-OWNED ENTERPRISES

Determining whether a transaction with a Chinese SOE is reportable under HSR requires an understanding of specific HSR rules applicable to state-owned enterprises and to acquisitions of foreign assets and foreign issuers.

Most importantly, acquisitions between an SOE and another company incorporated in the same jurisdiction are exempt, out of deference to the foreign government. Thus, an acquisition is exempt, even if the size-of-person and size-of-transaction tests are met, if: “the ultimate parent entity of either the acquiring person or the acquired person is controlled by a foreign state, foreign government, or agency thereof”; and “the acquisition is of assets located within that foreign state or of voting securities or non-corporate interests of an entity organized under the laws of that state.”⁵⁴

The Statement of Basis and Purpose accompanying issuance of this rule explained that “[t]he transactions exempted by this rule are considered to be so directly involved with the acts of foreign states within their own borders as to merit exemption.” That is, “[s]ince the interests of a sovereign are generally paramount within its own borders, to require a State-controlled corporation to file notification with respect to these transactions might violate principles of international comity.”⁵⁵ Further, while the rule as drafted “would have exempted only acquisitions ‘solely’ of assets located within the foreign state or voting securities of a foreign issuer,” the final rule deleted the word “solely” so that the exemption applies “even if assets or voting securities located outside the foreign state in question, *e.g.*, in the United States, are also being acquired in a transaction.”⁵⁶ FTC staff have advised that the exemption may apply to transactions, even if the parties control subsidiaries in the US, regardless of the size of those subsidiaries and even if the transaction may combine competing commercial entities in the US.⁵⁷ As a result, a transaction between a Chinese SOE and another company, incorporated in China, will be exempt, even if both have subsidiaries in the US. That rule applies even if the business to be acquired is reorganized under Chinese

⁵² 16 C.F.R. § 801.1(b).

⁵³ See 15 U.S.C. § 7A(c), 15 U.S.C. § 18a(c) and 16 C.F.R. Part 802. Common exemptions include investments made “solely for the purpose of investment,” 15 U.S.C. § 18a(c)(9); 16 C.F.R. § 802.9; acquisitions of good or realty transferred in the “ordinary course of business,” 15 U.S.C. § 18(c)(1); 16 C.F.R. § 802.1; various property exemptions, 15 U.S.C. § 18a(c)(1), 16 C.F.R. § 802.3, 802.2; certain acquisition of voting securities or non-corporate interests, 16 C.F.R. § 802.4; stock options, warrants and convertible voting securities, 16 C.F.R. § 802.31; by security underwriters, 16 C.F.R. § 802.60; by institutional investors, 16 C.F.R. § 802.64.

⁵⁴ 16 C.F.R. § 802.52.

⁵⁵ 43 Fed. Reg. 33,450, 33,499 (31 July 1978).

⁵⁶ *Id.*

⁵⁷ See FTC Informal Interps. 1211002 (6 November 2012), 0502002 (3 February 2005); 0002011 (23 February 2000).

law just before being acquired, so long as there are legitimate reasons for such reorganization, and it is not a device aimed at avoiding an HSR filing.⁵⁸

The HSR rules also exempt the acquisition of assets located outside the US if annual sales in or into the US generated from those assets are USD 80.8 million (subject to changes in GNP) or less.⁵⁹ The rules also exempt the acquisition of voting securities of a foreign issuer unless the issuer holds assets in the US valued over USD 80.8 million or made annual sales in or into the US over USD 80.8 million in its most recent fiscal year.⁶⁰ Even if that test is not met, the rules exempt acquisitions of voting securities if: (i) both the acquiring and acquired person are foreign; (ii) the aggregate sales of the acquiring and acquired persons in or into the US were less than USD 177.7 million in their respective most recent fiscal years; (iii) the aggregate total assets of the acquiring and acquired persons located in the US are less than USD 177.7 million; and (iv) the transaction is not valued at more than USD 323 million.⁶¹ While these rules will not apply to the acquisition of a major US company by an SOE, they may apply to a joint venture, if structured so that the Chinese SOE acquires an entity incorporated in China or a US entity acquires a Chinese entity with a limited US presence.

Analyzing whether jurisdictional tests are met may require identifying the UPE of an SOE. While not obvious on the face of the HSR rules, the UPE of an SOE does not include the State. The HSR rules clarify that the term “entity” does not include “any foreign state, foreign government, or agency thereof (other than a corporation or unincorporated entity engaged in commerce).”⁶² Thus, the rules advise:

Corporations A and B are each directly controlled by the same foreign state. They are not included within the same “person”, although the corporations are under common control, because the foreign state which controls them is not an “entity”. . . . Corporations A and B are the ultimate parent entities within persons “A”, and “B” which include any entities each may control.⁶³

As a result, the UPE determination ends at the topmost entity that falls below a governmental body in the structure.

4.3 PREPARING THE HSR NOTIFICATION AND REPORT FORM

If a transaction has to be reported in the US, both the acquiring and acquired companies must file HSR Notification and Report Forms (the “HSR Form”) with the DOJ and FTC. This

⁵⁸ See 16 C.F.R. § 801.90 (“Any transaction(s) or other device(s) entered into or employed for the purpose of avoiding the obligation to comply with the requirements of the act shall be disregarded, and the obligation to comply shall be determined by applying the act and these rules to the substance of the transaction”).

⁵⁹ 16 C.F.R. § 802.50.

⁶⁰ *Id.* § 802.51. Interestingly, an acquisition by a US company of a foreign firm with no sales or assets in the US would be exempt under these HSR rules, while an acquisition of the US company by the foreign firm may require a filing, even though the substantive antitrust analysis of the two transactions should be the same.

⁶¹ *Id.*

⁶² *Id.* § 801.1(a)(2).

⁶³ *Id.* § 801.1(a)(1).

is in contrast to most jurisdictions where a single form is submitted by either the acquiring person or by the parties jointly. Preparing an HSR Form is generally less burdensome than compiling the information required for antitrust filings in Europe and other jurisdictions, but does still require substantial data and documents. Parties are required to disclose, among other things, information about their UPEs; a description of the transaction; detailed US revenue data; a list of controlled subsidiaries; the names, addresses and holdings of five percent or greater shareholders; geographic information if overlaps exist, and information regarding prior acquisitions. They are also required to provide a copy of transaction documents, financial statements and any non-compete agreements.⁶⁴ An officer or director must attest that the information provided is “true, correct and complete” subject to penalty of perjury.⁶⁵

In particular, it can be especially onerous to collect documents responsive to Items 4(c) and 4(d) of the HSR Form, which require: (i) confidential information memoranda or documents serving the same function such as management presentations relating to the acquired entities, (ii) documents prepared by or for officers or directors analyzing the transaction with respect to competition, competitors, markets, market shares, the potential for sales growth or expansion into product or geographic markets, or evaluating or analyzing synergies or efficiencies, and (iii) similar documents prepared by investment bankers, consultants or other advisors.⁶⁶

HSR filings and other information provided to the DOJ or FTC during an HSR investigation are exempt from disclosure under the US Freedom of Information Act and may not be made public “except as may be relevant to any administrative or judicial action or proceeding.”⁶⁷ If early termination of the HSR waiting period is requested and granted, then the grant of early termination is made public, though the content of the filings remain confidential.⁶⁸ The US antitrust agencies will seek waivers of these confidentiality rules from parties to transactions in order to share information with competition authorities in other countries when conducting in-depth investigations of transactions notified to other jurisdictions.⁶⁹

The obligation to file under the HSR Act is mandatory where the applicable thresholds are met and no exemption applies, and failure to do so can lead to significant fines. The maximum civil penalty for noncompliance is USD 40,654 per day for each day in violation.⁷⁰ Penalties can also be assessed for incomplete searches for documents required under Item 4

⁶⁴ 16 C.F.R. Part 803, Appendix; *see also* Checklist for Submitting an HSR Filing, *available at* <https://www.ftc.gov/enforcement/premerger-notification-program/hsr-resources/checklist-submitting-hsr-filing> (last visited 23 April 2017).

⁶⁵ 16 C.F.R. § 803.6.

⁶⁶ *Id.* Part 803, Appendix.

⁶⁷ 15 U.S.C. § 18a(h). The statute also authorizes disclosure to Congress. *Id.*

⁶⁸ *Id.* § 18a(b)(2).

⁶⁹ *See, e.g.,* DOJ/FTC, MODEL WAIVER OF CONFIDENTIALITY FOR USE IN CIVIL MATTERS INVOLVING NON-US COMPETITION AUTHORITIES: FREQUENTLY ASKED QUESTIONS, 13 March 2015, *available at* <https://www.justice.gov/atr/file/705866/download>.

⁷⁰ 15 U.S.C. § 18a(g)(1); 16 C.F.R. 1.98; 81 Fed. Reg. 42476 (30 June 2016).

of the HSR Form.⁷¹ False certification of the accuracy of an HSR filing can also result in criminal charges. Indeed, a few years ago, the DOJ criminally charged South Korean company Hyosung Corporation and one of its executives with obstruction of justice for altering documents before submitting them to the enforcer as part of an HSR filing.⁷²

4.4 CHINESE STATE-OWNED ENTERPRISES AND THE HSR REVIEW PROCESS

The information required by the HSR Form can give rise to hurdles unique to Chinese SOEs. SOEs, which are not used to operating in the US, may be reluctant to disclose the information required in HSR filings, let alone their internal strategy documents. Moreover, collecting the required information can be difficult, complicated by complex SOE structures and mixed governmental and private ownership. Transactions with competitors that may present substantive antitrust issues further complicate the process, as the enforcement agencies may request additional information informally during the initial HSR waiting period, regarding product overlaps and customers, requiring advance planning and speedy responses, to avoid a burdensome and costly Second Request. The challenges of collecting information increase exponentially if a transaction raises serious antitrust questions warranting a Second Request.

5 REVIEWS BY THE CFIUS AND ACQUISITIONS BY CHINESE STATE-OWNED ENTERPRISES

As mentioned in the introduction, acquisitions by Chinese SOEs of companies with operations in the US—whether based in the US or in other countries—may also face hurdles from the CFIUS, which reviews foreign investment transactions and advises the President on matters of national security arising from investments by foreign entities.

5.1 THE STATUTORY FRAMEWORK FOR CFIUS REVIEWS

The CFIUS is an inter-agency committee of the US government that reviews the national security implications of foreign investments in the US. It is led by the Department of the Treasury and is comprised of nine cabinet-level Executive Branch agencies and offices, and other non-voting offices with national security responsibilities.⁷³ Originally created by

⁷¹ See *United States v. Automatic Data Processing, Inc.*, Case No. 1:96C00606, (27 March 1996), available at <https://www.justice.gov/atr/case-document/complaint-civil-penalties-failure-file-documents-violation-premerger-reporting>.

⁷² Press Release, DOJ, Hyosung Corporation Executive Agrees to Plead Guilty to Obstruction of Justice for Submitting False Documents in an ATM Merger Investigation (3 May 2012), available at <https://www.justice.gov/opa/pr/hyosung-corporation-executive-agrees-plead-guilty-obstruction-justice-submitting-false>; Press Release, DOJ, Nautilus Hyosung Holdings Agrees to Plead Guilty to Obstruction of Justice for Submitting False Documents in a Merger Investigation (15 August 2011), available at <https://www.justice.gov/opa/pr/nautilus-hyosung-holdings-agrees-plead-guilty-obstruction-justice-submitting-false-documents>.

⁷³ In addition to the Department of Treasury, the eight other voting members include the Departments of

Executive Order in 1975, the CFIUS was tasked with monitoring the impact of foreign investment and to coordinate US policy on such investment.⁷⁴

The Exon-Florio Amendment (“Exon-Florio”), enacted in 1988 in response to the proposed acquisition of the Fairchild Semiconductor Corporation by Fujitsu Corporation, modified Section 721 of the Defense Production Act of 1950 to allow the review of foreign investments that may affect national security.⁷⁵ The law authorizes the President of the United States to “suspend or prohibit any covered transaction” if there is “credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security.”⁷⁶ President Ronald Reagan delegated the review process to the CFIUS.⁷⁷

The Foreign Investment and National Security Act of 2007 (“FISIA”) established the CFIUS by statute and required the President to conduct a national security investigation of certain proposed investments, while also providing a broader oversight role for Congress.⁷⁸ Today, the CFIUS has the authority to review “any merger, acquisition, or takeover. . . by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.”⁷⁹ The CFIUS does not, however, have jurisdiction to review start-up or greenfield investments whereby a company builds a new business in the US constructing new facilities (as opposed to acquiring an existing business).⁸⁰

Notifying the CFIUS of a proposed transaction is nominally voluntary though failing to file and receive the Committee’s approval can subject a transaction to significant risk where national security issues are involved as the CFIUS can investigate and modify or unwind a transaction on its own initiative. Once the CFIUS approves a transaction, it will not be subject to further review, unless the parties provided false, misleading or incomplete information or the parties breach obligations that the CFIUS required as a condition to clearing the deal.⁸¹

Commerce, Defense, Energy, Homeland Security, Justice and State, the US Trade Representative, and the White House Office of Science and Technology. There are two permanent non-voting members: the Director of National Intelligence and the Secretary of Labor. Others participate in reviews on a case-by-case basis or as observers. *See* Executive Order 13456, 73 Fed. Reg. 4677(23 January 2008).

⁷⁴ Executive Order 11858, 40 Fed. Reg. 20262 (7 May 1975).

⁷⁵ Omnibus Trade and Competitiveness Act of 1988, § 5021, Pub. L. No. 100-418 (1988), *codified as amended at* 50 U.S.C. App. § 2170; *see also* J. Jackson, Cong. Research Serv., *The Committee on Foreign Investment in the United States (CFIUS)* 3 (2016) (“CRS Report”).

⁷⁶ 50 U.S.C. App. § 2170(d).

⁷⁷ Executive Order 12661, 54 Fed. Reg. 779 (27 December 1988).

⁷⁸ Foreign Investment and National Security Act of 2007, § 2(a)(3), Pub. L. 110-49 (2007).

⁷⁹ 50 U.S.C. App. § 2170(a)(3).

⁸⁰ M.J. Burger, *et al*, *Revealed Competition for Greenfield Investments Between European Regions* (Tinbergen Institute Discussion Paper, TI 2012-063/3, 2012).

⁸¹ 31 C.F.R. §§ 800.601, 800.801.

5.2 THE CFIUS REVIEW PROCESS

A CFIUS review is initiated either by the voluntary submission of a Notice by the parties to a transaction, or by the Committee acting on its own initiative. Similar to the HSR Form, a CFIUS Notice requires the disclosure of detailed information regarding the parties and the transaction.⁸² The acquiring entity must disclose information such as: its organization and ownership structures; its business plans for the acquisition target's facilities, products, technology, and contracts; and personal identifier information including the names, addresses, dates of birth, nationalities, national identity and passport numbers for its board members, senior executives and beneficial owners. The target company is required to describe its business activities, facilities, competitors, products and services, and disclose detailed information about its contracts with US government customers, including whether it has a Facility Security Clearance or access to classified data, and whether it produces or trades in technology, software or goods listed on US export control lists. The Notice also requires information regarding the transaction, including the value of the interest in the US business to be acquired, a detailed description of the assets to be acquired, and copies of the transaction documents themselves.

Once the CFIUS deems that it has sufficient information from both parties to commence its review, the process moves forward according to a statutorily mandated timetable, beginning with an initial thirty-day review period. If the Committee believes further review is warranted, it may initiate a subsequent forty-five day investigation of the transaction. Notably, investigations of noticed transactions involving SOEs are mandatory. The Exon Florio statute was amended in 1992 to require the CFIUS to investigate proposed mergers and acquisitions where “the acquirer is acting on behalf of a foreign government” and which “could affect the national security of the United States.”⁸³ Congress went even further in 2007 in FINSA, to require investigations of all notified foreign government controlled transactions regardless of whether the initial CFIUS review revealed a national security concern.⁸⁴ Upon completion of its investigation, the CFIUS must provide a report to the President recommending a disposition of the transaction, *e.g.*, to suspend or prohibit it, and the President must issue a decision within fifteen days of receiving the Committee's report.⁸⁵ While the law thus contemplates a total review period of ninety days, in practice, CFIUS reviews often take longer. For example, it is not uncommon for parties to informally negotiate the contents of the Notice before the Committee accepts it for review. Moreover, the CFIUS can request that parties withdraw and refile their notice during the initial review or investigation stages in order to reset the regulatory clock.⁸⁶

The CFIUS may consider a broad range of factors when assessing the national security implications of a transaction. Transactions that have triggered scrutiny have ranged from the

⁸² *Id.* § 800.402.

⁸³ National Defense Authorization Act for Fiscal Year 1993, Pub. L. 102-484 § 837 (23 October 1992).

⁸⁴ Foreign Investment and National Security Act of 2007, § 2(b), Pub. L. No. 110-49 (2007); 50 U.S.C. App. § 2170(a)(4), (b)(1)(B).

⁸⁵ 50 U.S.C. App. §§ 2170(b)(1)(E), (b)(2)(C), and (d)(2).

⁸⁶ CRS Report, at 7–8.

obvious, such as the acquisition of a US business with federal defense contracts, to the seemingly benign, like investments in offshore windfarm projects. The CFIUS typically considers five issues, namely whether: the business has contracts with US government agencies with national security responsibilities; the business performs or has previously performed under any classified contracts; the business possesses critical technologies or products, including commodities, software, or technology controlled under export control laws; the transaction would result in foreign control over physical or virtual critical infrastructure; and the business has offices or facilities in locations near sensitive government facilities (such as military bases or national laboratories).⁸⁷ Depending on the nature and severity of perceived national security risks identified during its review, the CFIUS may allow a transaction to proceed with mitigation measures, including divestiture or forfeiture of sensitive assets, facilities or contracts, appointment of special compliance personnel, and/or appointment of proxy boards of US persons.⁸⁸

5.3 CFIUS REVIEW IN PRACTICE

According to annual reports filed by the CFIUS, there were 782 notices filed between 2008 and 2014.⁸⁹ Of those, approximately seven percent were withdrawn during the initial review, approximately thirty-four percent were subjected to an investigation, and approximately five percent were withdrawn during an investigation. Thus, about ninety percent of noticed transactions were eventually completed. More notices from Chinese investors were filed during 2012 to 2014, the most recent period for which data are available, than from any other country, accounting for sixty-eight, or nineteen percent, of 356 total filings.⁹⁰

Three transactions have been formally blocked or unwound by the President in connection with a CFIUS review. All have involved Chinese companies. In 1990, based on a CFIUS recommendation, President George H.W. Bush required a Chinese state-owned entity, the Chinese National Aero-Technology Import and Export Corporation, to divest MAMCO Manufacturing, Inc., a Seattle-based manufacturer of aircraft parts.⁹¹ In 2012, President Barack Obama ordered Chinese-owned Ralls Corp. to divest certain windfarm assets located near a defense installation.⁹² On 2 December 2016, President Obama issued an Executive Order blocking a proposed acquisition by Fujian Grand Chip Investment Fund, a Chinese fund, of the US operations of the German Aixtron SE, a chip equipment manufacturer.⁹³ It is notable that the US company was already owned by a foreign parent; nonetheless, its

⁸⁷ 50 U.S.C. App. § 2170(f).

⁸⁸ *Id.* § 2170(l).

⁸⁹ COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES, ANNUAL REPORT TO CONGRESS FOR CALENDAR YEAR 2014, (February 2016); COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES, ANNUAL REPORT TO CONGRESS FOR CALENDAR YEAR 2012, (December 2013).

⁹⁰ *Id.*

⁹¹ Order on the China National Aero-Technology Import and Export Corporation Divestiture of MAMCO Manufacturing, Incorporated, (1 February 1990).

⁹² Order Regarding the Acquisition of Four US Wind Farm Project Companies by Ralls Corporation (28 September 2012).

⁹³ Executive Order, 81 Fed. Reg. 88607 (2 December 2016).

acquisition by a Chinese company was blocked on the ground that the acquisition posed a national security risk. The order was limited to blocking the acquisition of the US subsidiary and not the German parent, but its effect was to kill the transaction.⁹⁴

There have been other instances—including several involving foreign investors from countries other than China—in which the CFIUS scuttled deals by informing the parties that they would make a negative recommendation to the President. In all the other cases, the action of the CFIUS was sufficient to cause the parties to abandon the proposed deal, without a Presidential determination. At least some acquisitions by Chinese companies have been withdrawn in the face of concerns, including the proposed acquisition of Global Communications Semiconductors by Xiamen San’an Optoelectronics Co., Ltd. in August 2016 and the proposed acquisition of Royal Philips NV’s LED business, Lumileds, by a Chinese consortium led by GO Scale Capital in January 2016.⁹⁵ Other companies have rejected bids from Chinese companies, citing concerns over CFIUS approval.⁹⁶

Even acquisitions by SOEs that have been cleared by the CFIUS have faced political opposition. In 2006, public and congressional concerns about the purchase of commercial port operations by Dubai Ports World, a state-owned company in the United Arab Emirates, led the company to sell off the US port operations to an American owner, despite the fact that the CFIUS determined that the transaction “could not affect the national security.”⁹⁷ Accordingly, Chinese SOEs must be prepared to file under the CFIUS process and disclose required information to the US authorities before acquiring businesses with US operations, and explain why proposed acquisitions do not affect national security.

5.4 THE POTENTIAL EXPANSION OF THE CFIUS

In recent years, there have been proposals to broaden the mission of the CFIUS by expanding the definition of national security to take into account economic considerations. For instance, in October 2012, the US House Permanent Select Committee on Intelligence issued a Report on the Counterintelligence and Security Threat Posed by Chinese Telecommunications Companies Doing Business in the United States, which recommended that CFIUS block acquisitions by Huawei and ZTE given the threat to US national security. The report recommended that Congress consider legislation to address the risk posed by telecommunications companies with nation-state ties to build critical infrastructure.⁹⁸

⁹⁴ *Id.*

⁹⁵ See *GCS Holdings Drops Sale, Announces Joint Venture*, TAIPEI TIMES (2 August 2016); *Philips Scraps Lumileds Sale on US Security Opposition*, BLOOMBERG (22 January 2016)

⁹⁶ For example, Fairchild Semiconductor rejected a bid from China Resources and Micron Technology rejected a bid from Tsinghua Holdings, citing CFIUS concerns. See *Fairchild Rejects Chinese Offer on US Regulatory Fears*, REUTERS (16 February 2016); *Micron Does Not Believe Deal with Tsinghua Is Possible*, REUTERS (21 July 2015).

⁹⁷ CRS Report, *supra* at 1, 6.

⁹⁸ US HOUSE OF REPRESENTATIVES, PERMANENT SELECT COMMITTEE ON INTELLIGENCE, INVESTIGATIVE REPORT ON THE US NATIONAL SECURITY ISSUES POSED BY CHINESE TELECOMMUNICATIONS COMPANIES HUAWAI AND ZTE, (8 October 2012).

More recently, a November 2016 report of the US–China Economic and Security Review Commission, established by Congress, recommended that Congress broaden the mandate of the CFIUS so it can bar SOEs from buying US assets, and even block greenfield investments. In 2012, the Commission recommended a mandatory review of all controlling transactions by Chinese state-owned and state-controlled companies investing in the United States and that a net economic benefit test be added to the CFIUS’ national security test.⁹⁹ Recent testimony has also argued that “it is difficult to properly classify SOEs and the distinction between private and state-owned companies for policy analysis based on nominal equity ownership is problematic.” It has been argued that “China’s state dominated financial system and the lack of rule of law means that state involvement can be pervasive, even if a firm is nominally privately owned.”¹⁰⁰

US lawmakers seem to have taken heed and have announced plans to introduce bills that will focus on, *inter alia*: adding an economic benefits or reciprocity requirement as part of the CFIUS’ review; creating a tier system that would give transactions involving companies from nations with defense treaties or that have an alliance with the US expedited reviews, while transactions with companies from nations viewed as hostile would receive more intense scrutiny; allowing CFIUS to block transactions that could allow the personal data or US citizens to fall into the hands of the acquirer’s government; expanding the CFIUS review to include joint ventures with US companies and greenfield investments; changing the agency which chairs the CFIUS from the Department of the Treasury to the Department of Commerce; and expanding the CFIUS to include additional agencies such as the Department of Agriculture and Health and Human Services.¹⁰¹

6. REVIEW OF TRANSACTIONS INVOLVING CHINESE STATE-OWNED ENTERPRISES IN THE EUROPEAN UNION

6.1 THE EU MERGER CONTROL REGIME

Merger review in the European Union (“EU”), which may take place at the EU, Member State level, or potentially both, can also significantly delay, and sometimes even prevent, the consummation of transactions with Chinese SOEs. Recent EU decisions may lead to the notification of transactions that parties would not have had to notify in the past.

The EUMR¹⁰² prohibits mergers and acquisitions in the EU¹⁰³ which may “significantly impede effective competition in the [internal] market or in a substantial part thereof,”

⁹⁹ 2016 REPORT TO CONGRESS OF THE US CHINA ECONOMIC AND SECURITY REVIEW COMMISSION (November 2016); 2012 REPORT TO CONGRESS OF THE US CHINA ECONOMIC AND SECURITY REVIEW COMMISSION (November 2012).

¹⁰⁰ T. Hanemann, *Chinese Direct Investment in the United States: Recent Trends and Policy Implications*, Testimony before the US–China Economic and Security Review Committee (26 January 2017), at 3.

¹⁰¹ C. Eichelberger, J. Sisco, and M. Tracy, *Congress Working on CFIUS Bills that Could Redefine National Security Reviews for Foreign Acquirers*, MLEX (1 March 2017).

¹⁰² EUMR, *supra*.

particularly as a result of “the creation or strengthening of a dominant position.”¹⁰⁴ The EUMR creates a mechanism for the review of mergers and acquisitions meeting specified thresholds at the European level by the Directorate General for Competition of the European Commission (“DG Comp” or the “Commission”) in Brussels. Transactions which fall below the EUMR thresholds may be reviewed by national competition authorities (“NCAs”), applying national merger control laws.¹⁰⁵ Transactions may also be subject to non-competition reviews at the national level, although transactions that are cleared by the Commission under the EUMR on competition grounds can be prohibited under national rules only in specific public interest situations, such as national security.

The EUMR applies to concentrations that have an EU dimension. The term concentration is defined to include a “merger of two or more previously independent undertakings or parts of undertakings” or the “acquisition . . . of direct or indirect control of the whole or parts of one or more other undertakings.”¹⁰⁶ The EUMR also applies to the creation and change of control of a so-called full-function joint venture, which is an autonomous economic entity which, once created, results in a permanent structural marketplace change, regardless of any resulting coordination of the parents. Non full-function ventures, such as strategic alliances and cooperative joint ventures including production joint ventures, are not subject to the EUMR.¹⁰⁷

The EU dimension requirement limits review to large acquisitions, mergers and joint ventures, based on jurisdictional turnover thresholds. A concentration is caught by the EUMR where: the aggregate worldwide turnover of all of the parties exceeds EUR 5 billion and the EU-wide turnover of each of at least two parties exceeds EUR 250 million, unless each party achieves more than two-thirds of its EU turnover in the same Member State; or the aggregate worldwide turnover of all of the parties exceeds EUR 2.5 billion, the EU-wide turnover of each of at least two parties exceeds EUR 100 million, the aggregate turnover of all the parties exceeds EUR 100 million in each of at least three Member States, and the turnover of at least two parties exceeds EUR 25 million in each of at least three of those Member States, unless each of the parties achieves more than two-thirds of its EU-wide turnover in the same

¹⁰³ The EU merger control regime applies in all twenty-eight Member States of the EU: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the UK. By virtue of the Agreement on the European Economic Area (“EEA”), EU merger control also extends to transactions affecting competition in the three members of the European Free Trade Association (“EFTA”), Iceland, Liechtenstein and Norway.

¹⁰⁴ Article 2(2) and (3) EUMR.

¹⁰⁵ Article 4(4) and 4(5) EUMR provide for a system of “referrals,” under which reviews are to be conducted by the authority best placed to conduct the assessment. Parties can request a referral of all or part of a transaction to the Commission or an NCA. NCAs may also request referrals under Article 9 of the EUMR (referral from the Commission to an NCA) or Article 22 (referral of a transaction to the Commission).

¹⁰⁶ The concept of control is defined broadly and rests on the appropriate analysis of rights, contracts or any other mechanisms that separately or together facilitates the possibility of exercising decisive influence over an undertaking. *See* the Commission’s 2007 Consolidated Jurisdictional Notice (2008 O.J. C95/1, 16.4.2008) (“CJN”). Joint control occurs when two or more undertakings both acquire the ability to exercise decisive influence over another undertaking.

¹⁰⁷ Council Regulation (EC) No. 139/2004 at ¶ 20.

Member State.¹⁰⁸ In order to determine whether the EUMR's turnover thresholds are met, it is the aggregate turnover of the undertakings concerned in the transaction that should be considered, together with the turnover of all undertakings that are in the same corporate group under common control.¹⁰⁹ EU law defines an undertaking as an entity that is "engaged in an economic activity, regard-less of the legal status of the entity and the way in which is financed."¹¹⁰

6.2 ANALYSIS OF STATE-OWNED ENTERPRISES IN THE EU

Identifying the undertakings whose turnover must be aggregated presents unique challenges when one of the parties is an SOE, given that control over the affairs of SOEs may ultimately flow from the state. The EUMR provides some guidance on this point, advising that, "In the public sector . . . calculation of the turnover of an undertaking concerned . . . needs . . . to take account of undertakings making up an economic unit with an independent power of decision," "irrespective of the way in which their capital is held or of the rules of administrative supervision applicable to them."¹¹¹

The Commission has advised that the turnover of SOEs need not be aggregated if they are "not subject to any coordination with other State-controlled holdings." However, turnover of SOEs must be aggregated if they fall "under the same independent centre of commercial decision-making."¹¹² In analyzing SOEs generally, the EU has considered both "the possible power of the State to influence the companies' commercial strategy" and the "likelihood for the State to actually coordinate their commercial conduct, either by imposing or facilitating such coordination."¹¹³ The Commission has taken into account factors such as the "degree of interlocking directorships" and the existence of "adequate safeguards ensuring that commercially sensitive information is not shared."¹¹⁴

With regard to Chinese SOEs in particular, some issues deserve particular attention. The extent of operational autonomy or control is relevant both to establishing jurisdiction and to assessing the competitive impact of a transaction insofar as the substantive assessment requires consideration of the total market power that will be held by a single economic unit as a result of a transaction. For several years, the EU left open the question of whether Chinese SOEs formed an economic unit by virtue of their common supervision by China's Central SASAC before recently resolving the issue. In several cases, the Commission

¹⁰⁸ Article 1(2) EUMR.

¹⁰⁹ Article 5(4) EUMR.

¹¹⁰ Case C-41/90, *Höfner and Elser v. Macrotron GmbH*, 1991 E.C.R. I-1979, para. 21.

¹¹¹ Recital 22 EUMR. *See also* Article 345 of the Treaty on the Functioning of the European Union (TFEU), prohibiting discrimination between the public and private sectors.

¹¹² CJN, para. 194.

¹¹³ Case COMP/M.6082, *China National Bluestar/Elkem*, at 10–12 (31 March 2011). *See, e.g.*, Case COMP/M.5549, *EDF/Segebel*, at 89–99 (12 November 2009); Case COMP/M.5508, *Soffin/Hypo Real Estate*, at 6–25 (14 May 2009); Case COMP/M.5861, *Republic of Austria/Hypo Group Alpe Adria*, (4 August 2010); Case COMP/M.931, *Nestle/IVO*, at 8 (2 June 1998).

¹¹⁴ Case COMP/M.7643, *CNRC/Pirelli*, at 9 (1 July 2015).

determined that it had jurisdiction over the transaction without considering other SOEs' turnover and that there were not competitive concerns even on the worst case assumption that all SOEs were under common control. These conclusions effectively enabled the Commission to side-step a potentially sensitive question.

In 2011, for instance, in *China National Bluestar/Elkem*, which involved an acquisition by a subsidiary of China National Chemical Corporation ("ChemChina") of a Norwegian company, the parties argued that ChemChina had decision making power independent of SASAC, and that SASAC "essentially exercise[d] the basic ownership functions on behalf of the State as a non-managerial trustee," nominating top management and reviewing year-end results to ensure the company was operating within its permitted business license. The parties argued that SASAC "does not interfere with . . . strategic decision making," "has not requested commercial information" and has not "influenced the commercial operations of the company."¹¹⁵ The Commission concluded it was not necessary to determine whether ChemChina was independent from Central SASAC, since "the proposed transaction would not lead to any competitive concerns even if all other SOEs in the markets concerned under Central SASAC were to be regarded as one economic entity".¹¹⁶ The parties also argued that Central SASAC had "no operational control over local SASACs or undertakings under local SASACs' control." The Commission decision in fact noted that there was "no indication that regional SASACCs and the SOEs under their supervision would form one economic entity with Central SASAC and affiliated companies." In clearing the transaction, however, the Commission still relied on finding that even including Chinese SOEs reporting to Regional SASACs in its analysis, the transaction would not raise any competition concerns.¹¹⁷

The Commission also left the issue open in *DSM/Sinochem/JV* in 2011, reviewing a joint venture between the Sinochem Group, a Chinese SOE, and a Dutch company. The Commission reasoned that "in the absence of representations by the Chinese State and accompanying evidence, it is not possible to conclude whether or not Sinochem enjoys an independent power of decision in the sense of the Merger Regulation." The Commission pointed to legislation "suggesting that SASAC does in practice have certain powers to involve itself in Sinochem's commercial behavior in a strategic manner" despite the parties' argument that Sinochem was an economic unit with independent power of decision from the Chinese state. The Commission concluded, however, that the transaction would not lead to any competition concerns, whether Sinochem was deemed to constitute an economic unit or its market position was taken together with other Chinese SOEs.¹¹⁸ In later decisions, the Commission similarly left the issue open by looking at "a worst case scenario in which all Chinese SOEs (including those under regional SASACs) [were] regarded as acting as one undertaking," since the transaction did not raise concerns "even if all the Chinese SOEs in the sector are part of a single economic unit."¹¹⁹

¹¹⁵ Case COMP/M.6082, *China National Bluestar/Elkem*, at 15–21 (31 March 2011).

¹¹⁶ *Id.* at para. 22.

¹¹⁷ *Id.* at paras. 15, 23–34.

¹¹⁸ Case COMP/M.6113, *DSM/Sinochem/JV*, at 13–16, 24–26 (19 May 2011).

¹¹⁹ Case COMP/M.6141, *China National Agrochemical Corporation/Koor Industries/Makhteshim Agan*

The Commission discussed the independence issue at greater length in *CNRC/Pirelli* in 2015, examining both horizontal overlaps and upstream and downstream vertical links, but still concluded that even if all SOEs were taken into account, the transaction was unlikely to give rise to input or customer foreclosure effects.¹²⁰ In March 2016, in *EDF/CGN*, however, the Commission concluded that Central SASAC “can interfere with strategic investment decisions and can impose or facilitate coordination between SOEs,” at least in the energy industry, and thus that Chinese SOEs in that industry should not be deemed to have an independent power of decision from Central SASAC. Therefore, the Commission aggregated the turnover of all companies controlled by Central SASAC active in the energy industry to find it had jurisdiction.¹²¹ Despite the very broad wording of the general principle of separation of the government and SOEs and non-intervention in business operations, the Commission pointed to specific provisions in PRC law authorizing the appointment and removal of senior managers and the assessment of managers, requiring SOEs to submit investment plans, and providing that Central SASAC shall supervise investment activities.¹²² As a result, it found that the SOE at issue did not “enjoy autonomy from the State in deciding major matters like strategy, business plan or budget.”¹²³ The Commission concluded that Central SASAC “participates in major decision making” and “can interfere with strategic investment decisions” of SOEs.¹²⁴ The Commission specifically relied on the fact that the energy sector is an “important industry that has bearings on the national economic lifeline and state security” in China, and noted that Central SASAC has the “power to influence coordination between companies active in the energy industry and in the nuclear power industry in particular”.¹²⁵ As a result, it is not clear that the decision extends to all Chinese SOEs.¹²⁶

If the *EDF/CGN* decision applies to sectors other than the energy industry, and all SOEs governed by central SASAC are considered a single economic entity, then the sales of all such SOEs would have to be aggregated in determining if EU jurisdictional thresholds are

Industries, at 5–7 (3 October 2011). See also Case COMP/M.6151, *Petrochina/Ineos/JV*, at 31 (13 May 2011); Case COMP/M.6807, *Mercuria Energy Asset Management/Sinomart KTS Development/Vesta Terminals*, at 33 (7 March 2013); Case COMP/M.7911, *CNCE/KM Group*, at 6–11 (15 March 2016).

¹²⁰ Case COMP/M.7643, *CNRC/Pirelli*, at 8–18.

¹²¹ Case COMP/M.7850, *EDF/CGN/NNB Group of Companies*, at 49 (10 March 2016).

¹²² *Id.* at paras. 37–40 (citing Law of the People’s Republic of China on the State-Owned Assets of Enterprises, Articles 4, 6, 22, 27 (2008); Interim Measure for the Supervision and Administration of the Investments by Central Enterprises, Articles 4, 8, 10 (May 2003)).

¹²³ *Id.* at para. 37.

¹²⁴ *Id.* at para. 42.

¹²⁵ *Id.* at paras. 43–48 (noting the China Nuclear Industry Alliance was directed by the Chinese government to “achieve some synergy” and to “eliminate detrimental or unseemly competition in export markets” and pointing to documents suggesting SASAC has oversight over investment and procurement strategies of SOEs in the energy sector).

¹²⁶ Interestingly, the EU aggregated revenues of ChemChina, which operated refineries that process crude oil but has no presence in the nuclear industry. *Id.* at para. 51, note 41. In its competitive assessment, the Commission left open the question what companies needed to be included, noting the transaction would not lead to competition concerns in any event. *Id.* at para. 53, note 43.

met. This may potentially require notification of transactions by SOEs that have no current sales in the EU themselves, by taking account of the revenues of other SOEs that do.

6.3 EU MERGER NOTIFICATION PROCEDURE

There is no deadline for filing under the EUMR. Rather, concentrations must be notified and cleared before they are implemented, and parties are subject to a fine of up to ten percent of their aggregate worldwide turnover if they intentionally or negligently fail to do so. Notification is done by the purchaser in an acquisition of sole control, or by both parties jointly in the case of an acquisition of joint control. The notification, made on a Form CO, requires information regarding the transaction and the undertakings involved, including corporate details and structure, similar to US HSR filings. Commission notifications, however, also require detailed information regarding relevant markets, contact details for customers, competitors, trade associations and potentially suppliers, as well as a description of the effect of the merger on the affected markets, including information on competitors and customers, and possible efficiencies arising from the transaction. Supporting documents, including copies of transaction documents, audit reports and internal documents such as board presentations that assess or analyze the transaction with respect to market shares, competition and deal rationale, must also be submitted. Parties can opt to notify using an abbreviated Short Form CO for transactions that are unlikely to raise competitive concerns, but the Commission may require the submission of a full Form CO to examine competition issues in more detail. The Commission strongly encourages parties to hold pre-notification discussions with Commission staff. Sharing drafts of filings is a standard part of the EU merger review process, even in straightforward transactions, and can significantly extend the overall timeline.

By regulation, the Commission must reach a Phase I decision within twenty-five working days from the effective date of a notification, though that period may be increased to thirty-five working days if the Commission receives a referral request from a Member State or the parties submit remedies to resolve competition issues. The deadline can be suspended, if the parties do not supply the information requested by the Commission in the time specified. If the Commission confirms its jurisdiction to review a transaction, and does not refer it to the NCA of one or more Member States, at the end of the Phase I review, the Commission can either: clear the transaction; clear the transaction subject to commitments offered by the parties to address any concerns identified during the Phase I review; or launch an in-depth Phase II investigation because the transaction raises “serious doubts” as to its impact on competition. Phase II investigations generally must be completed within ninety working days from when they are triggered. This time period may be extended or suspended, however, so that in complex cases it is not uncommon for the entire review process to last well over eight months.

7. CONCLUSION

Chinese SOEs, and any companies wishing to merge with them, must keep in mind the US and EU regulatory frameworks for mergers and acquisitions. The procedures for reporting and clearing these transactions can be burdensome, lengthy and potentially subject to pitfalls. In the US, it requires navigation of both the requirements of the HSR Act and the CFIUS,

which may involve increasingly intense scrutiny and attention from US actors. In the EU, SOEs must be prepared to explain why they are independent of other SOEs, notwithstanding the *EDF/CGN* decision, and also why a proposed transaction does not raise competition concerns. Insofar as Chinese SOEs do not have access to other SOE information, it can present a difficult burden. Moreover, Chinese SOEs should not lose sight of the risk of intervention in a transaction by Member State governments, irrespective of whether the transaction is reviewable on competition grounds by the Commission or by NCAs. While it is beyond the scope of this article to consider individual EU Member States' national review procedures, the risk of such interventions appears to be increasing in the current political climate.¹²⁷

¹²⁷ See, for example, the recent decision by the German government to reverse its approval of the takeover by Chinese investment fund Fujian Grand Chip Investment Fund LP of German chip equipment maker Aixtron, available at <http://www.wsj.com/articles/german-withdraws-approval-of-chinese-takeover-of-aixtron-1477297215> (last visited 17 April 2017).