THE COSTS OF PERCEIVED HYPOCRISY: THE IMPACT OF U.S. TREATMENT OF FOREIGN ACQUISITIONS OF DOMESTIC ENTERPRISES

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ABSTRACT

The People’s Republic of China’s revised rules governing foreign acquisitions of domestic enterprises, promulgated in the fall of 2006, disappointed many observers who had hoped for a more open and transparent approach to Chinese foreign investment. On closer inspection, however, the United States’ own laws and policies restricting foreign acquisition of domestic enterprises influenced the Chinese rules’ protectionism. The costs of U.S. trade policy have extended beyond Chinese law. Both the U.S. and Chinese rules limiting foreign investment likely violate each country’s respective GATS commitments. These violations bring consequences beyond the borders of these two nations, undermining free trade in the global economy.

INTRODUCTION

“If American companies are allowed to buy out any Chinese company they like, but Chinese companies are prevented from doing the same in the U.S., that’s not fair.”

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In August of 2006, the People’s Republic of China (China) promulgated its long-awaited revised regulations governing foreign acquisitions of Chinese companies, the Provisions on Acquisition of Domestic Enterprises by Foreign Investors (Chinese M&A Rules). Despite hopes that the revised rules would provide clearer guidance than earlier acquisition regulations, the revised rules continue to lack precision. More controversially, the revised rules continue to give the Ministry of Commerce broad power to review and refuse acquisitions of China’s domestic companies by foreign entities on a case-by-case basis with few concrete judging criteria. The crux of the controversy is the vaguely worded Article Twelve, which allows the Ministry of Commerce to refuse and even undo acquisitions if they affect “economic security.”


3. Id. The Ministry of Commerce promulgated the regulations, and they became effective on September 8, 2006. Id.


5. See INV. DIV., ORG. FOR ECON. CO-OPERATION AND DEV., RECENT DEVELOPMENTS IN CHINA’S POLICIES TOWARDS CROSS-BORDER MERGERS AND ACQUISITIONS (M&A) 3 (2006) [hereinafter OECD REPORT] (“The lack of definition of terms . . . appears to render the new screening requirement less than wholly transparent.”); see also Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 10 (vesting examination and approval authority in the Ministry of Commerce).

6. See Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12 (stating that the Ministry of Commerce has the power to review mergers and to stop those mergers not submitted to it for review).
The United States is one of China’s biggest trading partners, and American investors and others reacted strongly to the Chinese M&A Rules. Many observers both in the United States and abroad saw the revised rules as a step back in China's progressive economic liberalization. The United States, however, may have actually contributed to the content of the new rules. Although the U.S. Congress did not pen the words of Article 12, U.S. policies resisting acquisitions of domestic American companies by foreign entities had a discernible impact on the content of the revised rules. After the United States prevented a Chinese company from acquiring a California corporation, China responded with revised rules that heightened Chinese protectionism.

Both the Chinese and U.S. acquisition rules may also run afoul of World Trade Organization (WTO) commitments. The United States has argued that its own acquisition rules are no more restrictive than necessary to maintain national security. Even if this argument is accepted, the perceived hypocrisy of the United States blocking politically unpopular acquisitions of U.S. entities by Chinese companies while simultaneously urging more openness in the global market undermines American influence and credibility. The costs of

9. See OECD REPORT, supra note 5, at 3 (noting that the revised rules amount to an “ex post restriction which can substantially impede the stability of cross-border merger or acquisition transactions”).
10. See infra Part I.B.
11. This Note also uses “acquisition” to mean both mergers and acquisitions under U.S. M&A Rules, because like the Chinese rules, see supra note 2, the U.S. rules apply to mergers and acquisitions equally, 50 U.S.C. app. § 2170(a) (2000) (“The President or the President’s designee may make an investigation to determine the effects on national security of mergers, acquisitions, and takeovers proposed or pending on or after the date of enactment of this section.”).
12. See Comm. on Foreign Inv. in the U.S. (CFIUS), U.S. Dep’t of the Treasury, Section 721 of the Defense of Production Act of 1950, http://www.treas.gov/offices/international-affairs/exon-florio/ (last visited Apr. 31, 2008) (“The intent of Exxon-Florio is not to discourage [foreign direct investment] generally, but to provide a mechanism to review and, if the President finds necessary, to restrict [foreign direct investment] that threatens the national security.”).
this perceived hypocrisy are not always clearly defined or restricted to national borders.

Part I of this Note examines the relationship between the U.S. and Chinese policies regarding acquisitions of domestic enterprises by foreign investors. It describes how U.S. policies have triggered heightened protectionism in China. Part II analyzes the legality of U.S. and Chinese acquisition rules in light of both countries’ commitments to the WTO’s General Agreement on Trade in Services (GATS). It concludes that both countries have violated their obligations under the GATS, and it argues that these violations carry potential costs to the United States, China, and the world economy. Given U.S. commitments to free trade in services through the GATS, the United States must consider the impact of the perception of its own seemingly anti–free trade policies on the rest of the world, both in terms of developing the policies of their trading partners and in terms of the economic costs of violating treaty obligations.

I. THE U.S. AND CHINESE RULES

This Part compares U.S. and Chinese policies governing acquisitions by foreign investors of domestic companies. Section A introduces the U.S. rules on acquisitions of domestic companies by foreign investors (U.S. M&A Rules). Section B focuses on the application and expansion of those rules in the context of a failed bid to buy the U.S. oil company Unocal by the Chinese domestic oil company CNOOC. Section C explores the Chinese reaction to the failed bid and the subsequent promulgation of the Chinese M&A Rules. Section D compares the two systems and their respective motivations.

A. The U.S. Rules

In 1975, in the midst of the cold war, President Ford issued an executive order that created the Committee on Foreign Investments in the United States (CFIUS)\textsuperscript{13} to review acquisitions of domestic companies by foreign entities “determined to threaten the national

security of the United States.”\textsuperscript{14} This concern about national security has dominated acquisition restriction discourse since the creation of CFIUS.\textsuperscript{15} In 1988, for example, Congress passed the Exon-Florio Amendment\textsuperscript{16} in response to growing fears of increased foreign ownership of domestic corporations.\textsuperscript{17} That amendment “empowered the president to block mergers and acquisitions of U.S. companies by foreign firms when such takeovers threatened national security and where that threat could not be addressed effectively through other laws and regulations.”\textsuperscript{18}

CFIUS does not review every foreign acquisition. It looks only at foreign acquisitions that the parties voluntarily submit for review,\textsuperscript{19} that the president determines could affect national security,\textsuperscript{20} or when the president makes a special request.\textsuperscript{21} When CFIUS does review an acquisition, it issues an opinion about whether a credible threat to

\begin{itemize}
  \item \textsuperscript{14} CFIUS, supra note 12. The members of CFIUS are the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, the Assistant to the President for Economic Policy, Secretaries of Treasury (Chair), State, Defense, Homeland Security and Commerce, the Attorney General, the Director of the Office of Management and Budget, the U.S. Trade Representative, and the Chairman of the Council of Economic Advisers.
  
  \item \textsuperscript{15} ALAN P. LARSON & DAVID M. MARCHICK, COUNCIL ON FOREIGN RELATIONS, COUNCIL SPECIAL REPORT No. 18, FOREIGN INVESTMENT AND NATIONAL SECURITY: GETTING THE BALANCE RIGHT 4 (2006).
  
  
  \item \textsuperscript{17} See 50 U.S.C. app. § 2170(a) (delegating broad power to the president to review covered transactions, which include those that “could result in foreign control of persons engaged in interstate commerce in the United States”); id. § 2170(f)(3) (listing “the control of domestic industries and commercial activity by foreign citizens” as a factor the President or President’s designee may take into account); Exec. Order No. 12,188, 3 C.F.R. 131 (1981), reprinted in 19 U.S.C. § 2171 app. at 480–82 (2000) (delegating responsibility under 50 U.S.C. app. § 2170 for trade negotiations, including those “concerning direct investment incentives and disincentives and bilateral investment issues concerning barriers to investment,” to the United States Trade Representative).
  
  \item \textsuperscript{18} LARSON & MARCHICK, supra note 15, at 4. Not every transaction with a foreign corporation requires CFIUS approval. Id. at 6. For example, “[i]n the last few years, CFIUS has reviewed between forty and sixty-five transactions out of the more than 1,000 foreign acquisitions of U.S. enterprises made annually.” Id.
  
  \item \textsuperscript{19} See 50 U.S.C. app. § 2170(a) (“[T]he President’s designee may make an investigation . . . .” (emphasis added)).
  
  \item \textsuperscript{20} Id. § 2170(b).
  
  \item \textsuperscript{21} Id. § 2170(d).
\end{itemize}
national security exists.\(^\text{22}\) Parties generally opt to file their acquisitions with CFIUS because if they do not, the president or CFIUS can undo the acquisition at any time, even years after the completion of the deal.\(^\text{23}\) Filing with CFIUS is supposed to provide assurance that a deal will not be rejected later.\(^\text{24}\) That assurance, however, is not absolute. In the last two years, Congress has blocked at least two major deals that CFIUS initially approved.\(^\text{25}\) It is reported that “53 percent of Americans believe foreign ownership of U.S. companies is ‘bad for

\(\text{22.} \) Id. § 2170(b)(3)(B). The Organization for International Development has summarized the process of the CFIUS review since the Exon-Florio Amendment:

Filing a notice with CFIUS of a foreign acquisition is voluntary and typically done at the initiative of the parties. However, parties are motivated to file by the fact that the law empowers CFIUS and the President to dissolve the acquisition at any time in the future, even after an acquisition has been completed, if a filing was not made.

After a transaction has been filed, CFIUS conducts an initial review, utilizing the full intelligence and national security infrastructure of the U.S. government, based on detailed information from the parties, which frequently receive questions and requests for clarification from CFIUS. The scope of these reviews focus on two key thresholds:

Test 1: Is there credible evidence that the foreign interest exercising control might take action that threatens national security?

Test 2: If yes, do laws other than Exon-Florio and the International Emergency Economic Powers Act provide adequate and appropriate authority for the President to protect national security?

If consensus exists that no credible threat to national security exists, or threat has been mitigated, CFIUS decides—within 30 days—not to open a further investigation.

If threats exist, or agencies are divided, CFIUS conducts an investigation for an additional 45 days, after which CFIUS is required to file a report with the President. The President will have 15 days to make a decision whether or not to block a transaction.

\(\text{23.} \) Org. for Int’l Inv., \textit{supra} note 14.

\(\text{24.} \) \textit{Cf.} \textit{JAMES K. JACKSON, CONG. RESEARCH SERV., THE EXON-FLORIO NATIONAL SECURITY TEST FOR FOREIGN INVESTMENT 4 (2006), available at http://www.fas.org/sgp/crs/natsec/RS22197.pdf} ("Despite the voluntary nature of the notification, firms largely notify voluntarily because the regulations stipulate that foreign acquisitions that are governed by the Exon-Florio review process that do not notify the Committee remain subject indefinitely to divestment or other appropriate actions by the President.").

\(\text{25.} \) \textit{House Panel Votes to Block Ports Deals, FOONEX.COM, Mar. 9, 2006, http://www. foxnews.com/story/0,2933,187147,00.html} (discussing the congressional decision to block the takeover of several U.S. ports by UAE company Dubai Ports World); \textit{US Lawmakers Meddle in CNOOC’s Unocal Bid, CHINA DAILY, July 6, 2005, http://www.chinadaily.com.cn/english/doc/2005-07/06/content_457677.htm} (discussing congressional interference in the proposed Unocal merger). Some commentators have speculated that the block of the CNOOC bid was in part because of “[a]nti-China sentiment in Congress” which had been “building for several years, stemming from security concerns, complaints of currency manipulation and intellectual property theft, and other unfair trade practices.” Ben White & Justin Blum, \textit{Chinese Consider Assurances to Unocal, WASH. POST, July 14, 2005, at D3}.\)
Not surprisingly, in both cases in which Congress intervened to block an acquisition of a U.S. enterprise by a foreign corporation, there was a great deal of popular support for the congressional action.\(^{27}\)

In part to prevent such ad hoc interventions, on July 27, 2007, President George W. Bush expanded the power of the CFIUS system by signing into law the Foreign Investment and National Security Act.\(^{28}\) This legislation broadens the range of deals that are subject to CFIUS review and mandates a “45-day probe for most cross-border deals.”\(^{29}\) Some observers have hailed this legislation for strengthening CFIUS by “provid[ing] greater security during this perilous time,”\(^{30}\) but others have expressed concern that the changes, especially the length of the mandatory investigation period, will place foreign investors and potential acquirers at a disadvantage relative to their American competitors.\(^{31}\)

B. CNOOC and Unocal

Prior to the signing of the Foreign Investment and National Security Act into law, the U.S. Congress intervened to prevent Chinese oil giant China National Offshore Oil Company (CNOOC) from acquiring the California-based energy company Unocal.\(^{32}\) This intervention was widely accepted as necessary and important in the United States\(^{33}\) but was strongly criticized in China.\(^{34}\) In 2005,
CNOOC commenced “Operation Treasure Ship” and entered its bid for Unocal at $67 per share.\textsuperscript{35} CNOOC rival Chevron was also interested in Unocal and offered Unocal $60 per share.\textsuperscript{36} As the deal between Unocal and CNOOC progressed, it was met by increased political opposition.\textsuperscript{37} Members of the U.S. Congress went on record stating that “Cnooc’s proposal should be rejected on security grounds.”\textsuperscript{38} They reasoned that “China’s purchase of Unocal would dramatically increase its leverage over [critical players and key U.S. allies in the global war on terror] and therefore its leverage over U.S. interests in those regions.”\textsuperscript{39} On June 30, 2005, the House of Representatives voted 398 to 15 in favor of a nonbinding resolution that condemned the takeover as a threat to national security.\textsuperscript{40} On August 1 of the same year, Unocal’s board of directors recommended that shareholders take the Chevron offer because the CNOOC bid price did not sufficiently “compensate Unocal shareholders for the ‘higher risk of the CNOOC transaction.’”\textsuperscript{41} On August 2, CNOOC announced the withdrawal of its takeover offer for Unocal. The SEC subsequently approved Chevron’s acquisition of Unocal.

The failed deal provoked outrage among China’s economic and political elite.\textsuperscript{42} China responded on behalf of its embattled company by accusing the U.S. government of “politicizing economic and trade issues” and “interfering in the normal commercial exchanges between enterprises of the two countries.”\textsuperscript{43} The cost to Unocal shareholders of the accepted lower Chevron offer was more than 1.5 billion dollars.\textsuperscript{44} The loss caused by the intervention, however, may not have


\textsuperscript{36} \textit{US Lawmakers Meddle in CNOOC’s Unocal Bid}, supra note 25.

\textsuperscript{37} \textit{See} White & Blum, \textit{supra} note 25 (discussing how “[o]pposition to the Chinese firm’s bid intensified in Washington” as CNOOC considered adding additional assurances to its unsolicited takeover bid).

\textsuperscript{38} \textit{Id.}

\textsuperscript{39} \textit{Id.}

\textsuperscript{40} H.R. Res. 344, 109th Cong. (2005).


\textsuperscript{42} \textit{See, e.g., US Lawmakers Meddle in CNOOC’s Unocal Bid, supra} note 25 (“China angrily responded to a vote by US lawmakers last week that urged the US administration to block CNOOC’s 18.5-billion-dollar takeover bid for Unocal.”).

\textsuperscript{43} \textit{Id.} (quoting a Chinese foreign ministry statement).

\textsuperscript{44} \textit{CNOOC Withdrawal Clears Way for Chevron Merger, supra} note 41.
been limited to this specific transaction.\textsuperscript{45} China appears to have learned much from Congress’s reactions to CNOOC’s bid for Unocal. The revised Chinese M&A Rules, promulgated almost exactly one year after the withdrawal of CNOOC’s offer, contain similarly protectionist language.\textsuperscript{46} Although some may believe that intervening to halt the purchase of Unocal was necessary to maintain national security through domestic ownership of vital oil supplies, few probably considered that U.S. actions would prompt changes in Chinese legislation.

\textbf{C. The Chinese Rules}

In theory, the revised Chinese M&A Rules are intended to focus Chinese investments on quality rather than quantity.\textsuperscript{47} But the rules’ vague provisions giving the Ministry of Commerce sweeping authority to restrict foreign acquisitions\textsuperscript{48} disappointed many observers who had hoped that the revised rules would signal a change in China’s opaque practices of acquisition approval.\textsuperscript{49}

The history of acquisitions in China is relatively brief. Before 1983, Chinese law prohibited foreign investors from acquiring a stake

\textsuperscript{45} See Mekay, \textit{supra} note 27 (“[A] move by Congress to block the deal outright would send a message that US rhetoric about open investment rules ‘is a one-way street.’”). Even before the merger attempt fell apart, commentators suggested that this was a test for the U.S. free-trade rhetoric in Asia. \textit{Id.}

\textsuperscript{46} OECD \textit{Report}, \textit{supra} note 5, at 2 (“On 8 August 2006 the Ministry of Commerce . . . posted . . . a new set of \textit{Regulations on the Acquisition of Domestic Enterprises by Foreign Investors} . . . .”); CNOOC Withdrawal Clears Way for Chevron Merger, \textit{supra} note 41 (noting the withdraw of the Unocal bid in August of 2005); see also E-mail from Jonathan Ocko, Professor and Head, North Carolina State University Department of History, to author (May 1, 2008, 23:05:49 EST) (on file with the \textit{Duke Law Journal}) (“[I]n the fall of 2006, I had a conversation with a senior official in the National Development and Reform Commission who wouldn’t come right out and say that China had copied US statutes . . . . Instead he observed that American lawyers were always lecturing China on the need to learn from US legislation, and that China had simply followed this advice . . . .”).

\textsuperscript{47} OECD \textit{Report}, \textit{supra} note 5, at 2 (“The new policy towards cross-border mergers and acquisitions is explained in the 11th five-year plan for utilising foreign investment, published by the National Development and Reform Commission (NDRC) on 9 November 2006. This states that priority will be given to quality rather than quality of foreign investments . . . .”).

\textsuperscript{48} See discussion \textit{infra} Part I.C.

\textsuperscript{49} See generally OECD \textit{Report}, \textit{supra} note 5, at 1–2 (reviewing Chinese foreign investment policy in an effort to “contribut[e] to the OECD’s co-operation with China to develop more open, transparent and non-discriminatory investment policies in support of China’s development”).
in Chinese companies. From 1983 to 2003, the central government dealt with acquisitions of domestic companies by foreign entities on an ad hoc basis. In April of 2003, the Chinese government promulgated the Interim Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Interim Regulations). The Interim Regulations outlined a process for foreign corporations to acquire controlling stakes in domestic Chinese enterprises, but the regulations’ vague language provided little certainty for investors. The Interim Regulations were merely a starting place; China planned to enact more detailed regulations.

Since 1994, the Chinese government, motivated by a desire for international capital and an exponentially growing economy, has welcomed foreign investors with progressively open arms and given them more and more access to lucrative shares of Chinese companies. In 2005, however, the Chinese business community grew increasingly concerned that foreign enterprises were being given too many advantages in the emerging market and were thus gaining “capacity and market share in China, without adequate oversight by the central government.” The very public battle between the Chinese Sany Corporation (Sany) and American Carlyle Group (Carlyle Group) magnified this sentiment. Both companies wished to take over China’s largest construction machinery manufacturer, Shanghai-based Xugong Construction Machinery Group (XCMG). The Carlyle Group was the first to enter into an agreement with XCMG on the takeover. After having its own takeover bid

51. Id.
52. Waiguo touzi zhibing goujing nei qiye zhixing guiding [Interim Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors], supra note 4; Neumann & Zhang, supra note 4, at 21.
53. Waiguo touzi zhibing goujing nei qiye zhixing guiding [Interim Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors], supra note 4.
54. Id.
55. See Neumann & Zhang, supra note 4, at 21 (“[O]ver 250 Chinese enterprises worth more than US$14 billion have been acquired by foreign purchasers.”).
56. Id.
58. Id.
59. Id.
dismissed, however, Sany launched a popular opinion protest against the proposed Carlyle Group acquisition.\textsuperscript{60}

The president of Sany launched the media attack on his personal internet blog,\textsuperscript{61} criticizing the government for allowing foreign ownership of a vital part of the Chinese construction market.\textsuperscript{62} In the face of growing public discontent, the Ministry of Commerce suspended review of the acquisition, placing it in bureaucratic limbo for over a year until the Carlyle Group decided to scale back its initial investment from 85 percent to 50 percent.\textsuperscript{63} The Carlyle Group changed its majority ownership position to secure central government approval of the deal, something that had become less and less likely as time dragged on.\textsuperscript{64}

The same year the Carlyle Group’s takeover was thwarted, the Ministry of Commerce promulgated and adopted the revised Chinese M&A Rules.\textsuperscript{65} Although the revised rules consist of sixty-one provisions, as opposed to the twenty-six provisions in the interim rules, the additions to the revised rules primarily extend and clarify versions of the vague interim rules.\textsuperscript{66} There are some pronounced

\textsuperscript{60} See id. (“Sany aims to block the purchase of its bigger government-owned domestic rival, Xugong Group Construction Machinery, by America’s well-connected Carlyle Group.”).


\textsuperscript{64} See id. (discussing the sale of 49 percent of China’s largest machine tool manufacturer). Sany was still not satisfied; the president of the company called the deal “illegal” and alleged that the Carlyle Group had manipulated the system to result in a higher share of control than what the central government had agreed upon. Xiang Wenbo de Boke [Blog of Xiang Wenbo], supra note 60 (Aug. 5, 2006, 11:12).

\textsuperscript{65} See OECD REPORT, supra note 5, at 2 (“On 8 August 2006 the Ministry of Commerce . . . posted . . . a new set of Regulations on the Acquisition of Domestic Enterprises by Foreign Investors . . . ”); Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 61 (“These Regulations shall come into force as of September 8, 2006.”).

\textsuperscript{66} Compare Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2 (promulgating more detailed rules for the regulation of foreign investment), with Waiguo touzi zhibing goujing nei qiye zhixing guiding [Interim Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors], supra note 4 (presenting a basic outline for the regulation of foreign investment).
differences, however.\textsuperscript{67} Some of the revised rules are likely to smooth the way for foreign investors who would otherwise be unable to acquire ownership in Chinese companies.\textsuperscript{68} Other articles, however, have caused a great deal of concern among foreign investors.

One of the most controversial of the Chinese M&A Rules, and the focus of this Note, is Article Twelve. Article Twelve requires all acquisitions involving any “key industry,” “famous trademarks,”\textsuperscript{69} or “traditional Chinese brands,” or which impact or may impact “national economic security,” to be submitted to the Ministry of Commerce for approval.\textsuperscript{70} If it is determined that the acquisition causes or may cause a “significant impact” on “state economy security,” the Ministry of Commerce can stop the acquisition or force the return of assets.\textsuperscript{71}

The lack of a clear definition for terms like “impact” on “national economic security” makes the process less than transparent\textsuperscript{72} and gives wide discretion to officials charged with approving foreign acquisitions.\textsuperscript{73} Such broad discretion may make investing in China more difficult for foreign firms.\textsuperscript{74} In addition,

\textsuperscript{67} Several authors have speculated on the most important aspects of the changes. See, e.g., Fei Ya, \textit{CSRC Releases New M&A Rule}, \textit{China Daily}, Aug. 3, 2006, http://www.chinadaily.com.cn/bizchina/2006-08/03/content_656053.htm (“The new rule ... is expected to give more options to acquirers, reduce takeover costs and increase takeover efficiency.”); Client Alert, \textit{supra} note 8, at 1 (“The key changes introduced by the Acquisition Regulations relate to the reporting procedures to, and approval by, MOFCOM.”).

\textsuperscript{68} See \textit{Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors}, \textit{supra} note 2, arts. 27–29 (providing for acquisitions by foreign investors of domestic enterprises through the “payment of equity interests” in certain circumstances). Before these rules, this method of payment was not allowed. See \textit{Waiguo touzi zhibing goujing nei qiye zhixing guiding [Interim Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors]}, \textit{supra} note 4 (not providing for the use of equity interests as a form of payment in an acquisition).

\textsuperscript{69} OECD \textit{REPORT}, \textit{supra} note 5, at 3 (“‘Famous trademarks’ can be certified by a People’s Court and also by Chinese administrative agencies, including the Trademark Office of the State Administration for Industry and Commerce. Since People’s Court certifications are not listed publicly, it is difficult for foreign investors to see whether a trademark falls into the category of ‘famous trademarks.’ It is not usual for developed countries to restrict cross-border mergers or acquisition by reason of ‘famous’ trademark or ‘traditional’ brands.”).

\textsuperscript{70} \textit{Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors}, \textit{supra} note 2, art. 12.

\textsuperscript{71} \textit{Id.}

\textsuperscript{72} OECD \textit{REPORT}, \textit{supra} note 5, at 3.

\textsuperscript{73} \textit{See id.} (“Chinese government agencies charged with implementing the new regulations may not have enough information to be able to apply these terms to an actual transaction.”).

\textsuperscript{74} \textit{Id.}
Article Twelve’s general language implicates nearly every Chinese
domestic company. Officials could consider that even a small and
rather localized corporation might impact economic security in some
minor way.  

The Organization for Economic Cooperation and Development (OECD) expressed grave concerns over the “distinction [created by
the rules] . . . between domestic enterprises and foreign investors.”  
The OECD had hoped, and China had even reassured it, that the
discriminatory acquisition notification procedures would be replaced

75. It is also important to recognize that the Chinese system is still in transition between a
fully state owned and operated economy and a private market economy. See Corinna-Barbara
Francis, Quasi-Public, Quasi-Private Trends in Emerging Market Economies: The Case of China,
33 COMP. POL. 275, 275 (2001) (describing the “interdependence and mutual constitution of
state and market” in modern capitalist states). The distinctive nature of the Chinese economy
often makes it difficult to differentiate between what is private and what is government. See id.
(“While market transitions have contributed to the emergence of new, relatively autonomous
market and social forces, they intersect with the state in complex ways. . . . These features make
it difficult clearly to draw the boundaries of the state and to say where the state ends and
‘society’ and ‘the market’ begin.”). This impacts the way that the government analyzes domestic
takeovers in part because when government assets are to be sold to private entities, other
governmental bureaus must be involved. See Robert Lewis, Chinese SOEs: Playing the State
?Page=17&ISS=24509&SID=700971 (discussing the role of the State-owned Assets Supervision
and Administration Commission in the sale of State Owned Enterprises). Thus, Article Twelve
truly could extend to small, localized, partially government owned corporations.

76. OECD REPORT, supra note 5, at 4. The OECD wondered whether the new procedures
would differentiate between domestic organizations and foreign investors with respect to
monopoly law:

The OECD’s 2006 Review also noted that “the 2003 Interim Provisions contain
regulations on pre-merger notification that appear to discriminate against foreign
investors and others that are based on unquantifiable pre-merger notification
thresholds.” The Review welcomed the Chinese government’s intention to
promulgate a non-discriminatory anti-monopoly law and meanwhile recommended
changes to the merger notification procedures in the 2003 Interim Provisions to
increase their transparency. It was understood informally from the Chinese
authorities that they intended to replace the discriminatory merger notification
procedures in the 2003 Interim Provisions with a merger notification procedure in the
anti-monopoly law that did not distinguish between domestic enterprises and foreign
investors. This reassurance was needed in view of recent calls from some officials for
the new anti-monopoly law to block undesirable cross-border acquisitions, following
a report by the State Administration for Industry and Commerce (SAIC) in 2004 that
foreign companies were building monopolies in China (an allegation that MOFCOM
has since publicly refuted). The merger notification procedures in the 2006
Regulations do not reflect the OECD’s recommendations and are essentially the same
as those in the 2003 Interim Provisions. It remains to be seen whether these
procedures will be rescinded when the anti-monopoly law is promulgated and
whether there will be any distinction in the anti-monopoly law between domestic
enterprises and foreign investors.

Id.
with an acquisition notification procedure that “did not distinguish between domestic enterprises and foreign investors.”

Many foreign investors have experienced difficulties when “attempting to acquire majority stakes in Chinese companies, even in the absence of express legal restrictions on foreign equity participation.” Further, the vague wording of Article 12 has created a sense of “considerable uncertainty surrounding the likely success or completion of forthcoming transactions.” Corporations fear that the heightened scrutiny may result in costly delays.

The revised rules have slowed or halted a higher percentage of acquisitions of domestic companies by foreign investors. In 2006, China halted the approval process of 27 percent of proposed leveraged buyouts. The year before it only had refused to approve 6 percent. Despite an economy that grew over 10 percent in 2006, the volume of acquisitions of domestic corporations by foreign investors as well as the value of those acquisitions only increased by about 1 percent. As a whole the rules disappointed those who had hoped for a clearer roadmap to foreign ownership of domestic enterprises in China.

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77. Id.
78. Client Alert, supra note 8, at 1.
79. Id.
80. Id. at 3. For example, Baker & McKenzie, a law firm with wide experience in the Chinese market, explained concerns about the new rules in a recent client alert:
   In light of recent reports that a number of foreign investors have run into difficulties when attempting to acquire majority stakes in Chinese companies, even in the absence of express legal restrictions on foreign equity participation, these new provisions have sparked concerns among foreign investors that future acquisitions will be subject to much tighter control and further scrutiny by the Chinese government. Coupled with the lack of clarity on terms such as “key industry” and “national economic security,” there is considerable uncertainty surrounding the likely success or completion of forthcoming transactions. Furthermore, the need for obtaining government approval at the central level may also cause delay to deals.

82. Id.
83. Id.
86. See id. (describing insufficient financing levels for mergers). The Chinese management of the targeted corporation may also be negatively affected because if the foreign investor's equity stake is reduced, then there is less equity available for Chinese management of the targeted corporation. See David Patrick Eich & Chuan Li, Private Equity Investments In China:
The popular sentiment against the Carlyle Group takeover and the political reaction in the form of the revised rules was at least in part fanned by the United States’ block of the Unocal-CNOOC acquisition, which some perceived as hypocritical. In the words of Xiang Wenbo, Sany Corporation’s president, “[i]f the U.S., Europe, Korea and Japan are doing it, then China should do the same,” and “[i]f American companies are allowed to buy out any Chinese company they like, but Chinese companies are prevented from doing the same in the U.S., that’s not fair.”

Although Chinese resentment may be justified, and U.S. intervention in the Unocal-CNOOC acquisition may have been necessary, it is important to step back and look not just at the connection between these two actions but also at the separate and distinct reasoning behind each system. Part D explores the differences between the ways that the two countries deal with proposed takeovers of domestic enterprises by foreign entities and the reasoning behind their respective systems.

D. Differences

The differences between the U.S. and Chinese approaches to the approval of foreign takeovers of domestic enterprises begin with the differences between the two systems themselves. The United States is a well-established rule-of-law jurisdiction, where law is supposed to trump all other concerns. This may not always be the reality, but it is the norm. China, on the other hand, is in the midst of legal reform and is still debating whether rule by law or rule of law should be the

Impact of Recent Legal Reforms, VENTURE CAPITAL REV. (Nat’l Venture Capital Ass’n and Ernst & Young LLP, Arlington, VA), Winter 2007, at 7, 9, available at http://www.kirkland.com/siteFiles/kirkexp/publications/2261/Document1/Recent_Legal_Reforms.pdf (“Historically it was therefore common for foreign investors acquiring a Chinese company . . . to offer Chinese management an opportunity to own equity interests in the offshore holding company established to make the acquisition.”). The management is often working with the foreign acquiror and using the foreign equity to essentially create a management leveraged buyout of the target. Id.

87. See discussion supra Part I.B. 88. Tang & Benjamin, supra note 1, at 3.
89. See, e.g., U.S. Dep’t of State, Rule of Law, http://usinfo.state.gov/dhr/democracy/rule_of_law.html (“[I]n the United States, the rule of law is based primarily on the U.S. Constitution and on the assurance that U.S. laws—in conjunction with the Constitution—are fair and are applied equally to all members of society.”).
norm. In China, the law is not supreme and does not always provide certainty to civil and commercial parties in the face of other interests. This difference between the two systems is important because it affects the ways that the two countries view and implement their respective acquisition rules.

The facial differences between the two M&A regimes are as follows. First, the language of Article Twelve of the Chinese M&A Rules is much more demanding than that of the U.S. rules. Article Twelve states that parties “concerned in the acquisition by a foreign investor of a domestic enterprise . . . shall apply to [the Ministry of Commerce] for examination and approval.” In addition, there is no guarantee that if submitted and approved, Ministry of Commerce will not later undo the acquisition in the name of economic security. In the United States, parties are not required to submit their acquisitions for screening by CFIUS. If the parties do not ask for review, the U.S. rules allow the government to undo the acquisition, even years later. In practice, therefore, parties may feel as if they are required to submit their acquisitions for screening in the United States as well as in China. Unlike the Chinese system, however, those firms that do submit to CFIUS and are approved are guaranteed a large measure of security for their acquisition after it is completed.


91. See id. at 4–9 (describing China’s struggles with a lack of judicial independence, insufficient judicial authority, political corruption in the judicial system, and a dearth of and respect for the rule of law).


93. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12.

94. Id. Although the rule does provide that a merger or acquisition of a domestic enterprise by a foreign entity fitting the criteria listed in Article 12 that is not submitted it will be undone, there is no promise that the Ministry of Commerce will not later halt or undo approved transactions. Id.

95. LARSON & MARCHICK, supra note 15, at 4.

96. Id.

97. Id. Congress has, however, intervened in special circumstances, such as CNOOC’s proposed takeover of Unocal, even when the CFIUS has approved a merger. White & Blum, supra note 25.
Second, the Chinese rules do not have a clearly defined process for analyzing claims, but the U.S. rules do spell out such a process. Although outsiders have complained that the U.S. evaluation process is opaque and difficult to understand, the process includes clear timelines for every part of the process. In contrast, the Chinese rules involve fluid timelines that are not explained in detail. In addition, the U.S. rules include an appeals process, a remedy unavailable under the Chinese system.

The final and core difference is the breadth of the rules. Under the U.S. rules CFIUS only screens those transactions that affect national security, whereas the Chinese rules require the Ministry of Commerce to screen acquisitions of famous trademarks, traditional Chinese brands, and key industries in addition to acquisitions that may affect national economic security. Therefore, the U.S. rules focus on a narrower interest, national security, whereas the Chinese

98. See Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, § III (articulating a loose framework for analysis).
99. See supra note 76.
100. LARSON & MARCHICK, supra note 15, at 4.
101. See supra note 76.
103. See LARSON & MARCHICK, supra note 15, at 4 (“[The Exon-Florio Amendment] empowered the president to block mergers and acquisitions of U.S. companies by foreign firms when such takeovers threatened national security and where that threat could not be addressed effectively through other laws and regulations.”).
104. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12.
105. The U.S. rules state at their outset that the rules are not intended to be used to retaliate against foreign countries and that the rules are not a departure from the U.S. market’s openness to foreign capital. See CFIUS, supra note 12 (“[T]he Committee on Foreign Investment in the United States (‘CFIUS’) . . . seeks to serve U.S. investment policy through thorough reviews that protect national security while maintaining the credibility of our open investment policy and preserving the confidence of foreign investors here and of U.S. investors abroad that they will not be subject to retaliatory discrimination.”). This underscores the intended narrowness of the U.S. rules. See id. (explaining that the Exon-Florio Amendment was intended to operate in
rules focus on an arguably more material interest, economic security.\textsuperscript{107}

II. THE U.S. AND CHINESE RULES' VIOLATIONS OF THE GATS AND THE COST TO GLOBAL TRADE

As discussed in Part I, U.S. policies resisting foreign investment in domestic enterprises have already provoked China to similarly restrict foreign trade.\textsuperscript{108} The costs of U.S. and Chinese protectionism may extend beyond the borders of either nation. Because both the United States and China are members of the GATS,\textsuperscript{109} the U.S. and Chinese M&A Rules implicate international law. The rules also affect the central policy concern driving the GATS: promoting free trade in the global economy.

Section A evaluates the compatibility of both countries’ foreign investment policies with the GATS provisions. Despite the differences between the U.S. and Chinese M&A Rules, this Section concludes that both countries’ rules violate the GATS. Section B explores the costs associated with violating the GATS. It argues that the rules harm the credibility of two nations that claim a commitment to the principles of free trade and economic development—and the WTO’s efforts to encourage free trade in the global economy.

A. The Compatibility of the U.S. and Chinese M&A Rules with the GATS

The stated purpose of the GATS is to “establish a multilateral framework of principles and rules for trade in services . . . as a means

congruence with the United States' tradition of “welcom[ing] Foreign Direct Investment . . . and provid[ing] foreign investors fair, equitable and nondiscriminatory treatment with few limited exceptions designed to protect national security”).

\textsuperscript{107} The official understanding of the Chinese M&A Rules is that they are a policy planning tool. \textit{See Sustainable Investment and Not Speculation}, XINHUA, Sept. 18, 2006, http://news.xinhuanet.com/english/2006-09/18/content_5102935.htm (“The new laws are designed to help China maintain market order and balance national economic security and fair competition. The amendments ensure the protection of indigenous industries but also continue to encourage the investment enthusiasm of foreign companies.”). These comments show how broad the rules are really intended to be.

\textsuperscript{108} \textit{See supra} notes 87–88 and accompanying text.

of promoting the economic growth of all trading partners . . . . †10 In pursuit of these goals, the GATS clearly outlines the commitments of each signatory and the exceptions to those commitments, and it provides for dispute resolution in case of alleged violations.†11 The GATS defines “trade in services” as supply of a service through four modes of economic activity.†12

WTO members have two categories of obligations under the GATS, general obligations and specific obligations.†13 General obligations apply to all service sectors regardless of whether the country has made any specific commitments in those sectors.†14 Specific obligations, on the other hand, apply only to those service sectors in which a WTO member has made commitments.†15 The specific obligations include market access and national treatment.†16 Together market access and national treatment “commit Members to giving no less favourable treatment to foreign services and service suppliers than provided for in the relevant columns of their Schedule.”†17

The GATS includes some exceptions that effectively allow members to violate their GATS obligations in limited circumstances.†18 These exceptions include temporary restrictions on


†11. See id. (explaining the rights and obligations of members along with dispute resolution in detail); see also WTO, Legal Texts – A Summary of the Final Act of the Uruguay Round, http://www.wto.org/English/docs_e/legal_e/ursum_e.htm#mAgreement (last visited Apr. 31, 2008) (describing the obligations set out by the agreement).

†12. GATS, supra note 110, art. I.2. Those modes of economic activity are
(a) from the territory of one Member into the territory of any other Member;
(b) in the territory of one Member to the service consumer of any other Member;
(c) by a service supplier of one Member, through commercial presence in the territory of any other Member;
(d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.

†13. Id. pts. II, III (defining the general and specific obligations of Members).

†14. Id. arts. II–XV.

†15. Id. arts. XVI, XVII.


†18. GATS, supra note 110, arts. XII–XIV bis.
trade in services to safeguard balance of payments; measures to protect public morals or maintain public order; measures to protect human, animal or plant life or health; and measures to enforce compliance with laws or regulations not inconsistent with the whole agreement, including avoidance of fraud. The GATS also allows measures intended to protect military or essential security interests. These measures, however, must meet specific criteria laid out in the GATS so that nations do not misuse the exceptions to avoid treaty obligations.

In the event that a member nation chooses to violate the GATS, other member nations may challenge the action of the offending nation. At the request of the parties, the WTO Dispute Resolution Body (DRB) may establish an arbitration panel (panel) to examine the allegations. The panel considers the challenge and issues a report. Any party to the dispute then may seek further review of the arbitration decision by the DRB Appellate Body (Appellate Body) made up of judges from various member nations. The offending nation, if found in violation, is expected to immediately correct the violation. A failure to correct the violation within a reasonable time may result in limited trade sanctions against the violator on behalf of the offended country.

1. Compatibility of the Chinese M&A Rules with the GATS. In analyzing whether Article Twelve of the Chinese M&A Rules violates the GATS, this Note uses the approach followed by the

119. Id. arts. XII–XIV.
120. Id. art. XIV bis.
121. See id. art. XIV (setting out these measures).
123. GATS, supra note 122, arts. VI–VII.
124. WTO, supra note 122; see also GATS, supra note 122, art. XVII (describing the Appellate Body and its procedures).
126. WTO, supra note 122.
127. Id.
Appellate Body in *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services (U.S.-Gambling)*, which resolved a dispute between the United States and Antigua over U.S. measures affecting the cross-border supply of gambling and betting services. According to that standard, China has violated the GATS if (1) the GATS governs acquisitions of domestic companies by foreign-owned enterprises, (2) China has undertaken specific commitments as to acquisitions, (3) the revised Chinese M&A Rules have violated articles of the GATS, and (4) no defenses apply to the violations.

First, the GATS applies to investment of capital in domestic enterprises. Of the four modes of economic activity that the GATS governs, mode three is a commercial presence in the territory of another member country. A commercial presence includes “the constitution, acquisition or maintenance of a juridical person” in a member nation. Because a juridical person includes a commercial entity, acquisition of a company creates a commercial presence in the member country. Therefore, acquisitions meet the definition of mode three activity, commercial presence, and so the GATS applies to foreign acquisitions of Chinese enterprises.


131. Id. § VI(B).

132. Id. § VI(C).

133. Id. § VI(H).

134. GATS, supra note 110, art. I(2)(c).

135. Id. art. XXVIII(d)(i).

136. See GATS, supra note 110, art. XXVIII(l) (defining a “juridical person” as “any legal entity duly constituted or otherwise organized under applicable law, whether for profit or otherwise, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, joint venture, sole proprietorship or association”).

137. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 1.

138. GATS, supra note 110, art. XXVIII(d)(i).
Second, China has undertaken specific commitments under the GATS for mode three economic activity. The Chinese schedule of commitments adopts few restrictions for mode three activity, only limiting minimum investment percentages for foreign joint ventures, establishment of branches and representative offices, and land use and ownership. The schedule further stipulates: “The conditions of ownership, operation and scope of activities, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of the China’s accession to the WTO.”

There are no limitations on market access across all industries; the schedule lists further restrictions, where they exist, on an industry-specific basis. Although for some industries the schedule lists specific restrictions on investment or the creation of wholly foreign-owned enterprises or majority foreign ownership, most are scheduled for removal within two to five years of China’s accession to the WTO. China was accepted into the WTO in 2001. Therefore, many of the limitations listed under the original Chinese schedule

139. People’s Republic of China – Schedule of Specific Commitments, Nov. 10, 2001, WT/MIN(01)/3/Add.2 (“The proportion of foreign investment in an equity joint venture shall be no less than 25 per cent of the registered capital of the joint venture.”).
140. Id. The schedule states that

[the establishment of branches by foreign enterprises is unbound, unless otherwise indicated in specific sub-sectors, as the laws and regulations on branches of foreign enterprises are under formulation.]

... Representative offices of foreign enterprises are permitted to be established in China, but they shall not engage in any profit-making activities except for the representative offices under CPC 861, 862, 863, 865 in the sectoral specific commitments.

Id.

141. Id. (“The land in the People’s Republic of China is State-owned. Use of land by enterprises and individuals is subject to... maximum term limitations [specified in the schedule].”).
142. Id.
143. Id. Therefore, an initial inquiry would be whether the new Chinese M&A Rules are more restrictive than rules or customs in existence in 2001, when the China joined the WTO. See infra note 145 and accompanying text. This question may not be controlling, however, because there is nothing in the schedule of commitments that exempts China from following GATS rules that would require China to be less restrictive in its approach to foreign acquisitions of domestic enterprises than the 2001 rules. See infra note 145 and accompanying text.
144. See generally id. (showing that most of the exceptions expire within a two to five year period).
have expired.\textsuperscript{146} China has then made specific commitments under the GATS for some sectors, listing no limitations on market access or national treatment.

\textit{a. Violations.} Third, to have violated the GATS, China must have committed a specific violation of its commitments as defined by the articles of the trade treaty.\textsuperscript{147} Here, member nations to the GATS could challenge China’s regulations as a violation of the commitment to either market access or national treatment.

The market-access commitment requires that “[w]ith respect to market access through the [four] modes of supply, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.”\textsuperscript{148} To violate this market-access commitment, a member nation must first have undertaken a specific commitment to provide market access in the relevant area of service.\textsuperscript{149} China has accepted specific commitments as to some sectors without market-access limitations.\textsuperscript{150} When a member nation has assumed “a market-access commitment in relation to the supply of a service through [the commercial presence mode of supply]” it has committed to “allow[ing] related transfers of capital into its territory.”\textsuperscript{151} Second, the GATS provides that in all sectors in which there is a market-access commitment, a member state may not adopt measures that place “limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding.”\textsuperscript{152}

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\item \textsuperscript{146} By providing that many limitations would expire once China joined the WTO, the Chinese schedule of commitments further indicates an intention to gradually open almost all domestic markets to international competition.
\item \textsuperscript{147} \textit{See U.S.-Gambling Appellate Body Report, supra note 128, ¶ 215} (looking at the consistency of the measures and then their consistency with the GATS).
\item \textsuperscript{148} GATS, \textit{supra} note 110, art. XVI(1) (footnote omitted).
\item \textsuperscript{149} \textit{U.S.-Gambling Appellate Body Report, supra note 128, ¶ 215}.
\item \textsuperscript{150} \textit{See People’s Republic of China – Schedule of Specific Commitments, supra note 139} (“The conditions of ownership, operation and scope of activities, as \textit{set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of China’s accession to the WTO.” (emphasis added)); \textit{supra} notes 139–46 and accompanying text.
\item \textsuperscript{151} GATS, \textit{supra} note 110, art XVI(1) n.8.
\item \textsuperscript{152} \textit{Id.} art. XVI(2)(f).
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China is likely violating its market-access commitment by not allowing the free flow of foreign capital necessary to supply services through commercial presence. The Chinese rules, although not prohibiting the transfers of foreign capital altogether, restrict the flow of foreign capital into specific companies and other service providers. For example, in thwarting the Carlyle Group’s investment in Xugong, China obstructed the Carlyle Group’s ability to provide services to the Chinese domestic market. It kept the Carlyle Group from establishing a commercial presence in the building sector through Xugong. More broadly, by limiting the ability of foreign corporations to acquire domestic corporations, China has limited the ability of foreign corporations to provide services in the domestic market. If all foreign companies must create their own enterprises from scratch, they will stand at a distinct disadvantage relative to their domestic Chinese counterparts who enjoy already-constructed systems, supply chains, and enterprises. Therefore, China is likely violating the market-access commitment by limiting the foreign capital flow into domestic enterprises.

In addition, China has arguably placed a maximum percentage limit on foreign shareholding in violation of its market-access commitment by requiring potentially every foreign acquisition to have Ministry of Commerce approval. Even if a country has not established an actual percentage for the limitation, it still may have a quota. Antigua raised this argument in the argument in U.S.-Gambling. It contended that the complete prohibition of gambling in the United States resulted in a quota of zero percent. Similarly, China’s arbitrary approval mechanism arguably creates a de facto quota that

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153. See, e.g., id. art. 4 (stating in part that “[a]n acquisition shall not result in a foreign investor owning all of the equity interests” of certain specified industries).
154. Cf. Mexico Panel Report, supra note 129 (finding that Mexico was blocking the US access to the Mexico telecommunications market by not guaranteeing access on a cost based basis).
155. Cf. Largest Machine Tool Manufacturer to Sell Shares, supra note 63 (discussing how the Carlyle Group’s bid to takeover Xugong was rejected for fear of foreign control).
156. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, arts. 10–12.
157. See U.S.-Gambling Appellate Body Report, supra note 128, ¶ 238 (“[L]imitations amounting to a zero quota are quantitative limitations.”).
158. Id.
159. Id.
160. See discussion infra Part II.B; see also Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, arts. 10–12 (not specifying the criteria
China can change as conditions in its economy or the global economy change. Therefore, nations could challenge the Chinese M&A Rules for creating an illegal maximum-percentage limit on foreign shareholding and therefore violating China’s market-access commitments.

Alternatively, nations might challenge the revised rules as a violation of China’s commitment to the GATS national treatment provision, which states that a member nation may not formally or informally treat services or service suppliers from another member nation less favorably than it treats domestic enterprises. As with the market-access provision, China has made specific commitments as to national treatment for many industries. Less favorable treatment is treatment that “modifies the conditions of competition in favor of services or service suppliers of the Member compared to like services or service suppliers of any other Member.” This standard does not impose any new duties on the member country; it simply implies that when a member country has made a commitment to allow foreign member companies to operate in a market, the foreign companies must be able to do so on equal footing with their domestic competitors.

The Chinese rules likely violate the national treatment provisions of the GATS because they are facially discriminatory against foreign investors and therefore place the foreign investors at a disadvantage when competing against domestic investors to acquire a domestic

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161. GATS, supra note 110, art. XVII.
162. Id. art. XVII(1).
163. People’s Republic of China – Schedule of Specific Commitments, supra note 139.
164. Id. GATS, supra note 110, art. XVII(3). The only exception listed in China’s schedule of commitments as to national treatment is a stipulation that China is “unbound for all the existing subsidies to domestic services suppliers in the sectors of audio-visual, aviation and medical services.” People’s Republic of China – Schedule of Specific Commitments, supra note 139. Thus, the schedule leaves all other industries in which commitments have been undertaken unprotected. Further, for most of the industry specific commitments, China maintains no restrictions under national treatment for commercial presence. See id. (mandating that national treatment is “[u]nbound for all the existing subsidies to domestic services suppliers in the sectors of audiovisual, aviation and medical services”). So for most of the categories, China has not reserved the right to treat domestic and foreign entities differently as to services which China has committed to allow foreign entities to provide, including investment. Id.
165. See Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12 (stating that the rules only apply where it is an acquisition by a foreign party by a domestic corporation).
corporation. First, the rules are facially discriminatory to foreign investors of member and nonmember states because they apply only to acquisitions of domestic companies by foreign entities.\textsuperscript{166} Second, Article Twelve of the Chinese M&A Rules specifically states that certain corporations may not be acquired by foreign entities at all.\textsuperscript{167} These two rules show that foreign competitors for the takeover of domestic companies would be at a distinct disadvantage relative to domestic competitors wishing to take over the same companies. Because the regulations place the foreign competitor at a disadvantage in sectors in which there are no national-treatment limitations as to commercial presence, China has likely violated its national-treatment commitments.\textsuperscript{168}

\textbf{b. Exceptions.} Even if China has violated its treaty obligations, the GATS provides for narrow exemptions for treaty violations.\textsuperscript{169} The exceptions are limited to extreme circumstances and are not meant to be a means of avoiding treaty commitments.\textsuperscript{170} To determine whether a specific measure is justified by one of the enumerated exceptions, panels follow a two-tier analysis.\textsuperscript{171} First, the panel determines whether the challenged measure addresses the particular issue specified by that exception.\textsuperscript{172} Second, if the measure does have the required “degree of connection” with the interest specified in the exception,\textsuperscript{173} the panel then resolves whether the measure is consistent

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\item[166.] \textit{Id.}
\item[167.] \textit{See id.} art. 4 (stating that there are certain industries where foreign investors may not acquire a stake).
\item[168.] GATS, \textit{supra} note 110, art. XVII.
\item[169.] \textit{See id.} art. XIV (stating that behavior that would otherwise violate the GATS will be exempt under the prescribed circumstances).
\item[170.] \textit{See id.} (granting exceptions only if the member nation’s actions were necessary to protect important interests including public safety and order, human life or health, data privacy, and enforcement of contracts).
\item[171.] \textit{See U.S.-Gambling Appellate Body Report, supra} note 128, ¶¶ 291–372 (addressing exceptions regarding the gambling issue).
\item[172.] \textit{Id.}
\item[173.] \textit{Id.} “The required nexus—or ‘degree of connection’—between the measure and the interest is specified in the language of the paragraphs themselves, through the use of terms such as . . . ‘necessary to.’” \textit{Id.} ¶ 292. The panel then determines whether the measures are designed to protect the specified interest, and, if they are, whether the measures are necessary. \textit{Id.} ¶ 294. This Note does not examine whether the Chinese M&A Rules are necessary because the Note determines that the Chinese M&A Rules are not designed to protect any of the interests specified in the GATS exceptions. \textit{See infra} notes 175–98 and accompanying text.
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with the chapeau of the Article delineating the claimed exception. China could assert that its M&A Rules fit into two of the listed exceptions: the public morals and public order exception and the national security exception. It is unlikely, however, that the Chinese violation would fit into either exception.

First, the Chinese M&A Rules likely are not narrowly tailored enough to fit into the public order and public morals exception of the GATS, which permits nations to take action “necessary to protect public morals or maintain public order.” The public order and public morals exception “may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.” The U.S.-Gambling decision broadly defined the public-morals exception as “standards of right and wrong conduct maintained by or on behalf of a community or nation.” In that case, the Appellate Body upheld the arbitration panel’s decision that laws enacted by the United States to combat internet gambling were intended and designed to protect the public morals and maintain public order by targeting certain undesirable social side effects of online gambling, including underage gambling. The laws at issue in U.S.-Gambling, however, were tailored to target a specific activity in a specific industry.

The Chinese M&A Rules are not limited to a specific activity but instead encompass a broad range of activities, services and industries. The rules’ asserted purpose of “safeguard[ing] . . . the economic security of the State” could be intended to convey a message of preserving public morals and public order by preventing any shocks to the economic system. Economic security does not appeal to specific standards of right or wrong, however. In addition, there is no evidence that China intended its restrictions on the

174. Id.
175. Id.; GATS, supra note 110, arts. XIV(a), XIV bis.
176. GATS, supra note 110, art XIV(a).
177. Id. art. XIV n.5.
179. Id.
180. Id. ¶ 332 (“[T]he statutes prohibit the remote supply of gambling and betting services.”).
181. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, arts. 10–12 (stating that Ministry of Commerce authority extends across any industry that meets the criteria set out in Articles X–XII).
182. Id. art. 1.
purchase of domestic enterprises by foreign investors to address a particular or even general social concern other than market stability, a concern addressed in other exceptions to the GATS such as those for measures to maintain the balance of payments. Instead, from the language of the rules and the social context of their development, it is likely that China intended them to be market protection tools. Therefore, because of the rules’ broad nature and their failure to address a specific moral or public danger, the Chinese M&A Rules likely do not fit the public morals and public order exception of the GATS.

Even if a panel found that the Chinese M&A Rules fell within the public morals and public order exception of the GATS, however, the panel would likely conclude that the rules were nevertheless noncompliant with the chapeau of Article XIV. According to the Appellate Body in U.S.-Gambling, the focus of the chapeau is on whether a measure is being applied in a manner that “does not necessarily constitute arbitrary or unjustifiable discrimination, or a disguised restriction on trade in services.” In U.S.-Gambling, the Appellate Body ruled that the U.S. restrictions on online betting and gambling were inconsistent with the chapeau and therefore not exempted by the public order and public morals exception. The Appellate Body based its conclusion on the U.S. failure to show that

183. GATS, supra note 110, art. XII.
184. The Chinese government–controlled newspaper Xinhua gives market stability as the reason for the revised rules. See Sustainable Investment and Not Speculation, supra note 107 (“The [Chinese] laws are designed to help China maintain market order and balance national economic security and fair competition. The amendments ensure the protection of indigenous industries but also continue to encourage the investment enthusiasm of foreign companies.”).
185. It would also be unlikely that the measure would pass the “necessity” test as applied in US-Gambling. In that decision, the Appellate Body stated that the standard of necessity is an objective standard. U.S.-Gambling Appellate Body Report, supra note 128, ¶ 304. A WTO panel must “objectively assess the ‘necessity’ of the measure” based on all the evidence in the record. Id. This analysis should include a “determination of whether a WTO-consistent alternative measure which the Member concerned could ‘reasonably be expected to employ’ is available for whether a less WTO-inconsistent measure is ‘reasonably available.’” Id. ¶ 305. A “merely theoretical” alternative, however, may not be considered to be reasonably available. Id. ¶ 308. In US-Gambling, the Appellate Body found that the gambling restrictions were necessary because there was only a theoretical alternative to the restrictions, bilateral discussions between the United States and Antigua. Id. ¶ 317. In the case of the Chinese M&A Rules, WTO-compatible ways likely exist to address any concerns rather than restricting the purchase of domestic corporations by foreign investors. For example, the law could be tailored more narrowly to only disallow those mergers which would endanger public morality or public order as defined by the GATS.
the rules applied to both domestic and foreign services equally. The Chinese M&A Rules facially apply only to foreign entities and not to their domestic competitors. Thus, like the U.S. gambling rules, the Chinese M&A Rules on foreign acquisitions of domestic enterprises likely do not comply with the chapeau of Article XIV and therefore do not qualify for the public morals and public order exception of the GATS.

The second GATS exception available to China is the security exception, which allows members to take “action . . . necessary for the protection of its essential security interests.” The GATS limits this exception to a list of three permissible actions. The Chinese M&A Rules, however, do not qualify under any of these security exceptions. First, the rules are not limited to acquisitions of companies “relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment.” The revised regulations could affect industries completely unrelated to the military, like the haute couture fashion industry. In fact, the rule protecting “famous trademarks or traditional Chinese brands” seems to contemplate industries with products of primarily civilian

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187. Id. ¶ 369.
188. Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12.
189. GATS, supra note 110, art. XIV(b) bis. The GATS security exception contains two other provisions that exempt a member nation from its rules if the nation withholds information essential to its security interests or acts pursuant to the United Nations Charter to maintain peace and security. Id. art. XIV(a) and (c) bis. Because neither of these provisions readily applies to international acquisitions, this Note does not address them.
190. The GATS permits member states to take “any action” necessary to protect “essential security interests”
   (i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
   (ii) relating to fissionable and fusionable materials or the materials from which they are derived;
   (iii) taken in time of war or other emergency in international relations.
Id. art. XIV(b) bis.
191. Id. art. XIV(b)(i) bis; Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12. Although they are not limited to military establishments, the Chinese M&A Rules contains clauses that would include such establishments as some of the corporations that cannot be acquired by foreign entities. Id. (stating that those industries that could affect national economic security must be submitted to the Ministry of Commerce for approval). In those specific cases, the exception probably applies, and China may treat foreign companies differently than domestic companies.
192. See Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 1 (stating that the provisions were created for the purpose of regulating foreign investments in China); see also discussion supra Part I.C.
consumer use. Second, the Chinese M&A Rules and in particular Article Twelve are not limited to the dangerous materials exception, which is limited to action “relating to fissionable and fusionable materials.” Article Twelve does not mention either fissionable or fusionable materials. Finally, it would be a stretch to say that China adopted these rules in a time of war, as China was not officially at war with anyone and there was no declared emergency in international relations at the time it adopted the M&A Rules. Even if China’s protectionist measures are considered part of the aftermath of the Cold War, the GATS specifies that exceptions are only available during a time of war or major declared emergency in international relations. This presumes that the violating behavior would cease when the moment of crisis had passed.

Therefore, the Chinese rules on the acquisition of domestic corporations by foreign entities likely violate the GATS and are not justified by any enumerated exception.


194. GATS, supra note 110, art. XIV(b)(ii) bis; Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, supra note 2, art. 12.


196. See GATS, supra note 110, art. XIV(b)(iii) bis (granting an exception for national security concerns if actions are “taken in time of war or other emergency in international relations”).

197. Id.

198. Scholars have questioned whether nations may raise a facial challenge to enabling legislation before a WTO tribunal. See, e.g., Roger P. Alford, Essay, Reflections on US—Zeroin; A Study in Judicial Overreaching by the WTO Appellate Body, 45 COLUM. J. TRANSNAT’L L. 196, 216, 219 (2007) (noting that “the doctrine that only mandatory laws may be subject to an ‘as such’ challenge is a well-established doctrine in WTO jurisprudence” but arguing that the “Appellate Body has evolved in its jurisprudence from [this mandatory/discretionary] doctrine . . . to an approach . . . that eschews the mandatory/discretionary distinction altogether and permits an ‘as such’ review of all methodologies that are of general and prospective application”). Legislation that merely enables a government to take an action that would violate the GATS usually does not violate the GATS unless such action is taken. See Panel Report, United States—Sections 301–310 of the Trade Act of 1974, ¶¶ 7.26–7.28, WT/DS152/R (Dec. 22, 1999). Therefore, when asserting that this legislation violates the GATS, this Note assumes that China has actually taken the action violating the GATS. On the other hand, the Chinese M&A Rules are written broadly, and only a very narrow application of the rules would comply with the GATS. See discussion supra II.A.1.a. A nation thus might properly raise a facial challenge to the rules, even though they are enabling legislation.
2. **Compatibility of the U.S. M&A Rules with the GATS.** Despite differences between the U.S. and Chinese rules, the U.S. rules also likely violate the market access and national treatment provisions of the GATS and are not justified by any of its exceptions. Like China, the United States has undertaken specific commitments as to commercial presence in many industries.\(^{199}\) The U.S. schedule of commitments to the GATS, with the exception of some land use and tax treatment provisions, does not list any limitation as to market access or national treatment that spans all industries.\(^{200}\) Therefore, any additional inquiries into limitations would be on an industry-specific basis.\(^{201}\) Because the U.S. rules on the acquisition of domestic enterprises by foreign entities span all industries,\(^{202}\) they implicate at least some industries for which there are no limitations.

   a. **Violations.** First, the United States, like China, has likely violated its commitments to provide equal market access because the U.S. rules do not allow the free flow of foreign capital necessary to supply services through commercial presence, and this restriction arguably creates an illegal quota on the investment of foreign funds.\(^{203}\) The U.S. rules do not halt the flow of foreign capital altogether.\(^{204}\) Instead they put restrictions on the flow of capital\(^{205}\) which could

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200. Id. at 1–14.
201. Id. at 15–76.
202. See 50 U.S.C. app. § 2170(a) (2000) (“The President or the President’s designee shall make an investigation, as described in subsection (a), in any instance in which 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 control of a person engaged in interstate commerce in the United States that could affect the national security of the United States.”).
203. See discussion supra Part II.A.1.a.
204. See 50 U.S.C. app. § 2170(a) (allowing the president to review those transactions “which could result in foreign control of any person engaged in interstate commerce in the United States”).
205. Id. The GATS allows for domestic regulation so long as it is “not more burdensome than necessary to ensure the quality of the service.” GATS, supra note 110, art. VI.4.b. Here, the inquiry is not limited to the quality of the service. See 50 U.S.C. app. § 2170(a). (“The term ‘covered transaction’ means 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.”). In addition, the regulation is administered in a discriminatory manner, as it only applies to foreign firms, which would also make it an impermissible domestic regulation under GATS. See GATS, supra note 110, art. VI.1 (“In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade
impede the ability of foreign entities to establish a commercial presence and provide services to the U.S. domestic market. The rules also may create an illegal quota because, by allowing each deal to be reviewed, the United States has established a de facto quota based on changing circumstances. Therefore, the U.S. rules likely violate the United States' market-access commitments.

Second, the U.S. rules likely also violate the national treatment provisions of the GATS because they place foreign service providers at a disadvantage relative to their domestic competitors by resting additional burdens on foreign service providers to achieve a commercial presence in the U.S. domestic market. The U.S. rules are facially discriminatory because they apply exclusively to foreign entities, treating domestic competitors more favorably. Therefore, the U.S. rules likely are also a violation of the national-treatment provisions of the GATS.

b. Exceptions. The enumerated exceptions in the GATS would probably not apply to the U.S. rules either. The U.S. rules, although narrower than their Chinese counterparts, are probably too broad to be exempt in their entirety by the security exception of the GATS. Under the U.S. rules, in choosing whether to investigate a particular transaction, CFIUS must consider as a threshold question whether there exists “credible evidence that the foreign interest exercising in services are administered in a reasonable, objective and impartial manner.” (emphasis added)).

206. See discussion supra Part II.A.1.a.
208. See 50 U.S.C. app. § 2170(a) (stating that the transactions subject to review include “mergers, acquisitions, or takeovers . . . by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States”).
209. See Rappeport, supra note 29 (“[F]oreign companies could soon face greater scrutiny in the interests of national security when investing in the United States.”).
210. See supra Part II.A.1.b. Given that the U.S. rules do not speak of any other motivation other than national security, it is unlikely that the United States would try to justify its actions under the public morals and public order exception. See 50 U.S.C. app. § 2170(a) (providing that the president “may make an investigation to determine the effects [of the transaction] on the national security of the United States”). The motivations of the rules are not necessarily without merit. It is entirely possible that the rules are necessary regardless of any violation of the GATS. This Note only analyzes the compatibility of the rules with the GATS for the purpose of exploring the Chinese view that the United States has been hypocritical in its free-trade stance.
control might take action that threatens national security.\textsuperscript{211} This standard is broad enough to encompass acquisitions that are unrelated to the provisioning of military establishments or fissionable materials, and are not necessarily taken in a time of war.\textsuperscript{212} In addition, the Foreign Investment and Security Act of 2007\textsuperscript{213} mandates a period of investigation that would arguably put any acquisition by a foreign investor at a disadvantage to their domestic competitors.\textsuperscript{214}

One could argue that because the United States is in an ongoing war on terror, any action taken for national security purposes is justified under the GATS. This interpretation would likely violate the spirit of the GATS, however, by allowing member nations to disregard their WTO commitments as long as they are at war with someone or something on some front. For example, the United States could halt all motor vehicle part imports from Mexico on the grounds that the United States is at “war” with drugs, and cars coming from Mexico have been used to transport drugs. This use of the word “war” would conflict with the goal of consistent and predictable behavior desired by the GATS.\textsuperscript{215} Therefore, the security exemption of the GATS likely does not justify the U.S. violation of the market-access or national-security commitments of the GATS.

Thus, despite significant differences, the U.S. and Chinese rules on the acquisition of domestic enterprises by foreign investors likely violate each country’s respective commitments under the GATS.

The revised Chinese rules reflect a knowledge and perhaps resentment of the perceived hypocrisy of the United States and others who preach free trade and yet continue to perpetuate policies that violate their own free trade obligations.\textsuperscript{216} Whether or not this view of the United States and others as hypocritical is fair or justified, this

\begin{itemize}
\item \textsuperscript{211} Org. for Int’l Inv., supra note 14.
\item \textsuperscript{212} For an example of the United States’ latitude in invoking national security interests to prevent a foreign acquisition of a U.S. enterprise, see the discussion about the CNOOC-Unocal merger supra Part I.B.
\item \textsuperscript{213} Pub. L. No. 110-49, 121 Stat. 246 (to be codified at 50 U.S.C. app. § 2061).
\item \textsuperscript{214} See Rappeport, supra note 29 (noting that the mandated investigation period increases transaction times for foreign companies, thereby “hurting [their] chances to compete fairly against a U.S. acquirer”).
\item \textsuperscript{215} See GATS, supra note 110, pmbl. (recognizing that a goal in instituting GATS is “to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency”).
\item \textsuperscript{216} See supra Part I.C.
\end{itemize}
perception has had an effect on the development of Chinese law in the area of acquisitions. The next Section explores the possible costs of this perception and the Chinese and U.S. violations on the world economic community.

B. Costs of Violating the GATS

By violating the terms of the WTO GATS, China and the United States do more than simply undermine their international credibility; they undermine the benefits provided by the GATS system itself. The benefits of the GATS for China, the United States, and the world depend not just on one country’s acquiescence but on the willingness of all involved parties to consistently maintain their commitments even when a violation would better accomplish immediate national interests.217 Likewise, the consequences of one country’s violation are not limited to that country. They multiply exponentially throughout the organization, affecting everyone involved and perhaps ultimately affecting the efficiency of the world economy.218

The GATS provides many benefits.219 The WTO lists ten benefits that it believes come from having a World Trade Organization:

1. The system helps promote peace
2. Disputes are handled constructively
3. Rules make life easier for all
4. Freer trade cuts the costs of living
5. It provides more choice of products and qualities
6. Trade raises income
7. Trade stimulates economic growth
8. The basic principles make life more efficient
9. Governments are shielded from lobbying
10. The system encourages good government[.220


218 See WTO, 10 BENEFITS OF THE WTO TRADING SYSTEM 2 (2007), available at http://www.wto.org/English/res_e/doload_e/10b_e.pdf (“The longer term reality is that one protectionist step by one country can easily lead to retaliation from other countries, a loss of confidence in freer trade, and a slide into serious economic trouble for all . . .”).

219 See id. at 1 (“[T]here are many over-riding reasons why we’re better off with the [WTO trading] system than without it.”).
As a part of the WTO, the GATS agreement likewise promotes these goals. In fact, it more directly promotes these goals than the WTO alone because the GATS encourages the cross-border flow not only of goods but also services, which constitute a much more intimate and personal exchange between nations.\footnote{221}

More specifically, the GATS can potentially better the lives of consumers by increasing competition within a traditionally domestic service industry like telecommunications.\footnote{222} Competition drives down prices and enhances efficiency within industries.\footnote{223} In addition, it promotes the advancement of technology, thus improving the lives of the public at large.\footnote{224} These benefits are likewise important financially. Competition for supplying goods may drive the price of the good to the consumer down.\footnote{225} Competition to buy corporations is likely to drive the price of the corporation up, however, creating wealth for the ownership\footnote{226} and therefore benefiting the society as a whole.

When laws enabling actions that violate the GATS create barriers to trade in services, they undermine these benefits. Even limiting the analysis to the two acquisitions discussed in this Note, CNOOC and the Carlyle Group, over 1.3 billion U.S. dollars were forfeited in preference for security concerns. The creation of additional legal frameworks to support similar restrictions on acquisitions would likely only compound the problem and further undermine the benefits of the WTO and the GATS agreement.

Additionally, China’s entry into the WTO has provided a multiplicity of benefits to other developing countries in the Pacific

\footnote{220. Id.}
\footnote{221. See Taunya L. McLarty, Liberalized Telecommunications Trade in the WTO: Implications for Universal Service Policy, 51 FED. COMM. L.J. 1, 5 (1998) (“The conclusion of the GATS in 1994 set the stage for continued negotiations on various service sectors and subsectors.”).}
\footnote{222. Id. at 56.}
\footnote{223. See id. at 57 (stating that trade liberalization leads to prosperity, which “increases the capital base for social benefits and diversity through technological innovation and more efficient resource use”).}
\footnote{224. Id. (suggesting that technological innovation is a result of trade liberalization).}
\footnote{225. See WTO, supra note 218, at 5 (“The WTO’s global system lowers trade barriers through negotiation and applies the principle of non-discrimination. The result is reduced costs of production (because imports used in production are cheaper) and reduced prices of finished goods and services . . . .”).}
Rim area.\textsuperscript{227} These benefits are in part due to the increased economic activity between surrounding developing countries and China as a result of decreased trade barriers.\textsuperscript{228} If the Chinese entry into the WTO had positive benefits for other countries, it stands to reason that China’s violation of the WTO rules, which undermines its core principles, may also have effects far beyond its borders.

Finally, Congress estimates that U.S. trade agreements have added billions of dollars in benefits to the U.S. economy.\textsuperscript{229} These benefits go far beyond the U.S. national borders.\textsuperscript{230} Since World War II, the United States has promoted increasingly free global trade to maintain peace and avoid another world war.\textsuperscript{231} Many of the benefits of the WTO are likewise benefits of free trade generally.\textsuperscript{232} Therefore, undermining the principles of free trade by violating international agreements affects both benefits to the United States of free trade and benefits garnered by other countries from U.S. free trade policies.

CONCLUSION

Despite these economic costs, it is important to recognize that the rules created to deal with foreign acquisitions of domestic enterprises were motivated in many cases by serious national concerns. The United States worries about the prospect of important

\textsuperscript{228} Id.
\textsuperscript{230} See WTO, supra note 218, at 4 (stating that trade agreements provide benefits for smaller countries as well as for the leading economic powers).
\textsuperscript{231} See Bradford, supra note 229, at 65 (“[T]he United States has led the world in negotiating freer international trade and investment.”).
\textsuperscript{232} Compare WTO, supra note 218, at 2 (“The WTO trading system plays a vital role in creating and reinforcing that confidence that arises from knowing that other countries will not engage in protectionist behavior.”), with Denise H. Froning, The Benefits of Free Trade: A Guide for Policy Makers, HERITAGE FOUND., Aug. 25, 2000, http://www.heritage.org/Research/TradeandForeignAid/BG1391.cfm (“Free trade helps to spread the value of freedom, reinforce the rule of law, and foster economic development in poor countries.”).
pieces of its infrastructure being in the hands of foreign powers. Likewise, China fears that indiscretions of foreign investors will devastate its economy. These concerns are real and cannot be simply dismissed as protectionist rhetoric. They resonate deeply with both the politics and populace of both countries.

The United States acted in what it perceived to be its best interests in blocking the CNOOC acquisition of Unocal. China then acted in its own interests in blocking the Carlyle Group takeover of Xugong and issuing revised regulations on foreign acquisitions of domestic enterprises that disappointed many with their vagaries and lack of commitment to free and open trade in services through developing a commercial presence in China. The Chinese perception that the United States’ denial of the CNOOC acquisition was unfair and hypocritical connected these two actions.

Judging from the independent

233. See, e.g., LARSON & MARCHICK, supra note 15, at 4 (describing Congress’s concerns about foreign investments in the United States); CFIUS, supra note 12 (stating that the purpose of the provision is “to serve U.S. investment policy through thorough reviews that protect national security while maintaining the credibility of our open investment policy”); supra note 27.

234. See Sustainable Investment and Not Speculation, supra note 107 (“The new Chinese rules are aimed to properly regulate the merger and acquisition practice, because many problems have surfaced in this area. Some of the deals have damaged the market order and even threatened the country’s economic security.”); see also Neumann & Zhang, supra note 4, at 21 (“The New Provisions reflect fundamental underlying concerns that foreign interests are acquiring capacity and market share in China, without adequate oversight by the central government . . . .”); Tang & Benjamin, supra note 1 (“China is trying to manage the influence of foreign companies on their domestic economy . . . .” (quoting Christopher McNally, a China specialist)).

235. See supra notes 233–34.

236. See supra note 233.

237. See supra note 234.

238. See OECD REPORT, supra note 5, at 3.

239. See supra Part I.A–C; cf. New Rules for Chinese Company M&A Transactions Involving Foreign Investors, KIRKLANDPEN (Kirkland & Ellis LLP, Chi., Ill.), Sept. 1, 2006, at 1, available at http://www.kirkland.com/siteFiles/Publications/2862933E994B6CCBC83903986270D0C5.pdf (suggesting that “Chinese authorities are keen to protect their key industries and assets, a reaction not completely dissimilar” to the United States’ interference with the CNOOC merger).

240. See, e.g., Carlyle to Buy Minority Stake in Xugong, TAIPEI TIMES, Mar. 20, 2007, at 10, available at http://www.taipeitimes.com/News/worldbiz/archives/2007/03/20/2003353109 (noting that China’s actions in protesting the Carlyle Group merger may have been protectionist in nature).
standard of the GATS, both accusations were somewhat justified.\textsuperscript{241} Both the United States and China are likely violating their treaty obligations and thereby incurring costs for themselves and possibly for the rest of the world.\textsuperscript{242}

This Note is not intended to condemn the policies or rules of either China or the United States concerning the acquisition of domestic enterprises by foreign entities. Rather, it shows that even perceptions of hypocrisy can have serious consequences. When choosing to act, even in the interests of national security, the United States should be careful to consider the detrimental effect its policies may have on other countries.

\textsuperscript{241} See discussion \textit{supra} Part II.A.1–2.
\textsuperscript{242} See discussion \textit{supra} Part II.B.