

## 5 Bounded Intervention

### Mitigating Threats to National Security

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#### Introduction

Bounded (like unbounded) intervention is a type of non-military internal balancing. Its primary objective is to balance another state's power, without fundamentally disrupting the overall diplomatic relationship with that other state. Bounded and unbounded intervention are also motivated by the same factors: i.e., economic nationalism and/or geopolitical competition concerns. The purpose of this chapter is not only to confirm the validity of the primary and secondary hypotheses posited in Chapter 1, but also to clarify how bounded intervention is different from unbounded intervention. In other words: what does it entail, and when and why will a state employ this balancing strategy?

This chapter begins by refining the definition of bounded intervention and identifying the government actions and methods that characterize it. The motivations for bounded intervention are then revisited, followed by an in-depth examination of two further critical case studies: the takeover of America's Lucent Technologies by France's Alcatel and that of IBM's American PC Business by China's Lenovo. Figure 28 provides an overview of these cases, which were chosen for their vital importance to a proper understanding of bounded intervention and their ability to provide further insight into the statistical results presented in Chapter 2. At the end of this chapter, it should be clear what bounded intervention is, what motivates it, and why governments choose to use it.

#### Defining Bounded Intervention

##### *Definitions*

The difference between bounded and unbounded intervention lies largely in degree, intensity, and intent. With *unbounded* intervention, the intent of the government in question is to block a deal through whatever

**Figure 28 Bounded intervention: critical cases**

	Case 6	Case 7
<b>Acquirer Name</b>	Alcatel	Lenovo Group
<b>Acquirer Country</b>	France	China
<b>Target Name</b>	Lucent Technologies	IBM Corporation's PC Business
<b>Target Country</b>	USA	USA
<b>Target Industry</b>	Telecom	High-Tech
<b>Deal Type</b>	Acquisition	Acquisition
<b>Deal Value (in \$US Thousands)</b>	13,400,000	1,750,000
<b>Deal Status</b>	Completed	Completed
<b>Deal Year</b>	2006	2005

means are necessary. Further, the government believes such action is necessary to resolve its concern over relative power positions, regardless of whether it is economic nationalism or geopolitical factors that have motivated that concern. However, when the government believes the circumstances of a particular deal make it possible to resolve its concerns through a more limited form of intervention, it will often take the opportunity to exhibit restraint by using the *bounded* alternative instead. This is because bounded intervention is even less likely to produce antagonism in the general relationship between the states involved.

With bounded intervention, the state employs a restricted (and hence “bounded”) strategy, the intent of which is simply to modify a cross-border deal in its favor, rather than to block it in its entirety. In other words, the state’s intent is to allow the cross-border deal to occur, but in a modified form, which it has shaped. The means of modifying, or “mitigating,” a deal naturally varies in accordance with concerns raised by the host government of the target company (state *A*). So, too, will the level of bounded intervention that the government feels it is necessary to employ. This section seeks to differentiate between the two levels of bounded intervention: high and low. It also identifies some of the methods governments have at their disposal to “mitigate” the negative effects of a deal in the interest of state security, as that state defines it, though the list of possible government concerns and solutions is theoretically endless.

A hypothetical example will elucidate the basic difference between high- and low-bounded interventions. Let us assume that state *A* is concerned by the inclusion of a certain corporate division in a cross-border transaction – perhaps because it retains government contracts, is the primary manufacturer of a significant piece of military technology, or

plays an important role in the military-industrial complex of that state. There are a number of ways that state *A* might handle this concern, depending on the sensitivity of the technology involved, the nature of the government contracts, and the degree of concern that these factors raise vis-à-vis national security.

If state *A* is exceptionally worried about the implications of the inclusion of this corporate division in the transaction, as well as the intentions and reliability of the company and/or country involved in the takeover, it might choose a high level of bounded intervention. High-bounded intervention entails the imposition of severe or exceedingly restrictive changes on the transaction in question, and may even require unique measures. For instance, state *A* might pursue a formal arrangement by which the division in question remains entirely run and controlled by nationals of state *A*, allowing only the revenue of that division to go to the acquiring company in state *B*. Alternatively, state *A* might go so far as to request that the division be excluded entirely from the sale of the domestic company.

The government of state *A* may, however, choose to engage in a low level of bounded intervention if it feels that severe measures are unnecessary to protect its national security. Low-bounded intervention entails simpler, less intrusive actions, which are not necessarily unique to the deal in question. For instance, in the hypothetical transaction under discussion, state *A* might feel that it is an adequate solution to simply require the acquiring company to respect its export control laws, and not pass on the technology involved in the deal to countries it deems “unfriendly.” Alternatively, if the acquiring company comes from a country that is a close ally and economic partner of state *A*, it may have already signed a comprehensive security agreement as the result of high-bounded intervention in a previous transaction. In that case, state *A* may simply rely on that previous agreement to resolve its concerns, necessitating only a low level of intervention in the current transaction.

A real-life example of this latter type of case would be when the UK’s BAE Systems purchased America’s United Defense Industries (UDI) in 2005. BAE Systems has purchased a number of US companies in the past through its US subsidiary BAE Systems North America. The US government had, in previous deals, asked BAE Systems North America to sign a comprehensive set of security agreements. Thus, one industry analyst has pointed out that when the BAE/UDI takeover occurred, only minimal intervention was required on the part of the US government because, even though UDI was a major government supplier with sensitive technology, the earlier agreements signed by BAE would allay the majority of the security concerns inherent in the UDI transaction.

No matter what level of bounded intervention a state chooses to employ, it will usually ensure that the modifications it makes to a deal are made legally binding upon the companies involved. In other words, the contracting parties (the acquiring and target companies) will be asked to sign a legal document (or series of documents) enumerating the ways in which the government has chosen to mitigate the negative effects of the deal, and confirming the contracting parties' willingness to be bound by those modifications and requirements. In the US, for example, the government is unlikely to be satisfied with such agreements unless it "believes that the risks it identifies can be managed" successfully through deal modifications and assurances agreed to by the acquiring company (Graham & Marchick 2006, 71–2). Indeed, in any country, in order to be satisfied with this more restricted form of intervention, the government must be confident that the changes made to the deal will effectively protect its national security and, in some cases, its economic position, if that state believes economic security to be tied to national security.

In summary, bounded intervention is a restricted type of intervention used as a form of non-military internal balancing, where the goal is once again to protect or maximize the economic and/or military power of the state, without damaging the greater meta-relationship between the states involved. Such intervention allows cross-border M&A activity to continue, while preventing foreign governments – through the market actions of companies that they may either wholly control or later gain influence over – from gaining access to sensitive technology or information, or from gaining control of resources, materials, and networks, that could eventually help to alter the economic and/or military power balance.

### *Different States, Different Means . . .*

The exact method and means through which a bounded intervention is executed varies by country. For example, the level of institutionalization of the procedures for intervention, the tools available for intervention, and the formality of the agreements negotiated between the government and the companies in question can differ substantially depending on the country involved. Before moving to the case studies, it is therefore important for comparison to examine how bounded intervention is effected in four different countries – the US, China, Russia, and the UK – both during the case studies and at the time of writing. A brief overview is also provided of the overarching foreign takeover regimes in these countries (with the exception of the US, whose regime was

comprehensively examined in Chapter 3, pp. 110–11), in order to place these different approaches to bounded intervention in context.

### **The United States**

In the US, the foreign takeover review process, and therefore the process through which a deal might be mitigated, is highly institutionalized. Throughout the course of a proposed takeover for a US company, the foreign acquirer and the domestic target companies will regularly consult with CFIUS, often even before the formal review process begins. During the course of this interactive process, CFIUS may raise its concerns with the companies on an informal basis, allowing them to address an issue before it is formally raised as part of the Committee's official investigation. According to Graham and Marchick, the government agencies represented within CFIUS may also contact the parties directly. They explain, for example, that the DOD may "negotiate mitigation measures with the transaction party," "if [it] believes that the risks [to national security] it identifies can be managed" successfully through alterations to the deal, or through other assurances agreed to by the acquiring company (Graham & Marchick 2006, 71). They reveal that such measures "generally fall into four categories (in ascending order of restrictiveness)" (Graham & Marchick 2006, 71–2). These measures include: (1) some form of "board resolution" to ensure citizens of the target state remain involved in management, (2) the creation of a "limited facility clearance" to restrict foreign access to secure areas or technology, (3) a "Special Security Agreement (SSA)" or "Security Control Agreement (SCA)" that enumerates a series of security measures to be followed by the acquirer, and (4) a "voting trust agreement" or a "proxy trust agreement" (Graham & Marchick 2006, 71–2). CFIUS may, on its own, also impose mitigatory measures as part of a national security agreement, which it can ask the contracting parties to sign before recommending a deal to the President for approval. Such national security agreements may include onerous changes or modifications to a deal, or may seek more simple assurances that the company in question will adhere to US export control laws and other industrial and security regulations. More severe and involved actions are considered to be cases of high-bounded intervention. In rare cases, companies might be forced to divest a portion of the target company. On one extraordinary occasion, in the Alcatel/Lucent case examined in this chapter, the government reserved the right to force a future reversal of the takeover if the acquiring company fails to adhere to the assurances it made to the US government regarding measures to safeguard US national security.<sup>1</sup>

Thus, while the US process is not completely transparent, it is highly institutionalized and fairly straightforward to navigate for those companies that wish to make a deal work. Bounded interventions occur within a recognized, established, and coherent legal framework, which can easily be adapted to handle different threats to national security.

### **China**

Relative to the US, the foreign takeover review process in China is not as highly institutionalized, predictable, or consistent (see e.g., Stratford & Luo 2015; US GAO 2008, 42–52). As China has moved toward a more open economy, and since its accession to the WTO in 2002, the Chinese government has sought to reform and clarify the FDI laws and regulations in its country in order to bring them in line with WTO members' expectations. Yet, the laws and regulations applicable to foreign investors can be difficult to follow, and can vary depending on the type of foreign investment made and the type of purchasing vehicle used to make it. In fact, by 2008, China reportedly had “more than 200 laws and regulations that involve foreign investment” (US GAO 2008, 45), and, by 2017, more than 1,000 of them (US DOS 2017). For example, the Company Law of the PRC,<sup>2</sup> the Takeover Rules,<sup>3</sup> and the Securities Law<sup>4</sup> apply to both domestic and foreign public M&A (Jian & Yu 2014, 2), while the basis for the body of regulations covering foreign M&A of Chinese companies lies in the 2002 Provisions on Guiding the Orientation of Foreign Investment<sup>5</sup> and the 2006 Provisions for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (amended in 2009).<sup>6</sup>

The 2004 Decision on Reforming the Investment System outlines the instances in which investment deals are “encouraged, restricted, and prohibited by the state,” though it only provides general “guidelines” as to which industries might be included in these broad categories.<sup>7</sup> The Catalogue for Guiding Investment in Foreign Industries provides more detailed guidance on this topic. First released in 1995, the Catalogue has been reissued in 1997, 2002, 2004, 2007, 2011, 2015, and 2017 (CECC 2012; Koty & Qian 2017), and lists those industries that fall within the encouraged, restricted, and prohibited categories for foreign investment. In 2017, this included thirty-five restricted and twenty-eight prohibited industries, with the latter category including industries ranging from the mining of rare-earth metals to the retail of tobacco products.<sup>8</sup> In the past, it was assumed, but not explicitly stated, that foreign investors were generally permitted to invest in those industries not listed, with special rules for some regions and sectors (Qian 2016, 6–7). The 2017 Catalogue, however, explicitly states that it is now to be used

nationwide as a “negative list for foreign investment.”<sup>9</sup> This means that prohibited industries “are completely closed to foreign investment,” and that restricted industries “are subject to restrictions such as shareholding limits, and must receive prior approval from MOFCOM.” All other industries not appearing on this negative list now “do not require *prior* approval from MOFCOM,” though they “are still subject to record-filing requirements” (Koty & Qian 2017, emphasis added). That being said, the Catalogue is far from simple or comprehensive, as particular regions and sectors may still have additional restrictions on foreign investment (see Koty & Qian 2017). Notably for our discussion here, the Catalogue generally “prohibits foreign investment in sectors that China views as key to its national security, . . . [but] does not prohibit investment for stated reasons, or define national security” (US GAO 2008, 44).<sup>10</sup>

Anti-trust competition review of M&A has also evolved and become more institutionalized over time, bringing with it more formal mechanisms through which the Chinese state can intervene in foreign takeovers on national security grounds. In the time period covered by the database (2001–07), China had several laws that included “antitrust provisions and prohibitions on anti-competitive conduct,” but these were “fragmented, confined in scope, and rarely enforced” (Ha & O’Brien 2008). The 2003 Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, and the 2006 Provisions that replaced it, prohibited foreign takeovers that would result in unacceptably high market concentrations or ultimately restrict competition, but the Provisions did “not specify any penalties,” and in most cases there was “no follow-up” (Ha & O’Brien 2008). In 2007, the Chinese government passed a comprehensive Anti-Monopoly Law (AML), implemented in 2008, which in contrast includes broad powers to review the competition effects of both domestic and cross-border M&A transactions and institutes enforceable penalties for non-compliance with government decisions regarding a particular transaction (Ha & O’Brien 2008; Wang & Emch 2013). The Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), and the State Administration of Industry and Commerce (SAIC) implement and enforce the AML, with MOFCOM handling merger control (Wang & Emch 2013).<sup>11</sup>

In addition to the ability to review a foreign investment on competition grounds, the 2008 AML notably included the first institutionalized regulatory mandate for the Chinese government to review a foreign investment on national security grounds, under Article 31 of its provisions.<sup>12</sup> Though, as demonstrated in the Macquarie/PCCW case, an informal process of intervention operated during the 2001–07 period covered in the database (see Chapter 3). China then established a more formal

security review of foreign takeovers in 2011 with the Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors<sup>13</sup> and the subsequent associated implementing provisions.<sup>14</sup> The 2011 Circular created a Joint Commission to undertake these reviews, led by MOFCOM and the NDRC under the oversight of the State Council (see US DOS 2017). This review process examines the “national security” implications of a proposed foreign takeover, as well as the potential impact of a transaction on “steady economic growth, . . . the basic social living order, and . . . the R&D capacity of key technologies involving national security” in China.<sup>15</sup> Deals subject to the security review process are those that involve

acquisitions of a controlling interest in a PRC enterprise within a sensitive sector, such as key agriculture, key energy resources, key infrastructure, key transport systems, key technology and critical equipment manufacturing sectors, which may affect national security; or acquisitions by a foreign investor of any stake in a PRC military or military supportive enterprise, any enterprise located in the surrounding area of important or sensitive military facilities and any other enterprise which is of importance to national defence security. (Linklaters 2015, 37)

The Chinese national security review process is modeled loosely on the CFIUS process, with an initial review period, followed by a more extensive special review if a relevant government department believes the deal may affect Chinese security. Parties involved in the deal also file voluntarily for a review with MOFCOM, or the deal can be referred to MOFCOM for review by “other government agencies, or . . . third parties” (Jalinous et al. 2016, 5). Parties may not withdraw their application for approval under this review system without “MOFCOM’s prior consent,” however, and there is no administrative appeals process or avenue for judicial review of MOFCOM decisions (Jalinous et al. 2016, 6).

In China, both unbounded and bounded intervention are possible, though the level of formalization and institutionalization of the methods used to intervene has increased over time. The 2011 Circular, for example, now clearly provides that when a foreign acquisition or merger is believed to impact national security, MOFCOM or another relevant government department can veto the deal or modify it by “transferring related equities, assets or [taking other measures] to eliminate the effect of [the deal on] national security.”<sup>16</sup> In other words, once a deal goes through the review process, MOFCOM can approve it, mitigate it (bounded intervention), or veto it (unbounded intervention). Moreover, if MOFCOM is made aware of a foreign takeover that has been



completed without having voluntarily filed for approval, and it raises national security concerns, MOFCOM has the authority at that point to apply “sanctions or mitigation measures, including a requirement to divest the acquired Chinese assets” (Jalinous et al. 2016, 6). Once the foreign takeover is completed, the new entity must then register as a foreign-invested enterprise (FIE) (ABASAL 2015, 43–4).

It should be noted, however, that the approval process may vary according to the specific nature of the deal, as the acquisition of a Chinese firm can take place through a number of different routes and via various types of acquisition vehicles.<sup>17</sup> Most deals of the size and sector examined in this study *will* likely require government approval from MOFCOM,<sup>18</sup> though foreign investment in financial institutions is covered by a different set of regulations and approval authorities (see Chan et al. 2015b; Linklaters 2015), and some deals – depending on the size, vehicle used, and sector involved – may also require additional local and/or regional approvals (US GAO 2008, 46). There are also additional rules and regulations that might apply to foreign investments.<sup>19</sup>

It should be noted that further changes have been proposed and made to the Chinese foreign investment review process in 2015 and 2016 that, while offering further clarity to foreign investors, may also increase the opportunities for Chinese state intervention in both bounded and unbounded form. At the beginning of 2015, China released a Draft Foreign Investment Law looking at the possibilities for streamlining and reforming its foreign investment regime. It was in this Draft Law that China first considered extending national treatment to FIEs for investments beyond those restricted or prohibited in a negative list (US DOS 2016a), a policy that appears to have come to fruition with the 2017 Catalogue (US DOS 2017). The Draft Law also proposed changes to the national security review process, including a “broader scope of application . . . to *any* foreign investment that endangers or may endanger national security, regardless of structure and degree of control by the foreign investor” (Chan et al. 2015a, 6). In May 2015, the Trial Measures for the National Security Review of Foreign Investments in Pilot Free Trade Zones introduced a new security review process for the FTZs, likely as a trial for later national use, which broadened the definition of national security and widened the scope of security reviews “to include greenfield projects” (Stratford & Luo 2015, 3–4; US DOS 2016a).<sup>20</sup> In July 2015, the National Security Law of the PRC was adopted, which broadened the scope of national security reviews nationally, “to include an investment’s impact on cultural security, information security, industrial security, military security, technological security, and territorial security, among others” (US DOS 2016a).<sup>21</sup> Further implementing

legislation was not published at the time of writing (Jalinous et al. 2016), but it seems that all of these actions are intended to “reinvigorate the national security review system [and] seem to signal the awakening of a rather dormant regime that existed under the [2011] Circular” rules (Stratford & Luo 2015, 5).

In 2016, China also adopted and implemented the Decision of the Standing Committee of the National People’s Congress on Amending Four Laws Including the Law of the PRC on Foreign-Funded Enterprises,<sup>22</sup> reforming part of the FDI system in China. It amends laws pertaining only to foreign investments made by FIEs<sup>23</sup> in permitted sectors not covered by the Catalogue, which now is treated as a negative list for investment made by FIEs (Ye 2016). This reform *does not* yet alter the national rules described earlier that apply to wholly foreign investors purchasing domestic Chinese enterprises (Cai 2016, 1; Livdahl et al. 2016, 2). The foreign M&A approval process, national security review process, and competition process under the AML, for example, remain in place at the time of writing. It is expected that reform may occur among these processes, but that such reform will allow for greater ease of FDI in those sectors desired by the Chinese state, while also allowing China greater maneuverability to block and/or modify deals to protect Chinese interests and the very “broad definition of national security” set out in the 2015 National Security Law (Stratford & Luo 2015, 5).

In sum, the purpose of all of these decrees has been to create a legal regime meant to protect China’s strategic and economic security by ensuring the government’s ability to modify cross-border deals to protect Chinese interests (see e.g., Stratford & Luo 2015; US GAO 2008, 42). The changes have not necessarily increased the transparency or efficiency of the review process, but have demonstrated a trend toward greater bureaucratic protection of China’s self-defined strategic interests, in addition to a higher level of economic protectionism.

Thus, there is wide latitude for the Chinese government to engage in bounded intervention, and clearly identifiable means through which the state might mitigate a deal in order to reduce any perceived or potential threat to national security. MOFCOM, the evolving security review process, and various local reviews, all provide opportunities for the government to request that changes be made to a deal in order to place it in line with Chinese interests. The latitude for the government to make, or encourage, any modifications to a deal that it deems necessary is enhanced by the complexity of FDI legislation (see US GAO 2008, 42–50). Foreign investors can find it difficult to understand “when central versus local rules apply,” or when particular regulations are more likely to be enforced (US DOS 2016a). Therefore, Chinese review authorities

essentially have the latitude to decide how a deal must be structured in order for it to comply with Chinese strategic interest, if they desire to do so. Companies seeking approval for their transaction then have the choice whether or not to adjust to those demands. These conversations are rarely made public, however, helping to explain the extremely low levels of data available on bounded intervention in China.

### **Russia**

The foreign takeover process is perhaps even less transparent and institutionalized in Russia. Officially recognized by the US and EU as a working market economy in 2002, Russia acceded to the WTO in 2012 and has been slowly opening itself to foreign investment over time. The 1999 Federal Law No. 160-FZ on Foreign Investment in the Russian Federation, in conjunction with the 1991 Investment Code, are intended to “guarantee that foreign investors enjoy rights equal to those of Russian investors” (US DOS 2016b). Yet, Russia has also “set foreign ownership caps in industries or individual companies in what are considered ‘strategic’ or sensitive sectors, including the power and gas monopolies, banking, insurance, mass media, diamond mining, and civil aviation” (EIU 2003, 14). The Russian government also maintains strategic stakes in what it calls “the natural monopolies,” such as the oil and gas sectors, “for the sake of stability and national security” (EIU 2003, 10). In many instances, however, the laws surrounding foreign investment and ownership caps have “not always [been] enforced in practice” (US DOS 2015, 3), and the purchase of assets and the takeover of private companies have remained possible in some of the industries examined in this book.

During the time period covered in this book’s dataset, from 2001 to 2007, the national security review process had not yet been formalized in law, and intervention into foreign takeovers was made on a case-by-case basis. For the industries covered, a fundamental requirement for a foreign takeover at the time was that it comply with Russian anti-competition rules, and thus that the “acquisition of more than 20% of a company’s stock requires prior approval of” the competition authority (IFLR 2002). In the early 2000s, this was the Ministry of the Russian Federation on Antimonopoly Policy and Support to Entrepreneurship (MAP), which was replaced in 2004 with the Federal Antimonopoly Service (FAS). In 2006, Federal Law no. 135-FZ On Protection of Competition was adopted, which “reflected the existing system of anti-monopoly regulation” (FAS 2015, 16).<sup>24</sup>

Yet, the attitude toward foreign investment arguably took a distinct inward turn in 2003/04 following the downfall of the oil company

Yukos. After that incident, Russian government intervention into foreign takeovers in these sectors tightened under then President, and later Prime Minister, Vladimir Putin. As one industry source noted, there was little formality to the review process at the Anti-Monopoly Ministry during this period, and takeovers of assets deemed to be strategic by Putin were often subject to an additional review by the relevant government authority or ministry (Interview 2008a). This appears to be clearest in the energy and natural resources sectors, where Putin has sought to maintain control over certain resources in order to use them as a tool for Russian policy and the furtherance of Russian power. Furthermore, by 2008, it was clear that any energy deal involving a foreign investor would only get approval if 51% of the new entity were to be owned, or designated to eventually be owned, by Russian citizens – a trend that seemed to affect other strategic sectors as well (Interview 2008a). This is clearly one rather blatant way in which the Russian government has sought to mitigate the proposed foreign takeovers of certain companies it believes to be tied to its nation's future security – a strategy which, at the time of writing, it still seems to employ in a variety of industries, companies, and circumstances.

An excellent example of this is provided by the 2007 EniNeftegaz-Arktikgaz case. In this case, a JV company (EniNeftegaz) owned by two Italian energy companies (Eni and Enel) bid for 100% of the assets of the gas production company Arktikgaz in a public auction. The Italian JV was allowed to take over the assets by the Russian authorities upon winning the auction, but it is clear that this was only allowed to happen because a preliminary deal had been forged with the Russian gas giant Gazprom, whereby Gazprom would eventually control the assets. The companies “negotiated” an agreement in advance whereby Gazprom retained “the option to buy a 51% stake in [Arktikgaz]” (Global Insight 2007). Furthermore, Dmitry Medvedev – then Chairman of Gazprom's Board, and President of Russia only a year later – was quick to announce “that Gazprom plans to exercise the option” to buy the controlling stake (Global Insight 2007). One member of the beleaguered Russian legal community made it plain that this was not a case of “open, free auctions but rather [of] organized sales at knockdown prices . . . with predetermined winners,” where “in reality Gazprom,” a Russian government controlled entity, “is the winner” (Global Insight 2007). This case highlights the desire of the Russian government to ensure that its most strategic companies remain domestically controlled, making it clear to foreign investors that foreign takeovers are only likely to be allowed to occur in strategic sectors when they have been mitigated in such a manner.

In 2008, just after the time period covered in the database, Russia adopted a more formalized national security review process for screening foreign investments in designated strategic sectors, but, importantly, the dynamics of Russian intervention into foreign investment appear to remain largely the same. In April 2008, Russia adopted Federal Law No. 57-FZ on Procedures for Foreign Investments in the Business Entities of Strategic Importance for Russian National Defense and State Security,<sup>25</sup> often referred to as the Strategic Investments Law. This law established a Government Commission for Control over Foreign Investments, chaired by the Russian Prime Minister, which must pre-approve foreign investments into designated strategic sectors and above particular ownership thresholds that vary by the type of foreign investor and sector involved. In other words, attempts by foreign investors to gain controlling stakes, much less complete ownership, over a company in an industry associated with national security in Russia must be approved by the committee. This law has been periodically amended, notably in 2011 and 2014, but again remains broadly consistent in its approach.<sup>26</sup> It was reported that “as of April 2015, 45 activities require government approval for significant foreign investment” (US DOS 2016b, 3). These include, but are not limited to: aerospace and defense sectors, such as the production and development of munitions, armaments, and aviation equipment; media and telecommunications, such as printing activities, broadcasting, and fixed-line telephone communications; energy and natural resources, such as nuclear energy and specially designated subsoil areas for natural resource extraction given federal status; and so-called “natural monopolies” (see Article 6, Strategic Investments Law; Syrbe et al. 2014, 2). It should be noted that under separate legislation in 2014, Federal Law no. 305-FZ simply caps foreign ownership of Russian media companies at 20% (US DOS 2016b, 3).

Investment thresholds triggering a national security review by the Commission for Control over Foreign Investments varies, as already mentioned, by type of investor and sector, with some of the latter subject to separate legislation. For state-controlled foreign investors, like state-owned enterprises (SOEs), investments in over 25% of a Russian company in most strategic sectors will trigger the need for a review, investments in over 5% of a subsoil block with federal status will trigger a review, and any “acquisition of over 50% is prohibited” in a strategic sector (Stoljarskij 2011, 79), making it virtually impossible for a foreign state-controlled investor to undertake a complete foreign takeover and merger in a strategic sector in Russia. For a private foreign investor, a review is generally triggered if over 50% of a company in a strategic industry, or over 25% of a subsoil block with federal status, is acquired;

review will occur at lower levels of investment if they result in influence or control over the decision-making processes in a company in a strategic industry (Stoljarskij 2011, 79; 2012, 2). Once a company files, its application is registered and examined to see if it is, in fact, necessary to proceed with a detailed review. The application is returned to the investor without further review if the investment is either clearly prohibited under the law or doesn't meet the requirements for review (Stoljarskij 2011, 81). If a review is required, and the investor does not withdraw from the process, an investment may be approved, denied (unbounded intervention), or mitigated (bounded intervention). In the latter case, "condition[al] consent [may be given] subject to the applicant's discharge of specific obligations," such as the "maintenance of specific production sectors, [or] the continued discharge of specific state orders" (Stoljarskij 2011, 81). Deals not submitted for approval are rendered "null and void," and the parties involved will be subject to penalties (Stoljarskij 2012, 2). Negative decisions by the Commission can be appealed in court under the Strategic Investments Law, but as of May 2014, no investors had yet done so (Syrbe et al. 2014, 7; Wehrle & Pohl 2016, 70). From the establishment of the Commission and formalization of the national security review process in 2008,

the Commission has received 395 applications for foreign investment (as of March 11, 2016). Of that total number, 150 were recognized as transactions for which approval was not required; 43 applications were withdrawn by applicants; and seven had not been completed. Of the 195 applications that the Commission reviewed, 183 were approved (93.8 percent), including 49 with certain conditions. Only 12 applications (6.2 percent) were rejected. (US DOS 2016b, 4)

While the outright veto rate is not too high, the restrictions in strategic sectors erect significant barriers to foreign investment of the type examined in this book – and a number of deals are clearly modified to ensure the continued control and influence of the state and the protection of national security in these sectors.

In summation, there is now a more regularized and somewhat more transparent process for the national security review of foreign investments in Russia, but the dynamics behind this process – intended to protect Russian control of strategic industries and companies, while encouraging the "foreign investment and technology transfer...critical to Russia's economic modernization" – has remained consistent over the time period covered in the database and up to the time of writing (US DOS 2016b). There is, after all, no published or public set of criteria used by the Commission in its review process to assess what might

actually constitute a risk to nation security, giving the Commission extra leeway in how it approaches foreign investment in relation to state security and strategy, and making it difficult for investors to foresee which deals might be considered to have a “strategic element” (Syrbe et al. 2014, 1; Wehrle & Pohl 2016 30). Moreover, concerns over the unpredictability of the process, and over a “Russian investment climate . . . marked by high levels of uncertainty, corruption, and political risk,” also continue through to the time of writing, and “are unlikely to improve in the near term” (US DOS 2016b, 1; see Stoljarskij 2012; Syrbe et al. 2014).

### **The United Kingdom**

The UK provides yet another example of the many different national approaches to bounded intervention that are possible. For the time period covered in this book, the UK has arguably represented one of the most open economies to FDI, though it is possible that this degree of openness may be subject to change in the future.

Until 2002, foreign M&A were subject to the 1973 Fair Trading Act (FTA), which supplied the framework for the competition review of all mergers in the UK. Section 84 of the FTA “set a broader public interest test” to be considered by those making decisions as part of this process, including, for example, whether a proposed transaction would have an effect on “maintaining and promoting the balanced distribution of industry and employment in the United Kingdom” (Seely 2016, 9). Toward the end of the FTA regime, however, “most merger decisions were already focused on competition” alone, rather than on wider considerations (Seely 2016, 9). The FTA was replaced in 2002 with the Enterprise Act, which, as of November 2016, provides the framework for the review process for all M&A in the UK. This act, as amended, establishes an anti-trust review that is triggered for deals that reach certain thresholds: transactions that would result in an entity with over £70 million in turnover, or which would have a post-transaction market share of over 25% (Seely 2016, 4). These competition reviews were originally handled by the Office of Fair Trading and the Competition Commission, and since 2014 have been handled by the body into which these entities were merged: the Competition and Markets Authority (CMA).

Section 58 of the 2002 Enterprise Act provides for the only instance in which the Secretary of State can intervene in the M&A review process. It “allows for the Secretary of State to intervene in mergers where they give rise to certain specified public interest concerns: specifically, issues of national security; media quality, plurality & standards; and financial



stability” (Seely 2016, 3).<sup>27</sup> When the market share and turnover thresholds triggering the general merger review are not met, “the Secretary of State may [also] intervene in a very limited range of ‘special public interest cases,’ . . . where one of the enterprises concerned is a relevant government contractor . . . in defence mergers, or where the merger involves certain newspaper or broadcasting companies” (Seely 2016, 6). As in many other countries, concerns over national security or the public interest will trigger a further investigation, in the UK called a “phase 2 investigation,” after which the Secretary of State makes the final decision over whether to approve the deal, prohibit it, or mitigate the concerns raised by the transaction by making it subject to certain “conditions related to, for example, security of supply or security of information” (Wehrlé & Pohl 2016, 72). The entire review process may take up to six or nine months, and decisions can be appealed through both administrative processes and judicial review (Wehrlé & Pohl 2016, 72). Interestingly, the 1975 Industry Act also “provides the UK government with the authority to intervene when the takeover of important manufacturing concerns by nonresidents is against the national interest” (GAO 1996, 40).

For the time period covered in this book, and up to the time of writing, the UK has not hesitated to engage in bounded intervention when it feels that it is necessary to preserve national security. Indeed, the Department for Business Enterprise and Regulatory Reform (BERR), and later its replacement the Department for Business, Innovation, and Skills (BIS), even maintained a list of the most serious potential “mergers with a national security element” on its website, and provided the legal documentation given to justify intervention in those cases, as well as documentation of the undertakings made by companies in respect to the conditions imposed on the deals.<sup>28</sup> While this list only seems to have related to those mergers in the aerospace and defense sector, despite clear evidence of intervention in other strategic sectors, such transparency regarding the details of bounded intervention, even in one industry, is extremely rare, and is a sign of the UK’s valued commitment to an open FDI regime. In 2016, BIS was replaced with the Department for Business, Energy, and Industrial Strategy (BEIS), and this information can still be found using the search function on its website, or on the archived BIS website.

A good example of how bounded intervention is achieved in the UK is provided by the Finmeccanica/BAE case. In 2005, the Italian aerospace and defense company Finmeccanica sought to buy BAE Systems’ avionics and communications businesses, which had a close relationship with the UK military community. The Secretary of State<sup>29</sup> determined the deal



might adversely affect the public interest on national security grounds as a result of both the communications and avionics business transferring to the ownership and control of an overseas company. The MoD has identified two main areas of concern arising from this merger: the maintenance of strategic UK capabilities and the protection of classified information. (Boys 2005)

The government intervened and negotiated a solution with the two companies that helped to ensure those national security concerns would be mitigated, while still allowing the deal to occur. The changes made to the deal were that “the companies [would] . . . keep the businesses under the management of UK nationals [and] under the control of UK boards” (DMA 2005). Additionally, “the UK government [was provided] with ‘golden-share’-esque guarantees that the businesses cannot be re-sold by Finmeccanica without its approval” (DMA 2005). Such agreements and remedies provide clear examples of how bounded intervention may be undertaken even by states with the most open of investment regimes.

Over past decades, the UK has prided itself on its openness to FDI, and only minimal evidence exists of *unbounded* interventions on the part of the UK government during the time period covered by the cases in this book (2001–07). Periodic public debates over the UK’s openness to FDI have, however, coincided with unpopular potential and completed foreign takeovers of large UK companies. In 2006, a potential bid for the UK gas company Centrica by the Russian company Gazprom raised concerns over energy security, but the UK Prime Minister at the time reportedly “ruled out any possibility that UK ministers might actively seek to block” such a bid outright (Blitz & Wagstyl 2006; Seely 2016, 16). The 2010 takeover of the beloved UK chocolate company Cadbury by the US food company Kraft resulted in a vigorous public debate over foreign takeovers, led some Members of Parliament to call for the reintroduction of a public interest test for foreign investment, and resulted in some procedural modifications to the UK Takeover Code (Seely 2016, 16–26). And, “in May 2014, debate on the public interest test was rekindled by the plans of US pharmaceuticals company Pfizer to make a bid for the UK company AstraZeneca,” due to fears over the impact it could have on the UK science and research base (Seely 2016, 30).

Shortly after the British public voted to leave the EU by referendum in June 2016, the soon-to-be Prime Minister Theresa May indicated that under her leadership the UK government would re-examine its foreign investment review system and look into the reintroduction of a broader public interest test that takes into account a wider range of factors than those specified in the 2002 Enterprise Act. Specifically referencing Cadbury and AstraZeneca in a speech on July 11, 2016, while running for leadership of the Conservative party, May said that

a proper industrial strategy wouldn't automatically stop the sale of British firms to foreign ones, but it should be capable of stepping in to defend a sector that is as important as pharmaceuticals is to Britain.<sup>30</sup> (May 2016)

Yet, in September 2016, the UK government approved the Hinkley Point C nuclear power plant project, with significant investment from China and the French company EDF, after examining the national security implications of the foreign investment. Though this is a greenfield investment, and not a foreign takeover of the type examined in this book, it is notable for two reasons. First, the investment was mitigated through actions to ensure that EDF's controlling interest in the project could not be sold in the future without UK government approval, and the government also announced that it would take a golden share in *future* nuclear projects to make sure they could not be sold without approval (UK BEIS 2016). Second, as regards the national security review process for all foreign investment, including foreign takeovers, the government announced that:

There will be reforms to the Government's approach to the ownership and control of critical infrastructure to ensure that the full implications of foreign ownership are scrutinised for the purposes of national security. This will include a review of the public interest regime in the Enterprise Act 2002 and the introduction of a cross-cutting national security requirement for continuing Government approval of the ownership and control of critical infrastructure. (UK BEIS 2016)

Changes to the national security review process, or the adoption of a broader public interest test for foreign investment in the UK, have not been made at the time of writing. Though, in a January 2017 interview, Prime Minister May said that the UK would "in due course . . . come up with some proposals" regarding the foreign takeover review process, and indicated that the focus would be on "national security and critical infrastructure," without referencing a public interest test (Parker 2017). It will be interesting to watch developments in this area. The introduction of a wider public interest test, to place conditions or block deals on the basis of issues like domestic job retention, is beyond the subject matter of this book. Other potential changes to the national security review process, however, such as the adoption of a broader understanding of national security that includes sectors like critical infrastructure, could bring the UK review process in line with that of countries like the US, and provide the UK with a more comprehensive approach to ensuring the protection of strategic assets through both bounded and unbounded intervention.

### Summary

Differences exist in national approaches to the type of restricted intervention we associate with bounded balancing. The process for the review of cross-border M&A is more highly institutionalized among the Western advanced industrial states, which partially explains why we are more likely to see bounded intervention among the allies of the Western security communities. This is significant because higher levels of institutionalization allow allies to find alternative solutions to national security concerns, making it unnecessary for them to resort to other means, such as blocking a deal or throwing up such overwhelming opposition that the proposed acquirer voluntarily withdraws from the process. Low levels of institutionalization in states such as Russia and China – aside from the more closed natures of their markets, which pose a higher risk for investors – may also contribute to the low levels of cross-border deals in those states, especially in strategic sectors. This means we have even fewer examples of bounded intervention in these countries than we might otherwise expect.

### *Motivations for Bounded Intervention*

As with unbounded intervention, bounded intervention tends to be motivated by economic nationalism and/or geopolitical competition. The findings in Chapter 2 indicate that the relative importance of these factors varies depending on the subset of cases under examination (Figure 29).

**Figure 29 Bounded intervention: significant motivating factors**

	<b>Model I</b> <i>(All Deals)</i>	<b>Model II</b> <i>(Security Community Deals)</i>	<b>Model III</b> <i>(Non-Security Community Deals)</i>
<b>Low-Bounded Intervention</b>	Nationalism		Nationalism Inward FDI
<b>High-Bounded Intervention</b>	Nationalism	Nationalism Relative Military Power <i>(Negative Direction)</i> Resource Dependency	Nationalism Relative Military Power <i>(Negative Direction)</i>

Generally, the variable associated with a significant increase in the likelihood of bounded intervention across all cases (MNLM I) is nationalism. As suggested previously, this finding might indicate that higher levels of economic nationalism in state *A* could *also* lead a state to

protect its national interests through such measures. The analysis of the case studies that follow should help to demonstrate the accuracy of the assumption that economic nationalism is likely to play at least some role in a government's decision to employ bounded intervention.

When the population of cases was reduced to those that took place within the security community context (MNLM II), the significance of those factors representing geopolitical competition became apparent. As noted earlier, the probability of high-bounded intervention significantly increases when state *A* has higher levels of nationalism, resource dependency, and relative power.<sup>31</sup> Interestingly, relative military power is shown to be significant in the negative direction, which may indicate that under certain conditions state *A* might feel more comfortable imposing modifications to foreign takeovers when it is in an advantaged power position versus state *B*. Put simply, state *A* may not feel that it is necessary to use unbounded intervention to solve its security concerns when conditions allow for a solution to those problems through a more restricted form of intervention, which in turn helps to minimize political fallout from its actions. As will be demonstrated in the examination of the Lenovo case, this may remain true even when the acquiring state is a rising power.

In the subset of cases that occurred outside of the security community context (MNLM III), geopolitical factors again show their importance alongside nationalism. The statistical results show that low-bounded intervention was significantly more likely when state *A* had high levels of nationalism and inward FDI. The fact that IFDI is an indicator of the relative economic power positions of states *A* and *B* demonstrates that the concern over the relative geopolitical position of those states plays an important role in determining how state *A* will handle a foreign takeover that hails from outside of its security community. The results also show that high-bounded intervention was more probable in this subset of cases when state *A* had high levels of nationalism and relative military power. Military power is again significant in the negative direction, for reasons already explained.

It is evident that nationalism and geopolitical competition increase the likelihood of the restricted form of intervention identified here as "bounded intervention." As nationalism is used as a proxy for economic nationalism in the quantitative testing, the case studies that follow provide another opportunity to demonstrate the validity of this assumption and the importance of the role played by economic nationalism. The case studies also help to further refine our understanding of the role played by geopolitical competition in motivating this type of intervention. They focus on high-bounded intervention cases, which provide

both a tougher test of the hypotheses and a greater opportunity to study the dynamics behind them in detail. Low-bounded interventions, such as those discussed earlier, do not provide the same opportunity to highlight these dynamics due to their more “routine” nature, as states are usually addressing more minor national security issues in such instances.

Furthermore, the case studies in this chapter elucidate the general conditions under which a state might feel more comfortable engaging in bounded, rather than unbounded, intervention. Bounded intervention is more common than unbounded intervention, with the former representing 29%, and the latter only 8%, of the total cases in the database. This may be because allowing foreign takeovers to be completed in modified form is even less likely than unbounded intervention to disrupt trade relationships or produce antagonism between the countries involved. In other words, it best accomplishes the goal of non-military internal balancing: to balance power without necessarily disrupting the greater meta-relationship at stake between the two countries.

### **Case 6: Alcatel/Lucent**

#### *The Context*

Before delving into the Alcatel/Lucent case, it is important to understand where it stands in the context of the broader M&A market. This particular case involves a French company acquiring a US company in the telecommunications equipment manufacturing industry, which is part of the larger technology sector. Within the parameters of the database created for this investigation, sixty-eight US companies were targeted for foreign acquisition, and only *seven* of these deals occurred within this particular industry (see Figure 30). Of those, only one involved an acquirer from a country that the Correlates of War project does not classify as a member of the same security community as the US,<sup>32</sup> and that country was Sweden, which – though not a member of NATO – remains a very close NATO partner with significant economic, political, and cultural ties. This suggests that in the US, a foreign takeover in this industry is usually more likely to see successful completion when the acquiring company hails from a state with a close relationship to Washington.

Furthermore, of those seven cases, the US engaged in some form of intervention in almost every one: bounded intervention in five cases, unbounded intervention in one case, and no intervention in only one case. Significantly, there are indications that the US government would likely have engaged in some form of intervention in the latter instance

**Figure 30 Dataset subset: cross-border deals between the US and France**

<b>Year</b>	<b>Acquirer (French)</b>		<b>Target (American)</b>	<b>Sector</b>	<b>Industry</b>	<b>Intervention Type</b>	<b>Deal Outcome</b>	
2003	Business Objects	FR	Crystal Decisions	US	Technology	Software	None	Deal
2006	Alcatel	FR	Lucent Technologies	US	Technology	Telecom Equipment	Bounded	Changed Deal
2007	Compagnie Générale de Géophysique	FR	Veritas DGC	US	Oil & Gas	Producers, Equipment, and Distribution & Services	None	Deal
2007	Capgemini US	FR	Kanbay International	US	Technology	Computer Hardware	None	Deal
2007	Schneider Electric	FR	American Power Conversion Corporation	US	Technology	Computer Hardware	None	Deal
<b>Year</b>	<b>Acquirer (American)</b>		<b>Target (French)</b>	<b>Sector</b>	<b>Industry</b>	<b>Intervention Type</b>	<b>Deal Outcome</b>	
2002	Platinum Equity	US	Alcatel SA's European Enterprise Distribution & Services Business	FR	Telecom	Fixed Line Telecom	None	Deal
2003	PanAmSat Holding Corporation	US	Eutelsat	FR	Telecom	Satellite Telecom	Unbounded	No Deal
2002	Intelsat	US	Eutelsat	FR	Telecomm	Satellite Telecom	Unbounded	No Deal
2004	UGI Corporation	US	AGZ Holding	FR	Oil & Gas	Producers	None	No Deal
2005	Legg Mason	US	Permal Group	FR	Financials	Investment Services (Stock Exchanges)	None	Deal*
2005	Legg Mason	US	Permal Group	FR	Financials	Investment Services (Stock Exchanges)	None	No Deal*

\* In the first deal, Legg Mason acquired 80% of Permal; in the second, it failed to acquire the remaining 20% of the company.

if the proposed bid had not been dropped before it was formally announced. The suggestion here is that even among allies, this sector is considered so strategically important that deals must at the very least be mitigated in order to ensure the protection of technology related to national security.

The Alcatel/Lucent merger is also the only instance in the dataset in which a French company even tried to buy a US company in this particular industry. In fact, in the dataset as a whole, there are only fifteen cases of a French company buying a foreign company in one of the target countries being examined here, and only five of those cases involved the purchase of a US company. Four of these five cases occurred in the technology sector as a whole, but only the Alcatel/Lucent deal involved the telecommunications hardware industry. This indicates that while takeovers in this subset of the technology sector have been rare, French takeovers of US companies in the technology sector as a whole are not. Figure 30 shows that French takeovers in the rest of the sector met with little resistance, highlighting the need to explain intervention in this case.

### *Significance*

Beyond this market context, a number of factors make the Alcatel/Lucent merger a critical case. First, it is one of the most severe examples of high-bounded intervention. This is because the US government employed a mitigating tool now known as an “evergreen clause,” giving it the ability to reverse the merger at a future date if it becomes dissatisfied with the new entity’s adherence to the security agreement it signed as part of the review process. As the first known case in which such a method has ever been used, most market and research analysts consider it critical for understanding the nature of such intervention.

Second, this is also one of the clearest cases of bounded intervention available for study. Detailed knowledge of such cases is quite rare, because the mitigating measures taken by governments are usually classified. Thus, even when we know alterations are made to a deal, we normally only hear the details of those measures if they are voluntarily released by the companies or are leaked to the press. The wealth of information in this case is, therefore, important to study.

Finally, the case is critical to this investigation because it provides a better understanding of the role of bounded intervention within security communities. To understand how, it is necessary to momentarily return to a discussion of the statistical context illustrated in Figure 30. Out of the six attempts by US companies to buy French companies in any

sector in the database, only one was successful. This reflects the high level of economic nationalism in France generally, and the geopolitical antagonism toward foreign takeovers by US companies in particular – as illustrated by the infamous PepsiCo/Danone case examined in Chapter 3. Conversely, the Alcatel/Lucent case is the only instance in recent history in which the US intervened when a French company tried to purchase a US technology company. As will be discussed, this is partly because of the timing of the Alcatel/Lucent deal, which came immediately on the heels of the DPW debacle and shortly after the CNOOC case, ensuring that economic nationalism would play a small but important role in the reaction of the US government. Yet, as will be shown, intervention was also triggered by geopolitical concerns. Indeed, the Alcatel/Lucent case is the only one in which a French company targeted a US company that was involved in classified government work and contracts, heightening the geopolitical implications of the deal for the US.

The case is thus critical because it helps to highlight something that the statistical investigation in Chapter 2 could not: that although economic nationalism will tend to play a significant role in cases of bounded intervention within security communities, such an alliance relationship does not necessarily preclude an important role for geopolitical concerns. In the PepsiCo/Danone case, French fear of US hegemony almost mandated such a foreign takeover be blocked. In this case, the US had less to “fear” from France, but France’s desire to score a geopolitical coup against the US, its determination at the time to cast the US in a bad diplomatic light, and its disregard for certain US sanctions regimes ensured that the political tensions between the two countries would exacerbate the national security concerns raised by the sensitive nature of Lucent’s work.

### *The Story*

On March 24, 2006, rumors of a merger between Alcatel SA of France and Lucent Technologies of the US hit the newswires (Zephyr 2006b). The two companies had discussed a possible merger in 2001, but those talks had failed “over how much control [Alcatel] would have” of a new combined entity (Frost 2006). “Since then, however, Alcatel ha[d] grown faster than Lucent, giving it a clear upper hand in merger talks” (Frost 2006). Additionally, the sporadic bankruptcy rumors Lucent had faced in 2001 and 2002, as well as the periodic cutbacks and profit warnings it had suffered, made a merger with Alcatel now seem much more appealing (see McKay 2006a; Morse 2006).



Both Alcatel and Lucent were telecommunications equipment manufacturers in the technology sector.<sup>33</sup> Yet, while the majority of their business focused on the private sector, each company held defense contracts with its respective government, and each had divisions dedicated to the development of sensitive technology. Alcatel, for example, owned a stake in two satellite-manufacturing JVs, Alcatel Alenia Space and Telespazio, with Italy's Finmeccanica. Alcatel Alenia worked on sensitive projects such as the first iteration (Giove-A) of the Galileo Satellite (see Alcatel 2006b). Lucent, meanwhile, held a number of contracts with the US DOD that ranged from providing it with "classified technology" to supplying "telecoms equipment for the Iraqi reconstruction project" (MacMillan 2006). Lucent also owned and operated Bell Laboratories, an entity that for eighty years had conducted classified work for the US government: producing the transistor, the laser, and the touch-tone phone, while pioneering solar cells, cell phones, and the communications satellite (Alcatel-Lucent 2008; Reuters 2006a). Such pedigrees indicated that any deal between Alcatel and Lucent would raise national security concerns for both the US and France.

Not surprisingly, many analysts who felt the deal might make sense economically remained wary that its security implications could lead to failure if not addressed early, adequately, and carefully (see e.g., AFP 2006c; McKay 2006b; Morse 2006; Wickham 2006). Others believed that, even then, the deal might be blocked (see e.g., MacMillan 2006). Thus, while it remained only a rumor, analysts had already begun to contemplate the different ways the deal might be mitigated in order to satisfy both Washington and Paris. The most common suggestions and commentary assumed that, at the bare minimum, France would encourage Alcatel to sell its satellite divisions to another French company, such as Thales, and Lucent would need to protect Bell Labs by either divesting it, or creating a subsidiary that would be closed off from foreign influence (see e.g., Butler 2006; Dow Jones 2006c; McKay 2006a; Morse 2006). These hurdles were not low, but many market and industry observers believed that, if they were executed well, the merger would not be blocked unless it became "a political football" like the DPW deal (MacMillan 2006). Indeed, it was unlikely that France would completely block a deal that was largely in its favor, and that was viewed as a triumph for the French tech industry.<sup>34</sup> In the end, the lack of French cooperation geopolitically, combined with the need to protect classified materials and the rising protectionist sentiment in the US at that particular time, ensured the US government would at least intervene in a bounded fashion; and extreme politicization of the deal could have resulted in unbounded intervention.

By April 2, 2006, a definitive merger agreement was reached between the two companies valued at US \$13.4 billion, giving Alcatel shareholders a 60% stake of the new combined entity and Lucent shareholders 40% (Zephyr 2006b). Because concerns over equality had quashed attempts by the two companies to merge in 2001, a clear effort was made to sell this as a “merger of equals” (MacMillan 2006). Hence, it was announced immediately that Lucent’s CEO Patricia Russo would head the new combined company, and in return its headquarters would remain in Paris, its CFO would come from Alcatel, its COO from Lucent, and the new board of directors would be equally drawn from Alcatel and Lucent’s existing board members (AFX 2006a). Yet, despite these overt efforts toward equal partnership, the market generally viewed and treated the deal as a foreign takeover of a US company by a French one (Intereview 2008b). Lucent was clearly the “junior partner” in the merger, and even M&A databases such as Zephyr classify the deal as an acquisition of Lucent by Alcatel (MacMillan 2006; Morse 2006; Zephyr 2006b). Thus, while the details of the French position will still be discussed, Lucent will be treated as the target company for the purpose of this investigation.

Unlike most of the cases examined in the previous two chapters, Alcatel and Lucent sought to address the national security implications of their proposed deal before it was even officially announced.<sup>35</sup> In France, Alcatel sought early on to push through a previously discussed arrangement whereby the French defense electronics company Thales would take Alcatel’s stake in its satellite JVs in return for a stake in Thales (see TelecomWeb 2006c). This deal would both calm France’s worries about sensitive technology being seen by foreign citizens and help the government protect the vulnerable French Thales from a takeover by the European EADS (see Dow Jones 2006d; Financial Times 2006a; TelecomWeb 2006c). In the US, Lucent issued a press release when the proposed merger was announced in order to calm fears over the future security of Bell Labs. The release stated that “the combined company [would] form a separate, independent US subsidiary under Bell Labs . . . to perform research and development work for the US government that is of a sensitive nature,” and that Bell Labs would not be moved or its leadership changed (Lucent 2006). Lucent also announced it “ha[d] asked three experienced and distinguished members of the national security community to serve on the independent subsidiary’s board, . . . subject to US government approval,” namely former Secretary of Defense William Perry, former NSA Director Lieutenant General Kenneth Minihan, and former Director of Central Intelligence James Woolsey (Lucent

2006). These actions were meant to “black box” Bell Labs from foreign control and influence, allowing only the revenue from its activities to go to the new entity. Such special subsidiaries can alleviate national security concerns, allowing governments, that wish to do so, to mitigate foreign takeovers without having to block them outright. By announcing their willingness to create such a subsidiary early on, Alcatel and Lucent were trying to anticipate the problems their deal might face, and cast their intentions in a positive light. It was likely hoped this would alleviate existing geopolitical tensions between the two countries in order to prevent the kind of unbounded intervention that had been so recently faced by DPW and CNOOC in the US. The companies then “submitted a voluntary notice of the merger to CFIUS in August 2006” (Alcatel 2006a), and were reported to have worked (and cooperated) closely with that same body in order to resolve the US government’s concerns (Dow Jones 2006e).

In order to properly understand the US reaction to the Alcatel/Lucent merger, it is necessary to examine the political context in the US at that time. This deal surfaced just after the heavily politicized DPW case, which unleashed a furor of congressional rhetoric about the threat foreign takeovers could potentially pose to national and economic security. Both economic nationalism and national security awareness were therefore abnormally heightened by this time, and were being manifested in a rush of legislation proposed to reform CFIUS and make the foreign takeover review process more stringent.

Not surprisingly, Congressman Duncan Hunter (R-CA), who had been vociferously against the DPW deal, came out early on against the Alcatel/Lucent deal (see AFX 2006b). In a letter to President Bush dated April 28, 2006, Hunter stated:

I have several grave concerns about the potential merger . . . [that] arise in large part because Lucent Technologies and Bell Labs, a critical component of the parent company Lucent Technologies, conduct a significant amount of highly classified work for the United States government, including the Department of Defense. I am skeptical whether the current CFIUS process could provide adequate, verifiable assurances that such sensitive work will be protected. (Silva 2006a)

Both companies responded directly to Hunter’s concerns, reiterating the precautions they had already announced regarding the future of Bell Labs. Yet, it was clear that Hunter no longer believed CFIUS to be an effective review body and was voicing his concerns in order to make CFIUS more accountable.

Another issue raised by Hunter, which the companies, interestingly, did not immediately address, was the fact that the merger “could result in transfers of sensitive technologies or information to several countries with which Alcatel has dealings, including [Myanmar], China, Cuba, Iran, North Korea, Sudan, and Syria” (Inside US Trade 2006a). This is significant for the discussion of geopolitical tensions that follows, because though the US and France are part of the same security community, long-standing tensions over French disrespect for US-led sanctions regimes proved difficult to overcome, making it highly likely the US government would intervene in some way in this case in order to protect the technology involved.

Despite these concerns, Congressman Hunter was largely alone in his desire to block the deal. In other words, his rallying cry for unbounded intervention was not answered in this case, because the French position as a formal ally made bounded intervention both more desirable for the US and more creditable within the international community. Unlike the Check Point/Sourcefire deal, it seemed possible that mitigation could satisfactorily address the geopolitical and security issues raised by this deal, because the critical technology concerned did not represent all of Lucent’s business. Hence, it was reported that Hunter’s message did not “resonat[e] with many other members of congress” and was not echoed by them (Inside US Trade 2006a). Indeed, “one private sector source” made it clear that Hunter’s actions were an attempt “to politicize the CFIUS process,” but “doubted [his actions] would impact a presidential decision on the CFIUS recommendation” regarding this deal “or on the broader debate over how to reform the CFIUS process” in general (Inside US Trade 2006b).<sup>36</sup>

By mid-September 2006, the Alcatel/Lucent deal had received most of the necessary regulatory approvals. The deal was approved by the boards of directors of both Alcatel and Lucent on April 2, and by the shareholders of both companies on September 7 (Zephyr 2006b). The merger also received anti-trust approval from the US Department of Justice on June 8, and competition clearance from the European Commission on July 24 (Johnson 2006; Zephyr 2006b).

It is clear, however, that the heightened protectionist sentiment post-DPW/P&O, the one-off factor of the CFIUS reform debate that DPW and CNOOC had triggered, and geopolitical tensions with France, did contribute to a more rigorous investigation of the Alcatel/Lucent deal within CFIUS. On October 6, it surfaced that CFIUS would engage in the formal forty-five-day investigation (in addition to the normal thirty-day review) of the proposed merger. In fact, Clay Lowery, the

Treasury Assistant Secretary for International Affairs, later testified before Congress in regards to the Alcatel/Lucent review that “CFIUS conducted one of the most rigorous and thorough investigations ever on a transaction before the committee” (Dow Jones 2006e).

These factors motivated the US government to engage in one of the most severe cases of bounded intervention in its history. It was announced on November 14 that CFIUS had concluded its review of the proposed merger, and on November 17 that President Bush had accepted CFIUS’ recommendation to approve the deal, which by then included numerous mitigating changes requested by CFIUS and agreed to by both companies. It is likely that the proactive stance taken by both Alcatel and Lucent toward the mitigation of the US government’s national security concerns helped them to navigate this process successfully, as did the fact that “CFIUS ha[d] been in contact with the companies even before the . . . formal security review process began” (Dow Jones 2006e). By November 30, 2006, the merger was officially completed, and the entity Alcatel-Lucent opened for business under its new moniker the next day.

Yet, it is important to understand that while this deal seemed to the general public to go through without a hitch, the US government actually did engage in one of the clearest and intense examples of bounded intervention of which the details are publically known. For, in addition to the proposed provisions made by the two companies regarding Bell Labs, which were adopted in the final agreement, the US government required Alcatel and Lucent to “enter into two robust and far-reaching agreements designed to ensure the protection of [US] national security”: a “National Security Agreement and a Special Security Agreement” (TR Daily 2006). Though the exact details of these agreements are classified, it is assumed by the market that they covered the provisions made for the protection of Bell Labs and other classified work and contracts held by Lucent.

Furthermore, it was later confirmed that these agreements contained the evergreen clause mentioned earlier, allowing the US government to call for a reversal of the merger at any future date if it felt that the agreements were not being properly implemented. According to private-sector sources, such a clause had never been used before in the US, and many viewed it as highly detrimental because it might prohibit future FDI (Interview 2007). Thus, on December 5, 2006, the Business Roundtable, the Financial Services Forum, the Organization for International Investment, and the US Chamber of Commerce wrote to then Secretary of the Treasury Henry Paulson to “express concern over [the] so-called ‘evergreen’ . . . condition . . . attached to CFIUS’ approval

of the Alcatel/Lucent merger” (Inside US Trade 2006c). They pointed out that the serious nature of the inclusion of the evergreen clause lay in the fact that

The bedrock principle of openness...is challenged when the Executive imposes conditions on investments that effectively allow it to re-investigate transactions, impose new conditions, and even potentially unwind the transaction at any time. That CFIUS sought to and, apparently, did impose this condition on the Alcatel/Lucent merger is a disturbing departure from the government’s stated support for an open trade and investment regime. Such conditions can chill investment, make those who do invest more cautious about the types of commitments they are willing to give the government in the context of the CFIUS review and, ultimately, harm the economy. (Inside US Trade 2006c)

The text of their letter shows both how rare and how severe the nature of this particular bounded intervention was. For, it was apparent that the government did not intend to block the merger, i.e., did not intend to engage in unbounded intervention. However, it is also clear why this was a case of high-bounded intervention in the dataset, for this is the closest a country can come to blocking a deal without actually doing so. The investigation of the variables that follows shows that national security concerns combined with geopolitical tensions and economic nationalism to result in this outcome.

### *Geopolitical Competition*

The overall US–French geopolitical relationship had not significantly altered since the PepsiCo/Danone case in 2005, though in the Alcatel/Lucent case the target company was American. France and the US remained part of the same security community, yet geopolitical tensions still existed between the two major powers. The US, of course, did not view France as a threat in the same overarching manner that France viewed US hegemonic power. However, France’s stated desire to compete with the US for strategic power within the international system would necessitate that the US could not necessarily trust France in the same way it might other allies. Indeed, the French government remained opposed to the US stance on Iraq and Iran, and continued to do business with countries on which the US had imposed explicit export control regulations or strict sanctions regimes.

This deal therefore had very different geopolitical implications for France and the US. For the French, this takeover was seen as a great achievement for French economic power. Yet, because fears of American hegemony remained, the French government was careful to take steps

that would protect its sensitive technology “from prying American eyes” (TelecomWeb 2006c). French President Jacques Chirac thus became personally involved in the deal, with the French government eventually backing a sale of Alcatel’s satellite divisions to Thales, as already mentioned.<sup>37</sup>

For the US, the geopolitical implications of the deal had a tri-fold effect on government intervention. First, the geopolitical relationship between the US and France ensured that the deal would not be blocked outright, but rather that it would be mitigated if necessary. The US had no need to intervene in an unbounded fashion that would arouse French anger unnecessarily, and that would be likely to cause a resurgence in the tensions that had only just begun to ease. Given the sector and the countries involved, it is fairly obvious that US resource dependency did not play a role in this deal.<sup>38</sup> As the clearly more powerful country in terms of military and economic might,<sup>39</sup> the US also did not need to react to this case in the way that France had reacted to Pepsi’s bid for Danone. Furthermore, there was a desire not to engage in the same kind of overt protectionist rhetoric or unbounded intervention for which France was so well known. For, if unbounded intervention had been used in this case, it would undoubtedly have caused the French (albeit somewhat ironically) to use their soft power to denounce the US as a protectionist country on the world stage, which was an unwelcome possibility following the wealth of such statements that had flowed in the wake of DPW and CNOOC. Hence, the Administration’s statement that President Bush’s decision in favor of the deal “demonstrates the commitment of the United States to protect its national security interests and maintain its openness to investment, including investment from overseas which is vital to continued economic growth, job creation, and an ever-stronger nation” (Silva 2006b). Also, the US still hoped at this point to obtain French assistance on such diplomatic fronts as the nuclear situation with Iran (see Wendlandt 2006). For such reasons, the market foresaw that there would be problems with the deal because of US–French politics, but there was a general belief that such problems could be overcome through the type of mitigation classified here as “bounded intervention” (Morse 2006).

Second, France’s stated desire to enhance its geopolitical position vis-à-vis the US ensured that mitigation would be necessary. French geopolitical and economic aspirations, as well as its previous truculence toward the US on the world diplomatic stage, necessitated (at the very least) the rigorous protection of national security-related technology through measures such as the national security agreement and special security agreement that were eventually implemented as part of the deal. If unbounded



intervention was not a seemly option for the US in this case, it was clear that bounded intervention of some form would be necessary. Furthermore, it was clear that France was engaging in similar mitigating measures in order to protect its satellite technology from the US through the sale of the Alcatel Alenia and Telespazio JVs. Hence, Congressman Hunter argued in his letter to President Bush that “the United States government must be able to protect its national security interests in at least the same manner as the French government” (Inside US Trade 2006a). On this particular point, at least, the rest of the US government seemed to agree with Hunter.

Finally, the French position of doing business with countries from which the US most wanted to protect its vital technology contributed to the severity of the mitigating measures that were eventually imposed. The need to ensure the security of the highly sensitive technology conducted at Bell Labs and involved in the government contracts held by Lucent would by necessity make the US mitigation procedures rigorous. Yet, given the outcome of the CFIUS review process and the implementation of the evergreen clause in the security agreements concluded between Alcatel/Lucent and the US government, it is clear that at least one of the other issues Congressman Hunter raised publicly was echoed confidentially within the CFIUS review process. This, of course, was the concern that the merger might “result in transfers of sensitive technologies or information to several countries with which Alcatel has dealings, including [Myanmar], China, Cuba, Iran, North Korea, Sudan, and Syria” (Inside US Trade 2006a). Indeed, upon the merger’s completion, the new Alcatel-Lucent CEO Patricia Russo, a US citizen, announced, “I am forbidden by law from being involved in business in Iran . . . Clearly we have to respect US laws” that say “US citizens cannot participate in business done in US-sanctioned countries” (Optical Networks Daily 2006; Wendlandt 2006). The timing of her announcement implies that this was an issue raised within the CFIUS process. It was also followed by speculation, which was likely accurate, that the possibility of Alcatel-Lucent continuing to do business with Iran after the merger may have prompted CFIUS to include the evergreen clause that would allow the US to unwind the merger in the future (see e.g., Wendlandt 2006). Professor Antonia Chayes later commented that “if Alcatel were to actively pursue business with Iran it could create tensions between the US and France at a time when the US is trying to bring France into supporting sanctions against Iran” (Wendlandt 2006). Thus, tensions with France and the French position on Iran motivated the US to intervene in this case in order to protect its technology and national security. At the same time, however, the US desire to gain French cooperation on the Iranian



issue and ease tension with its French ally ensured such intervention would be bounded rather than unbounded.

### *Economic Nationalism*

Though economic nationalism had been relatively low in the recent history of the US, economic nationalism and national security awareness were abnormally heightened in 2006 in the wake of CNOOC's attempted acquisition of Unocal and the row over DPW. As already mentioned, this was highlighted by the large number of legislative and regulatory proposals put forward at that time both to reform CFIUS and to make the foreign takeover review process it oversees more stringent. US nationalism was, as usual, fairly high in 2006, at 71% (WVS 2001–04), and pro-globalization sentiment, while still above the median value among the fifty-four surveyed countries, was at the lowest level since its peak in 2002 (see IMD 2007b).<sup>40</sup> Rising protectionist sentiment was also clearly recognized in the US at the time (AFP 2006c), and some analysts feared that the deal “could yet fall afoul of political obstacles at [such] a time of heightened protectionism” (Frost 2006).

Furthermore, though Bell Labs, within Lucent, was not officially labeled or discussed within the national discourse as a national champion per se, it would certainly qualify as one because of the integral role its technology has played in the making of America as a superpower. It has provided some of the innovations in military, surveillance, and communications technology seen as vital to the protection, projection, and augmentation of that power's national capabilities. Thus, though the US has not traditionally supported companies as national champions, it is clear that the special role of Bell Labs in the American power structure helped to ensure that its work would be protected by the government from an unconditional foreign takeover, and that the deal would need to be altered to accommodate this fact.

Nevertheless, the transaction did not see the same kind of virulent reaction as did the DPW deal. This was largely because the Alcatel/Lucent deal was not heavily politicized, helping to stem the forces of economic nationalism that may have been present at the time. Only one member of the legislature, Congressman Hunter, was deeply opposed to the deal, and his true concern seemed to be the safety of the technology produced by Bell Labs and the possibility it would be sold on to unfriendly regimes, rather than opposition to the sale of the company as a complete economic entity. Furthermore, complete agreement existed in the market that these concerns and Hunter's activities would not be strong enough to block the deal as a whole (see AFP 2006c).

Thus, the real role of economic nationalism in this case was more indirect: its presence forced CFIUS to review the case more thoroughly than any other in US history (Dow Jones 2006e), and in this way it may have contributed to the decision to impose stricter mitigation measures than ever before in the form of the evergreen clause.

### *Interest Group Presence*

Though a small number of interest groups opposed the Alcatel/Lucent deal, their pressure did not play an important or decisive role in prompting government intervention in this case. In part, this was because these groups were unconcerned with either geopolitics or the protection of a national champion, but instead opposed the deal on the grounds that those they represented would not be making enough of a profit. In France, “Proinvest, a shareholder-rights consultant to leading French institutional investors, . . . advised [its] clients to vote against the . . . merger” on the basis that Alcatel was overpaying for Lucent (Matlack 2006). Meanwhile, in the US, “some Lucent shareholders . . . pursu[ed] a class-action lawsuit contending just the opposite – that they will get too little from the merger” (Matlack 2006). Significantly, this minority shareholder group’s attempt to get a court order to postpone the shareholder vote was unsuccessful, and Institutional Shareholder Services, a powerful corporate governance/proxy voting services firm that provides research and recommendations on such deals, came out in support of this one (Les Echos 2006). In the end, the shareholders of both Alcatel and Lucent approved the merger, as did the boards of both companies (Zephyr 2006b). Most importantly, at no time did any of these interest groups suggest that the US government should intervene in the deal in any way.

The only group that even suggested the deal “raises national security issues and should be referred to . . . CFIUS” was the “US Business and Industry Council lobbying group” (Jane’s Defence Weekly 2006). Yet, this was also the same group that later came out against the inclusion of the evergreen clause in the security agreements that Alcatel and Lucent eventually signed with the US government. Thus, while it is apparent that this particular group may have desired some form of bounded intervention if it was deemed necessary for national security purposes, it certainly did not desire it on such a scale. Furthermore, in hindsight, it is clear that the Council’s position was taken long after both companies were already in consultation with CFIUS because of the early recognition that some form of mitigation would be necessary for the protection of national security and the satisfaction of the geopolitical concerns

already mentioned. It can be concluded that this particular lobbying group did not play a role in motivating government intervention in this case either.

Finally, the labor unions in both the US and France did not play a role in US government intervention on this occasion. It is true that the French labor unions were “upset” by Alcatel’s plans “to do away with a 23 year-old practice of having employee representatives on its board” once the merger was completed (Gauthier-Villars 2006). Yet, this did not ultimately end up being an issue, and opposition quickly died down in France. Though heavy job losses were expected as a result of the merger (McLean 2006), it did not result in heavy union opposition. This is partly because the cuts were expected to take place in the US rather than France. If the scenario were reversed, union opposition would have been much more likely (see Sage 2006). Though labor groups and employees in the US were aware that most of the job cuts would take place in their country, they seemed more concerned over the fate of “health benefits and pensions” (McKay 2006c), and did not attempt to prompt the type of bounded government intervention that eventually occurred.

#### *Competition Concerns*

Anti-trust competition concerns also did not turn out to be an issue in this case. The EU Commission announced its approval of the “proposed transaction” on the basis that it “[would] not significantly impede effective competition” (EU Commission 2006a). This was because the companies, though “engaged in similar activities,” were sufficiently “focused on different regions” (AFP 2006b). The US Department of Justice also “granted antitrust approval” to the deal on the basis that it did not raise any significant competition concerns (Johnson 2006).

#### *Conclusions on Alcatel/Lucent*

The preceding discussion of the variables illustrates that in the Alcatel/Lucent case, both geopolitical competition concerns and economic nationalism played a role in motivating bounded government intervention, and that the former factor played a more direct role than the latter. It has also been shown that competition concerns and interest group pressure did not play a significant role in motivating government intervention in this case.

Thus, the US was not intervening solely for reasons of heightened economic nationalism at that particular point in time, but because of geopolitical concerns that were exacerbated by the sensitive nature of Lucent’s

work. This fact shows the importance of both variables, highlighting a behavior that can be lost in MNLM I, where most cases of bounded intervention are associated with economic nationalism, and geopolitical concerns only near significance. The case supports the findings in MNLM II, which show that geopolitical factors can play a significant role in increasing the likelihood of bounded intervention within security communities, as can economic nationalism. Critically, this case demonstrates that even within security communities, geopolitical competition considerations can be of equal or greater importance compared to economic nationalism in motivating bounded intervention.

### **Case 7: Lenovo/IBM**

#### *The Context*

The next case examines Lenovo Group Ltd.'s takeover of the International Business Machine (IBM) Corporation's PC business in 2005. Lenovo is a Chinese company whose majority stockholder is Legend Holdings Ltd., a holding company owned and controlled by the Chinese government. IBM, of course, is the pioneer of the original personal computer, and, in 2005, retained its position as the primary supplier of computers to the US government.

This case is critical for two reasons. First, the Lenovo/IBM takeover is an excellent example of an extremely rare case type. Chinese acquisitions of this size, and in the national security industries examined here, have only been attempted twice in the US between September 11, 2001 and May 15, 2007.<sup>41</sup> The first instance was the CNOOC/Unocal case of unbounded intervention examined in Chapter 3, the second the Lenovo/IBM transaction. Such cases have largely been viewed as threatening in the US, because the government of the rising Chinese power has openly stated its desire to use the market to gain power, influence, and technology for military and civilian use.

This case is also critical for testing the primary and secondary hypotheses, as it helps explain why two cross-border acquisitions between similar countries, and under seemingly similar conditions, might lead to dissimilar outcomes. For, while the CNOOC/Unocal case resulted in unbounded intervention and no deal, the Lenovo case only led to bounded intervention and a mitigated deal. Yet, both cases occurred in the same year (2005), and were therefore subject to the same general level of geopolitical tension and economic nationalism. How, then, can the different outcomes be explained within the context of the primary and secondary hypotheses?

The answer is that, while geopolitical concerns were once again the primary, and economic nationalism the secondary, motivation for intervention in a case that occurred outside of the context of a security community, specific elements of the case helped to ameliorate those variables in a way that ensured intervention would only take the form of bounded intervention. In other words, this case is critical because it enables us to examine the hypothesis in a way that strict statistical data testing cannot. The results of the multinomial logit function performed in Chapter 2 only confirmed that the presence of geopolitical competition and economic nationalism makes both bounded *and* unbounded intervention more likely than no intervention at all. This case study, however, in conjunction with the CNOOC case, can help us to understand why a government might choose one of these forms of intervention over the other.

### *The Story*

On December 7, 2004, it was announced that Lenovo would acquire 100% of IBM's PC Division for a total consideration of \$1.75 billion.<sup>42</sup> It seemed that despite "Big Blue's" traditional role as the flagship of US computer technology, the PC division had become its least profitable business, with its software development and consulting services divisions providing much higher margins. IBM was thus looking for a buyer for the division, and welcomed Lenovo's bid (see Hachman 2004). As will be discussed, no competition concerns were expected and the deal received an early termination of its anti-trust review from the Federal Trade Commission on January 7, 2005 (Spooner 2005a). Similarly, there was no real interest group movement against this deal. Shareholders were eventually won over, and US labor groups were largely unconcerned as it was clear that no real job losses would result from the takeover.

However, it was obvious early on that the deal would need CFIUS approval. This was both because of the industry involved, and because the majority shareholder in Lenovo was, and remains, the Chinese government, which owned 57% of Lenovo's stock through a government-owned and controlled holding company called Legend Group Holdings (Bilodeau & Kennedy 2005; Ramstad 2004). As a result, the companies "formally filed a notice seeking CFIUS clearance on December 29, [2004]" (Bilodeau & Kennedy 2005).

By January 24, 2005, the first report surfaced of concerns emerging within CFIUS on national security grounds in a widely read and cited Bloomberg article (see Bilodeau & Kennedy 2005). This article cited anonymous sources saying that "members of [CFIUS], including

the Justice Department and Department of Homeland Security, [were] worr[ie]d that Chinese operatives might use an IBM facility in North Carolina to engage in industrial espionage, using stolen technologies for military purposes” (Bilodeau & Kennedy 2005).

On the following day, three congressmen sent a letter to CFIUS urging it to conduct a more rigorous forty-five-day review of the deal because of national security concerns (Orol 2005e). They were three fairly powerful congressmen, whose input was likely to be taken into consideration by CFIUS: Duncan Hunter, Chairman of the House Armed Services Committee, Henry Hyde (R-IL), Chairman of the House International Relations Committee, and Donald Manzullo (R-IL), Chairman of the House Small Business Committee (Orol 2005e). Only Rep. Manzullo seemed to be truly motivated by what could be identified as economic nationalism. He feared the deal might provide China with control over the PC industry, or that China might be using “unfair” government subsidies in order to help Lenovo purchase IBM. As will be discussed further, however, the congressmen were primarily focused on the geopolitical concern that sensitive or dual-use technology might be transferred to a non-allied state, which could then apply it to military use. Given the Chinese government’s own stated intent to use foreign takeovers for this purpose,<sup>43</sup> and its control over Lenovo, the idea was not far-fetched.

Despite this, the market was still somewhat surprised on January 27 when CFIUS extended its review to the further, and more intensive, forty-five-day investigation (see Moody 2005). For, while some analysts had expected the deal to result in stark unbounded intervention (see e.g., MPR 2005; WSJ 2005b), others truly believed that any security concerns could be dealt with in the initial thirty-day review (see Bilodeau & Kennedy 2005). This was because, though the PC business did involve some “high tech” aspects, and was once at the forefront of technology in the US, it was now considered to be relatively “low tech,” in addition to “low margin,” by some market analysts (see e.g., Blustein & Musgrove 2005; Sinocast 2005b). As will be discussed, however, the more optimistic analysts were not really thinking of the dual-use military applications of some of that technology, nor did they realize how seriously the US government seemed to take the Chinese espionage issue. IBM’s PC business was located in Triangle Park, NC, where other IBM research and development projects were being carried out for the US government.

In the end, the government was able to work out a solution to these national security concerns with the cooperation of the companies involved. On March 9, 2005, IBM announced that the takeover “was

cleared by the US government” at the end of the forty-five-day extended review (Moody 2005). It was reported that “Lenovo overcame US concerns that the Chinese government would use Lenovo’s PCs and the US facilities for espionage” so successfully that CFIUS eventually agreed to “give the deal its unanimous consent” (Auchard 2005a; Moody 2005). The deal was officially completed on May 2, 2005. Though many of the exact details of the alterations made to the deal for national security reasons remain confidential, both the government and the companies publicly acknowledged such measures were put in place. Furthermore, the changes that were announced or leaked to the press, as discussed later, highlight the credence given to geopolitical concerns over espionage and technology transfers to non-allied states.

The investigation of the variables demonstrates that, as with the CNOOC/Unocal case, intervention in the Lenovo bid was primarily motivated by geopolitical competition concerns, and secondarily by economic nationalism. In other words, the presence of these factors made some form of intervention more likely than no intervention at all. In this case, however, the result was bounded rather than unbounded intervention because the specific aspects of the deal afforded the government the option to choose mitigation over an outright block, which was a more diplomatic solution to the protection of national security, and a more favorable one given the US’ preference for open and engaged economic relations with China.

#### *Interest Group Presence*

No real interest groups were pressing for government intervention in this case. Though some of Lenovo’s shareholders originally came out against the takeover, their concerns were soon overcome and they approved the deal on January 28 (Datamonitor 2005). Significantly, however, Lenovo’s shareholders were worried that the deal would be blocked by the US government, or that a new combined entity might face difficulty in successfully combining the very different cultures of the two companies (ComputerWire 2005). In no way did they desire the US government to intervene, because it was clear that a successful deal would be to their benefit.

Labor groups were not incensed by the deal because the companies made announcements very early in the process that “no layoffs [we]re planned” and, furthermore, that “the deal w[ould] have a minimal effect on employment, benefits or compensation” (Cox 2004). This news seemed highly effective in quelling the initial fears of both IBM’s and Lenovo’s workers (Witte 2004; see also McMillan 2005).

One interest group did mobilize in favor of the deal: IBM. The company “hired consultants to help secure approval from CFIUS,” one of whom was “Brent Scowcroft, the former national-security adviser to President George H. W. Bush and Gerald Ford” (Bilodeau 2005). It was also reported that IBM hired

Bruce Mehlman, who served as President George W. Bush’s assistant secretary for technology policy at the Department of Commerce until January 2004, and partners at DC-based law firm Covington & Burling . . . includ[ing] Mark Plotkin and David Marchick, a former deputy assistant secretary for trade policy at the State Department, according to federal lobbying records. (Bilodeau 2005)

These individuals were highly respected within the government and had an intimate understanding of the CFIUS process. Marchick, for example, wrote one of the only books on US government intervention into cross-border M&A on national security grounds, with Edward Graham. Though it is unknown what their exact brief from IBM entailed, it is generally thought that they were hired to help IBM and Lenovo navigate the CFIUS process successfully. Given the consultants hired, their expertise, and their current and former government positions, it is likely that the companies were advised on what mitigatory measures might be necessary to gain approval, rather than how to achieve the more unlikely “no intervention” outcome, as these individuals would also have been highly concerned with the preservation of national security in this case. In other words, they were likely hired to help the companies successfully navigate the process and achieve a bounded intervention outcome, rather than an unbounded intervention outcome, and it is fairly unlikely that they were pushing for no intervention. It is also important to note that they were reported to be serving in an advisory, rather than a lobbying, capacity.

Thus, there were no real interest groups pushing for intervention in this case, or attempting to prevent the US government from pursuing bounded intervention.

### *Competition Concerns*

Similarly, economic competition concerns did not seem to factor into the Lenovo/IBM case. By January 7, 2005, the Federal Trade Commission declared “that it ha[d] granted Lenovo and IBM an early-termination ruling under the Hart-Scott-Rodino antitrust act” (Spooner 2005a). It was possible for the decision to be made quickly because there was no apparent evidence that the takeover would create a monopoly or anti-competitive concentration within the personal computer, or broader



technology, industry. Thus, it seems clear that this was not a factor motivating bounded intervention in this case.

### *Economic Nationalism*

As discussed in the CNOOC and DPW cases, the US is not always associated with economic nationalism, though distinct pockets of such nationalism do exist within some parts of the US government and its institutions, as evidenced periodically in its history. Displays of economic nationalism in the US have historically been targeted and rare, and have often been caused by distinctive massive influxes of FDI from a particular country, such as Japan in the 1980s. Nationalism was relatively high in the US in 2005, providing a solid base for potential economic nationalism.<sup>44</sup> Yet, the Lenovo bid came at the very *beginning* of China's notable surge in overseas investment and cross-border M&A activity; it would not be until later the same year that Haier<sup>45</sup> and CNOOC would both attempt large-scale takeovers in the US. Though some evidence can be found of antipathy toward Chinese FDI at this point, it is not nearly as marked or widespread as it was by the time CNOOC had made its bid for Unocal.

As also mentioned in the CNOOC case, the US has not traditionally shown great support or protection for so-called "national champions," and this attitude remained true in this case with IBM. Often called "Big Blue" in the media and press, IBM ostensibly makes a good candidate for a national champion. For decades, the company as a whole has stood at the forefront of the US technology sector, and it is viewed as "the original grand dame flagship of the industry" (Sullivan 2004). Its large market share, and its relationship with many government agencies, has made it an American icon.

At the time, some commentators and analysts noted the importance and significance of such an iconic brand as IBM being "sold to China" – but they were not incensed by the possibility, and were clearly not advocating either for or against intervention in this case. Some did, for example, ask "how . . . America's top PC maker end[ed] up as nothing more than lunch for an Asian Tiger" (Sullivan 2004). However, the focus was mainly on the fact that it was a momentous and historical deal, as it was "the first major Chinese acquisition of a Fortune 100 company," and clearly "a harbinger of deals to come" (Bilodeau & Kennedy 2005; Sullivan 2004). It seems that in the American psyche, "no brand is eternal" (Boston Herald 2004), an attitude that truly sums up the reluctance of the US government, and the public, to protect what would have been one of its national champions from a foreign takeover.

An icon does not necessarily translate into a national champion, and a single division of such an icon, even less so. It is important to reiterate here that IBM as a whole was not in danger of being taken over, only its “lower tech” PC division, and this was because IBM wanted to sell that part of the business, which had become a “drag on margins and profitability” (Hachman 2004; see also Blustein & Musgrove 2005). Market analysts were thus largely reported to believe that the White House’s attempt to “foster cooperative economic ties with Beijing,” combined with IBM’s need and desire to get out of an unprofitable business, likely meant “that in the end Washington will allow the IBM/Lenovo deal to go ahead” (Blustein & Musgrove 2005). Of course, such a view was based on the inherent assumption that the larger geopolitical and national security concerns could be overcome through some form of mitigated intervention.

Despite this general lack of support for IBM as a national champion, however, there is some evidence that members of Congress believed the deal should be blocked on grounds that might be identified as economic nationalism. In the letter that Congressmen Hunter, Hyde, and Manzullo sent to President Bush, they were evidently “concern[ed] that Lenovo [would] have an unfair competitive advantage over US computer makers because the People’s Republic of China subsidizes the company” (Orol 2005e). It should be noted, however, that Congressman Manzullo seemed to be the only one who was *primarily* motivated by such concerns. Certainly, Rep. Manzullo, known for “worr[y]ng frequently about a . . . loss of US manufacturing jobs to China” (WSJ 2005b), was the only one to have publicly, and consistently, attempted to make an issue of the deal on these grounds. One of his representatives stated that Manzullo’s concerns stemmed from a belief that “China gets a competitive advantage for many things because they are a nonmarket economy,” and that “by selling IBM’s PC Business to China, it could corner the global market on computers” (Orol 2005e). Such comments caused a sparse few, such as the China Business Strategy group (quoted here), to claim that the deal had met with resistance due to those “who oppose globalization and economic integration” (PZMN 2005). At the same time, “Manzullo insist[ed] that his campaign [wa]s not protectionist” because “his concerns might be unfounded, but he won’t know unless Congress has more time to review the deal” (Kessler 2005). Despite this rather interesting logic, however, it is clear that Manzullo was mainly worried about the economic ramifications of the deal giving the Chinese undue control of, or advantage in, the PC market versus the US.

It also later surfaced that the US–China ESRC had sent a letter to Congressmen Hunter, Hyde, and Manzullo in which it

advocated intervention in the deal. In the letter, the Commission reportedly

made plain . . . [their] view, that the CFIUS mandate is broader than a technical security-minded technology transfer, export-control oriented event, and that in fact it implicates the defense industrial base, the national security capabilities of the United States in a broader sense . . . the bottom line is, in a sense, the security implications of the impact [of the deal] on the US economy. (Commission Vice Chairman Roger Robinson Jr. in US–China ESRC 2005)

This statement demonstrates the Commission’s opinion that economic security and national security are intertwined, a position that has itself been tightly linked with protectionism (see e.g., Graham & Marchick 2006). The Commission was clearly also concerned by the increasing level of Chinese FDI, and Lenovo’s bid for IBM was a prime example of China’s efforts to become a “global player.” In a later hearing, the US–China ESRC stated that because the “velocity and the size of those Chinese acquisitions [is] clearly on the rise,” it “hope[d]” that there would “be an increasing use of the CFIUS process” (US–China ESRC 2005). Unfortunately, it is unclear whether the Commission’s letter was sent to the three congressmen before or after they sent their own letter to the President advocating a further CFIUS investigation.

It is clear, however, that some elements of economic nationalism were present in this case, and that these may have acted at least as a secondary motivation for government intervention. CFIUS would be unlikely to seek alterations to the Lenovo/IBM deal on economic nationalist grounds alone, as previously discussed in other cases. Yet, it does seem that the three congressmen’s letter, which included Rep. Manzullo’s economic fears, did help ensure a forty-five-day CFIUS investigation. This, in turn, made it more likely that bounded intervention would occur, as it provided greater focus on the national security concerns discussed in the next section, and provided the opportunity for the government to seek changes to the deal that would allay those concerns.

It is important to note that though there is evidence of economic nationalism in this case beginning to be directed against Chinese foreign investment, as will be shown, it had not yet reached the level that it would in the later CNOOC case, when Chinese investment came to be viewed as more threatening to US economic security. It should be remembered, however, that even in the CNOOC case, more traditional geopolitical and national security concerns overshadowed those of economic security when it came to decisions regarding intervention. As discussed in detail in the section on that case, instances of unbounded intervention

into the Chinese purchase of a US company have always entailed a heavy presence of traditional national and military security concerns, whether or not economic nationalism was present. The next section, on geopolitical competition, illustrates that the Lenovo/IBM case resulted only in *bounded* intervention because it was possible to mitigate such national security concerns, whereas this was not possible in the cases that resulted in *unbounded* intervention.

### *Geopolitical Competition*

The level of geopolitical competition between China and the US was basically the same in this case as it was in the CNOOC case of the same year. In 2005, as today, China and the US were geopolitical strategic rivals with a highly complex relationship. China was positioned as a major power, with rising relative power in both the economic and military realms. This fact, combined with a widespread US government belief that China posed a potential future military threat, ensured that the intent of Chinese actions would be carefully examined. Disagreement over the status of Taiwan, worries over increasing Chinese military spending and their quest for natural resources, on top of the economic disputes over the valuation of the yuan and intellectual property rights, created constant tension between the countries at the very time that the Bush Administration was attempting to engage China diplomatically and economically. It was not surprising, therefore, that “while US officials such as [Treasury Secretary] Snow [had] called for closer ties between the two countries to foster trade, lawmakers such as Republican Senator James Inhofe of Oklahoma [had] raised objections to embracing China for security reasons” in 2005 (Bilodeau & Kennedy 2005). The Chinese government’s intent to use cross-border acquisitions to increase its economic, and even military, power generally only intensified such fears.<sup>46</sup> With this in mind, the following discussion focuses on the specific geopolitical concerns that affected the Lenovo/IBM case. For a more detailed description of the general geopolitical relationship between China and the US in 2005, see the CNOOC/Unocal case in Chapter 3.

It should also be noted here that certain aspects of the geopolitical competition between the two countries led to a dissimilar outcome in the Lenovo and CNOOC cases, because of differences in the industries involved. The level of US dependence on oil and China’s desire for ever-greater control over its own natural resource supply affected the type of intervention sought by the US government in the CNOOC case to a much greater degree than it did in the Lenovo one. In the CNOOC case, the target was an oil company with proprietary dual-use technology.

The likelihood of unbounded intervention was heightened because the purchase of Unocal by CNOOC would have meant complete control over a resource that was the focus of competition and contention, even if the deal could have been altered to prevent the transfer of the dual-use technology. Bounded intervention would not really have solved all of the national security concerns involved in that case. In the Lenovo case, however, it was possible, as will be shown, to effectively mitigate the deal in a manner that assuaged the national security concerns it raised. As the control over the PC business as a whole did not (in and of itself) pose a threat, and no resource was at risk, bounded intervention was a viable solution to the problem.

What were the national security concerns that were raised and intensified in this case by the level of geopolitical competition between the US and China?

The first concern that emerged was over the possibility that the Chinese government would use the facilities purchased in the takeover as a base for conducting both international and industrial espionage (see e.g., Bilodeau 2005; Bilodeau & Kennedy 2005; Blustein & Musgrove 2005; Orol 2005a, 2005b; Spooner 2005b; Tsuruoka 2005).<sup>47</sup> IBM's PC facilities were largely located in the industrial compound of Triangle Park, NC, where it had also stationed a number of its other business divisions. These included some IBM research and development facilities that do work "specifically" for the US DOD, making the security of these projects, and the park as a whole, of special concern to CFIUS (Orol 2005b). It was reported that "CFIUS . . . decided on January 27th to begin [the forty-five-day] formal investigation over concerns that the Chinese government will use Lenovo-made PCs and the company's new US facilities for espionage" (Bilodeau 2005). The same fear was voiced by Michael R. Wessel of the US government-sponsored US-China ESRC, who told the media that he had discussed this concern with the relevant government officials (see Blustein & Musgrove 2005). Well into the forty-five-day review, the issue seemed to remain at the forefront of the US government fears regarding the takeover. For, in late February, it was reported that the US DHS and Justice Department, both of which are represented in CFIUS, were still "question[ing] whether Chinese operatives could use the facility [in Triangle Park] . . . to engage in industrial espionage" (Bilodeau 2005).

The espionage issue seems to have been the primary focus of discussions between CFIUS, IBM, and Lenovo over possible mitigatory measures that could be taken to make the deal viable. It also appears that negotiations began long before the formal review process. They intensified when "agents from the US Secret Service and the Federal Bureau

of Investigation inspected the Research Triangle site” in early February, leading IBM to “[offer] to take measures such as closing its buildings in the office park to access by Lenovo employees” (Bilodeau 2005). IBM apparently “balked at other demands,” and “in a proposal that CFIUS considered [on February 23], the company refused to agree not to transfer any employees involved in research and development to the Research Triangle site and objected to some security measures, such as installing new safety doors” (Bilodeau 2005).

The concern over espionage was compounded by the fact that the Chinese government holding company that controlled Lenovo (Legend Group Holdings) had links to the Chinese military and the Chinese Academy of the Sciences. In fact, Legend Group “was established in 1984 by the Chinese Academy of Sciences, a government institution” that “plays a key role in exploiting technologies in China” (Bilodeau & Kennedy 2005; Tsuruoka 2005). Not surprisingly, this fact fanned “the fear [that] Lenovo might transfer sensitive technology it develops with IBM to China’s military” (Tsuruoka 2005).

This argument ties in with the second concern: that Lenovo, and by extension the Chinese government, would be gaining access to dual-use technology that could be deployed for military purposes. The dual-use issue was among those raised early on by Mr. Wessel of the US–China ESCRC (WSJ 2005b) and William Triplett, a former member of the Senate Foreign Relations Committee (Tsuruoka 2005). This was because some of the PC components being developed by IBM at the time, such as super long-life batteries, could potentially have “military applications in the field” (Orol 2005a). Some observers also worried that IBM’s microprocessor technology could be applied for use in missiles (Orol 2005a). Adam Segal of the Council on Foreign Relations summed it up well when he pointed out that the CFIUS investigation was “symptomatic” of the fact that “as China develops its more competitive civilian sector, there are pretty large concerns in the United States... about civilian technology bleeding over to the military side” (Tsuruoka 2005).

A third concern was that China would re-export dual-use technology to countries that were unfriendly to the US, such as Iran, given China’s past history of flouting US export control laws (see e.g., Tsuruoka 2005; Rash 2005). One of the aspects of the Sino-US geopolitical context at the time that intensified national security concerns over the transfer of sensitive technology to China, beyond its position as a strategic rival to the US, was China’s poor record of adhering to US export control laws. In January of 2005, the tension over this issue was heightened when the US government “imposed penalties” on eight “of China’s largest

companies” for exporting technology that would assist “Iran’s efforts to improve its ballistic missiles” (Sanger 2005).

Finally, there may also have been a fear that the Chinese government and/or military might use the Lenovo acquisition to gain backdoor access to US government computers. IBM provided PCs to a number of government agencies. Yet, China was at the time “blacklisted” (along with Iran, Iraq, and North Korea) by the US Trade Agreements Act (TAA), meaning that the US government was not supposed to use Chinese suppliers (Aitoro 2005).<sup>48</sup> Many analysts believed that the issue of supply would be easily obviated, because it was likely that the PCs would still be assembled in the US, or ignored. The worry over the security of that supply, however, remained. Mr. Wessel, again, pointed out that

IBM has “other facilities” in North Carolina “that do R&D . . . so the issue is not just the making of boxes; it’s how the networks work. IBM has service contracts throughout the government and (knowledge about) how one networks these computers gives one not only the opportunity to do reverse engineering, but greater opportunities to hack in.” (Blustein & Musgrove 2005)

Thus, there was likely also concern that the Chinese government could arrange backdoor access to computers provided to the US government by Lenovo.

Eventually, a number of measures were agreed upon between CFIUS and the two companies as part of the US government’s strategy of bounded intervention to alleviate the national security concerns rooted in the geopolitical tension between the US and China at this time. In order “to win federal approval . . . Lenovo employees working at IBM’s manufacturing and design facility in Raleigh, NC, [had to] be housed in a separate building on campus” (CMP TechWeb 2005). By March 9, it was revealed that the “staff working in the Research Triangle Park, North Carolina, area w[ould] be relocated to a central facility that [was] sold by IBM to Lenovo and is located in the same industrial park” (Auchard 2005a). This modification to the deal was obviously intended to protect the security of the IBM government R&D projects at the park, and to prevent opportunities for espionage. Though a number of modifications were apparently made to the deal as a result of government intervention, these changes are among the few that were made public by the companies.

Overall, neither IBM nor Lenovo appeared upset at the mitigation measures required by the government, likely because they were fairly reasonable and simple given the concerns voiced. In fact, the new CEO of Lenovo, Mr. Ward, told reporters that “everything that CFIUS asked of us was perfectly reasonable” (Auchard 2005a). Thus, bounded



intervention was an option in this case because it was possible for mitigation to alleviate the national security concerns without losing the cooperation of the companies involved, and without having to block the deal as a whole.

### *Conclusions on Lenovo/IBM*

The discussion of the variables in the Lenovo/IBM case clearly shows that geopolitical competition was the primary, and economic nationalism the secondary, motivation for bounded intervention in this case, resulting in a changed deal. Once again, interest group pressure and economic competition concerns did not play an active role in guiding government intervention. This result is in line with the primary hypothesis, and with our expectations as a result of the statistical findings from Chapter 2. In other words, given the presence of economic nationalism and geopolitical competition in a case that took place outside of a security community context, we expected to see some form of intervention, either bounded or unbounded, rather than its absence.

The preceding examination of the variables also helps us to understand something that the statistics did not: why we saw *bounded* intervention into the Lenovo takeover, when the ostensibly similar CNOOC case resulted in *unbounded* intervention. The result of the Lenovo/IBM takeover differed from that of the CNOOC/Unocal one because, in the latter instance, bounded intervention would have not been as successful an option for the government. The issue there was that Chinese control over Unocal in and of itself became associated with the struggle for control over resources, and politicization of the deal made it difficult for bounded intervention to appear to be enough to alleviate fears that the Chinese company's intent was nefarious. With Lenovo, it *was* possible to mitigate national security concerns in a way that could not be accomplished in the CNOOC case. In the Lenovo case, the company being purchased was relatively "low tech" for a "high tech" industry, it was losing money rapidly, IBM wanted to exit the business, and there was a viable government strategy for protecting the technology that was deemed to be at risk of espionage in other parts of the company. Control over resource access was not at stake, and it was possible to solve the national security concerns posed by the deal *without* having to block the deal as a whole. In other words, bounded intervention in the form of mitigation strategies is likely to occur when the circumstance of the deal make it a viable option for the government to pursue, without jeopardizing its security. Few states would want to employ unbounded intervention unless it was considered absolutely necessary, because, though unbounded



intervention will not damage the relationship between two countries in the same way other balancing techniques might, bounded intervention is even less likely to create tension between states. This is because, though it is done on the basis of national security, it is pursued in a manner that is unlikely to negatively affect valuable trading relationships, and that is often seen as an amicable compromise to a difficult problem. It can also be a matter of timing, for after the US government's perceived need to block both the CNOOC/Unocal deal, as well as the Hutchinson Whampoa deal, there was likely an even greater desire to seek a compromise in this case, where compromise was possible, in order to ease fears of anti-FDI sentiment among Chinese and other foreign investors.

### Conclusion

The purpose of this chapter has been to provide a deeper understanding of the nature of bounded intervention. First, the definition of bounded intervention was refined. A state can effect a policy of bounded intervention by engaging in restricted forms of intervention into foreign takeovers, by mitigating the parts of the deal it deems dangerous to its national security and strategic position. An examination of the foreign takeover review processes in the US, China, Russia, and the UK established that different states will employ different tools and methods to alter a deal, and that the modifications made will naturally vary in accordance with the concerns that the deal raises. This discussion also examined the possibility that bounded intervention may occur more frequently within security communities, where the review process through which such deals are mitigated is more highly institutionalized and regularized.

Second, the case studies confirmed that *both* economic nationalism and geopolitical competition concerns can play a significant role in increasing the likelihood of bounded intervention. Additionally, economic competition concerns and interest group politics did not seem to have a great effect on behavior in either case. This provides clear support for the primary hypothesis. Though the statistical results in MNLM I only showed nationalism to be significant when examining the entire population of cross-border cases, MNLMs II and III demonstrated that the significance of geopolitical factors emerges alongside nationalism when the cases are restricted to subsets of either security community or non-security community cases. In the Alcatel/Lucent case, bounded intervention was demonstrated to have been motivated both by a heightened economic nationalism at that particular point in time in the US, and by geopolitical concerns that were exacerbated by the sensitive nature of

Lucent's work (which involved classified government contracts). This was a case that took place within the context of a security community, highlighting the fact that one should not discount the possibility of geopolitical competition among allies. In the Lenovo/IBM deal, which took place outside of a security community context, bounded intervention was primarily motivated by geopolitical competition between the US and China, and by concerns arising from the potential for the deal to be used as a springboard for espionage; economic nationalism was a secondary motivation. It should also be noted that in both cases, economic nationalism did prove significant, rather than just nationalism alone, demonstrating that the use of the latter as an indicator of the former in the statistical analysis is not off base.

Third, in both cases the type of intervention chosen by the government affected the outcome of the deal in question, supporting the secondary hypothesis. In both cases, the decision to utilize bounded intervention for balancing purposes resulted in a modified (or "changed deal") outcome.

Fourth, both of the cases examined helped to clarify something that the statistical modeling could not: under what conditions a state will choose to employ bounded, instead of unbounded, intervention. This study has clearly demonstrated that both forms of intervention are a more probable outcome than "no intervention" when geopolitical concerns and/or economic nationalism are present in high levels. Yet, bounded intervention is more common than unbounded intervention, with the former representing 29% of total cases, and the latter only 8%.<sup>49</sup> So, why do states choose one over the other? *They do so because allowing these foreign takeovers to be completed in modified form is even less likely to disrupt trade relationships or produce antagonism between the countries involved than is unbounded intervention.* In other words, it best accomplishes the goal of non-military internal balancing: to balance power without necessarily disrupting the greater meta-relationship at stake between the countries involved. Thus, if state *A* feels that restricted intervention can adequately address the problems presented by a foreign takeover, it may prefer to engage in bounded intervention, which is largely seen as a more desirable outcome by economists (because the market is not completely disrupted) and tends to be viewed as a more creditable action by the international community (which tends to see unbounded intervention as protectionism, no matter what its motivation).

This was certainly true in the Alcatel/Lucent case, where it was viewed as possible for mitigation to satisfactorily address the geopolitical and security issues raised by the deal, because the critical technology concerned did not represent all of Lucent's business. Additionally,

the position of France as a formal ally made bounded intervention more desirable for the US. These dynamics were also present in the Lenovo/IBM case, where it was possible to effectively mitigate the deal in a manner that assuaged the US government's concerns, largely because giving the Chinese control over the PC company as a whole did not, in and of itself, pose a threat. This is in stark contrast to the CNOOC/Unocal case examined in Chapter 3, where the likelihood of unbounded intervention was heightened, because allowing the purchase of Unocal would have entailed giving the Chinese complete control over a resource that was the focus of state competition and contention, even if the deal had been altered to prevent the transfer of the dual-use technology. Therefore, it can be concluded that bounded intervention is more likely to occur when the circumstances of a given foreign takeover make a restricted intervention strategy a viable option for the preservation and/or maximization of security and power.

## NOTES

- 1 This provision, known as an "evergreen" clause, was part of the security agreement between the US government and the companies involved. It is believed that such a clause has never been used before in a US security agreement regarding a cross-border acquisition (TelecomWeb 2006a), indicating that new forms of mitigation may be emerging.
- 2 The Company Law, first adopted in 1993, has been periodically revised, e.g., in 1999, 2004, 2005, and 2013, with the latter revision coming into effect in March 2014. For an English translation of this law as amended in 2013, see [www.fdi.gov.cn/1800000121\\_39\\_4814\\_0\\_7.html#\\_Toc381707436](http://www.fdi.gov.cn/1800000121_39_4814_0_7.html#_Toc381707436).
- 3 The Takeover Rules date from 2006, and were amended in 2012 (Jian & Yu 2014, 2).
- 4 The Securities Law, which dates from 1998 and was amended in 2014, is "the basic statute governing securities-related activities in China" (Jian & Yu 2014, 2).
- 5 Before this point, the primary law covering FDI of this type was the 1995 Provisional Regulations for Guiding the Direction of Foreign Investment. The Provisions on Guiding the Orientation of Foreign Investment, Decree of the State Council of the People's Republic of China, No. 346, was released on February 11, 2002 and entered into force on April 1, 2002. It replaced the State Council's Interim Provisions on the Guidance of Foreign Investment Directions, originally released in June 1995. For an English translation of the 2002 Provisions, see [www.fdi.gov.cn/1800000121\\_39\\_2169\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_2169_0_7.html).
- 6 The 2006 Provisions for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors was originally introduced in draft form in March 2003 as the Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, and was then updated with the No. 6 Decree of the Ministry of Commerce PRC on Promulgation of the Provisions on Mergers & Acquisitions of a Domestic Enterprise by Foreign Investors on

- June 22, 2009, in order to bring it in line with the 2007 Anti-Monopoly Law. For English translations of the 2006 Provisions and the 2009 Decree, respectively, see <http://english.mofcom.gov.cn/aarticle/policyrelease/domesticpolicy/200610/20061003434565.html> and [www.fdi.gov.cn/1800000121\\_39\\_4115\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_4115_0_7.html).
- 7 It is inferred that investment is permitted in those areas not covered by the 2004 Decision on Reforming the Investment System. For an English translation of the Decision, see [www.fdi.gov.cn/1800000121\\_39\\_1465\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_1465_0_7.html).
  - 8 For an English translation of the 2017 Catalogue, see [http://www.fdi.gov.cn/1800000121\\_39\\_4851\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_4851_0_7.html).
  - 9 China had been under pressure for some time from other countries, and investors, to adopt a less complicated “negative list” system for foreign investment, in which only items on the list are prohibited or restricted. China first adopted a negative list for its Free Trade Zones on April 8, 2015 (see the Circular of the General Office of the State Council on Issuing the Special Administrative Measures (Negative List) for Foreign Investment Access to Pilot Free Trade Zones). For a period of time after this, it was unclear whether the Catalogue was to be considered a negative list for the rest of China (Ye 2016), but this has now changed with the 2017 Catalogue (see Koty & Qian 2017, as well as the English translation of the 2017 Catalogue, [www.fdi.gov.cn/1800000121\\_39\\_4851\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_4851_0_7.html)).
  - 10 For example, as in previous versions, the 2015 Catalogue specifically prohibited investment projects that might “endanger the safety and performance of military facilities.” (See, e.g., [www.cov.com/files/upload/Blog\\_Insert\\_Foreign\\_Investment\\_Catalogue\\_Redline\\_Comparison.pdf](http://www.cov.com/files/upload/Blog_Insert_Foreign_Investment_Catalogue_Redline_Comparison.pdf).)
  - 11 According to Wang and Emch (2013), the NDRC is additionally “responsible for... price-related conduct, [and the] abuse of dominance and... administrative powers... that eliminate or restrict competition,” while “[SAIC] has enforcement powers for other anti-trust cases falling outside the jurisdiction of MOFCOM and NDRC.”
  - 12 For an English version of the 2008 AML, see <http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045909.shtml>.
  - 13 For an English version of the Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors, see <http://english.mofcom.gov.cn/article/policyrelease/aaa/201103/20110307430493.shtml>.
  - 14 The associated implementing regulations are the Provisions of the Ministry of Commerce for the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, Announcement No. 53 of the PRC’s Ministry of Commerce, originally made on August 25, 2011. For an English translation of these Provisions, see <http://english.mofcom.gov.cn/article/policyrelease/aaa/201112/20111207869355.shtml>.
  - 15 See Article II of the Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors, February 3, 2011.

- 16 See Article IV (VI) of the Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors, February 3, 2011. See also Article 7 (3) of the 2011 Provisions of the Ministry of Commerce for the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, which states that “where a merger with or acquisition of a domestic enterprise by a foreign investor has already produced or may produce a serious impact on national security, based on the review opinion of the Ministerial Panel, the Ministry of Commerce shall, along with relevant departments, terminate the transaction of the parties concerned or take measures such as the transfer of the equity or assets in question or other effective measures so as to eliminate the impact of such merger or acquisition on national security.” It remains to be seen, however, how this new provision will be implemented in practice.
- 17 For a discussion of the different types of acquisition vehicles that a foreign company might use to merge with, or acquire, a Chinese entity, see ABASAL 2015, 6–7. Though there are additional acquisition and taxation regulations that apply to each different type of investment vehicle, the national security review regime in China discussed in this chapter will “generally apply” regardless of the type used (ABASAL 2015, 7).
- 18 This review process was formalized in the 2003 Interim Provisions for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors and the later 2006 Provisions for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, as such deals became more commonplace. Reviews seem to have occurred on a more ad hoc basis before 2003, conducted by the Ministry of Foreign Trade and Cooperation (MOFTEC), which MOF-COM has since replaced.
- 19 For example, a foreign investor acquiring companies listed on the stock exchange will be subject to the Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors, while one seeking to invest in state-owned enterprises (SOEs) will be subject to “special rules for acquiring state-owned enterprises” (Qian 2016, 6), though it is highly unlikely that a 100% acquisition of an SOE would be allowed by a foreign investor, at least at the time of the cases examined in this book. Other foreign investment laws of possible relevance, depending on the type of investment made, include those covering the different types of FIEs: the Law of the PRC on Foreign Funded Enterprises, the Law of the PRC on Chinese-Foreign Equity Joint Ventures, and the Law of the PRC on Chinese-Foreign Contractual Joint Ventures, among others (see US GAO 2008, 45). For an English translation of the 2006 Administrative Measures on Strategic Investment in Listed companies by Foreign Investors, see <http://english.mofcom.gov.cn/aarticle/policyrelease/domesticpolicy/200604/20060401971375.html>.
- 20 National security under the Trial Measures is linked to “investments in military, national defense, agriculture, energy, infrastructure, transportation, culture, information technology products and services, key technology, and manufacturing” (US DOS 2016a).

- 21 The English translation of Article 59 of the National Security Law was sourced from <http://chinalawtranslate.com/2015nsl/?lang=en>.
- 22 For an English translation of the Decision of the Standing Committee of the National People's Congress on Amending Four Laws Including the Law of the PRC on Foreign-Funded Enterprises, see [www.fdi.gov.cn/1800000121\\_39\\_4849\\_0\\_7.html](http://www.fdi.gov.cn/1800000121_39_4849_0_7.html). This was followed shortly by the Interim Administrative Measures for the Record-filing of the Incorporation and Change of Foreign-Invested Enterprises. For an English translation, see <https://hk.lexiscn.com/law/law-english-1-2951857-T.html>.
- 23 The laws amended include the Law of the PRC on Foreign Funded Enterprises, the Law of the PRC on Chinese-Foreign Equity Joint Ventures, and the Law of the PRC on Chinese-Foreign Contractual Joint Ventures.
- 24 For an English translation of this law, as amended in 2016, see <http://en.fas.gov.ru/documents/documentdetails.html?id=14737>.
- 25 For an English translation, see [www.wipo.int/wipolex/en/text.jsp?file\\_id=188843#LinkTarget\\_243](http://www.wipo.int/wipolex/en/text.jsp?file_id=188843#LinkTarget_243).
- 26 The 2008 Strategic Investments Law, Federal Law No. 57-FZ, was updated in December 2011 with Federal Law No 322-FZ, and again in November 2014 with Federal Law No. 343-FZ. For more information on these updating laws, see Nikiforov & Maximenko 2014; Stoljarskij 2012.
- 27 It should be noted that the Enterprise Act was amended in 2008 to include financial stability in the list of specified public interest concerns. This addition was made in light of the global financial crisis generally, but more specifically because it "allowed the Secretary of State to intervene directly in the takeover of HBOS, the UK's largest mortgage lender, by [another British bank] Lloyds TSB," which raised a number of competition concerns, but which was also deemed by the Secretary of State to be good for the overall financial stability of the UK given the economic conditions at the time (Seely 2016, 6–7).
- 28 For the archived version of the BIS website displaying the list of "Mergers with a National Security Element," see <http://webarchive.nationalarchives.gov.uk/20090609003228/http://www.berr.gov.uk/whatwedo/businesslaw/competition/mergers/public-interest/national-security/index.html>.
- 29 Before 2007, the full title of the Secretary of State was the Secretary of State for Trade and Industry, when the relevant government department was the Department of Trade and Industry. In June 2007, the Department of Trade and Industry was replaced by the BERR, and the title of the position changed to the Secretary of State and Industry. In June 2009, the BERR was replaced by BIS, which was in turn replaced by BEIS in 2016, and the relevant title became the Secretary of State for Business, Energy, and Industrial Strategy.
- 30 Notably, "on the same day as the Prime Minister's statement, Japan's Soft-Bank announced a £24 billion bid for the Cambridge-based tech company ARM Holdings" and made legally binding undertakings to the UK government to do things including protecting UK jobs (Seely 2016, 42–3).
- 31 As the reader will recall, none of the variables provides insight into why a state would be likely to pursue lower forms of bounded intervention within the security community context, a phenomenon most likely to be explained

- by two factors. First, many cases of even low-bounded intervention involve actions and agreements that are considered classified information in many countries – the public only learns about them if there is a press leak, or if one of the companies involved releases the information. Second, low-bounded interventions that occur within the confines of a security community are often not mentioned within the press, as M&A activity is so frequent and regularized between these countries that the companies involved in these transactions see the government's actions as standard operating procedure and, thus, may not feel the need to publicize them of their own accord.
- 32 In other words, they are not classified as a Type I ally of the US, because there is no formal treaty relationship for the provision of their mutual military defense.
- 33 Both were at the time classified by the industry benchmark number 9578, placing them in the technology sector and telecommunications equipment industry.
- 34 Reportedly, “the announcement of merger talks between Alcatel and Lucent . . . was greeted with quiet satisfaction in Paris, where the assumption is that the French group will effectively swallow its US counterpart . . . The Alcatel/Lucent talks appeared to have the blessing of the French authorities. They are confident that the headquarters would remain in France, enabling them to comfort Gallic public opinion by presenting the new group as French” (Sage 2006).
- 35 For reports of the companies meeting to discuss proposals for dealing proactively with these recognized issues, see e.g., McKay 2006a; TelecomWeb 2006b.
- 36 For example, as Chairman of the House Armed Services Committee, he tried to have a public hearing on the proposed merger, but was eventually forced into holding a closed hearing because of the classified nature of the discussion (Inside US Trade 2006b).
- 37 It became clear early on that the French government supported the sale of Alcatel's satellite divisions to Thales in order to protect sensitive technology from the US; see TelecomWeb 2006a. At the same time, “German Chancellor Angela Merkel and French President Jacques Chirac . . . met and agreed that EADS should take a stake in Thales” under a scheme that would allow EADS to sell its satellite arm to Thales as well (TelecomWeb 2006c). Thus, in an odd twist, the French government wanted the sale of Alcatel's satellite JVs, but opposed any sale that did not include EADS (of which it owns 15%) (AFP 2006a; TelecomWeb 2006c). In the end, the deal between Alcatel and Thales was approved (Aviation Week 2006), with the general understanding that Thales would remain open to future talks with EADS over its satellite assets.
- 38 The 2006 US general resource dependency ratio was around 0.38; though this is not low, the US did not depend on France for natural resources such as oil and gas. France was not among the top fifteen importers of oil and petroleum products to the US; the US only imported a tiny fraction from



- France (26,736) of its 5,003,082 thousand total imported barrels of crude oil and petroleum products in 2006; see EIA 2008a; 2008d.
- 39 France's military power relative to the US was only 10.04% in 2006, and US military power was rising at a rate of 8.98%, while that of France was rising at only 1.13%. Similarly, the relative economic power of France to the US was relatively low, with French GDP PPP being only 14.82% of that of the US in 2006. Interestingly, the growth rate of both countries was closer, with the five-year average economic growth rate registering at 3.38% for France and 4.96% for the US. Numbers calculated from SIPRI (2006) and the WDI database (WDI 2008).
- 40 In 2006, the IMD World Competitiveness Yearbook covered sixty-one countries, but for the variable "Attitudes towards globalization" survey data were available for only fifty-four (see IMD 2007b). In the US, pro-globalization sentiment was valued at 6.25 in 2006, above the median value of 6.21 among countries surveyed that year, but the lowest it had been in the US since 2002, when it was valued at 7.20 (IMD 2007b). While economic nationalism was generally still considered to be low in the US relative to other countries, it had arguably spiked there by the time of this particular case in the second half of 2006, which occurred in the wake of the 2005 and early-2006 US cases examined in Chapters 3 and 4.
- 41 The Hutchinson Whampoa/Global Crossing case can be instructive in our understanding of these two cases, as it provides another example of unbounded intervention into the takeover of a US company by a Chinese one. The Whampoa case, however, cannot provide a pure comparison to either the Lenovo or the CNOOC case, because Hutchinson made its bid for Global Crossing in conjunction with the Singaporean company STT. In other words, it cannot be classified as a "simple" cross-border takeover of the type examined in the database created for this book, because the acquisition involved two purchasing companies from different countries.
- 42 The \$1.75 billion figure comprises half a billion in Lenovo equity, which became IBM's stake in the new entity, and \$1.25 million in cash (Market News Publishing 2004; Zephyr 2007a).
- 43 For further details on this point, please refer to the CNOOC/Unocal case in Chapter 3.
- 44 It should be recalled from the CNOOC case that in the 2001–04 wave of the World Values Survey, 71.1% of US respondents claimed to be "very proud" of their nationality (2001–04). Yet, while 86.71% of US citizens claim to be proud of their nation's economic achievements, the US is not always identified with economic nationalism (ISSP 2003). Indeed, though levels of pro-globalization sentiment had been declining since 2002, it was valued at 6.34 in the US in 2005, which was above the median value of 6.22 among the fifty-four countries for which survey data were reported on this variable in that year (IMD 2007b).
- 45 The Haier Group (China) bid for Maytag (US) in 2005.
- 46 For example, see McKinsey & Co.'s analysis in Financial Express 2004.
- 47 It should be noted here that some people found these concerns to be "overwrought": examples of "anti-Chinese" sentiment rooted in geopolitical



(rather than economic) competition (see Blustein & Musgrove 2005). Yet, the fear apparently had a basis in past US experience. For, “15 years [earlier], the Washington Post [had] revealed that the Chinese government was secretly owner of a number of retail outlets and restaurants frequented by government officials” (Rash 2005). Apparently, “these businesses existed as a means of funneling Chinese spies into the US, and as a way to keep tabs on unsuspecting government officials” (Rash 2005).

- 48 The act provides that “the government can spend taxpayers’ money with certain countries that are considered friends to the United States and whose products, therefore, qualify for an exception to the government’s preference to acquire only domestic end products” (Aitoro 2005).
- 49 It is important to remember that the number of bounded intervention cases may be larger than the estimate provided here, as the actual existence of most of these forms of mitigation is meant to be confidential in any one case, and their content classified. Thus, we only know of the existence of these forms of mitigation if they have been made public through a press release made by one of the companies in question, or if news of their existence has been leaked to the press. This may affect the statistical results slightly, but this is an acceptable reality because it means we can largely assume that any correlation found in the database is in fact much *stronger* than the statistical results indicate.