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Unocal: Legal Implications of Acquisition Bids by Chevron Corp. and China National Offshore Oil Corporation

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Summary

The acquisition of Unocal — which includes Unocal's wholly owned subsidiary, Union Oil Co. of California — by either Chevron Corporation or the China National Offshore Oil Corp. (CNOOC) could have been subject to review by either of two U.S. agencies; *which* agency reviews a proposed merger or acquisition depends on the origin of the parties, and the reviews are conducted for different reasons. Certain mergers or acquisitions between domestic entities may be evaluated under the Premerger Notification Act by either the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice in order to assess a transaction's likely effect on competition within the United States. If the merger partner or acquiring party is a non-U.S. entity, the Committee on Foreign Investment in the United States (CFIUS) may monitor and evaluate the impact of the proposed transaction and determine whether the acquisition implicates national security issues. If the President determines that national security is threatened by the acquisition, he may suspend or prohibit the acquisition. This report will set out, briefly, the background and conclusion of the competing bids for Unocal, the mechanics of the review processes, and present some Congressional reaction to the situation. On August 2, 2005, CNOOC withdrew its bid for Unocal, and on August 10, 2005, Unocal shareholders approved the acquisition by Chevron. This report will not be further updated.

When Chevron announced its bid to acquire Unocal in early April 2005, its intention was to acquire all of the outstanding common stock of Unocal in a stock/cash transaction worth approximately $16-$18 billion. The transaction could not take place, however, prior to appropriate notification pursuant to the Premerger Notification Act,[1] which requires, *inter alia*, that transactions resulting in the acquiring party's holding assets or voting securities (1) in excess of $200 million, or (2) between $50 million and $200

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[1] 15 U.S.C. § 18a.

million plus the assets or voting securities of the acquired party[2] be reported to the Chairman of the Federal Trade Commission (FTC) and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice.[3] There is an initial 30-day waiting period before the transaction can be consummated; it begins on the day the reviewing agency *receives* the material to be filed as specified in 15 U.S.C. section 18a(b)(1)(A), (B). That waiting period may be extended for an additional 20 days if, before the expiration of the initial 30-day period, the reviewing agency asks for "additional material or documentary material relevant to the proposed acquisition."[4] Or, the original waiting period may be terminated prior to the end of the 30-day period if the reviewing agency indicates in a Federal Register notice that it intends to take no further action (15 U.S.C. § 18a(b)(2)). The FTC was the reviewing agency in this instance.

Simultaneously with the FTC's review of the proposed Chevron-Unocal merger, the Commission was involved in an administrative hearing with Unocal over the FTC charge in March 2003 that Unocal had unlawfully monopolized the market for reformulated gasoline meeting the specifications of the California Air Resources Board (CARB). The alleged monopolization, the Commission said, resulted from the fact that Unocal had misrepresented that its research concerning the reformulated gasoline was nonproprietary, while at the same time pursuing patents on the technology: inasmuch as CARB has incorporated the technology in its regulations concerning reformulated gasoline, entities that produce such gasoline are obligated to pay patent royalties to Unocal.

Upon review of the proposed Chevron-Unocal merger, the FTC acknowledged that because Unocal neither refines gasoline nor maintains any retail stations, "virtually all of the competitive overlaps between the two firms are in unconcentrated upstream markets [exploration and production of crude oil and natural gas], and the merger thus creates no competitive risk."[5] Nevertheless, the FTC noted that, if Chevron were to acquire Unocal, it would be in a position not only to enforce the questionably obtained patents but also to receive the detailed reports currently collected by Unocal from producers of the CARB-compliant gasoline:

> If Chevron had continued these license agreements after inheriting Union Oil's patents, it would have received information not otherwise available to members of the industry. Chevron could have used this information to facilitate coordinated interaction and detect any deviations. Chevron might also have been able to use the patents to discourage maverick behavior. Our present knowledge suggests that the likely competitive harm from this potential coordination and discipline would

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[2] All defined transactions between entities where either the acquiring or acquired company has assets or sales of at least $10 million or $100 million (which company is larger is immaterial to the premerger reporting requirement) must comply with the act.

[3] 15 U.S.C. § 18a(a), (b). Although the act does not specify which agency is to review which transactions, those in the petroleum industry have traditionally been reviewed by the FTC.

[4] 15 U.S.C. § 18a(e).

[5] Statement of the Federal Trade Commission, in In the Matter of Chevron Corporation and Unocal Corporation, File No. 51-0125 (June 10, 2005), Slip copy, available at [http://www.ftc.gov/os/caselist/0510125/050802statement0510125.pdf].

outweigh any likely efficiency gains from the vertical integration of a merged Chevron-Unocal.[6]

Both issues — the matter of Unocal's alleged monopolization and the potential for further anticompetitive activity arising from the Chevron-Unocal merger — were resolved in a single, proposed Consent Order that the Commission believes to be in the best interests of California gasoline consumers. It mandates that neither Chevron nor Unocal will take any action to enforce the patents or collect royalties, including pursuing any litigation that may be pending, and requires that Unocal disclaim its reformulated-gasoline patents and release the patented information to the public. But because the Consent Order became effective only upon the consummation of the Chevron-Unocal merger, in the event that the bid by CNOOC had been successful, Unocal would have been faced with a reopening of the FTC administrative hearing on the patent/monopolization matter.

The United States has for the most part welcomed foreign investment, although in certain industries considered vital to national interests, such as airlines, shipping, and communication,[7] there are restrictions on how much of a business may be owned by a foreign citizen. Further, there are specific statutes which allow or require, depending upon the circumstances, the President or the President's designee to investigate the effects on national security of a merger, acquisition, or takeover of an American company by a foreign person and to take appropriate action if a threat upon national security is determined. These statutes would likely have been crucial in CNOOC's bid for Unocal.

Section 5021 of the Omnibus Trade and Competitiveness Act of 1988,[8] often called the Exon-Florio provision, amended section 721 of the Defense Production Act of 1950 to allow the President or the President's designee to make an investigation to determine the effects on national security of mergers, acquisitions, and takeovers by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States.[9]

Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993,[10] called the Byrd Amendment, amended Exon-Florio to require an investigation when an "entity controlled by or acting on behalf of a foreign government seeks to engage in a merger, acquisition, or takeover which could result in control of a person engaged in interstate commerce in the United States that could affect the national security of the United States."[11]

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[6] *Id.*

[7] *See* CRS Report 94-610A, *Foreign Investment in the United States,* by (name redacted) (July 18, 1994). Available on request from author.

[8] 50 App. U.S.C. § 2170.

[9] 50 App. U.S.C. § 2170(a).

[10] 50 App. U.S.C. § 2170(b).

[11] H.Res. 344, 109th Congress, states that the People's Republic of China owns approximately 70 percent of CNOOC.

Exon-Florio lists the following factors that the President or the President's designee may consider in determining the effects upon national security:

> (1) domestic production needed for projected national defense requirements;
> (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
> (3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security;
> (4) the potential effects of the transaction on the sales of military goods, equipment, or technology to a country that supports terrorism, missile technology proliferation, or chemical and biological weapons proliferation; and
> (5) the potential effects of the transaction on United States technological leadership areas affecting United States national security.[12]

The President may take such action as deemed appropriate to suspend or prohibit any acquisition, merger, or takeover of a person engaged in interstate commerce in the United States by or with foreign persons so that control will not threaten to impair the national security.[13]

The Committee on Foreign Investment in the United States (CFIUS) was originally established in 1975[14] to monitor and evaluate the impact of foreign investment in the United States. In 1988 the President delegated to CFIUS his responsibilities under Exon-Florio.[15] CFIUS is an inter-agency committee chaired by the Secretary of the Treasury and having as members government officials including the Secretary of State, the Secretary of Defense, the Secretary of Commerce, the Attorney General, and the Secretary of the Department of Homeland Security. CFIUS has the primary continuing responsibility within the executive branch for monitoring the impact of foreign investment within the United States and for coordinating the implementation of United States policy on this investment.

On June 30, 2005, the United States House of Representatives passed H.Res. 344. This resolution states that it is the sense of the House that CNOOC, through control of Unocal, could take action that might impair the national security of the United States and that, if Unocal enters into an agreement with CNOOC, the President should immediately initiate a thorough review of the proposed acquisition, merger, or takeover. On July 13, 2005, the House Armed Services Committee held a hearing on the implications of the CNOOC proposed acquisition of Unocal. In H.R. 6, the Energy Policy Act of 2005, passed by Congress at the end of July, section 1837 requires a national security review of international energy requirements. The findings of the study, concerning the growing energy requirements of the People's Republic of China, shall be reported to Congress and the President not later than 120 days after the date of enactment of the act. No other instrumentality of the United States, such as CFIUS, may conclude a national security

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[12] 50 App. U.S.C. § 2170(f).

[13] 50 App. U.S.C. § 2170(d).

[14] E.O. 11858 (May 7, 1975).

[15] E.O. 12188 (Jan. 2, 1980).

review concerning an investment in the energy assets of a United States domestic corporation by an entity owned or controlled by the People's Republic of China for 21 days after the report to Congress and the President and until the President certifies that he has received the report. On August 2, 2005, CNOOC withdrew its bid for Unocal, citing the extreme politicization of a transaction it considered purely commercial in nature; and on August 10, 2005, the shareholders of Unocal approved the acquisition of the company by Chevron.[16]

[16] *See, e.g.*, "CHINA'S OIL SETBACK: THE OVERVIEW; CHINESE COMPANY DROPS BID TO BUY U.S. OIL CONCERN," NEW YORK TIMES, August 3, 2005; " Foiled Bid Stirs Worry for U.S. Oil," NEW YORK TIMES, August 11, 2005.

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