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参考丛书之二

美国对外国直接投资的监管体系

David N. Fagan

中国企业在美投资
参考丛书

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前 言

中国企业进入美国市场，必须为应对美国不断变化的监管环境做好充分的准备。由于美国对外国直接投资的监管有一个比较复杂的体系，中国企业要做到熟悉和了解美国的监管环境并不简单，因此，我们不妨从企业的“市场进入”和“日常运营”两个阶段开始入手准备。

美国是一个对外国直接投资开放程度很高的国家，同时，又是一个非常注重保护国家政治、经济利益安全的国家。因此，美国对于外国直接投资的基本政策框架是建立在一个辩证的基础之上——既认识到开放投资带来的好处，同时也强调国家安全的重要性。事实上，美国政府一直希望在开放投资环境和保护国家安全之间寻找到合适的平衡点。了解这一基本的立场对正确认识美国如何看待来自中国的直接投资非常重要。

对中国企业家而言，无论是绿地投资还是合并收购，只有那些有可能涉及到美国国家安全问题的投资，才会有审批或者政治风险，而其他的投资则无需在市场进入阶段过分担忧监管的问题；一旦获得审批进入美国市场，中国企业就享有与美国企业同样的“国民待遇”，因而需要像所有的其他企业一样在日常运营中遵守美国的法律规定。

911 事件之后，在美国的跨国并购案经常受到国家安全考虑的影响，而且，如果我们从更长的时间跨度来看，近几年美国政府的审查力度在逐步增强。根据美国财政部的估计，1998年到2006年期间共有21,700起跨国并购案，其中只有8%向美国外国投资委员会（CFIUS）申报备案；其中的33起备案受到了调查，而其中7起（占调查数量的 21%）都发生在2006年。更值得注意的是，2007 年 7 月通过的对《埃克森-佛罗里奥修正案》的修订规定，对于受到外国政府控制的企业在美从事并购交易，如果收购目标是对美国国家安全有影响的企业，美国外国投资委员会（CFIUS）都有权审查其交易。中国企业家对这一修订应给予充分地重视。

除了国家安全方面的考虑，美国还在某些行业对外国投资进行限制。例如，琼斯法案（1936）、联邦能源法（1935）、电信法（1934）分别禁止或限制外商投资沿海及内河航运业、运营或维护公共发电和输电设施、收购广播电视及无线电公司等等。此外，美国还通过反托拉斯法和反托拉斯改进法增加了大型跨国并购交易的难度。

不仅在市场进入阶段，中国企业还需要考虑到在美国开展日常经营的阶段所需面对的法律风险，如商业法规、企业税和个人税法以及劳工关系的相关法规。美国是一个习惯于、或者说是热衷于通过法律诉讼解决问题的社会，且执法的尺度相对来说更为严格和认真。根据以往外国企业在美投资的经验来看，与美国企业相比，外国投资者更容易在美卷入诉讼案件。仅以美国对雇佣关系和工作条件的法律规定为例，美国就有如下规定：

- 美国职业安全和健康法案（1970）
  - 针对工作场所的健康和安全制定最低标准，授权管理机关就违规行为进行调查和处罚
- 国家劳工关系法（1935）
  - 保护员工自行成立组织和进行集体谈判的权利
- 民权法（1964）

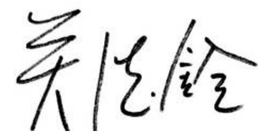
– 禁止因种族、肤色、国籍、宗教、性别(包括性骚扰和怀孕)而产生的就业歧视

- 就业年龄歧视法(1967)
  – 规定不得在就业方面歧视40岁或40岁以上的个人，并规定大部分形式的强迫退休都属于违法行为
- 美国残疾人法(1990)
  – 禁止歧视残疾人，并要求雇主在工作场所"合理包容"残疾人

由于中国企业有着不同的企业文化和商业惯例，如何对投资者、管理者和每一个外派员工都进行非常严格的法律培训，如何尽快适应新的文化和制度环境，以期在美国监管机构、媒体和公众的密切监督下，做一个奉公守法、负责任的企业公民，这是每一个赴美投资、在美开展经营活动的中国企业家需要思考的问题。

为了帮助中国企业家赴美投资，美国德勤中国业务部和Vale—哥伦比亚大学可持续国际投资研究中心(VCC)合作开展了"美国对中国外商直接投资的接受程度"的研究，并将研究成果汇集成"中国企业在美投资参考丛书"， David N. Fagan 的《美国对外国直接投资的监管体系》即是其中之一。该文重点介绍了美国对外国直接投资的监管规定、监管机构，并通过回顾近期颇受关注的一系列中国企业在美并购案的经验教训分析了各利益相关者的立场。希望该文对于那些处于市场进入阶段、意欲在美进行并购交易的中国企业能有所启发。为了方便中国企业家阅读，我们还专门提供了此文的中文提要。

我相信，在全球经济处于同步衰退的当下，坚持不懈地促进中美之间的跨境投资和经贸往来对中美两国都有着特别深远的意义。如何度过危机，寻求新的经济增长点；如何改革旧制，建立新的经济秩序；如何优势互补，争取实现双赢局面，这都不是哪一个国家可以凭一己之力完成的任务。只有合作，只有突破固有思维的创新型合作，才能为将来的发展带来转机。而在这个过程中，中国企业的全球化发展，以及中国企业家的远见卓识无疑将发挥非常重要的作用。



关德铨

德勤中国业务部主管合伙人

本文是“中国企业在美投资参考丛书”的一部分。 此丛书是美国德勤中国业务部和 Vale——哥伦比亚可持续国际投资研究中心（VCC）的合作成果。其主要课题为研究美国对中国外商直接投资的接受程度。

此丛书将陆续推出以下系列文章：

- 它山之石，可以攻玉：日本企业在美投资——中国可借鉴的经验
  作者：Curtis J. Milhaupt
- 美国对外国直接投资的监管体系
  作者： David N. Fagan
- 国际投资法对中国在美投资的保护
  作者：Mark Kantor
- 中国在美投资的政治问题
  作者： Timothy Frye and Pablo M. Pinto

此参考丛书中的观点仅代表作者个人立场，与美国德勤公司以及VCC无关。

美国对外国直接投资的监管体系

David N. Fagan

中文提要

美国外国投资委员会(CFIUS)对外资的审查

外国投资者在进入美国市场时所面临的法律和监管的风险，在很大程度上取决于具体投资的实际情况。其中的决定性因素是交易的形式和性质。是合并收购还是绿地投资？是股权收购还是资产收购？是百分之百股权收购还是部分股权收购？这些不同的交易形式会带来不同的监管风险和法律风险。其他影响进入美国市场的法律风险和策略的因素还包括投资地点、投资的行业或产业、投资规模、交易实情和交易双方的特点等。

回顾中国企业对美投资的历史，我们不难发现，美国对外国直接投资的监管机构和决策者格外关注中国企业的在美投资对美国国家安全的影响。在美国十大贸易伙伴当中，中国是唯一一个没有获得盟国待遇的国家。美国政府中的一些重要部门如国防部、情报部门和执法部门以及国会，对来自中国的某些投资还是怀有很大的戒心。到目前为止，已经有多家中国公司的在美并购活动遭遇困难或被迫宣告失败。

美国现行的外国投资审批制度是由根据1950年国防生产法中的“艾克森-弗罗里奥条款”(The Exon-Florio Provision)于1988年设立的美国外国投资委员会(CFIUS)具体体现的。该委员会的职能是监督与评估外国投资并购美国企业，视其对美国国家安全的影响程度，授权进行相关调查，并视情况上报总统就阻止外资并购作出最后决定。

美国外国投资委员会是一个横跨多个部门的机构。办公机构设在财政部，财政部作为主席单位负责总牵头，共有8个行政部门和7个白宫机构参加。其中，行政部门为财政部、商务部、国防部、国土安全部、司法部、国务院、能源部、劳工部；白宫机构为美国贸易代表办公室、科技办公室、管理和预算办公室、经济顾问委员会、国家经济委员会、国家安全委员会。

美国外国投资委员会对外国直接投资的审查建立在自愿申报的基础上，也就是说由外国投资人在收购某美国公司之前“自愿”将其收购意向申报给CFIUS，供其审阅并决定该收购交易是否会影响美国“国家安全”。另一方面，即使CFIUS没有收到外国收购人对收购意向的申报，CFIUS或任何其组成成员机构都有权力对某一交易项目进行调查。

美国外国投资委员会的审查程序为：收到申报后30天内进行初步审查；如果CFIUS认为一个项目可能对“国家安全”产生威胁，CFIUS要对项目(包括外国政府控制的交易项目)进行45天的调查；45天调查期结束后，向总统递交正式调查报告；总统在接到报告后15天内作出最终决定，是否阻止此项交易。

虽然美国外国投资委员会在对外国投资进行审查时的主要标准集中在保护国防工业基础和保持美国的技术领先地位方面，但实际上美国对“国家安全”至今尚无一个非常明确的定义，因为美国国会希望在“更广泛、更灵活”的情况下对“国家安全”这一字眼进行解读，以确保最大限度地保障美国的国家安全。

总体来说，美国对外国直接投资涉及“国家安全”问题的考察范围很广：如涉及关键基础设施、重要能源资产、重要技术、对战略资源的长期供应、外国投资者是谁、是否由外国政府控制，外国企业所在国在武器扩散和其他方面的纪录以及是否配合美国的反恐行动等等(详见表一)。尤其是那些涉及到军、民两用技术或产品、涉及外国政府控制的国有企业、涉及战略资源的控制的交易，就会格外敏感。

绝大多数申报到外国投资委员会的外国直接投资交易案，都在30天的初步审查期内结束审查。截至2007年底，共有1,900个交易案申报给CFIUS，其中只有不到40个交易案进入了45天的调查期，而由总统下令阻止交易的个案则少之又少。

但值得中国企业家留意的是，唯一遭到美国总统否决的并购交易案的买家正是来自于中国——中国航空技术进出口公司1990年对美国西雅图飞机零部件制造商MAMCO公司的收购案。事实上，中国企业在美进行的涉及到国家安全问题的交易案更容易受到更严格地调查。

美国国会如何看待来自中国的投资

除了外国投资委员会(CFIUS)和其他审批程序，美国最主要的外国直接投资审查制度的监管人是美国国会，尤其是涉及到国家安全问题的交易案。对于某些来自中国的收购交易，国会中存在政治分歧，中国投资者应着重考虑此问题。我们可以从过去一些中国在美投资的个案中看到美国国会是如何看待和处理来自中国的投资的。

中国远洋集团收购加州长滩港口案

1997年，中国远洋集团拟收购美国加州长滩港，由于这个港口是美国的一个前海军军事基地，尽管有些行政官员和国会的一些议员都说，这个交易不存在安全问题，但这起交易还是在政治上引起了很多负面的反应，美国的顾虑主要集中在中国远洋公司与中国人民解放军之间的关联以及中国控制美国前海军基地可能带来的威胁。

表一：CFIUS国家安全分析所考察的因素	
外国收购方	目标美国企业
• 收购方在遵守法律法规方面的纪录，重点考察遵守出口管制规定的表现，以及/或者以前履行对CFIUS所作承诺的表现。 • 收购方所属国对美国重要的国家安全目标给予配合的纪录，包括在核不扩散及反恐怖主义事务上的配合情况。 • 收购方管理层的纪录，包括收购方的管理人员及董事过去或现在是否与所属国军方或情报机构有关系。 • 收购方所属国在从事商业谍报活动或国家谍报活动方面的纪录。 • 收购方是否在美国实施禁运的国家（即：伊朗、朝鲜民主主义人民共和国、苏丹、古巴）从事业务活动。 • 交易是否可能增进与美国利益相背的国家的军事或情报能力。 • 收购方是否可能将重要科技或关键产品转移到海外。 • 外国政府是否对收购方施加控制或影响。 • 收购方如何为交易融资，该融资方法是否会让其他方（包括外国政府）控制收购方或该交易。	• 目标美国企业的资产，包括：资产本身是否为美国关键基础设施的一部分，是否供应美国的关键基础设施，或者可能形成其他威胁（例如资产或材料可被用于恐怖主义目的）。 • 该美国企业的政府客户，首先包括国防部门客户，其次包括非国防及情报部门客户。 • 该美国企业使用政府系统的权利。 • 获得美国政府保密信息的权利（以及美国政府核准的设施出入安全许可） • 该企业的美国资产对美国执法工作的重要程度。 • 该企业的美国资产或科技对国防供应链的重要程度。 • 该美国企业附近有哪些其他资产或企业。 • 该美国企业有哪些现行安全规则。 • 交易完成后，美国管理层是否留任，安全方面的重要职务是否由美国公民担任。 • 是否涉及敏感型科学技术，包括受出口管制的科学技术。 • 该美国企业在法规遵守方面的纪录，尤其包括遵守出口管制法规的纪录。 • 该美国企业的非政府客户群体（即：该美国企业所供应的客户群体是否对国土安全或国家安全具有关键意义）。 • 相关市场的竞争程度，尤其是该美国企业是否在重要战略产品、服务或科技的市场拥有支配优势。

其中一个最具煽动性的批评来自于加州的议员Duncan Hunter，他说："中远公司不是私营企业，它是中国政府的武器，是中国人民解放军的补充……一旦中国人控制了135英亩的长滩港，会给美国带来一系列的安全威胁。它会变成中国人在美国西海岸的谍报中心，能够变成侦听加州和其他地方通讯信息的强大基地。中国人将会对美国军方的行动了如指掌，获悉美军演习和调度的详情。北京甚至可以有办法干扰或误导我们赖以指挥和控制军队的信息网络。"

尽管五角大楼和至少两个国会议员在综合了中央情报局、海军情报办公室、海岸警卫队和海关部门的意见后都公开表示，该交易不会构成对美国安全的威胁，最终，国会迫使中国远洋公司不得不放弃投资长滩港的一些新建设施，而选择一些被人遗弃的地区进行投资。

和记黄埔收购巴拿马运河港口案

在中远拟购长滩港案之后的两年，美国国会又对和记黄埔中标大西洋和太平洋的通道——巴拿马运河的经营权作出了类似的反应。一群国会领导和退休军官对此项交易表示担忧，主要的批评集中在和记黄埔和中国人民解放军的合作关系、巴拿马运河对美国利益的战略意义以及巴拿马政府主导的竞标程序上。

中海油竞购优尼科案

2005年中海油竞购美国石油公司优尼科的时候，反对这个交易的意见集中在五个方面：第一，挤占美国的资源：反对者担心中海油把优尼科的石油储备囤积起来专供中国使用，进而影响建立在油气稳定供应基础上的美国国家安全利益；第二，背后有政府控制：中海油的收购实际上是中国政府打算控制重要的油气供应的一个行动，这种控制和由此带来的收入会增强中国政府的实力；第三，竞争不公平：中海油用于竞购的资金来源于中国国有银行和国有母公司，这给美国公司带来了不公平的竞争；第四，泄露敏感技术：中海油收购优尼科有可能导致敏感技术转移到中国；第五，待遇不对等：中国从来不允许美国公司收购中国的主要石油公司，为了对等，美国也不应该同意这一收购。

为了阻止这一交易，美国国会的很多议员采取了一系列行动。他们写信给布什政府的内阁成员表达自己对这起交易的担忧；众议院通过议案要求

CFIUS全面审查中海油竞购案；众议院通过修正案，禁止财政部将拨款用于审查中海油对优尼科的并购案；参众两院罕见地迅速通过了能源法案新增条款，要求政府在120天内对中国的能源状况进行研究，研究报告出台21天后，才能够批准中海油对优尼科的收购。这一法案的通过基本排除了中海油竞购成功的可能性，最终导致中海油撤出竞价。

华为拟购3Com案

华为与Bain Capital联手收购3Com公司，也遭到国会议员的反对。他们认为华为与中国人民解放军有密切关系——华为建立了中国人民解放军的骨干通讯系统，是中国人民解放军各种通讯产品的特约供应商。认为华为公司与中国军队有"长期的"和"明显深层"的关系，如果华为通过收购3Com公司进入了美国的通讯系统，这将对美国的国家安全构成威胁。

2008年3月20日，华为与Bain Capital宣布终止对3Com的收购。

为什么来自中国的投资容易受到美国监管部门的格外关注、甚至有的交易被阻止呢？来自中国投资的哪些方面特点容易在美国构成监管风险和政治风险呢？除了各自处于不同的利益集团、地缘政治问题和人权问题，至少有六个方面的原因导致中国投资在美国会引发国家安全和政治问题顾虑：第一，中国企业的国有性质及其可能与中国军队的关系；第二，中国企业背后得到中国政府的支持；第三，并购交易可能带来间谍活动的危险；第四，中国企业的合规纪录，包括在某些出口管制方面的合规纪录；第五，中国企业开展经营活动的其他国家（如伊朗、苏丹、朝鲜）；第六，美国军队和中国军队之间的对抗关系。

对中国企业家赴美投资的操作性建议

通过采取适当的措施，中国投资者可管理监管风险和政治风险，并在免受政治干预的同时提高通过审批的机会。

1. 中国投资者应充分了解投资的潜在风险。事实证明，有些中国公司在投资某些行业时低估了风险。对于某些行业，如国防、航空、通讯、与安全有关的软件业，即使中国公司只收购少数股权，也必须接受极其严格的审查，并有可能遭到监管机构和国会的反对。中国投资者应意识到，投资某些行业需承担很高的监管风险和政治风险，投资其他行业的风险则相对较低。投资前，应进行监管风险和政治风险分析，并以尽职调查的方式评估潜在投资。

2. 要制定在美国市场的长期发展战略。对于初次在美投资的中国投资者而言，以简单、低风险的方式进入美国市场不失为明智之举。比如在不敏感的行业内收购一个企业的少数股权，让美国合作方持有大部分股份；如果经济上合算的话，可以考虑绿地投资；或者进行容易获得CFIUS批准的相对简单的交易。这些方式可减少质疑，并为日后的大额交易做好铺垫。

3. 在条件允许的情况下，中国投资者可在美国建立起具有良好商誉的企业，以减少各界对中国投资者的质疑。

4. 美国外国投资委员会希望了解企业的股权结构、外国投资者的管理水平、商业准则和惯例以及交易的融资渠道。通过采取某些措施，中国投资者可提高企业透明度，并最终达到消除隔阂和质疑的目的。

5. 交易完成后，中国投资者应向美国官方机构展现自己的合规管理制度和文化，以进一步促进在美投资走向成功。

6. 在某些交易中，中国投资者可能会希望与知名的美国企业合作，共同进行投资，或者让美方合作者在公开声明和政治战略方面对美国公众发表意见。美国企业在当地具有更为深厚的人脉，有利于促成交易。联想与 IBM 的交易便印证了这一点。

7. 所有的投资者，包括中国投资者都应该知道，与那些受到美国经济制裁的国家（包括伊朗、苏丹、朝鲜和古巴）进行交易或大额投资，会影响投资者的对美投资。投资者将会面临合规问题并承担政治风险。中国投资者在这些国家中从事商业活动之前，应进行成本效益分析，权衡利弊后再决定是否进行交易或投资。

8. 欲在美收购资产的中国企业应该在投资前先制定综合战略，然后利用该战略管理政治风险。综合战略的内容可以包括增进交流、提高企业透明度以及融入华盛顿的政治环境等。

上述举措实施起来具有一定的难度。并且，即使这些举措全部得以实施，也未必能够完全抵御所有类型交易的政治风险和监管风险。尽管如此，美国仍然欢迎外国直接投资。因此，中国企业所面临的问题是，如何找到一条合适的道路，通过适当的交易实现对美投资，同时规避监管风险或政治风险。

（ 英文全文附后 ）

The U.S. Regulatory and Institutional Framework for FDI

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Introduction

In May 2007, President George W. Bush issued a statement on United States' policy toward foreign investment, termed by the Administration as a statement on "Open economies." The statement was spurred by a desire to affirm to the world that the United States remained open to foreign direct investment — a task made essential by the highly politicized reaction of the U.S. Congress in 2006 to the proposed investment in U.S. port operations by Dubai Ports World. The statement also anticipated the more balanced action taken by Congress later in 2007 to adopt reasonable reforms to the primary legal mechanism for vetting FDI, the Exon-Florio Amendment to the Defense Production Act. Importantly, though, President Bush's statement was not centered only on promoting foreign investment. Rather, it sought a balance between maintaining an open environment for investment and preserving important security interests, as follows:

> A free and open international investment regime is vital for a stable and growing economy, both here at home and throughout the world. The threat of global terrorism and other national security challenges have caused the United States and other countries to focus more intently on the national security dimensions of foreign investment. While my Administration will continue to take every necessary step to protect national security, my Administration recognizes that our prosperity and security are founded on our country's openness.
>
> As both the world's largest investor and the world's largest recipient of investment, the United States has a key stake in promoting an open investment regime. The United States unequivocally supports international investment in this country and is equally committed to securing fair, equitable, and nondiscriminatory treatment for U.S. investors abroad. Both inbound and outbound investment benefit our country by stimulating growth, creating jobs, enhancing productivity, and fostering competitiveness that allows our companies and their workers to prosper at home and in international markets.[1]

President Bush's statement affirming the importance of foreign investment to the United States was not ground-breaking. On the contrary, it followed a long line of Administration policy pronouncements expressing openness to foreign investment.[2] The significance of President Bush's statement on "Open economies" was that it explicitly linked the policy of open investment to U.S. national security interests. This basic policy framework — recognizing the benefits of open investment, but also emphasizing the importance of national security — is especially important when considering FDI from China. Indeed, not by coincidence, the issues presented by FDI from China in many respects embody the balance set forth in the Bush Administration's statement on "Open economies."

China has the potential to be a tremendous source of FDI for the United States. At the same time, the history of Chinese investments in the United States tells us that, from the perspective of U.S. regulators and policymakers, Chinese FDI can present unique considerations, especially in the area of national security. As described further below, of the United States' ten largest trading partners, China is the only one not considered an ally[3]; key institutions, including the Department of Defense, the U.S. intelligence and law enforcement agencies, and Congress view certain Chinese investments with great suspicion; and U.S. concerns over the unlicensed transfer of dual use technologies are especially acute with China. In fact, the

[1] President George W. Bush Statement on Open Economies (May 10, 2007), available at http://www.whitehouse.gov/news/releases/2007/05/20070510-3.html.

[2] In 1977, the Carter Administration had issued a policy statement recognizing that "international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces," and "the United States has an important interest in seeking to assure that established investors receive equitable and nondiscriminatory treatment from host governments." James Jackson, "Foreign direct investment: current issues," Congressional Research Service Report to Congress, April 27, 2007, at 6 (internal citation omitted). In 1983, President Reagan issued a statement welcoming foreign investment, and clarifying the U.S. government's "neutrality" position on international investment to include three objectives: liberalization of barriers to international investments abroad, encouraging FDI to assist in the economic development of developing countries and maintaining an open U.S. economy to contribute to FDI. Id. at 7 (internal citation omitted). The Administration of George H.W. Bush then issued a statement promoting foreign investment in 1991. The Clinton Administration, while not formally adopting a policy statement, sought the development of a Multilateral Agreement on Investment (MAI) among OECD countries that would have formally addressed various issues that hamper the free flow of investments, such as discriminatory treatment and creating dispute settlement mechanisms. Id. (internal citation omitted).

[3] Edward M. Graham and David M. Marchick, U.S. National Security and Foreign Direct Investment 103 (Institute for International Economics 2006).

only transaction ever formally blocked under Exon-Florio was an investment by a Chinese company[4]. More recently, in early 2008, the U.S. private equity firm Bain Capital Partners and the Chinese technology firm Huawei Technologies were forced to drop their bid for the U.S. computer communications equipment manufacturer 3Com Corp. after they were unable to address the national security concerns of the United States government[5]. Sensitivities over Chinese investment can extend to the state level as well, as demonstrated when the 1990s sale of the Indiana-based magnet company Magnaquench to an investment group that included Chinese state-owned companies belatedly became a political issue in the 2008 Democratic party primary campaign in Indiana[6].

In this context, the question of whether the United States is ready, from a regulatory and institutional perspective, for M&As from China takes on added significance. Whether Chinese FDI in the U.S. will increase substantially, and the U.S. in turn will receive the attendant benefits of this investment after years of outward investment flowing to China, depends on whether U.S. laws and institutions can treat Chinese investors at least approximately like other investors, i.e., whether Chinese investors can approach the U.S. market with some degree of certainty with respect to process, timeframes and, ultimately, results on the regulatory and political fronts — and whether the United States, at the same time, can preserve its legitimate non-economic interests.

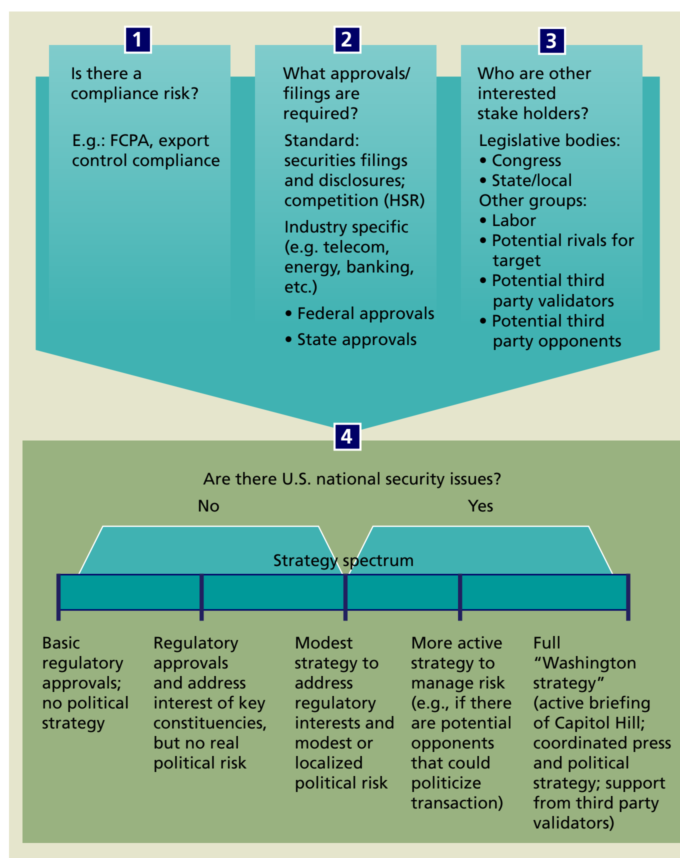
Before addressing this subject more fully, it should be emphasized that the discussion herein is not legal advice. As noted, the applicability of particular laws, whether federal, state or local, to any given transaction will depend highly on the facts and circumstances of that transaction. Elements of the U.S. legal and institutional framework addressed in this booklet will not be applicable in every case of foreign investment, or even necessarily in the majority of them. Rather, the booklet is intended to provide a general overview of the framework for cross-border M&As, with a more detailed focus on Exon-Florio, the potential political challenges that Chinese investors can face in Congress and potential strategies to mitigate regulatory and political risk for investment from China. With this in mind, investors would be prudent to consult with U.S. counsel on any particular investment to ensure that all relevant laws and regulatory requirements — at the federal, state and local levels — are identified and addressed.

The U.S. regulatory landscape for FDI from China and considerations for investors

The legal and corporate due diligence evaluation for any particular investment can be a complex exercise, touching on a wide range of laws, regulations and other issues. On the legal side alone, a due diligence review typically will encompass, among other elements, a review of material contracts, supply and licensing agreements, pending and ongoing litigation, intellectual property portfolios and potential liabilities, labor and employment issues, insurance coverage, and environmental issues. Such a due diligence review also must encompass three fundamental issues: (1) What, if any, regulatory compliance issues will be implicated by the investment? (2) What, if any, regulatory approvals are required to complete the investment? (3) What other stakeholders, such as legislative bodies or other third parties, may be interested in the transaction? For certain foreign investors, including in particular Chinese investors, there is an additional consideration that pervades each of these issues: whether the transaction implicates — in fact or in perception — U.S. national security considerations.

These due diligence-related factors and their impact on strategic considerations for an investment are discussed in further depth below. As the following due diligence and strategy flow chart demonstrates, and as described more fully herein, the answers to these fundamental questions and how they interact with U.S. national security considerations directly bear on the appropriate strategy for addressing regulatory and political risk for foreign M&A transactions in the United States.

Figure 1: U.S. regulatory and strategic due diligence flow chart.



Source: the author, copyright Covington & Burling LLP

4 See infra note 36 and accompanying text.

5 See infra notes 89–90 and accompanying text.

6 Hillary Clinton Press Release, "Hillary Clinton Promotes Plan for Strong Defense and Good Jobs in Indiana," Apr. 12, 2008 (claiming that Indiana lost 225 jobs when "Chinese investors moved the operations of Magnaquench to China" and, as a result, "today the U.S. military buys 'neo' magnets from China."); see also Jake Tapper, "Hoosier Responsible? Clinton Decries China's Acquisition of Indiana Company — Ignoring Her Husband's Role in the Sale," ABCNews.com (Apr. 30, 2008), available at http://abcnews.go.com/Politics/Vote2008/story?id=4757257.

1. Ongoing regulatory compliance considerations

As an initial matter, a thorough due diligence review of a potential acquisition target should assess not only current liabilities that have been identified, but also ongoing compliance issues that arise from a foreign acquisition. Two ongoing compliance issues, in particular, need to be identified and evaluated for foreign investment from China: foreign trade control compliance and compliance with the Foreign Corrupt Practices Act of 1977 ("FCPA").[7]

a. Foreign trade controls compliance

Compliance with U.S. laws and regulations governing foreign trade controls laws is particularly important in the context of Chinese M&A activity in the United States because of prominent reported cases of Chinese violations of these provisions. These cases have arguably contributed to a perception among U.S. regulatory officials, whether accurate or not, of heightened risk with respect to foreign trade controls compliance when Chinese companies or partners are at issue. They also have resulted in stricter licensing requirements for the export of products or technologies that could make a contribution to, or be destined for end use by, the Chinese military.[8]

The unlicensed physical export of controlled U.S. products or technologies is not the only compliance risk that should be understood and mitigated by a Chinese investor. Potential acquirers of U.S. companies as well as Chinese companies evaluating greenfield investments also should understand and be prepared to implement compliance programs for U.S. foreign trade controls governing not only access to and transfers of controlled technologies to foreign nationals in the United States but also compliance with U.S. trade embargoes. This section summarizes only briefly these U.S. programs which have far-reaching implications for owners of U.S. businesses.

There are three programs that principally comprise the U.S. foreign trade controls regime.[9] First, U.S. Commerce Department regulations, known as the Export Administration Regulations ("EAR"), apply to so-called "dual-use items" — i.e., products and technologies that may have both military and commercial applications. The EAR specifically provide restrictions on the export of commercial products (including software) and technologies from the United States and on the re-export between foreign countries of U.S.-origin (including foreign-made items with more than de minimis U.S.-origin content) commercial products (including software) and technologies.[10] The degree to which a particular item is controlled (e.g., whether export or re-export is prohibited or subject to specific licensing requirements) under the EAR depends upon the (i) technical capabilities and performance specifications of the product, software or technology involved (according to a classification list maintained by the Commerce Department); (ii) the country of destination; and (iii) in certain circumstances, the actual end-user and end-use of the item.

Second, the State Department administers the International Traffic in Arms Regulations ("ITAR"),[11] which control the export or foreign transfer of any defense article or service. In general, defense articles are products, software or technical information that are specially designed, modified or configured for military or intelligence uses, as defined on the U.S. Munitions List.[12] Defense services include any support or training for design, production, repair or use of defense articles, whether in the U.S. or abroad.[13] The State Department requires specific licensing authorization for the export of all defense articles and services to virtually any country. Under current U.S. legislation, export or re-export to China of U.S. Munitions List products, software or technical information subject to the ITAR is prohibited.

Third, the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") administers certain sanctions programs that generally preclude export-import transactions and other business and financial dealings with targeted countries (e.g., Cuba and Iran) and parties (e.g., terrorist organizations and drug kingpins and narco-traffickers) for U.S. national policy and security reasons. These restrictions apply quite broadly to U.S. persons, which include not only entities organized under the laws of the United States but, depending on the program, also their foreign subsidiaries (e.g., Cuba). In addition, "U.S. person" includes any individual or legal entity physically in the United States or any U.S. citizen or permanent resident wherever located or employed.[14] Thus, no foreign national in the United States and no U.S. citizen located abroad, including as an employee of a

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7 15 U.S.C. §§ 78m, 78dd.

8 Department of Commerce, Bureau of Industry and Security, Revisions and Clarification of Export and Reexport Controls for the People's Republic of China (PRC); New Authorization Validated End-User; Revision of Import Certificate and PRC End-User Statement Requirements, 72 Fed. Reg. 33646 (June 19, 2007).

9 For a thorough overview of the basics of the U.S. foreign trade control regime, see Peter L. Flanagan and Eric D. Brown, "Foreign trade controls," in *E-Commerce Law & Business* (Plotkin, Wells, and Wimmer, eds., 2003); see also GAO, "Export controls: agencies should assess vulnerabilities and improve guidance for export-controlled information at universities" (Dec. 2006), available at http://www.gao.gov/new.items/d0770.pdf [hereinafter "GAO Report on Export Controls"].

10 15 C.F.R. Parts 730 to 774.

11 22 C.F.R. Parts 120–130.

12 22 C.F.R. Pt. 121.

13 Flanagan and Brown, op. cit., pp. 15–16.

14 The restrictions are even broader with respect to the Cuba embargo, which applies to "persons subject to the jurisdiction of the United States" — a term that can mean even foreign affiliates are subject to control of a U.S. party and, in turn, the Cuba embargo.

foreign company, may take action to facilitate trade or other financial transactions with an OFAC-sanctioned country or party.

Each of these foreign trade controls programs provides for civil penalties, including substantial fines, for violations and criminal penalties for willful violations. In this regard, it is worth highlighting one aspect of U.S. foreign trade controls that can pose particularly challenging ongoing compliance issues — namely, the restrictions on "deemed exports" or technology transfers inherent in the Commerce Department and State Department regulations. As explained by the Commerce Department

> [T]echnology is 'released' for export when it is available to foreign nationals for visual inspection (such as reading technical specifications, plans, blueprints, etc.) even if such release occurs in the United States. This same interpretation applies to technology that is exchanged orally with a foreign national or technology that is made available by practice or application under the guidance of persons with knowledge of the technology.[15]

This broad restriction encompasses information necessary for the "development," "production" or "use" of a product. When such technology — or certain kinds of software source code — is released to a foreign national in the United States, it is **deemed** to be exported and, therefore, such release may require prior authorization from the Commerce Department. A similar requirement obtains with respect to technology retransfers abroad — namely, if State or Commerce-controlled technology is approved for export or otherwise transferred abroad and then, in turn, proposed for transfer to an individual from a third country that would require licensing for direct U.S. exports, the additional retransfer without a license would be a violation of Commerce Department regulations.[16] Likewise, with respect to defense articles, the State Department requires an export license "for the oral, visual, or documentary transmission of technical data by U.S. persons to foreign persons, by such means as in-person or telephone discussions and written correspondence including electronic messages, even when they are in the United States."[17] Like the Commerce Department, the State Department applies retransfer controls for "deemed" exports that occur outside the United States.

For Chinese investors who may wish to access U.S. technology in connection with their investments, it is especially important to be aware of the U.S. restrictions on deemed exports and to plan for ongoing compliance mechanisms to ensure that the acquired entity and existing and future employees act in compliance with applicable U.S. foreign trade control restrictions. In particular, prospective Chinese owners of U.S. businesses need to evaluate whether limitations on access to certain technology may interfere with managing their investment.

b. FCPA

The FCPA is a broad anti-corruption statute with both criminal and civil provisions that address bribery directly (corrupt offers, payments, gifts, etc., in exchange for a quid pro quo) and via provisions focused on accounting and internal controls that hide corrupt transactions.[18] Like the U.S. foreign trade control regimes, the FCPA is nuanced; a thorough discussion of its provisions, the various permutations in which it may apply, and the potential pitfalls for U.S. firms and others is beyond the scope of this booklet. For present purposes, the pertinent point with respect to the FCPA is that while the statute typically addresses activities of U.S. firms and nationals abroad (indeed, it was adopted in response to Congressional findings in the 1970s that U.S. firms "were routinely making payments to foreign officials in exchange for business favors"[19]), it also has relevance as an ongoing compliance matter for foreign investors in the United States.

The FCPA in particular can have special relevance for Chinese firms for several reasons. First, the anti-bribery provisions are not limited to gifts or other graft provided to employees of state agencies; they also can reach state-owned companies or quasi-private entities serving state functions.[20] Second, the statute's bribery prohibitions apply not only to all U.S. companies and persons, but also to any foreign national in the United States who violates the Act "by use of the mails or any means or instrumentality of interstate commerce."[21] Thus, for example, a Chinese employee from a Chinese company doing business in the United States who, while in the U.S., arranges for a gift to be made to an officer or an employee of a Chinese state-owned entity to obtain an advantage with that entity in a business matter could face criminal liability under the FCPA.

Given the potential scope of the FCPA and its tripwires for liability, it would be prudent for a Chinese investor to plan and implement a strong FCPA compliance program (if one does not already exist) in connection with acquisitions in the United States. Likewise, investors should be aware that, as with other compliance issues, a U.S. counterparty may seek certain FCPA-related representations or disclosures from the investor.

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[15] U.S. Department of Commerce Bureau of Industry and Security, "Deemed export questions and answers," available at http://www.bis.doc.gov/deemedexports/deemedexportsfaqs.html#1 (citing 15 C.F.R. § 734.2(b)(3)). For additional background on deemed export control rules, see Larry E. Christensen, "Technology and software controls," in *Coping with U.S. Export Controls*, at pp. 673-674 (Practicing Law Institute 2001).

[16] Id.

[17] GAO on Export Controls, p. 8.

[18] For a thorough overview of the FCPA's criminal provisions and pitfalls, see Jacqueline C. Wolff and Jessica A. Clarke, "Liability under the Foreign Corrupt Practices Act," 40 Review of Securities and Commodities Regulation 13 (Jan. 17, 2007).

[19] Id. at 13. FCPA also applies to "issuers" of registered securities in the United States, which can include foreign companies that trade American Depository Receipts in U.S. financial markets.

[20] Id. at 15 (citing 15 U.S.C. § 78dd-1(f)(1) and *U.S. v. DPC (Tianjin) Co. Ltd*, No. 05 Cr. 282 (C.D. Cal. May 20, 2005)).

[21] Id. (quoting 15 U.S.C. § 78dd-3(a)).

2. Required regulatory approvals

The second fundamental regulatory issue that foreign companies examining potential targets for acquisition or investment in the United States should consider is what regulatory approvals are required. On this issue, the conceptual framework can be broken down further as: (1) Are there any standard regulatory approvals or disclosures that are required for the transaction based on certain general characteristics, such as the value of the transaction and whether it involves any publicly listed entities? (2) Are there specific approvals that are required because of the nature of the assets, which would encompass approvals that are specific to certain industries?

a. Standard approvals and disclosures

Foreign M&A activity in the United States may implicate at least two standard regulatory approval and compliance matters depending on the specific transaction's terms — namely, whether there are any required filings with securities regulators and exchanges in the United States, which turns on whether the U.S. target or foreign entity are publicly listed in the United States; and whether there are any antitrust-related notifications and reviews required.

In terms of U.S. securities laws and regulations, there are several requirements that may be imposed on either the U.S. target company or the foreign investor. Again, the federal securities laws are detailed and nuanced, and the full range of rules and requirements cannot be covered here. However, the following is a non-exhaustive list of the types of filings and disclosures that may be required as a result of an investment or merger involving entities that are registered with the Securities and Exchange Commission (the "SEC") in the United States:

- Registered U.S. entities must make Form 8-K filings with the SEC to provide prompt disclosure of certain events, which would include a change of control of the entity and any material definitive merger, asset purchase or other business combination agreements.[22]

- Persons who acquire beneficial ownership interest of more than five percent of a class of voting equity securities registered under the Securities Exchange Act of 1934 ("1934 Act") must file with the SEC a form addressing, among other things, the shareholder's intent with respect to the target (including plans or proposals with regard to future actions), the percentage of ownership, the source and amount of any financing and an explanation of the transaction.[23]

- For exchange offers, issuers must submit a form addressing, among other things, the bidder's financial condition and results of operations, the reasons for the transaction, the shareholder's financing and prior material contacts with the company being acquired.[24]

- Tender offers for publicly held stock must comply with the SEC's tender offer rules, which include filing a schedule with the SEC describing the tender offer and providing substantive disclosures.[25]

- Shareholder votes required under state corporate law or stock exchange rules for mergers, asset sales, issuances of stock or similar transactions involve the filing of a preliminary proxy statement with the SEC followed by a definitive proxy statement when it is delivered to shareholders.[26]

The SEC will review, and may provide comments on, certain of these filings, and the parties will not be permitted to complete the transaction until the SEC confirms that it has no further comments on such filings.

In addition to these federal filing requirements, the various exchanges (NYSE, AMEX, Nasdaq) have certain requirements, such as disclosure and notification requirements for material events that may affect the value of a company's stock.[27] Many states also have anti-takeover laws that govern acquisitions of stock of companies incorporated in their jurisdictions. These state laws may impose requirements for shareholder or board approval for acquisitions of stock above a certain threshold (e.g., 10 or 15%).[28]

In addition to securities-related disclosures and filings, the other standard federal review in connection with M&A activity is a competition review conducted by the U.S. Federal Trade Commission ("FTC") and the Department of Justice ("DOJ"). The U.S. antitrust laws prohibit acquisitions of interests or assets of a party engaged in interstate commerce where the "effect of such acquisition may be substantially to lessen competition" in a relevant U.S. product market.[29] To provide the FTC and DOJ with an opportunity to review proposed acquisitions in advance, the Hart-Scott-Rodino Antitrust

[22] Jack Levin, "Structuring venture capital, private equity, and entrepreneurial transactions", at ¶ 503.3.2.1 (Ginsburg and Rocap, eds., 2007).

[23] Id. at ¶ 503.3.2.2; see also Ethiopas Tafara, Testimony before the Senate Committee on Banking, Housing, and Urban Affairs (Apr. 24, 2008).

[24] See Form F-4, Registration Statement Under the Securities Act of 1933, available at http://www.sec.gov/about/forms/formf-4.pdf.

[25] Levin at ¶ 503.3.2.4.

[26] Id. at ¶ 503.3.2.7.

[27] Id. at ¶ 503.2.1.

[28] Id. at ¶ 503.3.3.

[29] 15 U.S.C. § 18.

Improvements Act of 1976 ("HSR")[30] requires parties to submit a premerger notification for most significant acquisitions. The HSR notification requirements apply if the transaction meets certain thresholds based on the value of the transaction and the parties' sizes, or if, regardless of the parties' sizes, the transaction will result in the acquirer receiving at least $260.7 million of the target's interests and assets.

Upon receipt of the HSR notification, the FTC and DOJ have a 30-day "waiting period" to investigate the transaction to determine whether there is any potential harm to competition. If the FTC and DOJ believe that the transaction warrants closer scrutiny, they can further delay the transaction pending their review. Ultimately, if the agencies conclude that the acquisition would substantially lessen competition, they may seek a court injunction prohibiting the transaction. Notably, even if the FTC/DOJ do not act during the HSR waiting period, the transaction is not exempt from U.S. antitrust laws, and can be subject to later challenge by the FTC and DOJ, state enforcement officials, and even private parties.

b. Industry-specific requirements

Depending on the particular sector and assets at issue in an M&A, the transaction parties may be required to seek additional approvals from U.S. federal or state officials before consummating the transaction. Thus, in addition to potential securities-related filings (for publicly traded companies), a federal competition review (depending on the size of the transaction) and national security review (discussed below), Chinese firms looking to acquire control of a U.S. target must also consider what, if any, industry-specific federal and state regulatory approval processes they will confront. While it is not possible here to address in depth the various industry regulatory regimes in the United States, two sectors provide useful illustrations of the potential additional federal and state approvals required for M&A activity: telecommunications and banking.

First, with respect to transactions in the telecommunications sector, Section 310 of the Communications Act of 1934 restricts foreign ownership of broadcast, common carrier and aeronautical radio station licensees. Section 310 expressly prohibits a foreign corporation or "alien" from holding any broadcast, common carrier or aeronautical radio station license, but, as interpreted by the Federal Communications Commission ("FCC"), it does not prohibit indirect foreign control of certain licensees.[31] Section 310 also prohibits foreign governments, individuals and corporations from owning more than 20% of the stock of a broadcast, common carrier, or aeronautical radio station licensee. Yet, as the FCC has noted, most foreign investments occur through intermediate companies organized in the United States. Section 310 provides a presumptive 25% ownership limitation for foreign investment in entities that in turn control U.S. broadcast, common carrier and aeronautical radio licensees. However, Section 310 also grants the FCC discretion to allow higher levels of foreign ownership at the holding company level unless it finds that such ownership is inconsistent with the public interest. Thus, foreign entities may acquire, directly or indirectly, up to 100% of the stock of a U.S. company owning or controlling an FCC licensee if the FCC does not find the foreign ownership to be inconsistent with the public interest.[32] Although the FCC has frequently exercised its discretion under Section 310 to permit foreign investment in excess of the 25% limitation with respect to non-broadcast licensees, historically it has declined to do so in the broadcast context.

In addition, acquisitions of telecommunications providers may require approval by state public utility commissions, which typically have jurisdiction over transfers of control of state-issued telecommunications authorizations and also may have authority to review M&As for their competitive effects on the local market and impact on customers' rates, terms and conditions of service. Transactions in the U.S. telecommunications sector, therefore, may require both FCC approval for the transfer of federal authorizations to a foreign acquirer and approvals of state authorities based on a review of the qualifications of the acquirer and the competitive effects of the proposed controlling acquisition.

Second, with respect to banking transactions, the U.S. system of financial institution regulation involves multiple regulators, including at the federal and state level, and, in turn, may require multiple approvals for M&A transactions. As presently constituted, commercial banking in the United States is principally overseen by four primary federal regulators — the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. In addition, states have laws and regulations that govern the business of banking within the state, including in some cases mergers and acquisitions. Most foreign banks elect to enter the United States through the establishment of their own branches or other offices in the U.S.;[33] however, the federal and state regulators have ample authority to review M&A activity, whether it is the initial avenue for a foreign bank to enter the U.S. market or involves a foreign bank that already has existing branches in the United States.

In particular, at the federal level, the federal Bank Holding Company Act ("BHC Act") requires the Federal Reserve Board to review and either approve or disapprove any proposed transaction that would result in any company, foreign or domestic, acquiring control of a

30 15 U.S.C. § 18a.

31 FCC, Foreign Ownership Guidelines for FCC Common Carrier and Aeronautical Radio Licenses, DA 04-3610, at 7 (Nov. 17, 2007) (hereinafter "FCC Guidelines").

32 Id. at 10.

33 Carl Felsenfeld, Banking Regulation in the United States (Second Edition) 396 (Juris Publishing 2006).

banking holding company or certain types of banks. This includes, among other things, the acquisition of 25% or more of any class of voting securities of a bank or bank holding company. The Federal Reserve also can find control where an investment would result in a lower percentage (down to 5%) of ownership over voting securities, if other indicia of control are also present. In considering whether control is present, the Federal Reserve "considers the size of the investment, the involvement of the investor in the management of the bank or bank holding company, any business relationships between the investor and the bank or bank holding company, and other relevant factors indicating an intent or ability to significantly influence the management or operations of the bank or bank holding company."[34] The Change in Bank Control Act ("CIBC Act") provides similar authority to the Federal Reserve and the other federal regulators with respect to any acquisition of 10% or more of any class of voting securities of a regulated institution that is not subject to Federal Reserve review and approval under the BHC Act. Notably, in order for a foreign bank to make an acquisition in the United States, the BHC Act also requires the Federal Reserve to assess a number of other factors, including the supervision exercised by home country authorities. Foreign entrance into the U.S. market may not be permitted if the Federal Reserve does not determine that home country regulators exercise comprehensive consolidated supervision ("CCS").

3. Other interested stakeholders

In addition to identifying regulatory compliance issues and assessing what regulatory approvals will be required for foreign M&As, a critical due diligence consideration for certain foreign investments is an assessment of how other interested stakeholders may align on the transaction. This, in part, is an assessment of how controversial a transaction will be — and that is particularly relevant to foreign investors from potentially sensitive countries, like China. Specific considerations may include whether a transaction will be welcomed by the employees of the target; whether there are any highly organized political groups, such as unions, that may be interested in the transaction and how it may affect their constituencies; whether there are rival bidders who could seek to interfere in the transaction; and what other third parties will be oriented either in favor or against the transaction.

* * *

As figure 1 on page 8 demonstrates, national security considerations overlay each of these fundamental due diligence issues, especially with respect to M&A activity from China: reputation for ongoing compliance matters, such as export control and anti-corruption compliance, can impact the trustworthiness determination of a foreign acquirer for U.S. national security purposes (see section D); prior approval of CFIUS, which assesses the impact on U.S. national security of mergers, acquisitions and investments that result in foreign control, may be the most significant regulatory approval for certain foreign investments (see section B); and if there are national security implications of an investment, the existence of other interested stakeholders and their orientation toward a transaction becomes amplified in importance. In particular, with respect to the last point, because national security considerations can generate political interest in a transaction, they can provide greater leverage to potential opponents to create controversy and, in turn, may require more active outreach to potential supporters to head off such controversy. In turn, the combination of national security with the fundamental due diligence questions — compliance, approvals and stakeholders — that accompany cross-border M&As activity should help determine transaction parties' ultimate strategy for securing approval within the U.S. regulatory and institutional framework.

With this background in mind, the remainder of this booklet will focus in greater depth on the challenging U.S. regulatory and institutional issues associated with Chinese investment in particular: national security reviews undertaken by CFIUS; the role that the U.S. Congress can play in Chinese transactions; certain characteristics of Chinese investment that can make such transactions challenging for the U.S. system; and, finally, strategies that Chinese firms can deploy to manage regulatory and political risk.

National security: CFIUS reviews under Exon-Florio/FINSA

Mergers and acquisitions of U.S. businesses that may implicate national security are required to receive closer regulatory scrutiny from CFIUS. Of all potential investors, Chinese M&As are among the most likely to receive the greatest scrutiny. In fact, there have been several potential transactions involving Chinese firms that were abandoned after initial consultations with CFIUS or to avoid a potential negative Presidential decision,[35] with the Huawei Technologies' proposed investment with Bain Capital in 3Com (discussed more fully below) serving as most recent example. In addition, the only divestment of an acquisition ever formally ordered by a President under Exon-

[34] Scott Alvarez, "Testimony Before the Senate Committee on Banking, Housing, and Urban Affairs" (Apr. 24, 2008).

[35] Graham and Marchick, op. cit., p. 102.

Florio involved China — namely, President George H.W. Bush's order in 1990 requiring China National Aero Tech to divest MAMCO Manufacturing, Inc., an aerospace company based in Washington state.[36] Accordingly, as part of assessing the U.S. regulatory framework for investment from China, this section provides a more detailed discussion of the CFIUS process and the statute that controls the CFIUS process — historically known as the Exon-Florio Amendment.

1. Overview of Exon-Florio

The principal U.S. statute governing regulatory reviews of certain types of FDI is Section 721 of the Defense Production Act of 1950. Section 721 is known as the Exon-Florio Amendment after the original amendment to the Defense Production Act, which was adopted in 1988 amidst concerns over Japanese investment. The Exon-Florio Amendment provided the President with express authority to review the national security effects of foreign acquisitions, mergers and takeovers.[37] The law was recently amended by the Foreign Investment and National Security Act of 2007 ("FINSA").[38] FINSA left intact the essential elements of Exon-Florio, while also adopting amendments that provide for greater clarity on process, additional factors related to national security reviews under the statute, greater accountability among the agencies charged with implementing the statute, and enhanced Congressional oversight.

Under the statute as amended by FINSA, CFIUS, as the President's designee, has authority to review "any merger, acquisition, or takeover … by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States."[39] The purpose of the review is to determine the effects of a transaction on U.S. national security. CFIUS then must investigate any transaction that (1) threatens to impair the national security of the United States, if the threat has not been mitigated during the initial review period; (2) would involve control by a foreign government;[40] or (3) would result in foreign control of U.S. critical infrastructure, if such control threatens to impair U.S. national security and the threat is not mitigated during the initial review period. The President ultimately has authority to suspend or prohibit any transaction that threatens to impair the national security if, after a full investigation is completed, "there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security," and other laws except for the International Emergency Economic Powers Act,[41] "do not in the President's judgment provide adequate and appropriate authority for the President to protect the national security in the matter before the President."[42]

The Department of Treasury chairs CFIUS.[43] In addition, CFIUS is comprised of eight other voting members (the Departments of Commerce, Defense, Homeland Security, Justice, State, and Energy; the U.S. Trade Representative; and the White House Office of Science and Technology); two permanent non-voting members (the Director of National Intelligence and the Department of Labor); and several other White House offices that act as observers and, on a case-by-case basis, participate in CFIUS reviews.[44]

By statute, CFIUS is authorized to review a transaction either upon a voluntary filing by either party to the transaction, or upon initiation of the Committee. By regulation, CFIUS historically has also provided for any Committee member to issue its own notice to the full Committee requesting a review of a particular transaction.[45] The Treasury Department, as chair of CFIUS, also has considerable discretion on

[36] President Bush's order is available at http://www.presidency.ucsb.edu/ws/index.php?pid=18108.

[37] Omnibus Trade and Competitiveness Act of 1988, § 5021, Pub. L. 100-418 (1988), codified at 50 U.S.C. App. § 2170. The original authorization was scheduled to expire in 1991, but was made permanent by Section 8 of Defense Production Act Extension and Amendments of 1991, Pub. L. 102-99 (1991).

[38] Pub. L. 110-49 (2007) ("FINSA").

[39] Id. § 2(a)(3) (codified at 50 U.S.C. App. § 2170(a)(3)).

[40] An investigation of such transactions is not required if the Secretary or Deputy Secretary of the Treasury, and an equivalent official at the "lead" CFIUS agency, determine that the proposed transaction will not impair national security. For those acquisitions by state-owned enterprises that reach the investigation stage, the law requires an assessment of the foreign country's compliance with U.S. and multilateral counter-terrorism, nonproliferation and export control regimes.

[41] 50 U.S.C. §§ 1701–1706.

[42] FINSA, § 6 (codified at 50 U.S.C. App. § 2170(d)).

[43] The fact that the Treasury Department, the most naturally pro-investment of all executive agencies, chairs a national security review process is both a symbolic and practical nod to the importance of foreign investors and the open investment regime of the United States.

[44] Executive Order 13456, Further Amendment of Executive Order 11858 Concerning Foreign Investment in the United States § 3 (2008) (hereinafter "FINSA Executive Order"). The additional White House offices are the Office of Management and Budget, the Council of Economic Advisers, the Assistant to the President for National Security Affairs, the Assistant to the President for Economic Policy, and the Assistant to the President for Homeland Security and Counterterrorism.

[45] 31 C.F.R. § 800.401.

whether to accept a notice for review. Thus, for example, while the statute and regulations indicate a single party to a transaction may file a voluntary notice, it is extremely rare for the Treasury to deem a notice containing information and responses from only one party to a transaction sufficient to initiate a review.

Once CFIUS has sufficient information from both parties to begin a review, the statutorily mandated timetable for the review and "investigation" process is as follows:

- Initial 30-day review following receipt of notice.
- 45-day "investigation" period for transactions deemed to require additional review following the initial 30-day period, including foreign government-controlled transactions.
- Formal report to the President at the end of the 45-day investigation period.
- Presidential decision within 15 days of receiving the formal report.

Notwithstanding these statutorily-prescribed timeframes for reviews, there is no statute of limitations on the inherent Presidential authority in Exon-Florio. The President can act at any point, even after a transaction has closed. Moreover, the President's decision is not subject to judicial review by U.S. courts.[46] However, once a transaction has undergone a review, it receives a form of safe harbor: FINSA, the implementing Executive Order, and CFIUS's regulations provide that the Committee can unilaterally initiate another review only if certain limited circumstances are met — such as, the initial review was based on false or materially misleading information, or material omitted information, or if there has been an intentional material breach of a mitigation agreement upon which approval was originally conditioned.[47] Notably, Exon-Florio law does not provide a mechanism for the Executive Branch to review greenfield investments in the United States.

2. Exon-Florio in practice

CFIUS is a unique regulatory body insofar as it operates by consensus[48] and includes multiple agencies with viewpoints that reflect their distinct missions and equities. There is an inherent tension between the security agency members of CFIUS, with their focus on defense, homeland security, counterintelligence, and law enforcement, and the economic agencies, which are more focused on trade and investment.[49] This tension is purposeful: having a consensus-based, confidential process that requires input from cabinet agencies with differing equities is intended to facilitate careful, objective determinations that permit investments where possible but without sacrificing important national security interests.

At the same time, one consequence of having a consensus-based, confidential process that involves so many agencies and with limited information flow to the regulated parties is that the process itself can be opaque. In turn, much in CFIUS practice turns not only on what is set forth in the statute and regulations, but on understanding which agencies have particular interests in a transaction, who the key decision-makers will be at those agencies, and what questions or considerations are likely to be of principal concern to those decision-makers. Particularly for the hardest cases, understanding the idiosyncrasies of agency interests and perspectives and what issues will matter to the key decision-makers is more a regulatory art than a science. Added to this mix is the fact that prominent transactions, especially those involving FDI from China, can attract media and political attention. (See in this context also the booklet by Timothy Frye and Pablo Pinto in this series.)

Accordingly, investors and U.S. parties alike are well advised to understand and anticipate CFIUS's analysis and considerations before launching into transactions that might require a CFIUS review. This is particularly true for investments from China, which, for reasons described below, are more likely to raise both strategic and political issues. The critical threshold questions for a CFIUS review are: (i) whether there is foreign control over a U.S. business; (ii) if there is foreign control, whether the transaction may present any significant national security issues; and (iii) if there are national security concerns, whether they can be mitigated through contractual commitments from the transaction parties or other permissible means.[50]

a. Control over U.S. business

The threshold question for any CFIUS review is whether there is a transaction that presents a foreign person[51] with "control" over a U.S. business. Where there is potential foreign government ownership or influence, the control analysis is applied twice: first, in assessing, whether a foreign entity will be controlling a U.S. business and, second, in assessing whether in fact that foreign entity is itself controlled by a foreign government.

The definition of "control" in the CFIUS regulations has historically been quite broad, and that remained true in the revised definition implementing FINSA. "Control" means:

> [T]he power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity.[52]

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46 FINSA, § 6 (codified at 50 U.S.C. App. § 2170(e)).

47 FINSA, § 2 (codified at 50 U.S.C. App. § 2170(b)(1)(D)); FINSA Executive Order § 7(f).

48 The drive toward a consensus reflects the desire among CFIUS members to avoid sending a transaction to the President, if at all possible. Thus, there is internal pressure among the CFIUS cabinet membership to form a consensus view on every transaction. In the rare instance when a transaction does proceed all the way to the President for a decision, the reports prepared for the President by the member agencies of CFIUS can reflect differing views.

49 Graham and Marchick, op cit., pp. 34-35.

50 One common strategy deployed by transaction parties to help manage the various inputs into CFIUS and to alleviate the statutory time pressure on the Committee is to engage in informal consultations with the CFIUS agencies before filing a formal notice. In fact, the final regulations implementing FINSA expressly encourage parties to consult with CFIUS before filing a formal notice. In part as a result of this practice, the majority of CFIUS reviews are concluded in the initial 30-day period. For example, even under the heightened scrutiny applied under FINSA, only about one-eighth of all cases filed in 2008 with CFIUS proceeded to investigation.

51 "Foreign person" includes any foreign national, foreign government, or entity over which "control" is exercised by a foreign national, foreign government, or another foreign entity. Thus, controlling acquisitions of U.S. businesses by U.S. subsidiaries of foreign companies fall within the jurisdiction of CFIUS if they potentially impact U.S. national security.

52 31 C.F.R. § 800.204(a).

In practice, "control" is very much a functional definition. The amount of share interests and the right to board seats, for example, are highly relevant to finding control, but they are not necessarily determinative. Rather, CFIUS will take into consideration all relevant factors of a foreign person's ability to determine, direct or decide important matters affecting a U.S. business. Among other things that CFIUS will consider are the right to direct or determine certain extraordinary corporate actions such as the sale of all assets or dissolution of an entity, as well as other "matters," such as approval over major expenditures, closing or relocation of facilities, the appointment or dismissal of managers and officers, and how non-public information is treated.[53] At the same time, certain standard minority economic protections — including certain negative rights and anti-dilution rights — may not, by themselves, confer control.[54]

In addition, there must be control over a *U.S. business*. There are two important points with respect to the term "U.S. business." First, CFIUS's jurisdiction extends only to the extent that a business undertakes activities in interstate commerce in the United States.[55] Thus, for example, in the case of a foreign acquisition of a Canadian company that has a sales office in the United States, CFIUS's jurisdiction would only extend to the sales office and its business in the United States. Second, a transaction does not necessarily have to involve an investment into or acquisition of a legally organized entity to trigger CFIUS's jurisdiction. For example, the sale of a business unit or of assets in the United States that includes customer lists, intellectual property and employees (i.e., elements of a going concern) could be a covered transaction.[56]

b. National security analysis

FINSA formally requires CFIUS to conduct a risk-based analysis, informed by an analysis performed by the Director of National Intelligence, of the national security risk posed by any transaction.[57] This statutory requirement codified CFIUS's existing practice with respect to how it analyzes transactions.

Specifically, for every transaction, CFIUS engages in a three-part analysis comprised of: (1) a threat assessment focused on national security issues associated with the buyer; (2) a vulnerability assessment focused on national security issues associated with the U.S. assets and business at issue; and (3) an assessment of the potential consequences, that results from the "interaction between threat and vulnerability."[58]

What constitutes "national security" for CFIUS purposes — and, in turn, what might inform the threat and vulnerability assessments — is not defined precisely. Prior to FINSA, the Exon-Florio statute asked that the President assess the potential effects of a proposed transaction on:

- Domestic production needed for projected national defense requirements.
- 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.
- The control of domestic industries and commercial activity by foreign citizens as it affects U.S. capability and capacity to meet national security requirements.
- The sales of military goods, equipment or technology to a country that supports terrorism, or proliferates missile technology or chemical and biological weapons.
- U.S. technological leadership in areas affecting U.S. national security.[59]

These criteria reflected Congress's overriding interest at the time on protecting the defense industrial base and U.S. technological leadership. However, Congress purposely did not adopt an exclusive list of national security considerations, instead indicating that the term "national security" is "to be read in a broad and flexible manner."[60] CFIUS, in turn, has never formally defined the term.

FINSA attempted to provide additional indicia of the meaning of "national security" in the CFIUS context — or at least to codify CFIUS's existing practice with respect to considering those factors. First, the amendments stated that "national security" "shall be construed so as to include those issues relating to homeland security, including its application to critical infrastructure."[61] This reflects the practice of CFIUS, at least since September 11, 2001, and in particular since the Department of Homeland Security was added to CFIUS in 2003, to examine transactions in sectors that relate to "critical infrastructure." CFIUS has defined "critical infrastructure" to mean "in the context of a particular transaction, a system or asset, whether physical or virtual, so vital to the United States that the incapacity

[53] Id.

[54] Id. at § 800.204(c).

[55] Id. at § 800.226.

[56] Id. at § 800.301(c)(Examples 6 and 7).

[57] Pub. L. No. 110-049, §§ 2,5, 50 U.S.C. App. §§ 2170(b)(4), (l)(1)(B).

[58] Department of Treasury, Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, at 8 (Dec. 1, 2008) available at http://www.treas.gov/offices/international-affairs/cfius/docs/GuidanceFinal_12012008.pdf (hereinafter "CFIUS Guidance").

[59] 50 U.S.C. App. § 2170(f).

[60] Statement of Senator Exon, Congressional Record 134 (April 25, 1988): S 4833.

[61] FINSA § 2, 50 U.S.C. App. § 2170(a)(5).

or destruction of the particular system or asset … over which [foreign] control is acquired … would have a debilitating impact on national security."[62] not every foreign investment occurring in a critical infrastructure sector will be covered by CFIUS. Rather, it is the particular character of the assets and business that matter for CFUIS's purposes.

Second, FINSA codified many of the factors already discussed as additional indicia for the President to consider in assessing the national security impact of a transaction. Specifically, it added the following factors for the President to consider:

- The potential national security-related effects on United States critical infrastructure, including major energy assets.
- The potential national security-related effects on United States critical technologies (which means "critical technology, critical components, or critical technology items essential to national defense," subject to regulations issued by CFIUS).[63]
- Whether the covered transaction is a foreign government-controlled transaction.
- For transactions involving foreign government control that result in an investigation, whether the host country adheres to nonproliferation regimes, whether the host country presents any risk of transshipment of export and military-controlled items, and the relationship of the host country to U.S. counterterrorism efforts.
- The long-term projection of United States requirements for sources of energy and other critical resources and material.[64]

Third, FINSA required CFIUS to issue guidance on the types of transactions that the Committee has reviewed and that have presented national security considerations. This includes transactions that may constitute covered transactions that would result in control of critical infrastructure relating to United States national security by a foreign government or an entity controlled by or acting on behalf of a foreign government. However, the guidance issued by CFIUS also was required to preserve the confidentiality of CFIUS reviews. To strike this balance, CFIUS issued guidance that offers a measure of additional clarity in identifying transactions that present "national security considerations," but also largely repeats the statutory factors for national security and the information CFIUS requests of transaction parties in its regulations.[65]

Beyond the guidance and an enhanced number of information requests in the final regulations under FINSA, there are other unidentified factors that CFIUS will consider in its national security analysis. A more analytical list of factors that CFIUS considers is provided below at table 1. In the next section, this booklet will examine how characteristics of Chinese FDI relate to some of these factors, including the connection of a foreign company to its home country government; its reputation for compliance on regulatory issues related to national security, such as export control laws; the perception of a military rivalry with the foreign country; and the foreign country's reputation for commercial and state espionage.

Table 1: Factors considered by CFIUS in national security analysis

Foreign acquirer	U.S. company
• The acquirer's reputation for compliance with laws and regulations, with a particular focus on export control compliance and/or prior commitments to CFIUS. • The reputation of the acquirer's home country for cooperating on important U.S. national security policy objectives, including non-proliferation and counter-terrorism matters. • The reputation of the acquirer's management, including whether the acquirer's officers and directors have any past or current connection to the home country's military or intelligence agencies. • The reputation of the acquirer's home country for commercial or state espionage. • Whether the acquirer does business in countries subject to U.S. embargoes (e.g., Iran, Democratic People's Republic of Korea, Sudan, Cuba).	• The assets of the U.S. target company, including whether those assets themselves are part of U.S. critical infrastructure, supply U.S. critical infrastructure, or otherwise could be a threat (e.g., are assets or materials that could be used for terrorist purposes). • Government customers of the U.S. company, including in the first instance defense customers but also including non-defense and intelligence customers. • Access of the U.S. company to government systems. • Access to U.S. government classified information (and, in turn, the existence of a U.S. government approved facility security clearance). • The importance of the U.S. assets to U.S. law enforcement interests. • The importance of the U.S. assets or technology to the defense supply chain.

62 31 C.F.R. § 800.208.

63 A working group of U.S. government agencies, chaired by the Department of Treasury, has identified 14 sectors in which critical technologies arise: advanced materials and processing; chemicals; advanced manufacturing; information technology; telecommunications; microelectronics; semiconductor fabrication equipment; military-related electronics; biotechnology; professional and scientific instruments; aerospace and surface transportation; energy; space systems; and marine systems. See Report to Congress on Foreign Acquisition of and Espionage Activities Against U.S. Critical Technology Companies (Unclassified) 9-10 (Sept. 2007).

64 FINSA § 4; 50 U.S.C. App. § 2170(f)(6)-(10).

65 That information focuses on certain obvious national security criteria, including whether the U.S. company has any contracts with U.S. defense or intelligence agencies or defense contractors, whether the U.S. company has technology that is controlled under export control laws, whether a foreign government controls or directs the foreign acquirer, and what the foreign acquirer's intentions are for the U.S. operations. 31 C.F.R. § 800.402(c).

Foreign acquirer	U.S. company
• Whether the transaction could aid the military or intelligence capabilities of a foreign country with interests adverse to those of the United States. • Whether the acquirer is likely to move critical technology or key products offshore. • Whether a foreign government exercises control or influence over the acquirer. • How the acquirer is financing the transaction, and whether the financing would give any other party, including a foreign government, control over the acquirer or the transaction.	• What other assets or businesses are located near the U.S. company. • What existing security procedures the U.S. business has in place. • Whether U.S. management will remain in place, and whether U.S. citizens will occupy important security-related positions after the transaction. • The existence of sensitive technology, including export controlled technology. • The record of the U.S. company on compliance issues, including in particular export control compliance. • The non-government customer base of the U.S. company (i.e., whether the U.S. company supplies a customer base that is critical to homeland or national security). • The level of competition in the applicable marketplace and, in particular, whether the U.S. company occupies a dominant position in a market that involves important strategic products, services or technologies.

c. Mitigation

If CFIUS — specifically, the agency or agencies with the primary security equities presented by a transaction — determines that a particular transaction presents national security risks, it will seek to mitigate the perceived threats by imposing conditions and/or extracting commitments from the parties to a transaction. Such conditions and commitments may take the form of a signed agreement with agreed upon penalties between the transaction parties, on the one hand, and the relevant security agencies, on the other. Alternatively, the parties may be requested to provide somewhat more informal "assurances" via a letter from the principals of the parties to the applicable security agencies.

The types of commitments and assurances sought by CFIUS can vary. At the most basic level, they can be straightforward assurances that the foreign acquirer does not intend to change continued production levels, facilities in the United States or participation in certain U.S. government programs. Such assurances also can include concomitant recordkeeping and reporting obligations. On the other end of the spectrum, certain mitigation agreements may impose various governance requirements and more costly and onerous security measures, including technical and physical security requirements, U.S. government access to systems and personnel, testing and screening of personnel, and third-party auditing. The most extreme agreements also can limit a foreign acquirer's decision-making authority and access to the U.S. company.

In adopting FINSA, the U.S. Congress sought to clarify that mitigation agreements should only be adopted when (i) the transaction causes an incremental increase in the risk to national security; (ii) existing regulatory authority is not adequate to address the incremental risk; *and* (iii) a "risk-based analysis" of the threat to national security has been performed and approved by the Committee. Specifically, FINSA states that a mitigation agreement "may" be imposed "in order to mitigate any threat to the national security of the United States that *arises as a result of the covered transaction*" and that such an agreement "shall be based on a risk-based analysis … of the threat to national security of the covered transaction."[66]

Finally, while CFIUS agencies can bargain for various penalties, including agreed upon damages figures, FINSA also makes clear that CFIUS can re-open a transaction for a material breach of a mitigation agreement if there is a finding of intentional breach by the lead agency *and* a finding by all of CFIUS that no other remedies are available.[67]

* * *

While the CFIUS process focuses on a specific class of transactions — i.e., those that may raise legitimate national security issues — it can entail significant costs for FDI in certain types of U.S. businesses, including ongoing compliance costs with mitigation commitments

66 FINSA § 5, 50 U.S.C. App. § 2170(l)(1)(A)-(B) (emphasis added).

67 FINSA § 2, 50 U.S.C. App. § 2170(b)(1)(D).

to which investors must agree to receive CFIUS approval.[68] In the most extreme cases, the Exon-Florio statute, as amended by FINSA, can serve as an absolute bar to certain acquisitions that present national security issues. As evidenced by the experience of Huawei Technologies, the risk of investment screening and the potential costs related to CFIUS is greater for Chinese investors. Accordingly, as part of any due diligence exercise that Chinese companies undertake when considering an acquisition or significant investment in a U.S. business — and, likewise, as part of the U.S. business's consideration of Chinese investment — it would be prudent to assess fully the risks and costs associated with a potential CFIUS review and to plan appropriately for addressing those risks. The concluding section of this booklet sets forth certain strategies and steps that Chinese investors can take to help manage such risks.

The U.S. political landscape for Chinese investment

Apart from CFIUS and other regulatory approvals, the U.S. Congress can take an active interest in FDI and be an important institution for investors to consider and engage in the context of specific transactions. (See also the booklet by Timothy Frye and Pablo Pinto in this series.) This is particularly true for investments that present national security issues. In that regard, Congress's interest and attempted intervention in foreign investments has not been circumscribed to Chinese investment. A Japanese investment in Fairchild and a proposed British takeover of Goodyear Tire & Rubber Company originally led to the adoption of Exon-Florio. In 2000, members of Congress expressed concern over the sale of Silicon Valley Group, a semiconductor equipment manufacturer, to the Dutch company ASML Holding N.V., and in 2006 Congress famously intervened in the sale of U.S. port terminals to the Emirati firm Dubai Ports World.[69]

There is no question, however, that Congress will be a more important institutional consideration for investments from China than it will be for FDI from virtually any other country. Indeed, in 2000, Congress created a bi-partisan committee, the United States-China Economic and Security Review Commission ("USCC"), specifically "to monitor, investigate, and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China."[70] The USCC must submit an annual report to Congress, which includes recommendations for legislative and administrative action. In 2005, Congress directed the USCC to focus its work and study on proliferation practices, economic transfers, energy, U.S. capital markets, regional economic and security impacts, U.S.-China bilateral programs, WTO compliance, and the implications of restrictions on speech and access to information in China.[71]

Over the past decade, the experience of a number of Chinese companies — which can be defined broadly to encompass Hong Kong (China)-based companies as well— has proven the impact that Congress can have directly on individual transactions involving Chinese investors. These case studies include the transfer of port operations in Long Beach, California, to China Ocean Shipping Company ("COSCO"); China National Offshore Oil Corporation's ("CNOOC") bid for Unocal; and, more recently, the proposed investment by Huawei Technologies ("Huawei") in 3Com.

While these case studies demonstrate that Congress is an important consideration for FDI from China. However, as also described below, Congress does not always intervene in even high-profile transactions from China. Moreover, if some members express concern over a particular investment — which is likely to be the case in any high-profile investment from China — that does not necessarily mean the transaction is politically doomed.

1. COSCO's port operations in Long Beach

The transfer of a former military base in Long Beach, California, to COSCO in 1997 provoked considerable criticism in Congress. Although several administration officials and a few members of Congress stated that the transaction posed no security concerns, the weight of the political response was negative, focusing on an alleged connection between COSCO and the People's Liberation Army ("PLA") and the threat posed by having China operate the former naval station.

Rep. Duncan Hunter (R-CA), one of the most vocal critics of the transaction, summarized the arguments of the opponents:

> COSCO is not a private enterprise. It is an arm of the Chinese government and an auxiliary to the People's Liberation Army…Chinese control of a 135-acre terminal in Long Beach would pose a number of security threats to the United States. The terminal obviously would become a center for Chinese espionage on the West Coast. And it also would give the Chinese a stable, high-powered listening post for the interception of communications throughout California and beyond. The Chinese would know every move the U.S. military makes and could monitor training exercises as well as operational deployments. Beijing also could develop ways to interrupt, neutralize or mislead the command, control and communications networks upon which our military operations depend.[72]

However, the Pentagon and at least two members of Congress publicly stated that the deal posed no national security threat. Pentagon Spokesperson Kenneth Bacon said: "There are no national security concerns attendant to expanding COSCO's presence in the

68 In addition to the investment review provided by CFIUS, it should be noted that the Department of Defense, U.S. intelligence agencies, the Department of Energy, and the Nuclear Regulatory Commission have independent authority to review and restrict investments into companies that, as contractors to those agencies, possess U.S. government classified information. These authorities are less likely to be relevant to Chinese investors; it would be extremely unlikely for a Chinese company to be permitted to acquire outright — or even to make an investment that would be deemed "controlling" — in a business that is part of the defense industrial base or that possesses any classified contracts with the U.S. government.

69 Graham and Marchick, op. cit., pp. 124-125.

70 Floyd D. Spence National Defense Authorization Act for 2001 § 1238 (codified at 22 U.S.C. § 7002).

71 Pub. L. No. 109-108.

72 Rep. Duncan Hunter (R-CA), "U.S. turns a blind eye as China hits the beach," *Insight on the News*, April 21, 1997.

United States."[73] Representatives Steve Horn and David Dreier wrote in a joint letter to their colleagues that, based on intelligence briefings from the CIA, Office of Naval Intelligence, Coast Guard, and Bureau of Customs, "there is no evidence that the agreement between the City and Port of Long Beach and the China Ocean Shipping Company is a national security issue."[74]

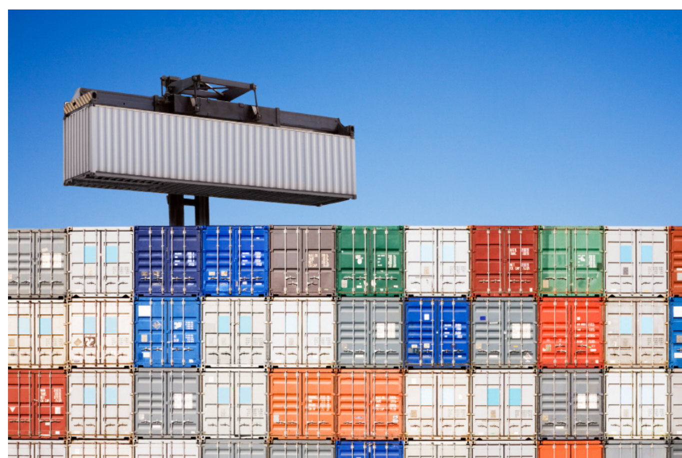
Nevertheless, Congress incorporated into the Defense Authorization Act for fiscal year 1999 restrictions that prohibited "any funding to be used to enter into or renew a contract with any company owned, or partially owned, by the People's Republic of China."[75] Long Beach and COSCO worked around the restriction by having other port tenants use the new facilities, with COSCO picking up the areas vacated by those tenants.[76]

2. CNOOC's proposed bid for Unocal

In their 2006 book on U.S. national security and FDI, Graham and Marchick comprehensively reviewed the political firestorm that erupted over CNOOC's bid for Unocal in 2005. They identified five arguments put forth by opponents to the transaction: (1) the transaction put global energy sources at risk, due to the possibility of CNOOC hoarding Unocal's reserves for China's exclusive use, thereby compromising U.S. national security interests that depend on secure supplies of oil and gas; (2) the CNOOC bid was an attempt by the Chinese government to control critical oil and gas supplies, and the control and accompanying revenues would strengthen China's government; (3) CNOOC's bid relied upon preferential loans from Chinese state-owned banks and CNOOC's state-owned parent, which put U.S. companies at a competitive disadvantage; (4) CNOOC's acquisition of Unocal would have potentially facilitated the transfer of sensitive technologies to China; and (5) because the Chinese would never allow a U.S. company to acquire a major Chinese oil company, based on reciprocity, the United States should not allow the transaction.[77]

Notwithstanding sound counter-arguments from supporters of the transaction, politics carried the day and overwhelmed CNOOC's bid. Congress's actions, which were detailed at length in Graham and Marchick, included the following:

- Multiple letters were written by Members of Congress to Cabinet-level officials in the Bush Administration expressing concern over the transaction. More than three dozen Members of Congress wrote to then-Treasury Secretary John Snow asking that the potential transaction "be reviewed immediately to investigate the implications of the acquisition of U.S. energy companies and assets by CNOOC and other



government-controlled Chinese energy companies."[78] Senators Kent Conrad (D-ND) and Jim Bunning (R-KY) complained to U.S. Trade Representative Rob Portman and Secretary of Commerce Carlos Gutierrez that CNOOC's bid was "inconsistent with China's WTO commitments," citing the financing terms for CNOOC as evidence that "[t]he proposed acquisition is not being conducted on commercial terms and has little commercial justification."[79]

- The House of Representatives was active in passing legislation expressing opposition to the CNOOC bid. It overwhelmingly (by a vote of 333 to 92) passed a bill prohibiting the Treasury Department's use of funds for recommending approval of the sale of Unocal to CNOOC.[80] It also approved, by a vote of 398 to 15, a nonbinding resolution urging an Exon-Florio review of the bid.[81]

- The House Armed Services Committee held a hearing on the CNOOC-Unocal transaction on July 13, 2005.

Ultimately, Congress provided the death knell for CNOOC's bid by adopting an amendment to an energy bill requiring that the Secretaries of Energy, Defense and Homeland Security conduct a study of China's growing energy requirements and the implications of "such growth on the political, strategic, economic, or national security of the United States."[82] The amendment would have prohibited CFIUS from completing any review of a CNOOC-Unocal transaction for 141 days, which is 51 days longer than the maximum of 90 days established by the Exon-Florio Amendment — thereby greatly

73 Otto Kreischer, "Navy sees no national security threat in Cosco lease," *Copley News Service*, April 1, 1997.

74 March 25, 1997 Dear Colleague letter quoted in CRS study on "Long Beach: proposed lease by China Ocean," 97-476 (June 3, 1998).

75 Department of Defense Appropriations Act of 1999, Pub. L. 105-262, § 8060, 112 Stat. 2311 (Oct. 17, 1998).

76 "The town the Navy left behind: Long Beach reinvents itself as tourist, shipping port of call," CNN, available at http://www.cnn.com/SPECIALS/cold.war/experience/the.bomb/route/08.long.beach/ (last visited November 19, 2007).

77 Graham and Marchick, op. cit., p. 120.

78 Letter to Treasury Secretary John W. Snow from Representative William J. Jefferson et al. (undated).

79 Letter to the Honorable Carlos M. Gutierrez and Ambassador Rob Portman from Senators Kent Conrad and Jim Bunning (July 11, 2005), available at conrad.senate.gov.

80 H. Amdt. 431 offered to HR 3058 by Rep. Carolyn Kilpatrick of Michigan, approved in roll call vote no. 353, 109th Congress, 1st sess., 151 Congressional Record H5515 (daily ed. June 30, 2005).

81 "Expressing the Sense of the House of Representatives that a Chinese State-Owned Energy Company Exercising Control of Critical United States Energy Infrastructure and Energy Production Capacity Could Take Action That Would Threaten to Impair the National Security of the United States," HR 344, 109th Congress, 1st sess., 151 Congressional Record H194 (daily ed. January 25, 2005): § 1, 4. The resolution was offered by Rep. Pombo and approved in roll call vote no. 360.

82 Energy Policy Act of 2005, § 1837, Public Law 109-58, U.S. Statutes at Large 119, 594.

increasing the cost of the CNOOC bid. Faced with this pressure, CNOOC withdrew its bid.

3. Huawei's proposed investment in 3Com

The most recent Chinese investment to elicit concern from Congress was Huawei's proposed joint investment with Bain Capital Partners in the telecommunications firm 3Com. According to public filings by 3Com, Bain Capital Partners and Huawei

> agreed to purchase 3Com … for $2.2 billion. Bain Capital will control 83.5 percent of the voting shares. Bain Capital will appoint 8 of 11 board members. Huawei will acquire a minority interest of 16.5 percent. Huawei will appoint 3 of 11 board members. Huawei can increase its equity by up to 5 percent (but no more), based on certain performance criteria, but cannot gain additional seats on the board or gain any measure of additional operational control.[83]

The Congressional response included the following actions and statements:

- A small group of principally Republican members of the House of Representatives introduced a proposed resolution opposing the transaction. Reciting a litany of alleged espionage-related activities attributed to China, Huawei's alleged ties to the PLA and other publicly reported concerns over Huawei's business, the proposed resolution specifically stated that the transaction "threatens the national security of the United States" and called on CFIUS to reject the transaction.[84]

- Sen. John Kyl (R-AZ), joined by 13 other Senators, sent a letter to the Treasury Department urging that the transaction be closely reviewed under FINSA. The letter stated the Senators' belief that "Huawei has built and currently maintains most of the PLA's telecommunications backbone systems and is the Chinese military's preferred provider for a wide variety of telecommunications products." The letter went on to say that, "because of this long-standing and apparently deeply-engrained relationship between Huawei Technologies and the PLA, we are concerned about the national security implications of this acquisition for the United States."

- Senator Chris Bond (R-MO), the ranking Republican on the Senate Select Committee on Intelligence, stated: "It is troubling to me that a foreign military organization with interests in communications might obtain access to our security systems."[85]

- Representatives Peter Hoekstra and Duncan Hunter wrote to Treasury Secretary Paulson formally requesting CFIUS review of the transaction regardless of whether it was submitted for examination by the parties.[86] The letter stated in part: "This review should be conducted, and a determination made, as to whether this sale will in any way impact the national security of the United States or increase the vulnerability of U.S. computer networks and telecommunications systems to Chinese intrusion." In an interview, Rep. Hoekstra (R-MI) said: "There is no doubt as to why the Chinese want a partnership with 3Com. They look at this as a key connection to stealing additional secrets from U.S. corporations and from our national security apparatus."[87]

- The House of Representatives Committee on Energy and Commerce, chaired by Representative John Dingell (D-MI) and led on the Republican side by Ranking Member Joe Barton (R-TX), wrote the Treasury Department on January 31, 2008 — in the middle of the investigation by CFIUS — that it intended independently to investigate the transaction, and requested that CFIUS respond to certain questions. The letter cited "growing apprehension" among Members of Congress over the deal and stated that concerns over national security "are more than justifiable, especially in light of recent increases in attacks on government and private networks [by Chinese military hackers]."[88]

- Representative Thaddeus McCotter (R-MI) made repeated statements, including on the House floor, calling on CFIUS to block the investment by Huawei.

3Com, Bain Capital, and Huawei subsequently announced that they had withdrawn the transaction from CFIUS following their failure to reach a mitigation agreement that adequately addressed CFIUS's concerns,[89] and Bain Capital later announced its intent to terminate the merger agreement with 3Com.[90]

4. The political environment going forward

The experiences of COSCO, CNOOC, and Huawei demonstrate that Congressional reaction to a potential investment is a factor that Chinese investors would be wise to consider and to strategize for. To be sure, the potential for a Chinese investment to become highly politicized — to the point that it might not be feasible — is significant. However, not all FDI from China has been subject to the same degree of Congressional scrutiny, and Chinese investors should not necessarily anticipate a Congressional environment that will always be as hostile as in the CNOOC case.

83 3Com 8-K, filed Oct. 11, 2007.

84 H. Res. 730, 110th Cong., 1st Sess. (introduced Oct. 10, 2007).

85 "GOP urges probe in China firm deal," *The Washington Times*, Oct. 4, 2007.

86 Id.

87 Id.

88 "Letter to Secretary of Treasury Henry Paulson from Chairman Dingell, Ranking Member Barton, and Representatives Rush and Whitfield," January 31, 2008, available at http://energycommerce.house.gov/Press_110/110-ltr.013108.DOTreasury.CFIUS.pdf.

89 3Com Press Release, "3Com and Bain Capital Partners announce mutual withdrawal of CFIUS application," February 20, 2008.

90 3Com Press Release, "3Com announces intent to pursue break-up fee from Bain Capital," March 20, 2008.

For example, the political reaction to Lenovo's acquisition of IBM's Personal Computer division was relatively mild. In that case, three Republican members of Congress — Henry Hyde, then-Chair of the House International Relations Committee; Don Manzullo, then-Chair of the House Small Business Committee; and Duncan Hunter, then-Chair of the House Armed Services Committee — requested that CFIUS investigate the national security ramifications of the Lenovo-IBM deal. They warned that the sale could result in corporate assets and technology with military uses being passed to the Chinese, and the Chinese could use its new acquisition to conduct espionage activities in the United States. Representatives Hyde, Manzullo, and Hunter indicated, however, that they were not necessarily opposed to the transaction going forward, so long as a proper review was undertaken. After the extended review by CFIUS that resulted in approval of the transaction, Congressional criticism was muted.

Recent transactions, while eliciting some concern on Capitol Hill, also have been less politicized. Senator Jim Webb (D-VA) expressed concern over CIC's minority investment in the U.S. private equity company Blackstone,[91] but he was relatively isolated in making an issue of that investment. The Congressional reaction to CIC's investment in Morgan Stanley was even more muted. CITIC's proposed investment in the subsequently defunct Bear Stearns likewise caught the attention of Congress at the time, but no Member issued exceptionally critical statements. Even in the case of 3Com-Huawei, the Congressional reaction arguably was milder than prior Chinese transactions, such as CNOOC and COSCO.

The political environment for investment from China likely will remain dynamic for the foreseeable future, dependent upon tangential factors that may rise or fall quickly as well as the particular facts of a transaction and transaction timing. Those factors may include the overall health of the U.S. economy, broader U.S.-China trade balance issues, attention by the press and human rights groups on Tibet, debate in the U.S. on sovereign investment, prominent press articles regarding potential Chinese espionage, and U.S. sensitivities to energy prices and consumption. Election cycles also may contribute to the politicization of certain investments.

Yet, there also is arguably a stronger overall sense today among leadership and rank-and-file Members of Congress that, for transactions that undergo a CFIUS review, the CFIUS process should be permitted to run its course before even broaching the possibility of any Congressional intervention. In this regard, FINSA's increased accountability and reporting mechanisms and the additional formal role of the intelligence in the CFIUS process may enhance the faith of U.S. politicians in the CFIUS process and tamp down instincts to intervene.

Special considerations of Chinese investment

Why is certain M&A activity from China likely to attract greater scrutiny from CFIUS and perhaps be prohibited outright? What factors about particular Chinese transactions may present other institutional challenges, including creating greater political risk? Apart from certain interest groups and geopolitical issues, including human rights, there are at least six factors that may be presented by Chinese FDI that can present challenging national security and political issues: (1) the predominance of state ownership and the perceived ties of Chinese companies to the Chinese military; (2) the use of state subsidies to assist Chinese investors; (3) a perceived risk of espionage presented by a transaction; (4) the regulatory compliance record, including in particular export control compliance record, of Chinese companies; (5) the other markets in which the Chinese company may do business; and (6) a perceived rivalry between the U.S. military and the Chinese military.

1. State ownership and control

As noted, FINSA formalizes a presumption of investigation in the CFIUS process where an acquirer is foreign government-controlled. Given the landscape of the Chinese economy and the strong history of Chinese companies being at least partly owned by the government, this issue of state control, and whether an entity is acting on the basis of commercial concerns or on behalf of government interests, may result in increased scrutiny when a Chinese company is involved.[92]

A recent U.S. State Department report noted that the state-owned sector accounts for approximately 40% of China's GDP.[93] As of 2008, the ten largest multinational enterprises in China were all SOEs.[94] Most large publicly traded SOEs remain subject to substantial state control due to restrictions on the transfer of state-owned shares, which constitute a majority of shares issued by listed companies,[95] as well as state approval over officers in management positions.[96]

[91] "Senator raises China concerns on Blackstone," *Reuters*, June 21, 2007, available at http://www.cnbc.com/id/19322421.

[92] Graham and Marchick, op. cit., pp. 105-106.

[93] U.S. Department of State, Background Note: China (April 2008), available at http://www.state.gov/r/pa/ei/bgn/18902.htm.

[94] OECD, Directorate for Financial and Enterprise Affairs, "Draft report: China's outward foreign direct investment," DAF/INV/WD(2008) at ¶¶ 33-35 (Feb. 22, 2008) (hereinafter "Draft OECD Report on China OFDI").

[95] Chi Hung Kwan, "Who Owns China's State-owned Enterprises? Toward Establishment of Effective Corporate Governance," in China in Transition (July 28, 2006), available at http://www.rieti.go.jp/en/china/06072801.html; Graham and Marchick, op. cit., pp. 106-107.

[96] Of nearly 1,400 publicly listed Chinese companies at the end of 2005, nearly two-thirds of the outstanding shares were non-tradeable. Randall Morck, Bernard Yeung and Minyuan Zhao, "Perspectives on China's outward foreign direct investment" at 11 (Aug. 2007). More than half of the non-tradeable shares were owned directly by governmental entities, and the remainder were owned principally by other large SOEs or state-managed investment funds. Id.

Many of the largest SOEs are also owned by the State-owned Assets Supervision and Administration Commission ("SASAC"), which has control over the budgets of the SOEs and has ultimate authority over approving M&As.[97] In addition, publicly listed firms have a parallel structure to their board — the firm's Party Committee, chaired by the Party Secretary, who reports to the Communist Party of China's Organizational Department. According to one study, the CEOs of the 53 largest SOEs in China are appointed directly by the Communist Party of China's Organizational Department.[98] Local governments or the Communist Party also can exercise control by informally influencing the composition of corporate boards and the corporation's management team.[99]

From the perspective of U.S. government officials and politicians evaluating Chinese investment, even publicly traded Chinese companies that otherwise look and feel like Western companies not affiliated with the state may present government control issues. Ministries and agencies within China have served as incubation grounds for companies that were later spun off privately. The fact that the founders of these companies have their origins with the Chinese government can contribute to a view of the companies as government-affiliated or controlled. Furthermore, the Chinese government often retains shares in publicly traded company.

That even publicly listed Chinese companies can have ownership interests held by the government or be aligned in some way with the government even when there is no apparent state ownership (e.g., if officials are tied to the government) is significant from the perspective of the U.S. regulatory and political environment. SOEs comprise a high share of China's outward bound FDI. Of the 30 Chinese companies that are the largest outward investors, only one — the Lenovo Group — is not officially state controlled.[100] Indeed, ten of these companies accounted for approximately 84% of all outward FDI from China between 2004 and 2006.[101] With this background, the U.S. officials involved in the CFIUS process may start with the presumption that all Chinese companies seeking to invest in the United States are controlled by the Chinese government — and it will be left to the Chinese company to convince the U.S. government otherwise.

2. State subsidies

As the CNOOC experience with Unocal indicates, the funding that Chinese companies rely upon in making investments in the United States may be an important regulatory and political factor. First, on the regulatory front, such funding can be indicative of state control. As Graham and Marchick noted, one of the factors that CFIUS considers to determine government control is "contractual arrangements" and the "pledge or other transfer of any or all of the principal assets of the entity." As a contract, a loan agreement likely could be considered to meet these terms if it included a "pledge" of certain of the acquirer's assets as collateral.[102] Further, if an entity appears to be making an investment on non-market terms, CFIUS may question whether the transaction is purely a commercial transaction or, instead, reflects state-related interests and direction. In this regard, it is significant that four state-controlled banks — the Bank of China, the Industrial and Commercial Bank of China, the China Construction Bank, the Agricultural Bank of China — are responsible for a sizeable portion of all commercial loans in China.[103] Financing from such state-controlled entities may impact CFIUS's threat assessment of the transaction.

State subsidies also can present policy questions that garner attention from Congress. For example, CNOOC reportedly received two low or no-interest loans totaling $7 billion from its state-owned parent to make its bid for Unocal.[104] In response, members of Congress, in a joint letter to the President, expressed concern with the appropriateness of states subsidizing investment transactions to acquire scarce natural resources that are in high demand. They observed that, when government subsidies are directed toward such highly demanded and scarce resources, "any ensuing market distortions should be of particular concern … [because] [s]uch subsidies may facilitate the allocation of scarce resources to inefficient or less-efficient producers."[105] The OECD has noted that large Chinese SOEs:

> have inherent advantages in undertaking large foreign investments since they enjoy formal as well as informal support from the government in the area of finance, networking, information access, and administrative procedures. They can also rely on monopolistic power in their respective subsector in the domestic market which has been protected by the government.[106]

[97] Jim Hemerling, David C. Michael, and Holger Michaelis, "China's global challengers: the strategic implications of Chinese outbound M&A" (The Boston Consulting Group 2006); Draft OECD Report on China OFDI, op. cit., ¶ 104.

[98] Morck, Yeung, and Zhao, op. cit. p. 13.

[99] Graham and Marchick, op. cit., p. 107.

[100] Morck, Yeung, and Zhao, op. cit., at 6 (Aug. 2007).

[101] Draft OECD Report on China OFDI, op. cit., ¶ 33 (citing Cheng, L. and Z. Ma, "China's outward FDI: past and future" (July 2007)).

[102] Graham and Marchick, op. cit., p. 116.

[103] Morck, Yeung, and Zhao, op. cit., p. 14.

[104] Allan Sloan, "Lending a helping hand: the math behind CNOOC's rich offer to buy out Unocal," Newsweek, July 18, 2005.

[105] Senators Charles E. Grassley and Max Baucus, "Grassley, Baucus express concern over potential CNOOC-Unocal deal," press release, July 13, 2005, available at grassley.senate.gov; Graham and Marchick, op. cit., p. 116.

[106] Draft OECD Report on China OFDI, op cit., ¶ 35.

More to the point, state subsidies to Chinese companies can easily translate into political concerns over the impact of FDI from China on small and medium-sized U.S. businesses. Indeed, in 2007 report to Congress, the USCC claimed that subsidies from the Chinese government negatively impact market conditions for U.S. companies, stating that "China's unfair trade practices, including … illegal subsidies for Chinese exports," harm small and medium-sized U.S. manufacturers.[107] In addition, subsidies to SOEs can raise questions — whether fair or not — about the SOE's ability to make efficient decisions and be a responsible owner of the U.S. target company.

3. Commercial and state espionage

Chinese FDI in certain sectors — in particular defense, aerospace, telecommunications, information technology — also can present regulatory and political challenges because of U.S. concerns over Chinese commercial and state espionage. The U.S. intelligence community has characterized the Chinese intelligence services as "among the most aggressive in collecting against sensitive and protected U.S. targets,"[108] and the Department of Justice "consider[s] China to be one of [its] top counter-intelligence priorities."[109] The USCC claims "Chinese espionage in the United States … comprises the single greatest threat to U.S. technology," and "is straining the U.S. counterintelligence establishment."[110]

U.S. officials have publicly claimed that there are over 3,000 Chinese "front companies" operating in the United States whose purpose is to gather intelligence and technology.[111] While that may have been an exaggerated number, in response to the threat, the FBI reportedly has increased the number of counterespionage agents assigned to China from 150 in 2001 to more than 350.[112] One-third of all economic espionage matters being actively pursued by the FBI in 2007 were reportedly tied to China.[113] Since the beginning of 2007, there have been at least a dozen guilty pleas or criminal charges resulting from alleged Chinese espionage activity in the United States.[114]

The implications of these concerns over Chinese espionage are two-fold. First, Chinese FDI in defense, aerospace, telecommunications, IT, and other high technology sectors will face very close scrutiny from CFIUS and may not be permitted; if it is permitted, it would likely only be on the basis of an entirely passive investment and/or considerable mitigation commitments. Second, as the proposed Huawei-3Com transaction makes clear, the potential nexus between an individual investment from China and broader concerns over Chinese espionage will remain a focus for Congress.

4. Regulatory compliance

A fourth special consideration for FDI from China is the issue of regulatory compliance by Chinese companies, including in particular with U.S. export control laws. The importance of export controls as an ongoing compliance matter is described in Section A above. However, the issue of export control compliance also may have a broader regulatory and political impact on the ability of Chinese firms to make investments in the first instance. As noted, under FINSA, CFIUS must formally consider compliance with the U.S. export control regime when investigating a transaction that involves foreign government ownership. Moreover, the U.S. government has adopted stricter licensing requirements for export to China. Specifically, under the so-called "China Rule," items controlled on the Commerce Control List will generally be denied for export if they would "make a direct and significant contribution to Chinese military capabilities" or otherwise would be destined for "military end-use" in the People's Republic of China, even if such items would not need an export license in typical circumstances.[115] As a result, CFIUS will apply additional scrutiny to transactions involving Chinese investment in U.S. companies possessing export-controlled technology.

Another compliance factor that may impact the regulatory and political environment for Chinese investment is the reputation of both the foreign investor and the U.S. party for compliance with anti-bribery laws.[116] First, as a political matter, ties between Chinese firms and the Chinese government and, in turn, any connection with public corruption, whether real or alleged, can be exploited politically by opponents of any particular investment.

Second, because so many Chinese firms are state-owned, there can be particular challenges for U.S. firms dealing with Chinese business partners, even when the dealings occur in the United States. For example, a U.S. firm may be interested in a particular investment from a Chinese firm because the partnership could also help open markets in China. However, in assessing that investment, the record and reputation of U.S. management for regulatory compliance and the Chinese firm with respect to its own compliance can impact the trustworthiness analysis conducted by CFIUS. In particular, CFIUS may consider compliance with the FCPA and the corruption reputation of the buyer when performing its analysis. Thus, in part because of the state ownership characteristics of Chinese investors, the general compliance record of both the Chinese firm and the U.S. firm in an M&A transaction — in particular, their respective reputations for export control and anti-bribery compliance — can take on added significance in the regulatory and political risk calculus associated with that transaction.

[107] United States-China Economic and Security Review Commission, Executive Summary: Annual Report to Congress 3 (2007), available at http://www.uscc.gov/annual_report/2007/executive_summary.pdf.

[108] Statement of John Negroponte, Director of National Intelligence, Before the Senate Select Committee on Intelligence, January 11, 2007.

[109] Testimony of Alberto Gonzalez, Attorney General, Before the House Judiciary Committee, April 6, 2006.

[110] USCC Executive Summary for 2007 Report, op. cit., p. 6.

[111] "FBI spy chief asks public for help," CNN.com, Feb. 10, 2005, available at http://www.cnn.com/2005/US/02/10/fbi.espionage/index.html.

[112] David J. Lynch, "FBI goes on offensive against China's tech spies," USA Today, July 23, 2007, available at http://www.usatoday.com/money/world/2007-07-23-china-spy-2_N.htm (last accessed November 20, 2007).

[113] Id.

[114] Joby Warrick and Carrie Johnson, "Chinese spy 'slept' in U.S. for 2 decades," Washington Post, Apr. 3, 2008, at A1.

[115] Department of Commerce, Bureau of Industry and Security, Revisions and Clarification of Export and Reexport Controls for the People's Republic of China (PRC); New Authorization Validated End-User; Revision of import Certificate and PRC End-User Statement Requirements, 72 Fed. Reg. 33646 (June 19, 2007).

[116] As with export controls, ongoing compliance with the Foreign Corrupt Practices Act, 15 U.S.C. §§ 78dd-1 et seq., is discussed in Section A.

5. Investments in other markets

Closely related to concerns that U.S. authorities may have over export control risks associated from Chinese investment are concerns over the markets in which a Chinese investor conducts business. In particular, U.S. government authorities and Congress are focused on Chinese investment in countries subject to U.S. sanctions, such as Iran, the Sudan, and the Democratic People's Republic of Korea, as well as other countries where the U.S. has proliferation concerns. Thus, for Chinese investors, CFIUS will consider the potential threat posed by the transaction for controlled materials and technology, including dual use technology relevant to nuclear and missile proliferation, to be transshipped to countries such as Iran, Pakistan, and the Democratic People's Republic of Korea.

In addition, given the level of Chinese energy-related investment in Iran and the Sudan, investments by the major Chinese energy SOEs in the U.S. in particular may be more difficult politically. In 2005, CNOOC did not have major concessions in Iran or the Sudan; however, other large Chinese SOEs, Sinopec and China National Petroleum Corporation, had investments in Iran and the Sudan that contributed to the politically charged nature of CNOOC's bid for Unocal.

6. Military rivalry

Finally, the United States' view of the Chinese military as an emerging strategic threat impacts the U.S. regulatory and institutional environment for Chinese FDI. The National Defense Authorization Act for Fiscal Year 2000 required the U.S. Department of Defense to issue an annual report to Congress on Chinese military power and strategy.[117] In its 2008 annual report, the Pentagon noted an increased "pace and scope of China's military transformation," "fueled by continued high rates of investment in its domestic defense and science and technology industries, acquisition of advanced foreign weapons, and far reaching reforms of the armed forces."[118] The report stated that, while "China's ability to sustain military power at a distance remains limited," China "has the greatest potential to compete militarily with the United States and field disruptive military technologies that could over time offset traditional U.S. military advantages."[119]

The Pentagon's concerns over Chinese military objectives and strategic behavior are important for Chinese FDI for three reasons. First, to the extent Chinese FDI involves a state-owned company or CFIUS has questions about the connection of a Chinese investor to the Chinese government or military, CFIUS will assess the Chinese investment in terms of how it might strengthen the Chinese military or reduce the strategic standing of the United States military. This may well be a significant factor given that many of the largest Chinese SOEs have been involved in the production of military items.[120] Second, in turn, Chinese investments in the technology sector as well as in the energy or natural resource sectors will receive even greater scrutiny from the Defense Department — and the other CFIUS agencies likely will provide great deference to DOD's interests in such transactions. Finally, as CNOOC and Huawei Technologies experienced, the perceived threat of the Chinese military is an issue that resonates with Congress, and Chinese investments that arguably might benefit the Chinese military or have some connection to the military — even remotely — stand the greatest likelihood of becoming highly politicized.

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117 Pub. L. 106-65, § 1202 (2000).

118 U.S. Department of Defense, Annual Report to Congress: Military Power of the People's Republic of China 2008, p. I.

119 Id. (internal quotation and citation omitted).

120 Graham and Marchick, op. cit., pp. 114-115.

Conclusions: strategic measures for Chinese FDI

Notwithstanding that Chinese SOEs and other investors may have inherent characteristics that, at least in the United States, raise their regulatory and, in particular, political risk profile, there are a number of practical measures that Chinese investors can take to help manage these risks and enhance the prospects of regulatory approval without political interference.

First, investors should understand the potential risks associated with any investment and be strategic about the sectors and U.S. businesses in which to invest. The experience of Bain Capital, 3Com and Huawei Technologies reflects the perils of potentially underestimating the risk inherent in Chinese investments in certain sectors. Based upon the public statements of the transaction parties, it would appear from the outside that, to varying degrees, they may have underestimated the degree to which Huawei's proposed 16% interest in 3Com and minority representation in 3Com's Board would strike regulatory and political nerves.[121]

This is not to argue that Bain Capital and Huawei Technologies should have refrained from the investment in 3Com, or that the decision by CFIUS to block the transaction was the right result. Outsiders to any transaction cannot know exactly the considerations that factored into the transaction parties' or CFIUS's respective analysis. However, the 3Com case does exemplify the importance for Chinese investors to conduct an informed regulatory and political risk analysis in connection with the due diligence evaluation of potential investments in the United States. In this regard, Chinese investors should be aware that certain U.S. businesses, including those in the defense, aerospace, telecommunications, information technology, and, to a lesser degree, energy sectors, will present considerable regulatory and/or political risk and may not be realistic transaction targets. Other assets may still be subject to CFIUS review but potentially will be less sensitive, such as chemicals and certain infrastructure (e.g., sea ports). Even with these assets, however, political risk may remain high. And still other assets, such as real estate and manufacturers of consumer retail products, may present minimal regulatory and political hurdles even for Chinese investors. In each asset class, though, the same lesson remains: be smart about the investment and conduct a full risk analysis before proceeding.

Second, in connection with a long-term strategy to develop and grow their position in the U.S. marketplace, investors from potentially sensitive regions and countries, including China, often are wise to initiate their entrance into the U.S. merger market by picking up "low-hanging fruit" with their initial investments. This may mean taking a minority share in a non-sensitive U.S. business with another U.S. partner holding the majority share. It also could mean exploring greenfield investments, if those make economic sense. Or, it may mean making a relative easy acquisition that is likely to receive CFIUS approval. The benefit of the latter approach is that the investor becomes a known quantity to CFIUS, including through a full intelligence analysis by the Director of National Intelligence. Having this first-time "scrub" occur in the depressurized context of a non-sensitive transaction can help reduce questions and establish a better environment for larger transactions down the road.

Third, along similar lines, establishing a strong record of business in the United States can be helpful to ease concerns and address questions from certain regulatory bodies like CFIUS. Indeed, in virtually ever CFIUS review, it is helpful, albeit far from dispositive, for the transaction parties to be able to note that the foreign investor already is selling products into the U.S. market and has an established record of doing business in the U.S. — the point being that the investment should not present any additional threat.

Fourth, measures to enhance corporate transparency of Chinese investors are important both for the CFIUS process and to help preempt potential criticisms from Congress. As described more fully above, among the characteristics that can make Chinese investment challenging for CFIUS and contribute to political risk are the perceived opacity of corporate governance structures and the belief that Chinese investors may benefit from government subsidies when making their investments. There is no magic bullet for any Chinese investor to address completely U.S. government concerns over the investor's ties, perceived or actual, to the Chinese government. However, as a regulatory matter, CFIUS seeks to probe ownership structures, examine management of the foreign investor, understand business lines and practices, and examine the financing for transactions. In this regard, there are certain fundamental steps that Chinese companies can take to address these questions and create greater confidence that they are acting on commercial grounds. These include publishing annual reports with standard financial disclosures, briefing reporters and financial analysts on commercial strategies, using Western financial advisors and financing transactions solely on commercial terms, and, in certain circumstances, offering briefings to CFIUS agencies regarding business plans and product developments.

[121] In a supplemental to a proxy statement issued by 3Com in February 2008, the company disclosed: "The Board of Directors considered Huawei's participation in the proposed transaction as a factor in their recommendation of the Merger. The Board believed that Huawei's participation increased deal certainty." 3Com Corporation, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934 (Feb. 19, 2008).

Fifth, given the potential post-transaction compliance concerns that are frequently attributed to Chinese investment, being able to demonstrate a strong compliance program and culture to U.S. authorities is another important measure to enhance prospects for successful investment in the United States. For example, having sound written policies and procedures for export control compliance and anti-corruption compliance, including training materials for employees, would reflect an understanding of U.S. regulatory interests and enhance the reputation for the Chinese investor.

Sixth, in certain transactions, the Chinese investor may wish to join with a well-known and reputable U.S. partner to pursue an investment or to defer to the U.S. party on the opposite side of a transaction to take the lead in public statements and political strategy. Having a U.S. partner obviously will not equate to a successful and quiet investment in all circumstances — after all, Huawei Technologies was the minority partner to Bain Capital's predominant position in the failed 3Com transaction. However, U.S. parties often will be able to deliver political supporters, and involving U.S. citizens in a transaction, in turn, may be prudent politically. The IBM-Lenovo transaction is one that demonstrates the potential import of having a strong U.S. party to a given transaction. In that case, IBM, with its virtually unparalleled reputation both in the Executive Branch and in Congress, provided a strong voice to the rationale for the transaction. Lenovo, to its credit, exercised discipline and enabled IBM to take the higher profile publicly in the transaction. By comparison, executives from CNOOC and Huawei each made public comments that hurt their cause and contributed to political controversy. Huawei's chief marketing officer famously called U.S. concerns over the transaction "bullshit."[122]

Seventh, it is important for all investors, including especially Chinese firms, to understand how business outside the United States can impact the ability to make investments in the United States. In particular, transacting business with and having significant investments in countries subject to U.S. sanctions, including Iran, Sudan, the Democratic People's Republic of Korea, and Cuba, can present regulatory compliance challenges as well as political risks for investments in the United States. Some potential investors may conduct a cost-benefit analysis of business opportunities in these sanction countries and conclude the risks, including risks of impact on U.S. opportunities, outweigh the potential rewards. Others may reach the opposite conclusion. In all events, for those firms that seek to invest in the United States and that also conduct business in such sanctioned markets, it is imperative that they be thoughtful about how their various investments are structured and who is involved to avoid legal minefields of U.S. sanctions laws.

Eighth, and finally, Chinese firms potentially contemplating major acquisitions in the United States may wish to develop a comprehensive strategy — well before any investment is made — to help manage political risk, especially in Washington. Such a "Washington strategy" might include a communications effort intended to help lay the groundwork for future investment and improve the investor's reputation among key Washington institutions; efforts to make the Chinese investor more transparent publicly as well as to key agencies and members of Congress, including by providing briefings to these audiences; and establishing a framework of third-party validators — i.e., well-respected third parties who, when asked to comment about the Chinese firm, will be favorably inclined. Such a "Washington strategy" may also involve participating in the larger Washington policy-related environment outside the context of any particular transaction — such as by participating in events hosted by trade organizations and think tanks and potentially even seeking opportunities to participate in certain industry organizations.

* * *

None of these measures is necessarily easy to implement. Even with the best intentions, Chinese firms may face resistance in pursuing certain of these measures — for example, certain members of Congress may not wish to meet directly with a Chinese firm, and other parties may be leery about being publicly associated with a prominent Chinese investor. Nor would these measures collectively insulate all Chinese firms against political and regulatory risk for all types of transactions. In the end, there will remain investments in certain U.S. assets that may be entirely off-limits to Chinese companies because of regulatory considerations (i.e., CFIUS would not approve the transaction), political considerations (i.e., the U.S. Congress or state or local officials would interfere to the point of killing the transaction), or both.

Nevertheless, the United States maintains an official policy of welcoming investment. The challenge for Chinese investors, therefore, is to find the right transactions that enable them to invest in the U.S. market without incurring regulatory or political trouble. This is the aim of the foregoing recommendations — namely, to help provide Chinese investors with a broad roadmap to lessen regulatory and political risk and avail themselves of the open investment environment in the United States.

122 Andrew Parker and Paul Taylor, "Huawei rails at 3Com deal security concerns," Financial Times, Feb. 12, 2008.

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