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Balancing National Security Interests against the Value of Chinese Capital

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NOTE

BALANCING NATIONAL SECURITY INTERESTS AGAINST THE VALUE OF CHINESE CAPITAL

I. INTRODUCTION

In August of 2017, the Chinese Commerce Ministry issued a statement expressing "strong dissatisfaction with the U.S. approach to unilateralism and protectionism."[1] The statement came in response to an investigation launched by U.S. Trade Representative Robert Lighthizer into the question of whether China was unfairly obtaining American technology and intellectual property.[2] China has often been accused of hacking, spying, and forcing companies to share commercial information, which has led to tremendous scrutiny of its economic and trade practices in the United States.[3] Consistent with this policy direction, within a month of launching the investigation, the Trump administration had blocked the acquisition of an American technology company, Lattice Semiconductors.[4] The administration objected to the acquisition on the grounds that Canyon Bridge, the private equity firm set to acquire Lattice, was backed by a Chinese state-owned asset manager.[5]

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1. Jethro Mullen & Serena Dong, *China Blasts U.S. 'Protectionism' After Trump Triggers Trade Probe*, CNN MONEY (Aug. 21, 2017, 7:00 AM), http://money.cnn.com/2017/08/21/news/economy/china-us-trump-trade-probe/index.html?iid=EL.

2. *Id.*

3. *Id.*; *see also* Jethro Mullen, *How China Squeezes Tech Secrets From U.S. Companies*, CNN MONEY (Aug. 14, 2017, 11:13 AM), http://money.cnn.com/2017/08/14/news/economy/trump-china-trade-intellectual-property/index.html?iid=EL. Chinese law requires that foreign firms that want to engage in economic activities within certain sectors in China, such as the energy, telecommunications, and automotive industries, must enter into joint ventures with local partners. Mullen, *supra*. These joint ventures mean the transfer of software code and product designs to foreign firms' Chinese partners. *Id.*

4. *Trump Blocks Chinese Purchase of Lattice Semiconductor*, AL JAZEERA (Sept. 14, 2017), http://www.aljazeera.com/news/2017/09/trump-blocks-chinese-purchase-lattice-semiconductor-170914045430005.html.

5. *Id.*; *see also Trump Blocks Chinese-Backed Lattice Bid*, BLOOMBERG POLITICS (Sept. 13, 2017, 8:21 AM), https://www.bloomberg.com/news/articles/2017-09-13/trump-blocks-china-backed-bid-for-chipmaker-over-security-risk.

The fear of government intervention through the use of state-owned enterprises is far from imaginary.[6] In early 2014, the Ukrainian government, then engaged in armed conflict with rebels in eastern Ukraine, faced a new twist in the conflict: Gazprom, the massive Russian state-owned energy corporation, threatened to cut off its natural gas supplies to the country.[7] Gazprom justified its price hike and threats to cease service altogether with references to Ukraine's failure to pay, but Ukrainian officials painted a different picture, one of politically-motivated retaliation intended to destabilize the country and further the political goals of the pro-Russian rebels.[8] Specifically, Ukrainian Prime Minister Arseny Yatsenyuk stated that Ukraine would not pay higher prices for the Russian gas to see that money channeled into arms for the rebels.[9] The role that Gazprom played in the conflict between Russia and Ukraine is informative and serves as a real example of the potential threat that foreign state-owned enterprises pose in the increasingly interwoven geopolitical landscape of the twenty-first century.[10]

Large Chinese investments and acquisitions in the United States and Europe are a fairly recent phenomenon, beginning with Lenovo's acquisition of IBM's personal computer division for 1 and 1.75 billion dollars in 2005.[11] They continued, and in April 2017, media sources reported that ChemChina had acquired Swiss pesticide and seed supplier Syngenta at a price of forty-three billion dollars, marking the largest cross-border acquisition of a Western corporation by a Chinese corporation in history.[12] While cross-border investment is hardly a direct problem, Chinese investment in Western corporations has a different flavor which makes these developments troubling. Namely, ChemChina is a state-owned enterprise ("SOE"),[13] as are many of China's largest corporations,[14] and the implications of an investment wave with such

6. *See* Michael Birnbaum, *Russia Threatens Embattled Ukraine With Cutoff of Gas*, WASH. POST, June 1, 2014, at A16.

7. *Id.*

8. *See* Michael Birnbaum & Carol Morello, *Moscow Halts Natural Gas to Ukraine*, WASH. POST, July 17, 2014, at A9.

9. *Id.*

10. *Id.*

11. *See* Sumner Lemon, *Lenovo Completes Purchase of IBM's PC Unit*, PCWORLD (May 2, 2005, 7:00 AM), https://www.pcworld.com/article/120670/article.html.

12. *See* Alanna Petroff, *China Gets Green Light for Biggest-Ever Foreign Acquisition*, CNN MONEY (Apr. 5, 2017, 8:49 AM), http://money.cnn.com/2017/04/05/investing/syngenta-chemchina-takeover-acquisition/index.html.

13. *See About Us*, CHEMCHINA, http://www.chemchina.com/en/gywm/A6016web_1.htm (last visited Nov. 10, 2018).

14. *See* Tanisha A. James & M. Howard Morse, *Regulatory Hurdles Facing Mergers with Chinese State-Owned Enterprises in the United States and the European Union*, 1 CHINA ANTITRUST L.J., 1, 5 (2017).

deeply rooted political undertones is worthy of scrutiny.[15] SOEs are often established by governments to achieve political ends in addition to the desires of traditional corporations, such as profit maximization. Scholars fear that the Chinese government may have political motivations in encouraging its SOEs to invest internationally.[16]

The commonly touted fears surrounding this influx of Chinese capital into Western economies concern the inaccessibility of Chinese markets, risks to national security, and the threat of Chinese surveillance.[17] Chinese regulatory provisions have made it difficult for Western corporations to invest in the country.[18] For example, the Chinese government's approach to protecting intellectual property rights has been cited as a primary reason that Western corporations find the Chinese market to be an unattractive investment target.[19] The risks to national security of SOE investments in United States corporations are often brought up in the nation's highest forum, Congress itself, which places such transactions under severe scrutiny.[20] In 2005, Congress took

15. *See* Alan Riley, *Dealing with the Chinese Investment Wave: Overhauling the Western Response*, INST. FOR STATECRAFT (Mar. 23, 2016), http://www.statecraft.org.uk/research/dealing-chinese-investment-wave-overhauling-western-response-0 (discussing the potential national security threats involved with Chinese investment in the U.S. economy).

16. *See* James & Morse, *supra* note 14, at 3-4 (discussing the various reasons governments have for establishing SOEs); *see also* Jennifer M. Harris, *Chinese Investment in the United States: Time for New Rules?*, LAWFARE (Apr. 11, 2017, 9:00 AM), https://www.lawfareblog.com/chinese-investment-united-states-time-new-rules (discussing the alignment of recent Chinese SOE acquisitions with the Chinese government's five-year plan to increase investment into primary resources and technology and the fears that Chinese SOEs will outcompete American corporations in these sectors). China has a long history of utilizing its SOEs to achieve policy goals. In the post-World War II era, the newly founded People's Republic of China created SOEs to rebuild the country's economy and infrastructure. James & Morse, *supra* note 14, at 3-4. SOEs have dominated the Chinese economy since, even after reforms aimed at loosening state control over the country's largest businesses. *Id.*

17. *See* Riley, *supra* note 15.

18. *See* David Dollar, *United States-China Two-way Direct Investment: Opportunities and Challenges*, BROOKINGS INSTITUTION, https://www.brookings.edu/wp-content/uploads/2016/06/us-china-two-way-direct-investment-dollar.pdf (last visited Nov. 10, 2018).

19. *Id.*

20. Timothy Webster, *Why Does the United States Oppose Asian Investment?*, 37 NW. J. INT'L L. & BUS. 213, 233 (2017) (describing Congress's reaction to the proposed acquisition of U.S. oil company Unocal by China National Offshore Oil Company ("CNOOC")). At the time of the transaction, seventy percent of CNOOC's shares were owned by the Chinese state, with the remaining thirty percent publicly traded on the Hong Kong and New York stock exchanges. *See id.* at 234. James Woolsey, at that time director of the CIA, described the proposed acquisition as evidence of a "[Chinese] strategy of domination of energy markets and of the Western Pacific." *China National Offshore Oil-Unocal Merger: Hearing Before the Comm. on Armed Serv.* H.R., 109th Cong. 110-12 (2005). CNOOC abandoned the acquisition due to this opposition. Ben White, *Chinese Drop Bid to Buy U.S. Oil Firm*, WASH. POST (Aug. 3, 2005), http://www.washingtonpost.com/wp-dyn/content/article/2005/08/02/AR2005080200404.html (discussing CNOOC's eighteen and a half billion USD bid on Unocal and its subsequent

issue with the potential acquisition of American oil company Unocal and its pipelines in the Middle East by a Chinese SOE, China National Offshore Oil Company ("CNOOC"), citing concerns that the deal would forfeit American influence in the region at the height of the global war on terror.[21]

Further concerns along the same lines involve the growing presence of sovereign wealth funds ("SWFs") in the United States.[22] Specifically, China Investment Corporation ("CIC"), an eight hundred billion dollar state-owned fund, was following Chinese investment of forty-six billion dollars in the United States economy in 2016—three times the nation's investment in the previous year.[23] Because SWFs are state owned and are a directed investment of the government's money, they are inherently political, and the financial decision-making of SWFs is usually guided by the political objectives of the state.[24] Similar to their SOE counterparts, SWFs have been greeted with skepticism by the Western economies in which they choose to invest.[25]

Meanwhile, shareholder activism, the leveraging of large minority stakes to influence boards of directors to take action according to the stakeholder's wishes,[26] is on the rise.[27] Nearly fifty percent of U.S. boards of directors engaged with agitators or prepared for such engagements in 2014.[28] Shareholder activism, used primarily by fund managers, has been tremendously successful, but the tactics employed by activists can be used by any entity with the capital and motivation to

withdrawal).

21. *See* Webster, *supra* note 20, at 233.

22. *See* Sui-Lee Wee, *China's Investment Fund Seeks Greater U.S. Access*, N.Y. TIMES, July 11, 2017, at B2.

23. *See id.*

24. *See id.*

25. *See* SANDRO GRUNENFELDER, UNDERSTANDING AND MANAGING POLITICAL RISKS OF SOVEREIGN WEALTH FUNDS 80-88 (2013). Concerns over international investments by SWFs predate the popularization of the term "sovereign wealth fund." *Id.* at 81. During the 1980s, the United States canceled a contract between a FIAT affiliate and the United States' Defense Department on the grounds that FIAT was partially owned by a Libyan SWF. *Id.* at 80. Margaret Thatcher objected to the Kuwaiti Investment Authority's 21.7% stake in British Petroleum, fearing that such a large share in the British corporation could be leveraged to further Kuwaiti political interests. *Id.*

26. *See* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 60-62 (2011) (describing techniques and tactics used by hedge funds). "The hedge funds in question held, on average, 9.8% of the shares of the companies they targeted." *Id.* at 60.

27. *See* Mary Ann Cloyd, *Shareholder Activism Who, What, When, and How?*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG., (Apr. 7, 2015) https://corpgov.law.harvard.edu/2015/04/07/shareholder-activism-who-what-when-and-how.

28. *See id.*

do so.[29] To date, Chinese acquisitions of Western corporations have largely been majority-control takeovers,[30] but if the Chinese government wishes to influence industry sectors in foreign countries through the use of its SOEs, much smaller capital investments, coupled with aggressive shareholder agitation, can be made to achieve those ends, especially if a full-scale takeover is a looming threat.[31]

That said, Chinese capital is incredibly valuable to the United States' industry sectors.[32] China is one of the five largest exporters of investment capital in the world, and over the past ten years the value of Chinese capital in the United States has increased by a factor of over one hundred.[33] Statistics from 2014 place those investments at approximately forty percent in the financial sector, seventeen percent in manufacturing, twelve percent in real estate, and five percent in the energy supply and production industry, with an additional nineteen percent spread across real estate, wholesale and retail trade, and leasing and business services.[34] These investments have tangible effects on the U.S. economy, creating jobs with wages substantially higher than industry averages.[35]

Taken together, there is a real threat of foreign SOEs and SWFs using shareholder activist tactics to advance politically motivated goals, but the benefits of Chinese direct investment in the United States should not be hand waved away in the face of national security interests.[36] As such, there is a need for a preemptive response that preserves the inflow of capital into the United States while foreclosing any avenue for abuse.[37] While the United States has a great deal of regulatory infrastructure aimed at preventing harmful foreign investment, such as the Foreign Investment and National Security Act of 2007 ("FINSA")[38]

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29. *See id.*

30. *See, e.g.*, Petroff, *supra* note 12 (discussing ChemChina's acquisition of controlling stake in Syngenta); Press Release, Google, *Lenovo to Acquire Motorola Mobility from Google*, LENOVO (Jan. 29, 2014), http://news.lenovo.com/news-releases/lenovo-to-acquire-motorola-mobility-from-google.htm (discussing Lenovo's acquisition of controlling stake in Motorola).

31. *See* MICHAEL BUKART & SAMUEL LEE, HEDGE FUND ACTIVISM VS. HOSTILE TAKEOVER BIDS 21 (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2585836.

32. Patrick Griffin, *CFIUS in the Age of Chinese Investment*, 85 FORDHAM L. REV. 1757, 1775-76 (2017).

33. *Id.* at 1776. Between 2005 and 2009, the United States received a combined average value of less than one billion USD per year. *Id.* Between 2012 and 2016, the net total of Chinese investment in the United States increased to just over one hundred billion USD. *Id.* at 1775-76.

34. *Id.* at 1776.

35. Theodore H. Moran, *Weighing Up China's Investment in the United States*, PETERSON INST. FOR INT'L ECON. (Feb. 15, 2017), https://piie.com/commentary/op-eds/weighing-chinas-investment-united-states.

36. *See infra* Part II.E.

37. *See infra* Part IV.

38. Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49 (2007).

and the Committee of Foreign Investment in the United States ("CFIUS"),[39] a section of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act")[40] should be amended.[41]

The HSR Act requires parties to significant voting securities transactions to submit notification to the Federal Trade Commission ("FTC") and Department of Justice ("DOJ"), abide by a waiting period, and receive approval of the transaction after review.[42] The HSR Act's investment-only exemption ("Investment-Only Exemption") provides that if an acquisition is "solely for the purpose of investment,"[43] and if the voting securities acquired represent less than ten percent of those outstanding,[44] then these regulatory hurdles may be avoided.[45] Perhaps not coincidentally, the average stake activist shareholders have in a corporation is 9.8%,[46] just under the Investment-Only Exemption's ten percent threshold.[47] This Note proposes a set of statutory amendments to FINSA and the HSR Act, which would function together to allow for judicial review of executive decisions blocking transactions, provide clarity to prospective participants in such transactions, and incentivize foreign investors to avail themselves of the dovetailed Investment-Only Exemptions of FINSA and the HSR Act by purchasing sizeable minority stakes as opposed to majority-control acquisitions.[48]

While the meaning of "solely for the purpose of investment" has established unclear boundaries for shareholder activity and abuses of the Investment-Only Exemption have grown in recent years, litigation has shown that the exemption is well-policed.[49] By expanding the threshold of the Investment-Only Exemption, the United States will be able to effectively incentivize greater investment of significant foreign capital in

39. *The Committee on Foreign Investment in the United States (CFIUS)*, U.S. DEP'T TREASURY, https://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx (last visited Nov. 10, 2018).

40. 15 U.S.C. § 18a (2012).

41. *See infra* Part IV.C.

42. *See* James & Morse, *supra* note 14, at 8 (discussing a dataset of 784 instances between 1993 and 2006 where a hedge fund disclosed that it owed five percent or more of the shares of a publicly traded company).

43. 15 U.S.C. § 18a(c)(9).

44. *Id.*

45. *Id.* § 18a(c).

46. *See* Cheffins & Armour, *supra* note 26, at 60.

47. 15 U.S.C. § 18a(c)(9).

48. *See infra* Part IV.

49. *See* Barry A. Nigro, *ValueAct Settlement: A Record Fine for HSR Violations*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (July 19, 2016), http://www.friedfrank.com/siteFiles/Publications/2016-07-19-valueact-settlement-a-record-fine-for-hsr-violation.pdf (last visited Nov. 10, 2018).

U.S. companies in a manner that will not threaten the United States' national security or political and economic integrity.[50]

This Note defines state-owned enterprises and sovereign wealth funds, specifically discussing those of Chinese origin[51] and assessing the impact they have had on the American economy in Part II.[52] This Note further assesses the existing legal framework surrounding the assessment of cross-border investment on securities grounds[53] and securities regulation[54] and the weaknesses inherent in the existing framework in Part III.[55] Finally, this Note will recommend legislative amendments to the process of assessing cross-border investments in the United States on national security grounds, as well as legislative amendments to existing securities and antitrust provisions with the goal of enticing SOEs and SWFs to take a passive, minority stake-oriented approach to investments in the United States in Part IV.[56]

II. THE COMPLEX WEB OF CHINESE FOREIGN DIRECT INVESTMENT

The web of regulation surrounding investment in the United States, specifically with respect to foreign investors, is complex.[57] In Subpart A, this Note examines SOEs, how they operate in general, and how Chinese SOEs have made investment inroads in the United States.[58] In Subpart B, this Note examines the so-called SWF, investment funds created by states by pooling excess capital reserves and the cross-border investments the Chinese Investment Corporation has made in the United States.[59] This Part then examines the aggregated effect of outbound investment from China.[60] Finally, this Part examines tactics used by large minority shareholders to leverage control over corporations[61] and how international investment and activist tactics are regulated, by the framework of FINSA and a host of securities and antitrust provisions, respectively.[62]

50. *See infra* Part IV.
51. *See infra* Part II.A–B.
52. *See infra* Part II.
53. *See infra* Part III.A.
54. *See infra* Part III.B.
55. *See infra* Part III.
56. *See infra* Part IV.
57. *See infra* Part II.A–F.
58. *See infra* Part II.A.
59. *See infra* Part II.B.
60. *See infra* Part II.C.
61. *See infra* Part II.D.
62. *See infra* Part II.E–G.

A. SOEs, in General and in China

SOEs are business entities owned by governments rather than private actors and, much like any business, generate revenue by providing goods or services.[63] However, SOEs differ from traditional, privately-held businesses in a variety of ways.[64] They are often tasked with promoting public-policy objectives, enjoy certain privileges and immunities unavailable to private businesses, such as tax exemptions, inexpensive financing, and tax and regulatory exemptions, and are frequently shielded from takeover attempts.[65] They may be used to tap into strategic resources, accelerate a nation's economic growth, promote growth in emerging sectors with high initial investment costs, promote economic stability and protections, or create easily and efficiently regulated monopolies.[66]

SOEs exist globally, including within the United States.[67] After the collapse of the housing market and the onset of the recent financial crisis, the U.S. government acquired sixty percent of General Motors's stock in an effort to protect the industry leader from collapse and remained a significant shareholder until selling the last of its stake in the corporation in 2013.[68] The United States government also owns and operates Amtrak, the Tennessee Valley Authority, the U.S. Postal Service, and sponsors the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.[69] Clearly, SOEs have their place in the global economy, and their presence is keenly felt in developing economies, where state-control over industry sectors can greatly support their development.[70] Of particular note is India, where SOEs account for ten to twenty percent of the country's gross domestic product ("GDP") employment, as well as Russia and China, where SOEs account for approximately thirty percent.[71]

The People's Republic of China was established in 1949, and after years of war and underdevelopment, the emergent state had limited

63. *See* James & Morse, *supra* note 14, at 2.

64. *See id.*

65. *See id.*

66. *See id.* at 2-3.

67. *See id.* at 3; Bill Vlasic & Annie Lowrey, *U.S. Ends Bailout of G.M., Selling Last Shares of Stock*, N.Y. TIMES, Dec. 10, 2013, at B1.

68. *See* Vlasic & Lowrey *supra* note 67.

69. *See* James & Morse, *supra* note 14, at 3.

70. *See id.* at 2-3.

71. *See The Role of State-Owned Enterprises*, ORG. ECON. CO-OPERATION & DEV., http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/CA/PRIV(2008)9&docLanguage=En (last visited Nov. 10, 2018).

infrastructure, capital, and industrial capability.[72] The Chinese government determined that rebuilding the country required a centralized alignment of state and commerce and established a host of SOEs that were entirely owned by the government and directed by state planners and ministries.[73] China has attempted to shift towards privatization for decades, and since 1978, the overall share of industrial production in China attributable to SOEs shifted from 77.6% (with virtually all of the remainder allocated to collective-owned enterprises) to approximately thirty percent in 2004.[74] Even so, SOEs are still massive players in the Chinese economy, accounting for seventeen percent of urban employment, twenty-two percent of industrial income, and thirty-eight percent of the country's industrial assets.[75] The top ten valued companies on the Shanghai Composite Index are government owned,[76] and the three largest Chinese SOEs listed on the Fortune Global 500 (of seventy-six) account for over $1.2 trillion in revenue.[77] Further, and most relevant to this discussion, Chinese SOEs are by far the biggest leader in foreign direct investment, and in 2006, at the outset of the surge in Chinese acquisition of corporations and investment in Western economies, accounted for eighty-one percent of China's aggregate investment.[78]

B. The Sovereign Wealth Fund, in General and in China

However, SOEs are not the only source of outbound Chinese capital.[79] SWFs are monolithic investment funds founded and owned by governments.[80] Large capital inflows into emerging economies, like China, come with the risk of inflation, which can be offset with the issuance of domestic debt at another, separate price, that of "negative

72. James & Morse, *supra* note 14, at 4.

73. *See id.*

74. *See The Role of State-Owned Enterprises*, *supra* note 71.

75. *See* Enda Curran, *State Companies: Back on China's To-Do List*, BLOOMBERG BUSINESSWEEK, Aug. 2015, at 49, 50.

76. *See* Scott Cendrowski, *Here's What You May Not Know About the Chinese Stock Market*, FORTUNE (Sept. 2, 2015), http://fortune.com/2015/09/02/heres-what-you-may-not-know-about-the-chinese-stock-market.

77. *See* Scott Cendrowski, *China's Global 500 Companies Are Bigger Than Ever—and Mostly State-Owned*, FORTUNE (July 22, 2015), http://fortune.com/2015/07/22/china-global-500-government-owned. The ten largest Chinese companies on the Fortune 500, all state-owned, account for over $2.1 trillion in revenue. *Id.*

78. *See The Role of State-Owned Enterprises*, *supra* note 71.

79. *See* Joel Slawotsky, *Sovereign Wealth Funds and Jurisdiction Under the FSIA*, 11 U. PA. J. BUS. L. 967, 975-76 (2009).

80. *See id.* at 967.

carry."[81] Negative carry refers to the negative cost of holding an asset when the interest payments on issued debt exceed the amount generated by reserve holdings.[82] The losses emerging countries suffer due to negative carry eat into budgets, taxes, and social programs; however, SWFs are curative.[83] By channeling excess reserves from central banks into funds, the state can proceed to invest these liquid assets and achieve returns that balance and exceed the weight of the negative carry.[84]

In China, the most visible SWF is the Chinese Investment Corporation, which was established in 2007 to help China increase its rate of return on its foreign exchange reserves.[85] CIC was founded with $200 billion in assets.[86] Over the past ten years, that number has risen to close to $815 billion, and in 2016, CIC posted continued increases in profits based on international investment performances.[87]

Many are made uneasy by the prolific international investments of SWFs.[88] Within the United States, there are fears that such investment is un-American, that public ownership is inefficient compared to private ownership, and, perhaps most importantly, that the United States may become subordinated to the policy interests of foreign states which have made strategic investments in key American economic sectors.[89] While proponents of free trade and open border approaches to foreign direct investment will decry these fears as irrational or overstated, this fear of foreign states exercising their investments to further geopolitical goals is not unfounded.[90]

Gazprom, the third largest corporation in the world in 2008, is a Russian SOE.[91] Prior to the winter of 2008, Gazprom flexed its position as the supplier of twenty-five percent of the European Union's natural gas by ceasing delivery of energy supplies to Ukraine.[92] After the

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81. *See* Brendan J. Reed, *Sovereign Wealth Funds: The New Barbarians at the Gate? An Analysis of Legal and Business Implications of their Ascendancy*, 4. VA. L. & BUS. REV. 97, 99 (2009).

82. *See id.*

83. *See id* at 99-100.

84. *See id.* at 100.

85. *See* Matthew Miller, *China Sovereign Fund CIC Profit Rises, Seeks More U.S. Direct Investment*, REUTERS (July 11, 2017, 2:48 AM), https://www.reuters.com/article/us-china-cic-results/china-sovereign-fund-cic-profit-rises-seeks-more-u-s-direct-investment-idUSKBN19W0HR.

86. *Id.*

87. *Id.*

88. *See* Mark E. Plotkin, *Foreign Direct Investment by Sovereign Wealth Funds: Using the Markets and the Committee on Foreign Investment in the United States Together to Make the United States More Secure*, 118 YALE L.J. POCKET PART 88, 89 (2008).

89. *See id.*

90. *See* Reed, *supra* note 81, at 111-13.

91. *See id.* at 111.

92. *See id.*

annexation of Crimea from Ukraine in 2014, Gazprom again shut down its oil supplies to Ukraine in the middle of the winter of 2015 when temperatures had dropped well below freezing.[93] It is indicative that the media's coverage of Gazprom's moves mirrors the way Ukraine treats Russia and Gazprom as one and the same.[94] It is further indicative that the multiple instances of suspension of gas supplies have tracked tensions between the two countries.[95] Russia cut off its supplies (through Gazprom) during the conflict between the Ukrainian government and the pro-Russian rebels in 2014 and hiked prices immediately following the removal of Ukraine's Kremlin-backed leader, Viktor Yanukovych.[96] This clearly hostile usage of economic leverage in foreign countries sets the stage for the analysis of SWFs, which are arguably even more politically entwined than their SOE counterparts due to the fact that they exist to invest their state's capital.[97]

SWFs are distinguishable from their SOE counterparts, but fears remain due to the lack of transparency with respect to their reported holdings[98] and for the fact that SWFs often do not look to maximize profits, investing with bias instead.[99] SWFs are not required to disclose their holdings—and the majority do not—leading skeptics to call for a "voluntary code of conduct" to be universally accepted as best practice in the SWF market.[100]

Furthermore, SWFs wield enormous power with which they can affect economies and political relations between nation-states.[101] In 2007, a Norwegian SWF came to the conclusion that Iceland's banks were overstretched and made the decision to short those banks' bonds.[102] While this made financial sense, the result was an international political confrontation, as the prime minister of Iceland declared the move a violation of a Nordic mutual-defense pact against economic destabilization.[103] As a result, the Norwegian SWF acquiesced and

93. *See* Associated Press, *Russia's Gazprom Cuts off Gas Supplies to Ukraine*, NBC NEWS (Nov. 25, 2015, 4:13 AM), https://www.nbcnews.com/news/world/russias-gazprom-cuts-gas-supplies-ukraine-n469351.

94. *See, e.g.*, Andrew E. Kramer, *Russia Cuts Gas; Europe Shivers*, N.Y. TIMES, Jan. 7, 2009, at A1; *Russia Halts Gas Supplies to Ukraine After Talks Breakdown*, BBC NEWS (July 1, 2015), http://www.bbc.com/news/world-europe-33341322.

95. *Russia Halts Gas Supplies to Ukraine After Talks Breakdown*, *supra* note 94.

96. *Id.*

97. *See* Reed, *supra* note 81, at 100, 103.

98. *See id.* at 106, 109.

99. *See id.* at 106-07.

100. *See id.* at 106.

101. *Id.* at 105-06.

102. *Id.*

103. *Id.* at 105.

purchased the Icelandic bonds, though the damage had, at some level, already been done.[104] Like Gazprom and similarly structured SOEs, SWFs are capable of making politically impactful moves, and their financial decisions are often extensions of their state's policy goals.[105]

C. Escalating Chinese Investment in the Western World

The outbound flow of Chinese capital, both by private and state-owned enterprises, dates back to 2002, beginning with investments in developing economies and shifting to Western economies in 2005,[106] with Lenovo's acquisition of IBM's personal computer business and CNOOC's bid on Unocal.[107] Since then, Chinese investment abroad has ballooned, with experts predicting growth of fifty percent per year in the coming years.[108] The values of these transactions have increased over time, with a number of multibillion-dollar acquisitions occurring across 2015 and 2016.[109]

Chinese acquisitions of American corporations have occurred in thirty-seven of fifty states and are well diversified across a broad range of sectors.[110] China has ventured into the energy industry with the SOE Sinopec Shanghai Petrochemical Company's acquisition of Devon Energy Corporation's shale oil and gas fields, a $2.5 billion acquisition and into American cinemas with Dalian Wanda Group Company's acquisition of AMC Entertainment Holdings, a $2.6 billion acquisition.[111] Additional energy sector investments include a series of oil and gas asset acquisitions by CNOOC, China Petrochemical Corporation, and Sinochem totaling over $8.6 billion.[112] In the food

104. *Id.* at 106.

105. *See id.* at 105-06.

106. *See* Riley, *supra* note 15.

107. *See* Lemon, *supra* note 11 (discussing Lenovo's acquisition of IBM's personal computer division for 1.25 billion USD); White, *supra* note 20 (discussing CNOOC's 18.5 billion USD bid on Unocal and its subsequent withdrawal).

108. *China's Foreign Acquisition Surge in 2016*, ASIA TIMES (Feb. 4, 2016), http://www.atimes.com/article/chinas-foreign-acquisitions-surge-in-2016.

109. *See* James & Morse, *supra* note 14, at 7. The table indicates several multibillion-dollar acquisitions of and joint ventures regarding Western corporations in 2015 and 2016, including the forty-three billion USD Syngenta deal. *Id.*

110. *See* Daniel H. Rosen & Thilo Hanemann, *The Rise in Chinese Overseas Investment and What it Means for American Business*, CHINA BUS. REV. (July 1, 2012), http://www.chinabusinessreview.com/the-rise-in-chinese-overseas-investment-and-what-it-means-for-american-businesses.

111. *See id.*

112. *Chinese Acquisitions of U.S. Companies*, CNN MONEY, http://money.cnn.com/interactive/economy/chinese-acquisitions-us-companies (last visited Nov. 10, 2018).

sector, Shuanghui International made a $4.7 billion acquisition of Smithfield Foods.[113]

As the values of the transactions have increased, so has the nature of the players.[114] Chinese SOEs are joined by the CIC, a sovereign wealth fund, in their overseas ventures.[115] Together, SOEs and the CIC create a massive flow of capital into the United States.[116] While those investments primarily take the form of majority share acquisitions of U.S. companies,[117] investors can exercise control over a corporation without purchasing a majority of a company's voting securities.[118]

D. Shareholder Activism, Controlling a Company Without a Controlling Percentage of Shares

In 1950, institutional investors in the United States held no more than eight percent of stock.[119] By 1989, that number had grown to forty-five percent.[120] It has been estimated that in 2015, the number of shareholders filing individual income taxes on dividends had declined to less than twenty-five percent of all shareholders in the U.S. equities market.[121] As institutional investing increased, a phenomenon that came to be known as shareholder activism developed, the goal of which is the improvement of corporate governance and the maximization of shareholder value.[122] As it happens, activist shareholder campaigns are often successful in achieving this goal.[123]

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113. Joel Backaler, *What the Shuanghui-Smithfield Acquisition Means for Chinese Overseas Investments*, FORBES (Nov. 5, 2013, 7:17 AM), https://www.forbes.com/sites/joelbackaler/2013/11/05/what-the-shuanghui-smithfield-acquisition-means-for-chinese-overseas-investment/#c48da59604e3.

114. *See* James & Morse, *supra* note 14, at 7.

115. *See* Wee, *supra* note 22.

116. *See supra* notes 79-87 and accompanying text.

117. *See* Rosen & Hanemann, *supra* note 110.

118. *See infra* Part II.D.

119. *See* Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447 (1991).

120. *Id.*

121. *See* Steven M. Rosenthal & Lydia S. Austin, *The Dwindling Taxable Share of U.S. Corporate Stock* (May 16, 2016), http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000790-The-Dwindling-Taxable-Share-of-U.S.-Corporate-Stock.pdf. Interestingly, foreign entities, whether they be private individuals or public entities, account for approximately twenty-five percent of equity ownership in the United States, equal to that of total individual ownership in equities. *Id.*

122. *See* Yaron Nili, *Missing the Forest for the Trees: A New Approach to Shareholder Activism*, 4 HARV. BUS. L. REV. 157, 162-63, 165 (2014).

123. *See* Joseph Cyriac, Ruth de Backer & Justin Sanders, *Preparing for Bigger, Bolder Shareholder Activists*, MCKINSEY & CO. (Mar. 2014), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/preparing-for-bigger-bolder-shareholder-activists.

In an analysis of four hundred activist campaigns conducted over the course of the last decade, business management consulting firm McKinsey & Company found that the median activist campaign "reverses a downward trajectory in target-company performance and generates excess shareholder returns that persist for at least thirty-six months."[124] The success of these campaigns has begotten further shareholder activism; between 2011 and 2014, activists launched over 240 campaigns, more than double the number of campaigns launched over the same time frame a decade earlier.[125] Furthermore, activists have become more ambitious, targeting larger and larger companies over time.[126] At the end of the last decade, the average market capitalization of a target company was two billion dollars,[127] a number which had grown to ten billion dollars by the end of 2013.[128]

PricewaterhouseCoopers identified a number of tactics shareholder activists use to achieve their goals.[129] One of the common tactics, and a relatively passive approach, is the "Say-on-Pay" vote and related investor activities.[130] A Say-on-Pay vote is a proxy item that asks shareholders to vote on the compensation schemes of the company's top executives, specifically the Chief Executive Officer, the Chief Financial Officer, and up to three other named executive officers.[131] Companies are required to present shareholders with an opportunity to participate in a Say-on-Pay vote every one, two, or three years.[132] When Say-on-Pay votes appear on proxies, activists will use the opportunity to leverage their significant share of voting securities, using letters to the company, meetings, and phone calls to affect a substantive change to the compensation plan.[133]

Activists' use of shareholder proposals is more aggressive than their Say-on-Pay related activities.[134] The use of a shareholder proposal, or often just the threat of a proposal, is made with one of several changes as the goal.[135] These goals are most often changes to the board's governance policies or composition, changes to the executive

124. *Id.*
125. *Id.*
126. *See id.*
127. *See id.*
128. *Id.*
129. *See* Cloyd, *supra* note 27.
130. *See id.*
131. *Investor Bulletin: Say-on-Pay and Golden Parachute Votes*, SEC OFF. INVESTOR EDUC. & ADVOCACY, https://www.sec.gov/investor/alerts/sayonpay.pdf (last visited Nov. 10, 2018).
132. *Id.*
133. *See* Cloyd, *supra* note 27.
134. *See id.*
135. *See id.*

compensation plan (similar to the goal of Say-on-Pay activities), changes to the company's oversight of certain functions such as audit or risk management, and changes to the company's activities as corporate citizens (such as political spending).[136] Shareholder proposals, especially with respect to the last goal, are often used by religious organizations and investor coalitions with broad societal and policy aims or as a supplemental strategy by hedge funds.[137]

The "vote no" campaign aims to withhold shareholder votes from a particular director or directors in an effort to exert pressure.[138] These campaigns are rarely successful—ninety-three percent of directors enjoy ninety percent support from shareholder voters—as most companies require support from a majority of total outstanding votes rather than those present at a given shareholder meeting.[139] However, challenged directors can buckle under pressure and withdraw or be made vulnerable to future campaigns after receiving weak support.[140]

The final and most aggressive activist method identified by PricewaterhouseCoopers is hedge fund activism.[141] The term "hedge fund activism," though not exclusively the domain of hedge funds, refers to extensive campaigns aimed at making a significant change to a corporation's strategy.[142] This strategy dates back to the 1980s, during which so-called "corporate raiders" would seek the breakup of companies.[143] In the modern era, hedge funds will purchase large minority stakes in the target company and will use minority board representation to influence corporate strategy.[144] In 2017, Nelson Peltz, through his activist fund Trian Fund Management, attempted to leverage its $3.5 billion stake in Procter & Gamble to secure a board position in a hotly-contested proxy contest.[145] Though Mr. Peltz ultimately secured the board position, it seemed as though Trian might suffer the first major

136. *See id.*
137. *See id.*
138. *See id.*
139. *Id.*
140. *Id.*
141. *Id.*
142. *See id.*
143. *Id.*
144. *See, e.g.*, Michelle Celarier, *Procter & Gamble's Win is Rare in a Year of Activist Gains*, INSTITUTIONAL INV. (Oct. 11, 2017), https://www.institutionalinvestor.com/article/b153zzrf8jqhr1/procter-amp-gambles-win-is-rare-in-a-year-of-activist-gains.
145. *Id.*

activist loss of 2017.[146] This sort of hedge fund activism, however, is generally extremely effective.[147]

While Nelson Peltz and Trian Fund Management campaigned to place Peltz on the board of Procter & Gamble, Trian managed to successfully place one of its partners, Ed Garden, on the board of General Electric, where Trian has a $2.5 billion stake.[148] Paul Hilal and his activist fund, Mantle Ridge, succeeded in acquiring five seats on the board of CSX Corp. and successfully lobbied for the replacement of the chairman.[149] The list goes on, with Arconic, Buffalo Wild Wings, and Hain Celestial Group each ceding board positions in the face of aggressive campaigns spearheaded by activist hedge funds.[150] In fact, the forfeiture of board seats in the face of activist aggression is the norm.[151] A study by J.P. Morgan found that activists won at least a single board seat in forty-six percent of launched campaigns, up from forty-one percent in 2016.[152] Of fifty-four contests in the study, only nineteen—just over a third—actually went to a proxy vote.[153]

Settlement and productive engagement with activist hedge funds has become increasingly common.[154] Sullivan & Cromwell's 2016 assessment of trends in shareholder activism has shown that the number of proxy contests initiated fell sharply in that year, suggesting an increased willingness of companies to work with activists to resolve disputes.[155] There has likely been no lack of interest in securing controlling positions on the boards of these companies.[156] In the four years Sullivan & Cromwell examined, nearly three-quarters of proxy contests sought a control slate or a slate for a majority of the board's seats.[157] In fifty percent of the proxy contests surveyed, the activist managed to obtain one or more seats on the board.[158]

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146. *Id.* Mr. Peltz attained the position on the board "just a bit more than a year after he launched what ultimately became the largest boardroom battle in the history of director fights." Ronald Orol, *Nelson Peltz Begins Showdown Over P&G CEO, R&D*, THESTREET (Mar. 1, 2018), https://www.thestreet.com/story/14507431/1/nelson-peltz-begins-showdown-over-p-g-ceo-r-d.html.

147. *See* Celarier, *supra* note 144 (discussing various wins by activist investors in 2017).

148. *Id.*

149. *Id.*

150. *Id.*

151. *See id.*

152. *Id.*

153. *Id.*

154. *2016 U.S. Shareholder Activism Review and Analysis* 17-18, SULLIVAN & CROMWELL LLP (Nov. 28, 2016), https://sullcrom.com/siteFiles/Publications/SC_Publication_2016_U.S._Shareholder_Activism_Review_and_Analysis.pdf.

155. *See id.* at 18.

156. *See id.*

157. *Id.* at 19.

158. *Id.*

When an activist launches a proxy contest with a slate that would grant them majority control if won, companies engage in settlement almost sixty percent of the time.[159] If put to a vote, the potential loss of majority control over the company is far riskier than short slate contests, which result in settlement some thirty percent of the time.[160] The net result is that companies are very vulnerable to activist shareholders with a stake large enough to threaten a bid for majority control over the company and as a result, are willing to reach painful compromises.[161] By leveraging less than nine percent of Hertz Global Holdings's outstanding corporate stock, Carl Icahn was able to force a settlement, striking a deal with the management to replace three board members and naming a new permanent CEO.[162]

E. The Benefits of Chinese Investment in the United States

Foreign direct investment ("FDI") is an important source of economic growth for any country, and the United States is no different.[163] FDI was the primary contributor to some twelve percent of the United States' total productivity growth in the twenty-year period between 1987 and 2007.[164] In 2016, economists from the International Trade Association's Office of Trade and Economic Analysis estimated that some twelve million jobs—8.5% of the United States' labor force—were attributed to FDI, with half of those individuals directly employed by U.S. affiliates of foreign-owned companies.[165] In 2013, foreign companies spent some fifty-three billion dollars on research and development in the United States and exported some $360 billion from the U.S. to other countries.[166]

To illustrate, while L'Oréal is a household name in the United States—the author of this Note has a bottle of the company's volumizing shampoo on a shelf in his shower—the company is headquartered in France.[167] However, L'Oréal directly employs more than ten thousand people in the United States, exports over $500 million in L'Oréal

159. *See id.*

160. *See id.*

161. *See, e.g.*, *Hertz and Carl Icahn Execute Definitive Agreement*, HERTZ (Sept. 16, 2014), http://ir.hertz.com/2014-09-16-Hertz-And-Carl-Icahn-Execute-Definitive-Agreement.

162. *See id.*

163. *See* Moran, *supra* note 35.

164. *Id.*

165. Felicia Pullam, *New Study: How Important is FDI to the U.S. Economy?*, TRADEOLOGY (Feb. 24, 2016), https://blog.trade.gov/2016/02/24/new-study-how-important-is-fdi-to-the-u-s-economy.

166. *Id.*

167. *Id.*

products from the U.S. and sources a great deal of its production-related purchases from contractors and sub-contractors within the country.[168] Similarly, the massive German airliner Lufthansa employs over 14,000 people across the United States and forms a cornerstone of the airline industry in the country.[169]

FDI affects a vast number of economic sectors in the United States.[170] Of particular interest is the fact that FDI creates jobs for some 44.6% of automotive industry employees, 36% of chemical products employees, 32.4% of ground transportation service employees, and 31.6% of petroleum and coal mining employees.[171] These figures, particularly those related to the automotive and petroleum and coal mining sectors, are important to keep in mind because these are vulnerable industries in the United States, suffering significant hits to production and employment figures and facing weak outlooks in 2018.[172]

Clearly, FDI is historically a major driver of the United States' economy.[173] China is the next major source of FDI, and while some are concerned about the implications for the United States' national security, others are optimistic about the economic boons the country could realize.[174] Chinese-owned firms employ more than 140,000 people nationwide, up nine times since 2009, and that number is poised to grow.[175] Of particular note are Chinese "greenfield" investments, the construction of factories and building of businesses from the ground up in America.[176] While the number of these investments is small at present, they are expected to increase substantially, along with Chinese FDI into

168. *Id.*

169. *Id.*

170. JULIAN RICHARDS & ELIZABETH SCHAEFER, JOBS ATTRIBUTABLE TO FOREIGN DIRECT INVESTMENT IN THE UNITED STATES 5 (2016).

171. *Id.* The raw numbers in these listed industries are 369,000, 286,000, 149,000, and 35,000, respectively. *Id.* Further, there are nineteen industries in which FDI is directly or indirectly responsible for the creation of more than ten percent of the jobs in the sector. *Id.* at 6. By raw number of jobs created, FDI creates over 600,000 jobs in the retail sector, nearly 500,000 in administrative and support services and wholesale trade, and 400,000 in the restaurant industry. *Id.*

172. *See* Steven Mufson, *Coal in the Trump Age: Industry has a Pulse, but Prospects for Jobs Are Weak*, WASH. POST, Mar. 19, 2017, at G1; Bill Vlasic, *Carmakers Cut American Jobs at Sales Slump*, N.Y. TIMES, July 5, 2017, at A1.

173. *See* Moran, *supra* note 35.

174. *See* Alana Semuels, *Will China Save the American Economy?*, ATLANTIC (June 27, 2017), https://www.theatlantic.com/business/archive/2017/06/china-american-factories/531507.

175. *See id.* Increasing wages, electricity costs, and industrial land prices are giving Chinese businesses strong incentives to look abroad in the coming years when making determinations about where to locate their factories. *Id.* Contradictory to popular understanding about global economics, Cao Dewang, head of Fuyao Glass, built a factory in Dayton, Ohio because "apart from labor costs, everything else is cheaper in the U.S. than in China." *Id.*

176. *Id.*

the United States more generally.[177] This wave of investment comes at a critical time for an American economy that is seeing new-business creation hitting forty-year lows.[178]

F. A Brief Primer on CFIUS, Exon-Florio, and FINSA

The Committee on Foreign Investment in the United States, created by executive order in 1975, reviews potential investments in the United States in consideration of their national security implications.[179] In 1988, Section 5021 of the Omnibus Trade and Competitiveness Act of 1988,[180] the "Exon-Florio provision," gave the President the power to suspend any merger, acquisition, or takeover by a foreign entity that he deems a threat to national security.[181] Importantly, the exercise of this power was established as not subject to judicial review.[182] The 1993 Byrd Amendment further developed the scope and responsibilities of the President and CFIUS by requiring these investigations any time an investment could affect national security and mandating full reports to Congress with respect to the decision-making process.[183]

In 2007, Congress passed the Foreign Investment and National Security Act, the most recent legislation dedicated to defining the role that national-security concerns play in the regulation of foreign investment in the United States.[184] FINSA was passed in the wake of the Dubai Ports World debacle[185] and served to codify the CFIUS review process in the most comprehensive treatment of this area of executive power thus far.[186]

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177. *Id.*

178. *Id.*

179. Stephen K. Pudner, *Moving Forward from Dubai Ports World—The Foreign Investment and National Security Act of 2007*, 59 ALA. L. REV. 1277, 1278 (2008).

180. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-4118 § 5021 (codified as amended at 19 U.S.C. § 2170 (2012)).

181. Pudner, *supra* note 179, at 1280. Ronald Reagan would delegate the powers granted to the Presidency by the Exon-Florio provision to CFIUS through the use of an executive order soon after the passage of the Act. *Id.* at 1281.

182. *Id.* at 1280-81.

183. *Id.* at 1281-82.

184. Christopher M. Weimer, *Foreign Direct Investment and National Security Post-FINSA 2007*, 87 TEX. L. REV. 663, 663 (2009).

185. Pudner, *supra* note 179, at 1282.

186. *See* Christopher S. Kulander, *Intruder Alert! Running the Regulatory Gauntlet to Purchase, Own, and Operate American Energy and Mineral Assets by Foreign Entities*, 46 TEX. TECH. L. REV. 995, 1021 (2014). The Dubai Ports World debacle involved the purchase of Peninsular and Oriental Steam Navigation Company by Dubai Ports World, a company owned by the United Arab Emirates, which gave the UAE control over six large United States seaports. CFIUS cleared the acquisition, much to the outrage of the general public. *Id.*

The result was an expansion of the parameters under which CFIUS could review transactions.[187]

CFIUS reviews a transaction once two threshold requirements are met.[188] The first is that the transaction gives "an alien entity control over a United States firm . . . ."[189] The second is that the acquisition implicates "interests that could be characterized as important for national defense . . . ."[190] What constitutes gaining "control" over a firm is largely in the hands of CFIUS; there is no specific threshold of security ownership in a company that would trigger an investigation.[191] Exon-Florio defines control "as the power to direct key matters affecting . . . the power to sell off the corporation's assets, dissolve the firm, close its facilities, and terminate its contracts."[192]

With respect to what constitutes "national security," Congress has provided a number of factors through the Exon-Florio provision and FINSA.[193] These initial factors outlined in the Exon-Florio provision are:

> (1) the domestic production needed for projected national-defense requirements;
> (2) the capability and capacity of domestic industries to meet national-defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services;
> (3) the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the U.S. to meet the requirements of national security;
> (4) the potential effects of the transaction on the sales of military goods, equipment or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and
> (5) the potential effects of the transaction on U.S. technological leadership in areas affecting U.S. national security.[194]

With the passage of FINSA—after the Dubai Ports World controversy—Congress expanded the criteria assessed by CFIUS to include a further six items:

> [1] the potential national-security related effects on United States critical infrastructure, *including major energy assets*;

187. *See id.* at 1010.
188. *Id.* at 1008.
189. *Id.*
190. *Id.*
191. *Id.*
192. *Id.*
193. *Id.* at 1009-10.
194. *Id.*

> [2] the potential national-security related effects on U.S. critical technologies;
> [3] whether the covered transaction is a foreign government-controlled transaction;
> [4] the subject country's adherence to nonproliferation control regimes and its relationship with the United States, specifically its record on cooperating in counter-terrorism efforts (as appropriate);
> [5] the long-term projection of U.S. requirements for sources of energy and other critical resources and material; and
> [6] other factors the President or the Committee may determine to be appropriate.[195]

The aggregated criteria CFIUS may use to define what constitutes an acquisition of a firm relevant to national security is considerably more robust than in the past.[196] This is firmly intentional.[197] The guidance Congress provided between the Exon-Florio provision and FINSA is not exhaustive, as the aim is to allow CFIUS to assess transactions without being confined to certain industries.[198]

There are certain types of transactions that are ineligible for CFIUS review.[199] Specifically, FINSA states that transactions "made solely for the purpose of investment" are not to be subject to the scrutiny of CFIUS.[200] This language is very similar to that of the HSR Act's Investment-Only Exemption.[201]

G. The Hart-Scott-Rodino Act and the Investment-Only Exemption

The HSR Act is a set of amendments to U.S. antitrust law, primarily the Clayton Antitrust Act.[202] A fairly straightforward statute, the HSR Act's provisions require that parties to major transactions file premerger notifications with the FTC and the DOJ.[203] The parties then abide by a waiting period, during which the FTC and DOJ conduct an investigation into the nature of the merger.[204]

195. *Id.* at 1010.
196. *Id.*
197. *Id.* at 1009.
198. *Id.*
199. *Id.*
200. *Id.*
201. 15 U.S.C. § 18a(c)(9) (2012).
202. *Id.* § 12; *see* Matthew S. Bailey, *The Hart-Scott-Rodino Act: Needing a Second Opinion About Second Requests*, 67 OHIO L.J. 433, 439-40 (2006).
203. 15 U.S.C. § 18a(a), (d)(1).
204. *See id.* § 18a(b).

Generally speaking, the HSR Act requires premerger filings when the parties to the transaction are involved in some form of commerce[205] and when the size of the transaction exceeds $200 million.[206] Alternatively, even if the size of the transaction does not exceed $200 million, premerger notification is still required if the transaction is in excess of $50 million and one party has more than $10 million in sales or assets, and the other party has more than $100 million in sales or assets.[207]

The premerger notification filing and the subsequent waiting period are burdensome to the parties.[208] The FTC and DOJ have the ability to delay acquisitions and mergers by months[209] and cause millions in direct expenses to the parties involved. The average cost of compliance with a second request is approximated at some five million dollars, with expenses of twenty million dollars and upwards common on complex transactions.[210] Obviously, there is significant incentive for companies interested in executing large acquisitions of voting securities to avoid these regulatory hurdles, and, fortunately, there are a number of exemptions built into the HSR Act to help companies effectively execute such trades.[211]

The Investment-Only Exemption provides that if an acquisition of voting securities is "solely for the purpose of investment," and the share of securities acquired or held does not exceed ten percent of the issuer's outstanding voting securities, the transaction is exempted from the regulatory requirements of the HSR Act.[212]

III. ALL-OR-NOTHING: THE PROBLEMATIC TREATMENT OF CHINESE CAPITAL

Currently, eighty-four percent of investments into the United States from China come in the form of acquisitions of domestic companies.[213] Acquisition proposals are often accompanied by considerable consternation and are reviewed by CFIUS.[214] Very recently, CFIUS has

205. *See* Bailey, *supra* note 202, at 440-41.

206. *See* 15 U.S.C. § 18a(a).

207. *See id.*

208. *See* Bailey, *supra* note 202, at 454-55 (noting that the Second Request process can delay the processing of a merger by as much as six months on a relatively simple transaction and in excess of a year for more complex deals).

209. *Id.*

210. *See id.*

211. 15 U.S.C. § 18a(c)(9)).

212. *Id.*

213. Moran, *supra* note 35.

214. *See id.* In 2016, when ChemChina proposed to acquire Syngenta as detailed above, an

become more prone to blocking transactions involving Chinese-backing, citing national security concerns.[215] By the end of the first half of 2017, CFIUS had sent at least nine letters advising potential Chinese investors that their deals would be blocked.[216] This regulatory scheme has led to an all-or-nothing dynamic where deals are either made and entire U.S. companies are sold, or the U.S. government reaches into the affairs of private entities and precludes massive potential injections of capital into the U.S. economy.[217]

In this Part, Subpart A discusses the issues at hand with CFIUS, primarily the lack of reviewability of executive determinations regarding FDI transactions and the broad nature of CFIUS's reviews,[218] while Subpart B discusses the underutilization of the passive investment exemptions written into FINSA and the HSR Act by Chinese investors.[219]

A. The Problem with CFIUS

CFIUS and the associated Exon-Florio Amendment, as empowered by FINSA, represent the primary means by which the U.S. government has sought to foreclose the possibility of foreign direct investments from affecting national security.[220]

CFIUS recently settled the first lawsuit in its history.[221] In 2015, CFIUS and President Barack Obama sought to force Ralls Corporation,

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Iowan Senator, Charles Grassley, demanded a CFIUS review of the transaction on the grounds that it would threaten the "food security" of the United States. *Id.* The Obama administration obliged, but CFIUS failed to find any national security threat. *Id.*

215. Greg Roumeliotis & Diane Bartz, *U.S. Toughens Stance on Foreign Deals in Blow to China's Buying Spree*, REUTERS (July 20, 2017, 7:44 PM), https://www.reuters.com/article/us-usa-china-companies/exclusive-u-s-toughens-stance-on-foreign-deals-in-blow-to-chinas-buying-spree-idUSKBN1A532M.

216. *Id.* In the first half of 2017, a record eighty-seven deals between Chinese and American companies had been proposed, and the nine letters sent by CFIUS represent government intervention in more than ten percent of deals between the two countries. *Id.*

217. *See, e.g.*, Ana Swanson, *Trump Blocks the Sale of a U.S. Chip-Maker*, N.Y. TIMES, Sept. 14, 2017, at B1; Ed Leefeldt, *U.S. Businesses, Now Owned by China*, CBS NEWS (Feb. 10, 2017, 5:30 AM), https://www.cbsnews.com/news/china-u-s-m-a-its-a-one-way-street (demonstrating examples of United States companies being purchased in their entirety by Chinese investors or where such transactions were blocked by the U.S. government); Greg Roumeliotis, *U.S. Blocks MoneyGram Sale to China's Ant Financial on National Security Concerns*, REUTERS (Jan. 2, 2018, 4:36 PM), https://www.reuters.com/article/us-moneygram-intl-m-a-ant-financial/u-s-blocks-moneygram-sale-to-chinas-ant-financial-on-national-security-concerns-idUSKBN1ER1R7.

218. *See infra* Part III.A.

219. *See infra* Part III.B.

220. *See supra* Part II.F.

221. *See* Judy Wang, Ralls Corp. v. CFIUS*: A New Look at Foreign Direct Investments to the United States*, 54 COLUM. J. TRANSNAT'L 30, 31 (2016).

a Delaware-based corporation owned by two Chinese nationals, to divest itself of four wind farm acquisitions that it deemed threatening to national security.[222] The ultimate settlement was a victory for foreign direct investors in the United States.[223] The implication for the greater international investment sphere is that CFIUS orders made after the fact—in this case, that the wind farms be divested *after* their acquisition—are reviewable in court under due process claims (i.e., deprivation of property).[224] This issue of reviewability seems to incentivize companies to forgo CFIUS review and submit notice after the transaction is complete, but it is clear that this is not the case, as international investors continue to file with CFIUS in advance of transactions.[225] However, the question of reviewability is an interesting one—the presidential determination that a transaction is a national security risk, and the subsequent blocking of that transaction, is not reviewable in court.[226] However, that determination is reviewable after the fact of the transaction.[227] This dichotomy will form the groundwork for a prospective solution to this imbalance.[228]

This problem is exacerbated by the broad nature of CFIUS's grant of power.[229] Under FINSA, CFIUS has the power to review and block transactions under a broad array of circumstances.[230] The catchall terms of FINSA—"other factors the President or the Committee may determine to be appropriate"—gives the committee and the executive wide latitude in determining where executive interference may exist in private transactions.[231] While this may seem appropriate, the preceding eleven factors outlined between the Exon-Florio Amendments and FINSA provide a broad array of circumstances to begin with; the grant of power over "other factors" as deemed appropriate extends CFIUS's reach beyond the already existing comprehensive outline of situations in

222. *See id.* at 37-40.

223. *See id.* at 46-49.

224. *Id.* at 47-49.

225. *Id.*

226. Ivan A. Schlager et al., *Court Finds CFIUS Violated Ralls Corporation's Due Process Rights*, SKADDEN, ARPS, SLATE, MEAGHER, & FLOM LLP (July 17, 2014), https://www.skadden.com/insights/publications/2014/07/court-finds-cfius-violated-ralls-corporations-due.

227. *See* Wang, *supra* note 221, at 46-47. Rather than informing CFIUS of its intended transaction and exposing itself to the possibility of being blocked without recourse in the courts, a company can complete the transaction and gain at least some minimal due process rights. *Id.*

228. *See infra* Part IV.

229. *See supra* Part II.F.

230. *See supra* Part II.F.

231. *See supra* Part II.F; *see also* 50 U.S.C. § 4565 (f)(11) (2012).

which national security is threatened.[232] Without clear boundaries, CFIUS's actions are largely unpredictable.[233] Indeed, Chinese telecommunications company Huawei Technologies Company ("Huawei") has had a difficult time investing in the United States for years, failing to secure CFIUS approval in no less than three acquisitions in the late 2000s.[234] In fact, one proposed Huawei acquisition of two million dollars in assets, equipment, and staff from a small firm in Santa Clara, California—a blip on the radar for a panel which routinely reviews multibillion dollar acquisitions—was threatened by a CFIUS review.[235] This is curiously out of line with the guidelines that CFIUS should review transactions implicating control over a company and highlights the uncertainty and arguably arbitrary nature of CFIUS review.[236]

B. "Solely for the Purpose of Investment," Underutilized

FINSA, like the HSR Act, has a provision pertaining to investments made "solely for the purpose of investment."[237] These two regulations work in tandem with each other to create a safe harbor for investors searching for a passive minority stake, but they are not particularly well-utilized by Chinese investors.[238] The reason is because the return on investment for U.S. securities is low, and Chinese investors are flush with cash and looking to make large bets to maximize their return on investment.[239] The HSR Act only permits purchases of up to ten percent of a company's outstanding voting securities before the transaction is subject to review regardless of the passive intent of the buyer.[240] While this is substantial at a cursory glance, the amount of wealth that these investors are channeling is comparatively massive, and there are clearly insubstantial regulatory incentives to entice Chinese investors from channeling their FDI capital into passive minority stakes rather than full acquisitions.[241] The regulatory scheme presented is underutilized and

232. *See supra* Part II.F.

233. *See* Reginald Cuyler, *Leaving Home the Bacon: Judicially Reviewing CFIUS' Approval of Shuanghui Acquiring Smithfield Foods*, 6 U. PUERTO RICO BUS. L.J. 206, 221 (2015).

234. *Id.* at 220-21.

235. *Id.* at 221.

236. *Id.*

237. Kulander, *supra* note 186, at 1009.

238. Moran, *supra* note 35 (indicating that eighty-four percent of Chinese FDI takes the form of acquisitions of American companies).

239. *See* Semuels, *supra* note 174.

240. *See supra* Part II.G.

241. *See* Moran, *supra* note 35.

could stand to be significantly overhauled to match the realities of supply and demand in the sphere of FDI.[242]

IV. NATIONAL SECURITY AND ECONOMIC POLICY: A REGULATORY SOLUTION

The solution to the issues presented is a cohesive set of amendments to existing legislation aimed at preserving the national security aims of CFIUS, while making them more precise so as to prevent CFIUS reviews from overly inhibiting the flow of FDI into the United States.[243] The first of these amendments is to create a private right of action for corporations whose transactions are blocked pursuant to FINSA and an executive determination based on a CFIUS recommendation.[244] The second of these amendments is a redrafting of the eleven criteria outlined by FINSA and the Exon-Florio Amendment, providing the guidelines as to what kind of transactions are subject to CFIUS review, making them more precise to ensure that corporations can enter into agreements they may reasonably anticipate will not be blocked by the executive branch.[245] Finally, the third of these amendments is a surgical alteration of the HSR Act's Investment-Only Exemption, doubling the threshold at which passive investments must be reviewed by the SEC and DOJ so as to create a regulatory scheme that incentivizes non-controlling minority stake purchases as a valuable alternative for potential FDI.[246]

A. Implementing Judicial Review in FINSA

In 2015, as stated, CFIUS settled its first-in-history lawsuit with Ralls Corporation, the Delaware company it had ordered to divest itself of four limited liability companies it had purchased in the energy sector.[247] Prior to the settlement, the District Court of the District of Columbia determined that this claim was reviewable within the judicial branch under the due process claim at hand, which is definitively at odds with those executive determinations made prior to the completion of transactions.[248] While the difference between an executive order barring a transaction from occurring and an executive order demanding the

242. *See supra* Part III.B.
243. *See supra* Part II.B, E.
244. *See infra* Part IV.A.
245. *See infra* Part IV.B.
246. *See infra* Part IV.C.
247. *See* Wang, *supra* note 221, at 31.
248. *See supra* Part III.A.

divestment of the limited liability companies in *Ralls* is significant, it stands to reason that unilateral executive determinations that bar corporations from realizing economic gains should be reviewable in a court of law to weigh the legitimacy of the government's interest in blocking a particular transaction.[249]

For example, in 2015 CFIUS refused to grant permission for a transaction to take place between Philips, a Dutch company and Chinese investor GO Capital, which would have sold eighty percent of its Lumileds division to the Chinese company for a price of $3.3 billion.[250] On the surface, this is a simple transaction involving the sale of a commercial lighting affiliate, but a closer look explains CFIUS's concerns—namely, that Philips was conducting experiments with gallium nitride, a substance that serves as a critical component in advanced radar and anti-ballistic missile systems.[251] CFIUS's concerns are often well-founded and reasonable, but the process of judicial review would refine the process and eliminate the accusations of unilateralism and (hopefully) overturn executive bars against transactions that are unreasonable or arbitrary.[252]

As such, this Note's first recommended solution to the legal issue at hand is the drafting and legislation of an amendment to FINSA granting a private right of action for corporations whose transactions with foreign companies are blocked by executive determination pursuant to the statute due to national security concerns.[253]

B. Redrafting the Criteria for CFIUS Review for Clarity and Precision

Currently, CFIUS will review a transaction when a foreign entity gains "control" over an American firm and when that acquisition implicates national security concerns.[254] What, precisely, constitutes "control" and "national security" is often difficult for prospective companies to decipher in anticipation of a proposed acquisition.[255] This has led to difficulty in executing transactions and broad and

249. *See* Wang, *supra* note 221, at 50.

250. Moran, *supra* note 35.

251. *Id.*

252. *See e.g.*, *id.* In 2015, CFIUS blocked a Chinese company's attempt to purchase a Canadian mining company with rare earth properties on the grounds that China controls ninety percent of rare earth exports and has historically been known to withhold the export of rare earths to Japan during territorial disputes. *Id.* CFIUS's order for Ralls Corporation to divest itself of the LLCs controlling the wind farms was due to the fact that the wind farms overlooked a military training facility's airspace where the Navy tests its latest generation of drones. *Id.*

253. *See infra* Part IV.B.

254. *See supra* Part II.F.

255. *See supra* Part II.F.

unpredictable results when it comes to CFIUS reviews.[256] Rather than any official block coming to pass, companies that face CFIUS reviews often abandon the transaction entirely rather than bearing the cost of doing business that is unlikely to prove fruitful.[257] In light of these issues of clarity, it is imperative that Congress take action to make CFIUS review more predictable, transparent, and—at some level—more lenient.[258]

The two terms at issue are "control" and "national security."[259] The second part of this solution is a series of amendments to FINSA and Exon-Florio that would resolve this issue of clarity by detailing more carefully the currently nebulous and expansive circumstances under which CFIUS review is triggered.[260] First, "control" should be more specifically worded to define what level of minority stake in a corporation would be considered a controlling stake.[261] To create synergy with the amendment to the HSR Act, this Note recommends a threshold of twenty-percent ownership of voting securities in a corporation.[262] Second, the criteria under which CFIUS shall review transactions due to national security concerns is overly broad and should be amended with specificity.[263] Specifically, this Note recommends that Congress draft and pass legislation amending the FINSA and Exon-Florio criteria to address specific industries that Congress believes are particularly vulnerable to foreign intrusion with respect to foreign investment, contrasted with the vague and broad criteria currently in place.[264] That said, this amendment should retain the eleventh clause within the criteria, granting the executive and CFIUS the power to

256. *See supra* Part III.A (discussing Huawei's repeated attempts at entering into transactional deals with American companies).

257. *See* Daniel N. Anziska, *The CFIUS Process is Becoming More Challenging for Foreign Investors*, TROUTMAN SANDERS (Oct. 10, 2017), https://www.troutman.com/the-cfius-process-is-becoming-more-challenging-for-foreign-investors-10-10-2017 (listing a number of transactions that were blocked by CFIUS or abandoned in the face of potential CFIUS intervention). The list of transactions Anziska discusses would have represented ten billion dollars of FDI across 2016 and 2017. *Id.*

258. *See supra* Part II.E (discussing the benefits of FDI in the United States).

259. *See supra* Parts II.F, III.B.

260. *See supra* Parts II.F, III.B.

261. *See supra* Parts II.F, III.B.

262. *See infra* Part IV.C. This Note recommends that the HSR Act increase the threshold of the Investment-Only Exemption provision of the HSR Act to twenty percent of outstanding voting securities.

263. *See supra* Part III.B.

264. *See supra* Part II.F.

review transactions that it deems a threat to the national interest.[265] Coupled with judicial review of CFIUS decisions as outlined above, such extensions of CFIUS review and executive determinations will be subject to scrutiny in order to ensure that they are reasonable in light of the transaction and the national security interest at hand.[266] Now, the final part of this solution—amending the threshold of the Investment-Only Exemption—combines this improved CFIUS process with a way to incentivize non-controlling, passive investments.[267]

C. Expansion of the Investment-Only Exemption

At present, transactions that would acquire ten percent or less of a corporation's outstanding voting securities are exempted from the reporting requirements of the HSR Act.[268] By expanding that number to fifteen or twenty percent, investors would be able to make significantly larger investments in domestic firms.[269] The provisions of the HSR Act nullify the threat of shareholder activist tactics, but the expanded threshold permits substantial capital injections into the United States's industry sectors.[270]

This use of the Investment-Only Exemption as a safe harbor necessarily relies on the effective enforcement of the provision, as without proper policing of investors' conduct CFIUS would have grounds to review the transaction under a theory of control.[271] As it happens, in recent years the FTC and DOJ have provided more clarity on the boundaries of the Investment-Only Exemption and have undertaken enforcement proceedings against violators.[272] As demonstrated by the

265. *See supra* Part II.F.

266. *See supra* Part IV.A.

267. *See infra* Part IV.C.

268. *See supra* Part II.G.

269. *See* Anziska, *supra* note 257. Unisplendor attempted to purchase a $3.8 billion equity stake in Western Digital, a minority, non-controlling stake in the company, but CFIUS determined that this fifteen-percent stake was sufficient to determine that the company would gain control over Western Digital. *Id.*

270. *See supra* Part II.D–E.

271. *See supra* Part II.F.

272. *See* Jennifer T. Wisinski, *HSR Update: Increasing Risk in Relying on Passive Investment Exemption*, HAYNES & BOONE, LLP (Apr. 12, 2016), http://www.haynesboone.com/alerts/hsr-update-increasing-risk-in-relying-on-passive-investment-exemption (describing enforcement proceedings taken against "certain ValueAct entities" for failing to comply with the passive investment exemption of the HSR Act); *see also* Debbie Feinstein, Ken Libby, & Jennifer Lee., *"Investment-only" Means Just That*, FTC (Aug. 24, 2015, 5:25 PM), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just. The FTC has provided a non-exhaustive list of activities violative of the passive investment exemption that cover a broad range of common business activities, all of which it considers to fall within the purview of the "formulation, determination, or direction of the basic business decisions" of the corporation. *Id.*

ValueAct and Third Point cases,[273] the DOJ and the FTC are willing and able to enjoin transactions violative of the Investment-Only Exemption.[274] The ValueAct enforcement in particular showcases how aggressive and punishing the trend in enforcement has become, as the DOJ levied the largest-ever fine of eleven million dollars against ValueAct Capital Management LP for utilizing hedge fund activist tactics after investing under the auspices of the Investment-Only Exemption and enjoined it from further abusing its stake in the company.[275] Demonstratively, the United States and CFIUS can expect foreign investors' use of the Investment-Only Exemption to be well-policed by the regulatory infrastructure currently in place.[276]

V. CONCLUSION

Addressing the inflow of Chinese capital into Western economies—especially the United States—is a challenge.[277] Capital brought to the United States through FDI has long been a powerful aid in the development of the country's economy, contributing to the employment of millions of Americans and increasing American exports by hundreds of billions of dollars.[278] Chinese investment in the United States is no different, being immensely valuable to the country's economy.[279] Chinese FDI directly employs some 140,000 individuals and indirectly employs many more.[280] Further, the injection of Chinese capital comes at a time when the United States is economically vulnerable, and the infusion of capital will help bolster American industries in sectors such as automotive, energy production, and mining for years to come.[281]

That said, there are significant concerns that the political nature of Chinese-owned companies and sovereign wealth funds pose a threat to American national security.[282] Concerns about acquisition of sensitive defense-oriented technology, patents, and

273. *See* Feinstein et al., *supra* note 272; Nigro, *supra* note 49; Wisinski, *supra* note 272.

274. *See* Feinstein et al., *supra* note 272.

275. *See* David Benoit, *ValueAct to Pay Record $11 Million to Settle Justice Department Suit*, WALL STREET J. (July 12, 2016, 4:54 PM), https://www.wsj.com/articles/valueact-to-pay-record-11-million-to-settle-antitrust-lawsuit-1468346589.

276. *See, e.g.*, *id.*

277. *See supra* Parts II, III.

278. *See supra* Part II.E.

279. *See supra* Part II.E.

280. *See supra* Part II.E.

281. *See supra* Part II.E.

282. *See supra* Part II.B.

monopolization of strategic resources has led the United States to place more Chinese-backed FDI transactions under CFIUS review than at any other time in the board's history.[283] While the intentions are good, this has resulted in a net decline of newly announced mergers and acquisitions between American and Chinese companies in 2017.[284]

Cross-border investment is valuable, and even if the fears of anti-competitive policies and national security risks are well-founded, it would be grossly imprudent to discourage Chinese investment altogether.[285] In fact, it is critically important that the United States abandon its all-or-nothing approach to Chinese investment in the United States, and works diligently to create legislation that promotes precision in CFIUS-recommended bars against specific transactions, clarity and transparency with respect to the conditions under which CFIUS review is to be required and alternative minority-stake investment by Chinese-owned companies.[286]

By drafting an amendment to FINSA that grants a private right of action to corporations whose transactions with foreign companies are blocked by CFIUS-recommended executive action, the United States can subject the process to the watchful eyes of the judicial branch to ensure that such actions are truly in the interest of national security.[287] By refining FINSA's and the Exon-Florio Amendment's criteria for blocking a transaction and clearly delineating which sectors and industries are to be the subject of such scrutiny, the United States can provide clarity such that companies interested in investing in the United States may reasonably anticipate what mitigation efforts they must take in making their deals palatable to the panel.[288] Finally, by increasing the threshold of the Investment-Only Exemption to exempt transactions made "solely for the purpose of investment" to twenty percent, the United States can take a meaningful step toward incentivizing minority-stake FDIs in U.S. companies.[289] Taken together, these changes will meaningfully preserve the security of the nation with respect to foreign

283. *See supra* notes 213-16 and accompanying text.
284. *See supra* Part II.
285. *See supra* Part II.
286. *See supra* Parts III-IV.
287. *See supra* Part IV.
288. *See supra* Part IV.
289. *See supra* Part IV.

investors with political ties while permitting the flow of trade to continue largely uninhibited.[290]

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290. *See supra* Part IV.

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