Testimony before the U.S.-China Economic and Security Review Commission

Hearing on Trends and Implications of Chinese Investment in the United States

Mark E. Plotkin[1]
Partner, Covington & Burling LLP
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Thank you to the Commission and, in particular, to Commissioners Bartholomew and Wortzel for convening this hearing and offering me the opportunity to participate. Chinese investment in the United States is an important policy issue for our nation, and I am honored to be asked to contribute to the Commission's work in this regard.

The subject of this particular panel is "Issues for Policymakers" and I accordingly will focus on the current state of U.S. law and policy concerning Chinese investment in the United States. My perspective is informed by my experience as an attorney representing parties involved in cross-border transactions, including before the Committee on Foreign Investment in the United States, or CFIUS. Many of these cases have involved Chinese investors. In some instances I represent sellers of U.S. assets, while in other instances I advise Chinese buyers of such assets. In these circumstances, I have developed some views as to how our laws and policies governing foreign investment in the United States are implemented and how they impact trade, commerce and U.S. national security.

I have three principal points to offer the Commission.

First, I believe that existing U.S. law is adequate to protect our national security interests. Although I may disagree at times with how the law is implemented, I submit that the dedicated individuals and institutions charged with protecting our national security have available to them the necessary legal tools to carry out their duties effectively and efficiently. In particular, CFIUS is a powerful institution because the Congress wisely crafted its statutory mandate with what I term "living" language — language that permits the Committee and its constituent agencies to adapt readily to a constantly evolving national security landscape. I urge the Commission to resist recommending any additional categorical requirements that would impede the Committee's ability to evaluate each transaction on a case-by-case basis in the context of the current security environment.

Second, CFIUS as structured pursuant to the Exon-Florio amendment was expressly designed to evaluate whether a proposed transaction threatens to impair U.S. national security. I believe that it would be an error to expand the Committee's mandate to include assessing the economic effects of a transaction, such as through a so-called "net benefit" test. A net benefit test would be

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[1] Mark E. Plotkin is a partner in the law firm Covington & Burling LLP in Washington, D.C. His practice encompasses foreign investment and national security, financial services, and data privacy matters. This testimony represents the personal views of Mr. Plotkin and is not offered on behalf of any client or of his firm. Mr. Plotkin can be contacted by email at *mplotkin@cov.com* or by telephone at (202) 662-5656.

inconsistent with our country's longstanding policy of open investment, it would be outside of CFIUS's institutional competence, and it would be inappropriate for a regulatory body that operates in secret. It also would risk detracting from the Committee's core function of protecting our national security and could unintentionally lend credence to allegations that CFIUS is a trade barrier dressed up as a national security tool.

Third, we should remember that foreign direct investment and national security need not be zero sum in combination. More Chinese investment does not mean that we are less secure. The goal of our laws and policies should be two-fold: to encourage foreign investment *and* to protect national security. I have seen for myself that the two need not be mutually exclusive. Rather, handled correctly, appropriately tailored CFIUS mitigation can permit Chinese and other foreign investment in the United States while actually enhancing U.S. national security at the very same time. In this respect, CFIUS — when utilized adroitly — can be an economic and a security tool of equal force using just the existing legal authorities available today. Our nation and our people will be best served when we can pursue both our security and economic goals in a manner that is complementary rather than exclusive.

Let me turn first to the adequacy of existing law to protect our interests.

I. The Adequacy of Existing Law to Address Chinese Investment

A. U.S. National Security Review of Foreign Investment

As I mentioned, I believe that CFIUS's strength comes from the "living" language of its statutory mandate, which leaves the phrase "national security" undefined and subject to the Committee's interpretation and discretion. This flexibility is crucial because national security is not a static concept. Our security interests change as we evolve as a nation and as the world shifts around us. If this hearing were held in 1988 when the Exon-Florio amendment was enacted, the topic of cyber security never would have arisen. Now cyber security is a critical part of nearly every CFIUS review. As this Commission is well aware, the past decade has seen heightened focus on China as a strategic competitor and economic partner. And CFIUS has responded by intensifying its scrutiny of proposed Chinese investments. At the same time, other issues have faded. The fears about Middle Eastern investment that drove the creation of CFIUS in the 1970s, and the concerns about Japanese investment that were the impetus for the Exon-Florio amendment in the 1980s, have largely dissipated. None of us can imagine, let alone predict, the primary issues that CFIUS will face 20 years hence.

CFIUS's statutory mandate is simultaneously narrow in scope and vague in its application. The Committee has the power to review certain transactions to "determine the effects of the transaction on the national security of the United States."[2] The statute was amended in 2008 by the Foreign Investment and National Security Act ("FINSA") to specify that national security shall be construed to include issues related to homeland security, but national security is not otherwise defined.[3] The statute provides a list of factors that the Committee must consider, but these factors are neither intended to be an exhaustive definition of the scope of national security

[2] *See* Foreign Investment and National Security Act, 50 U.S.C. App. § 2170 (b)(1)(A)(i) (2012).

[3] 50 U.S.C. App. § 2170 (a)(5).

nor are they treated as such in practice.[4] National security also is left undefined by the Department of the Treasury's regulations implementing FINSA.[5]

Because of this "living language," the CFIUS agencies are free to interpret national security consistent with their individual mandates and equities, instead of being locked into a rigid statutory box. Simply by way of example, the Department of Energy focuses on potential threats to our energy infrastructure, while the Department of Homeland Security concentrates on critical infrastructure, and the Department of Commerce scrutinizes compliance with export control regulations. Permitting the CFIUS member agencies to apply their own definitions of national security ensures that a broad range of interests are represented, weighed, and balanced as part of the review process.

Cyber security offers a topical and compelling example of how CFIUS has adapted to a changing national security landscape. Neither the Exon-Florio amendment nor FINSA make any mention of cyber security. Yet cyber issues play a significant role in nearly every review and investigation. The Commission may be considering whether to recommend a specific statutory requirement that CFIUS conduct a cyber security analysis for each transaction it reviews. I would caution against such a mandate for two reasons. First, it is unnecessary. As the threat of cyber attacks and cyber espionage has increased, I have seen CFIUS focus more acutely on cyber security in its reviews, investigations, and mitigation agreements, especially where there is a Chinese investor. The CFIUS regulations also specifically require the parties to submit details related to cyber security practices.[6]

Separately, unnecessary mandates have the potential to distract from other, more pressing national security risks presented by a transaction. I have never seen two transactions that were the same, or even largely similar. The nature and severity of the potential risks vary widely. In some cases, cyber security is the chief risk and should be the focus of the Committee's review. In other cases, it may be appropriate for the Committee to commit its resources elsewhere, such as assessing geographic proximity concerns (in CFIUS parlance, "persistent co-location") or regulatory compliance matters. A mandatory cyber security analysis would risk redirecting the Committee's limited resources from more pressing matters without offering any appreciable benefit.

The flexibility of the concept of national security is important for another reason. CFIUS's decisions can and do have a tangible and material impact on the foreign relations of the United States. I can tell you from experience that foreign embassies and governments take a very active interest in how their native companies are treated during the review process. It therefore is critically important that the CFIUS process reflect and complement the incumbent administration's broader foreign policy and national security priorities, within the parameters set by the Congress.

In practice, no administration has sought to adopt an explicit definition of national security for CFIUS purposes, instead leaving that determination to the agencies' discretion. The agencies'

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4 50 U.S.C. App. § 2170 (f).

5 31 CFR § 800.

6 § 800.402(c)(3)(viii).

views, in turn, are influenced and shaped by the President's agenda. If Congress attempts to influence the definition of national security that CFIUS applies through additional mandatory reviews, investigations, or assessments, there is a danger that the Committee will find itself at cross purposes with the administration, leading to a less integrated, less cohesive foreign policy.

I share this background to help explain why I believe the flexibility of the language in FINSA and the CFIUS regulations is so critical to the Committee's proper functioning. I would urge the Commission to resist recommending any changes that would limit the Committee's discretion in defining national security for purposes of reviews. It is neither practical nor prudent to amend the CFIUS statute each time the national security landscape changes. We cannot predict what security risks our country will face in ten years, or even next year, and we should not try. Instead, we should recognize that it is the living language of the CFIUS statute that makes the institution most effective year after year.

Finally, I would suggest that the Commission and Congress consider whether CFIUS and the Agency staff that support the Committee would benefit from additional resources. As the number of investigations conducted by the committee has increased year-by-year, so too has the workload. I have witnessed firsthand the tireless efforts of the Committee's dedicated civil servants. These are not clock-watching bureaucrats; these men and women regularly work nights, weekends and holidays with little appreciation and no recognition, and often with a punishing caseload. Additional resources would promote the twin goals of protecting national security and promoting investment by ensuring that they have sufficient staff to evaluate transactions in a thorough and timely manner.

B. State-controlled Entities and National Security

I recognize that investments from state-controlled entities, including state-owned enterprises ("SOEs") and sovereign wealth funds ("SWFs"), present unique challenges from a national security perspective. At the same time, these investors make valuable contributions to our economy. I would suggest to you that our national interests are best served if CFIUS is free to consider each such investment on a case-by-case basis and that additional statutory mandates targeted at SOEs and SWFs are both unnecessary and counterproductive.

There is always the possibility that a state-owned foreign investor may be motivated by political or national security considerations, rather than by purely commercial interests. At the same time, I believe that treating all entities with any form of government ownership stake or interest identically is unnecessary from a national security perspective, damaging to our economic interests, and will deservedly be seen as unfair by foreign observers.

SOEs are not a monolithic group. It is true that *some* SOEs are, in effect, organs of the state that operate with substantial direction from the government. Others are largely independent businesses with only incidental, historical or passive state ownership. And still others are in distinct phases of evolution on the continuum from state control to private control, with considerable conflict between the state and private stakeholders. To straitjacket all of these entities uniformly would be poor and unrefined policy.

If categorical protections are inadvisable, how then do we address the unique challenges that state-owned investors pose? I believe that we should require sufficient transparency from investors to permit CFIUS to make an informed decision about the risks of each individual transaction. The more transparent a corporation's governance and decision making, the more confidence we can have that its investments are motivated solely by business considerations. And, where there are credible risks, we can take appropriate steps to protect our security interests.

I note that, for transactions reviewed by CFIUS, we already demand an exceptional degree of transparency from investors, including SOEs. The CFIUS regulations require that all notices to the Committee contain a great deal of sensitive information. I can tell you from experience that foreign investors often are uncomfortable providing the level of detailed information sought by CFIUS. The foreign party is required to provide "Personal Identifier Information" about each and every officer and director, including date of birth, place of birth, "date and nature of foreign government and foreign military service," "national identity number, including nationality, date and place of issuance, and expiration date," and passport number, together with a detailed curriculum vitae.[7] The foreign party must also provide extensive information about its governance structure and ownership, including, where the ultimate parent is a public company, identifier information for any shareholder with an interest greater than five percent.[8] These data, once provided, are subjected to thorough analysis by CFIUS utilizing classified systems and databases.

In practice, some investors are simply unwilling to provide this information and self-select out of a potential transaction. Thus, by merely requiring this information, we reduce the pool of investors in the United States to those who are willing, at a minimum, to comply with our stringent information requirements. Moreover, state-controlled entities already are subject to additional scrutiny in the CFIUS process. Thus, FINSA creates a presumption that CFIUS will conduct an additional 45-day investigation for any transaction "that could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government."[9] This presumption may be overcome only if the Secretary of the Treasury and the head of the lead agency jointly determine . . . that the transaction will not impair the national security of the United States."[10] The authority may not be delegated to anyone other than the Deputy Secretary of the Treasury or the equivalent in the lead agency.[11] My experience is that this discretionary authority is rarely, if ever, utilized to shorten a review process.

In my view, these policies represent an appropriate balancing of the need to protect our national security while at the same time encouraging foreign direct investment. The informational requirements operate as a "gatekeeping" mechanism that deters investors who are unwilling to subject themselves to the deep scrutiny required by CFIUS. Similarly, the additional review requirements for foreign government-controlled entities ensure that SOEs and SWFs receive appropriate scrutiny when they invest in the United States.

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7 § 800.402(c)(6)(vi).

8 *Id.*

9 50 U.S.C. App. § 2170 (b)(2)(B)(i)(III).

10 50 U.S.C. App. § 2170 (b)(2)(D)(i).

11 *Id.*

I urge the Commission not to recommend additional mandatory reviews for state-controlled entities. As I have noted, SOEs and SWFs are far from a monolithic group, and treating them as such penalizes responsible investors and contributes unnecessarily to the impression that the CFIUS process is arbitrary and unfair. It is worth recalling that foreign manufacturers — including from Japan, Germany, and China, among others — have created tens of thousands of U.S. manufacturing jobs without presenting appreciable national security threats. In the highly competitive mergers and acquisitions market, additional scrutiny and delay in CFIUS approval can be a crippling competitive disadvantage. To subject all state-controlled entities to such disadvantages diminishes the incentives for those foreign companies that have partial government ownership to be responsible and transparent in their management and ownership structures.

Instead, I believe that Congress and the administration should work with our allies and partners to promote good governance and improved transparency in state-controlled entities. Some significant efforts already are underway. The Organisation for Economic Cooperation and Development has published Guidelines on Corporate Governance of State-owned Enterprises, which lay out principles for how countries can more responsibly and transparently manage commercial enterprises in which they have a stake.[12] Similarly, the International Working Group of Sovereign Wealth Funds has established the "Sovereign Wealth Funds: Generally Accepted Principles and Practices," commonly known as the "Santiago Principles."[13] These efforts demonstrate that some SOEs and SWFs are committed to transparency and responsible investment. The United States should encourage such responsible corporate behavior by rewarding those companies that embrace transparency and good governance.

In sum, it is true that investment by state-controlled entities raises unique national security challenges. Our national security review system already recognizes this risk and includes substantial provisions to ensure that such investors are scrutinized appropriately. Additional categorical requirements would serve only to punish responsible investors and distract from more pressing security concerns. As with other areas, my experience leads me to conclude that CFIUS functions most effectively when it is afforded the flexibility to consider each case on its own merits without being constrained by categorical mandates or requirements.

C. State-owned Enterprises and Protection from Unfair Competition

As the Commission is well aware, the issues related to state-controlled enterprises are not limited to the implications for national security. Some SOEs receive substantial economic benefits from the state that threaten to distort markets and put American companies at an unfair disadvantage. But we are not powerless. The United States has a number of legal tools available to help promote a level playing field for U.S. businesses, including trade remedies and antitrust laws. I cannot say that these remedies are perfect or sufficient to neutralize the benefits received by

[12] Organisation for Economic Cooperation and Development, OECD Guidelines on Corporate Governance of State-owned Enterprises (2005), *available at* http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf.

[13] International Working Group of Sovereign Wealth Funds, "Generally Accepted Principles and Practices (Oct. 2008), *available at* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.

Chinese SOEs. But I am confident that these laws and institutions — not CFIUS — are the appropriate mechanism by which to address the potential economic edge of Chinese SOEs.

China's membership in the WTO provides the United States with a number of legal options to remedy the effects of subsidies and other benefits provided to Chinese SOEs. The Agreement on Subsidies and Countervailing Measures ("SCM Agreement") specifically prohibits export subsidies, *i.e.*, any subsidies that are provided on condition of export or local content.[14] Subsidies that are not contingent on export may be actionable, (*i.e.*, subject to countervailing duties or challenge through the WTO's dispute settlement mechanism) if they are "specific," (meaning they are provided to one industry, such as SOEs), provide a "benefit," and cause "serious prejudice."[15]

Of course, these trade obligations only benefit U.S. businesses if they are enforced. Last year President Obama created the Interagency Trade Enforcement Center, led by the U.S. Trade Representative, to coordinate efforts across agencies to better monitor and enforce the United States' trade rights around the world.[16] This is a step in the right direction, but more work is needed. I encourage the Commission to consider whether the administration, and in particular USTR, has sufficient resources to enforce existing our trade rights and to protect U.S. businesses.

Our antitrust laws, which provide remedies for such practices as price fixing and predatory pricing, provide another opportunity to protect against unfair competition. Earlier this year, a federal jury returned a verdict against two Chinese companies for conspiring to raise the price of vitamin C exported to the United States, marking the first time that Chinese companies have faced trial in the United States under U.S antitrust law.[17] The companies defended on the basis that they were merely adhering to government-mandated volume and pricing restrictions, an argument the jury clearly rejected. The Court entered judgment for treble damages in the amount of $162.3 million. Another avenue the Commission could investigate is whether the Department of Justice and the Federal Trade Commission can take additional steps to pursue enforcement actions against Chinese business that violate our antitrust laws.

I offer these examples not to say that our existing competition and trade regimes are sufficient to entirely protect our economic interests. I do, however, submit that the trade and antitrust regimes are the correct mechanisms for protecting U.S. businesses and promoting a level playing field.

II. CFIUS is an Inappropriate Mechanism for Economic Benefit Assessment

That leads to me to my second key point. The CFIUS framework is ill suited to evaluating the economic effects of a transaction, such as through a net benefit test like that required by the Investment Canada Act.

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[14] WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), art. 3.

[15] SCM Agreement, art. 2.

[16] See Press Release, The White House, "Executive Order -- Establishment of the Interagency Trade Enforcement Center" (Feb. 28, 2012).

[17] See In re: Vitamin C Antitrust Litigation (E.D.N.Y. 2012).

First, the principles underlying the net benefit test diverge significantly from the core purpose of CFIUS, which is to evaluate whether a transaction threatens to impair national security and take action, as necessary, to protect our security interests. The Committee's statutes, regulations, membership, policies, and procedures all revolve around this essential function. For this reason the Departments of Defense and Homeland Security are typically two of the most influential agencies in the Committee process. The professional CFIUS staff itself within the Department of the Treasury is relatively small and primarily serves a coordinating role. While highly sophisticated, I do not believe that this staff itself has the capacity to conduct the complex economic analysis that would be necessary to support a net benefit test.

Instead, we have entire departments and agencies full of talented economists, diplomats, and regulators whose mission is to promote a level playing field for U.S. businesses. They work for the Office of the U.S. Trade Representative, the Federal Trade Commission, the International Trade Commission, the Department of State, and the Department of Justice's Antitrust Division.

Second, CFIUS operates under an exceptionally rare amount of secrecy for a regulatory agency. All submissions are confidential and protected from public disclosure. The Committee's orders are not made public and it is not required to make any public report or explanation of its decision in any particular case. There is no opportunity for public hearing and, as was recently confirmed, the Committee's decisions are not subject to judicial review. This secrecy is essential to protect not only the national security interests of the United States, but also the highly sensitive personal and business information that is submitted to the Committee. I submit that such lack of transparency is inappropriate to the conduct of an economic benefit test and would risk devolving into unprincipled protectionism — or, at a minimum, would be perceived as such. If we are to have a mechanism to review the economic benefits of transactions, it should be transparent and subject to public scrutiny.

Finally, Canada's experience also cautions against adoption of a net benefit test. Although some support the idea of a net benefit test in principle, nearly every Canadian political party seems to agree that they do not care for it in practice, albeit for different reasons. Opponents criticize the test as unnecessary, inconsistent with free trade and investment, and lacking in intelligible standards. Supporters, on the other hand, lament that the power to block transactions has been used only twice. Recently, the Canadian government has increased the threshold amount to qualify a transaction for review under the test to $1 billion, from $330 million, reflecting in part the reality that the measure has been controversial and difficult to apply in practice.

III. The Interrelation of National Security and Foreign Investment

The final point I wish to make concerns the interrelation of foreign investment and national security. Some of the policy proposals I hear considered seem to assume that national security and foreign investment are zero sum calculations; that is, an increase in foreign investment necessarily leads to a correlative decline in our national security. This simply is not the case. We need not sacrifice valuable investment to protect our security interests, nor must we risk our national security in order to welcome investment. Both are worthy ends that can and should be pursued simultaneously and with equal vigor.

Our nation has a longstanding policy of openness to foreign investment. In May 2007, President George W. Bush issued a statement on the United States' openness toward foreign investment, called a statement on "Open Economies."[18] In the wake of the Dubai Ports World controversy, the Bush Administration sought to reassure the world that the United States remained open to foreign direct investment. Similar policy statements were made by Presidents Carter, Reagan, and George H.W. Bush.[19] And in 2011, President Obama released a statement on the "United States Commitment to Open Investment Policy" that "reaffirms our open investment policy, a commitment to treat all investors in a fair and equitable manner under the law."[20]

There is good reason for this rare, longstanding, bi-partisan consensus. Clear and convincing evidence shows that foreign direct investment contributes to a stronger manufacturing base, creates higher paying jobs, promotes investment in domestic research and development, and generates greater tax revenue. The White House Council of Economic Advisors has reported that U.S. affiliates of foreign companies in 2008 produced $670 billion in goods and services, 42 percent of which is concentrated in the manufacturing sector, and employed 5.7 million U.S. workers, or about five percent of the U.S. private workforce.[21]

The United States traditionally has been the world's premier investment location, with twice as much foreign direct investment comes here as compared to second-ranked China in 2011. But our share of global foreign direct investment has dropped rapidly, from 37 percent in 2000 to 17 percent in 2011, due in large part to companies' shifting capital to fast-growing developing countries like China.[22] These figures should be a caution to those considering additional requirements on foreign investors.

With the increasingly competitive market for foreign direct investment in mind, I want to address in particular the idea of applying reciprocity requirements to our trade and investment laws. Such a policy would, in effect, require that the United States deny the right to invest in the United States to countries that do not extend the same rights to U.S. companies. This argument fundamentally misapprehends the nature of foreign investment. Foreign direct investment benefits the United States regardless of whether U.S. companies are extended equivalent access to foreign markets.

This does not mean that we should not advocate vigorously and aggressively to open markets overseas to investment by U.S. businesses. We should. But to make approval for foreign investment contingent on reciprocity would unnecessarily deny the United States the benefits of foreign investment and risk additional tightening of international investment regimes. We

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[18] Press Release, The White House, President Bush's Statement on Open Economies (May 10, 2007), *available at* http://2001-2009.state.gov/e/eeb/rls/prsrl/2007/84660.htm.

[19] James Jackson, "Foreign direct investment: current issues," Congressional Research Service Report to Congress, April 27, 2007, at 6-7 (internal citation omitted).

[20] Press Release, The White House, Statement by the President on United States Commitment to Open Investment Policy (June 20, 2011), *available at* http://www.whitehouse.gov/the-press-office/2011/06/20/statement-president-united-states-commitment-open-investment-policy.

[21] Executive Office of the President, Council of Economic Advisors, "U.S. Inbound Foreign Direct Investment" (June 2011), *available at* http://www.whitehouse.gov/sites/default/files/microsites/cea_fdi_report.pdf.

[22] Organization for International Investment, Foreign Direct Investment in the United States: 2012 Preliminary Data (Mar. 20, 2013), *available at* http://www.ofii.org/docs/FDIUS_2012_Annual_Data.pdf.

should keep in mind that our national security review process is itself more restrictive than its counterparts in many of our most important trading partners and closest allies, some of whom have no formal process for evaluating the national security risk of foreign investment. Requiring reciprocity in our laws and policies — even if limited to China — I believe would risk subjecting U.S. businesses to similar requirements when they invest abroad.

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Encouraging foreign investment, protecting our national security, and ensuring a level playing field for U.S. businesses are all worthy and important policy goals. Fortunately, they also are goals that can be pursued simultaneously. I would encourage the Commission to resist the temptation to recommend additional statutory mandates for our national security review process. It is the flexibility to review each transaction on a case-by-case basis that makes CFIUS effective. Instead, I encourage the Commission to consider how it can help empower CFIUS and our other institutions through additional resources.

Thank you again for the opportunity to address the Commission. I would be happy to take your questions.