# FINANCIAL STABILITY AND NATIONAL SECURITY IN AN ERA OF HEGEMONIC RIVALRY: THE NEED TO TIGHTEN UNITED STATES SECURITIES DISCLOSURE REQUIREMENTS

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ABSTRACT

Defending national security will become increasingly interconnected with developing, controlling and exploiting technological innovation, as well as preserving domestic financial stability and core economic strength. Sovereigns are empowered through shareholding to control corporations, and thus "conquer," or substantially influence and control another sovereign's political governance, industrial strength and economic future. Obtaining economic leverage and technological prowess over an adversary through share accumulation and share voting provides a compellingly attractive alternative (with a potential benefit of profiting from such leverage and supremacy) to open military confrontation and the associated costs and risk of loss.

Nations will need to evaluate these concerns and determine whether share ownership by foreign governments poses national security risks warranting a re-evaluation of shareholding regulation. While foreign investment review procedures such as the United States' CFIUS can serve as important vetting mechanisms, such regimes are focused on large transactions; share purchases will generally not be on the radar. Therefore, securities regulation should be updated to reflect the transformational developments in emerging technology and threats to financial stability, both directly and indirectly implicating national security concerns, particularly in the context of the hegemonic rivalry. Some have advocated for strictly limiting or outright banning Chinese investment in the United States. Rather than draconian bans on sovereign investing, foreign

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governmental entities purchasing shares should be more strictly monitored to ensure core economic sectors and emergent technology are protected. Legitimate governmental investors should not object to heightened disclosure and reporting requirements.



"*[O]nce upon a time securities regulation was entirely separate from banking supervision and financial stability. . . . Securities regulation must now be in the front line of efforts to preserve the stability of the financial system.*"[1]

"*American stock exchanges have emerged as the latest battleground in the ongoing political fight between the U.S. and China*."[2]

## I. INTRODUCTION

The December 2018 arrest of a Huawei executive in Canada at the request of the United States[3], the retaliatory invocation of national security

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1. PAUL TUCKER ET AL., CHALLENGES IN SECURITIES MARKETS REGULATION: INVESTOR PROTECTION AND CORPORATE GOVERNANCE 7, 23 (Pablo Gasós, Ernest Gnan & Morten Balling eds., 2015), http://www.suerf.org/docx/s_1ae [https://perma.cc/J77Z-KBGM].

2. Akiko Fujita & Krystal Hu*, New Bipartisan Bills Threaten Chinese IPOs and Chinese Companies Listed in the U.S.*, YAHOO FIN. (June 8, 2018), https://finance.yahoo.com/news/bipartisan-bills-threaten-chinese-companies-listed-in-us-000758485.html [https://perma.cc/6PKG-L4YM].

3. *See* Kate Conger, *Huawei Executive Granted Bail by Canadian Court*, N.Y. TIMES (Dec. 12, 2018), https://www.nytimes.com/2018/12/11/technology/huawei-executive-canada-bail-decision.html [https://perma.cc/NW44-BX4U] (detailing how the CFO was arrested at the behest of American authorities for potentially deceiving financial institutions into violating sanctions against Iran); *see also* Kiran Stacey & Tom Mitchell, *US Unveils Criminal Charges Against Huawei*, FIN. TIMES (Jan. 29, 2019), https://www.ft.com/content/ff000e70-233c-11e9-b329-c7e6ceb5ffdf [https://perma.cc/SC56-U4LT] ("The US has accused China's Huawei and its chief financial officer of stealing American technology and

by China to arrest two Canadians[4], and the increasingly contentious relationship between China and the United States[5] highlight the transformative age of hegemonic rivalry. As former Australian PM Rudd noted: "Last year [2018] represented a fundamental strategic turning point in the 40-year history of US-China relations. This is not just an American view; it is also the Chinese view."[6]

Following several decades of stable relations, the United States has radically transformed its perception of Chinese ambitions. No longer does the United States view China as being on the path to inevitably granting Westernized notions of rights to its citizens and embracing the U.S.-led liberal Western order. The United States now perceives China as a strategic rival for global dominance and has increasingly publicly accused China of debt trapping nations, warned countries about China's 5G, alleged Chinese election interference and criticized China's increased projection of

breaking US sanctions against Iran, in a criminal indictment that sharply escalates the two countries' technological rivalry.").

4. *See* Joel Gherke, *Mike Pompeo: China's 'Unlawful Detention of Two Canadian Citizens Is Unacceptable,'* WASH. EXAMINER (Dec. 14, 2018), https://www.washingtonexaminer.com/policy/defense-national-security/mike-pompeo-chinas-unlawful-detention-of-two-canadian-citizens-is-unacceptable [https://perma.cc/S8NF-UX7J] ("China detained two Canadian diplomats—one businessman, another a former diplomat—just days after Canada arrested a top executive from Huawei, a major technology company that the U.S. government accuses of violating sanctions on Iran. The detentions are widely regarded as Chinese retaliation against Canada, but officials on all sides maintain that none of the arrests have anything to do with political motivations.").

5. *See* Dominic Rushe & Lily Kuo, *China Accuses US of 'Deliberately Destroying' World Order*, GUARDIAN (Aug. 6, 2019, 4:41 PM), https://www.theguardian.com/us-news/2019/aug/05/us-designates-china-as-currency-manipulator [https://perma.cc/66ZW-JRML] ("Today some in America are obsessed with American privilege to the point of destroying international rules and the international system. . . ."); *see also* Wu Junhua, *Taking Sides -- US or China*, NIKKEI ASIAN REV. (Oct. 15, 2018, 12:00 AM), https://asia.nikkei.com/Opinion/Taking-sides-US-or-China [https://perma.cc/MTA8-JR87] ("The deterioration of the U.S.-China relationship has now gone far beyond what we can call a trade war. U.S. President Donald Trump and his administration have expanded the rivalry from an economic battle to all-out confrontation with Beijing over military and even ideological fields.").

6. Kevin Rudd, *Kevin Rudd on US-China Relations: This Is a New and Dangerous Phase*, FIN. REV. (Jan. 23, 2019, 4:09 PM), https://www.afr.com/opinion/kevin-rudd-on-uschina-relations-this-is-a-new-and-dangerous-phase-20190122-h1acu6. [https://perma.cc/N8T9-YDQJ] To be sure, the tension started 2018. *See, e.g.*, *Bien Perez, ZTE to Pay Record US$1.2 Billion Fine for Violating Iran, North Korea Sanctions*, SOUTH CHINA MORNING POST (Mar. 8, 2017, 2:00 AM), https://www.scmp.com/tech/china-tech/article/2076867/chinas-zte-pay-record-us12bn-fine-violating-iran-north-korea [https://perma.cc/8VKD-YYGG] ("ZTE Corp, China's largest listed telecommunications equipment supplier, has agreed to pay the United States government a record fine to settle a five-year probe of its trade sanctions violations, in a move to lift the ban on US exports of chips and components for its products.").

military power in the South China Seas.[7] The contest for supremacy—and associated national security concerns—have already impacted several key economic pillars of global governance and international economic law: trade and foreign direct investment.

Historically, national security had little to no connection to publicly traded capital markets or financial regulation, focusing instead on classic military attack and conquest. Today however, pure military capability has been trumped by the importance of non-military stratagems capable of degrading, weakening and vanquishing (virtually or ultimately physically) a strategic adversary.[8] Our interconnected global economy with cross-border investment makes open military conflict a less palatable option, given the potential economic losses which would accrue to a victorious state arising from a counter-attack or being "invested" in that strategic adversary.

From an economic standpoint, raw economic strength is in itself one of the three vital pillars of hegemony.[9] As a corollary, financial stability is a vital national security interest to ensure a continued robust economy and domestic social order.

> [T]he financial sector is one of the bedrocks of the U.S.—and global—economy. Significant disruptive or destructive attacks against the financial sector could have catastrophic effects on the economy and threaten financial stability. This could occur directly through lost revenue as well as indirectly through losses in consumer confidence and effects that reverberate beyond the financial sector because it serves as the backbone of other parts of the economy.[10]

7. *See* Keith Johnson & Elias Groll, *It's No Longer Just a Trade War Between the U.S. and China*, FOREIGN POL'Y (Oct. 4, 2018, 6:10 PM), https://foreignpolicy.com/2018/10/04/its-no-longer-just-a-trade-war-with-china-pence-spying/ [https://perma.cc/F7KE-6MYS] ("The U.S. confrontation with China that has been ramping up over the past year due to heightened trade tensions, military showdowns, and diplomatic ill will escalated to new levels on Thursday with a double-barreled assault on Beijing's growing economic and geopolitical heft.").

8. The fact that both the United States and China have nuclear weapons makes open military conflict a potentially lose-lose situation for both nations, further encouraging economic and technological supremacy as an alternative arena, at least in the short-term. However, certain red-line issues may risk causing (even by miscalculating the opponent's resolve) conventional conflict with unforeseeable outcomes.

9. *See* Joel Slawotsky, *The National Security Exception in US-China FDI and Trade: Lessons from Delaware Corporate Law,* 6 CHINESE J. COMP. L. 228, 241–45 (2018) (noting economic, technological and military power as the triad of hegemonic status).

10. Erica Borghard, *Protecting Financial Institutions Against Cyber Threats: A National Security Issue*, CARNEGIE ENDOWMENT FOR INT'L PEACE (Sept. 24, 2018), https://c

However, the financial health of capital markets is not only a national security interest of the United States. China understands the importance of capital markets in the hegemonic rivalry.

> In this sense, we should attach importance to the mutual influence of trade disputes and financial markets so as to achieve the following targets: to minimize the impact of trade disputes on China's financial market, to contain any harm to the rival's side in the trade war, *and to prevent the opponent from using the trade war to manipulate and attack the domestic financial market*.[11]

In the context of the hegemonic rivalry, financial stability is recognized as a vital factor by both China and the United States as materially contributing to crowning the ultimately successful winner. Threats to domestic financial markets are the quintessential national security risk, and in an integrated financial world, a serious risk to the global financial order as well.[12]

As national security factors have proximately caused trade and investment to be impacted, not surprisingly, literature has recently developed addressing national security in the context of tariffs and foreign direct investment. However, an overlooked sub-topic within the rubric of security implications of foreign direct investment is the inextricable link between national security and publicly traded shares. This paper will focus on the interrelationship between national security and capital markets in an era of hegemonic rivalry.

Some have argued for high-impact actions to curtail access to U.S. capital markets. Such measures "discussed have included forcing a delisting of Chinese companies from US exchanges, imposing limits on investments in Chinese markets by US government pension funds and putting caps on the value of Chinese companies included in indexes managed by US firms."[13]

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arnegieendowment.org/2018/09/24/protecting-financial-institutions-against-cyber-threats-national-security-issue-pub-77324 [https://perma.cc/UT6Q-NERG].

11. Mei Xinyu, *Financial Defense Important in US-China Trade War*, GLOBAL TIMES (Aug. 12, 2019, 6:18 PM), http://www.globaltimes.cn/content/1161201.shtml [https://perma.cc/D6HR-DPSE] (emphasis added).

12. *See* Borghard, *supra* note 10 ("In turn, the outsized role the United States plays in the global economy also implies that the stability and integrity of U.S. financial sector firms are critical to global financial stability.").

13. *See* Bloomberg, *Bridgewater Associates' Ray Dalio Outlines Path Trump Could Take to Limit US Capital Flows to China*, SOUTH CHINA MORNING POST (Oct. 2, 2019, 10:28 AM), https://www.scmp.com/business/china-business/article/3031181/bridgewater-associates-ray-dalio-outlines-path-trump-could [https://perma.cc/U39R-Q2UY] (documenting

As will be discussed infra, legitimate concerns exist with respect to Chinese investors. However, draconian measures[14] risk not merely retaliatory moves, but will remove potential capital investment and will set a transformative precedent. Securities regulation must be updated in view of the current national security implications of the hegemonic rivalry. The updates—crucial in the context of a transformative world—should allow for and in fact encourage cross-border investment. United States securities regulation must play a vital role in defending national security, which includes financial stability, and be sufficiently balanced to continue to serve its function of enabling a prosperous domestic economy. As discussed infra, tightening the disclosure requirements for government-linked buyers strikes a healthy balance between the two compelling needs: national security and economic prosperity.

## II. THE HEGEMONIC RIVALRY

Hegemons are perched on top of the pyramid—the alpha nation—dominating all other rivals economically, militarily and technologically,[15] and are empowered to enforce the global order to promote the hegemon's interests. Substantial advantages accrue to the hegemon in the international economic and legal orders. For example, the current hegemon, the United States, has exceptional authority to advance American interests extraterritorially.[16]

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how fund manager Dalio foresees the possibility of "capital and currency wars, the ability of the US president to unilaterally cut off capital flows to China and also freeze payments on the debts owed to China, and also use sanctions to inhibit non-American financial transactions with China must be considered as possibilities.").

14. *See* Alan Rappaport & Ana Swanson, *White House Weighs Blocking Chinese Companies from U.S. Exchanges*, N.Y. TIMES (Sept. 27, 2019), https://www.nytimes.com/2019/09/27/us/politics/trump-china-stock-exchange.html [https://perma.cc/RY7K-CS7P] (measuring the pros and cons of limiting Chinese access to U.S. markets); *see also* Kayla Tausche, *White House Floated Memo to Study Chinese Investment Limits*, CNBC (Oct. 1, 2019, 12:57 PM), https://www.cnbc.com/2019/10/01/white-house-floated-memo-to-study-china-investment-limits-amid-trade-war.html [https://perma.cc/RK4C-YZHS] (reporting that the U.S. is considering restricting Chinese investment, delisting Chinese shares traded in the U.S. and other measures).

15. *See* Slawotsky, *supra* note 9, at 241–45 (noting the triad of hegemonic pillars of power: economic, military and technological).

16. The hegemon "dictates the rules of the game and punishes deviators." O.F. Bahrisch & Jin-Suk Kim, *Hegemonic Power and Technology Advancement*, 261 COMM. COMPUTER & INFO. SCI. 562, 563 (2011). For example, no other sovereign was able to successfully overcome Swiss bank secrecy. *See* Robert A. Wood, *10 Facts About FATCA, America's Manifest Destiny Law Changing Banking Worldwide*, FORBES (Aug. 14, 2014, 2:27 AM), http://www.forbes.com/sites/robertwood/2014/08/19/ten-facts-about-fatca-ameri

China, a rival power, is challenging the existing hegemon.[17] This long-term contest for global leadership will ultimately affect all pillars of the transnational governance architecture: trade rules, cross-border investment policy, international financial institutions, international law, geo-strategic alliances, military inflection points and domestic governance.[18] The ultimately successful contestant will dominate each pillar of hegemonic power: (1) enjoying the strongest economy with the ability to shape and create trade rules and international finance; (2) a powerful military vested with cutting edge weapons and the ability to project that power globally to protect its national interests; and (3) supremacy in emerging technologies which can bolster tremendously the hegemon's domestic economy, as well as create devastating weapons that can crush or degrade an adversary.

The United States did not perceive a threat from China in recent decades, indeed encouraging its entry into the WTO in 2001.[19] However, the United States now perceives China as a competing *economic and political model*—a powerful strategic enemy—within grasp of dominating Asia and potentially re-shaping the global governance architecture. The radical transformation of the United States' perceptions of China is illustrated in the vast differences between contemporary National Security Strategy documents. As recently as 2002, the United States National

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casmanifest-destiny-law-changing-banking-worldwide/#300593551961 [https://perma.cc/3W7B-CSG7] (noting the ability of the United States to essentially override domestic laws of foreign nations). The example of Swiss banking is illustrative. As recently as 2005, Swiss banking was considered a safe place to stash money anonymously. *See* JOHN GRISHAM, THE BROKER 311 (2006) (noting the inviolably of Swiss banking secrecy, "the Swiss were immune to pressure [from foreign governments] . . . they were the Swiss!"). Yet, only a few years later, the ability of the United States to enforce its taxation system on foreign financial institutions and pressurize the Swiss banks to disclose the names of account holders eliminated this anonymity. *See also* Press Release, Dep't of Justice Office of Pub. Affairs, Justice Department Announces Four Banks Reach Resolutions Under Swiss Bank Program (Dec. 23, 2015), https://www.justice.gov/opa/pr/justice-department-announces-four-banks-reach-resolutions-under-swiss-bank-program-0 [https://perma.cc/7U6X-MQ5N] (illustrating the enforced transparency Swiss banks were demonstrating due to the penalties they were administered by the U.S.).

17. *See infra* notes 24–32 and accompanying text.

18. *See* Joel Slawotsky, *The Clash of Architects: Impending Developments and Transformations in International Law*, 3 CHINESE J. GLOBAL GOVERNANCE 83 (2017), https://doi.org/10.1163/23525207-12340025 [https://perma.cc/JE7N-MC8R] (discussing the effects of China's ascendancy and how this will affect international law and global governance, as well as potentially impacting domestic governance of sovereigns militating towards a Chinese governance model).

19. Joseph Kahn, *World Trade Organization Admits China, Amid Doubts*, N.Y. TIMES (Nov. 11, 2001), https://www.nytimes.com/2001/11/11/world/world-trade-organization-admits-china-amid-doubts.html.

Security Strategy non-confrontationally noted: "In time, China will find that social and political freedom is the only source of [national] greatness."[20] And the 2006 United States National Security Strategy opined in the context of optimism: "China's leaders . . . cannot let their population increasingly experience the freedoms to buy, sell, and produce, while denying them the rights to assemble, speak, and worship."[21]

Barely a decade later, the 2017 United States National Security Strategy clearly evinces a transformational re-characterization of China and the realization that the hoped-for results of economic engagement and integration[22] have failed to materialize. "China and Russia want to shape a *world antithetical to U.S. values and interests* . . . China seeks to displace the *United States in the Indo-Pacific region, expand the reaches of its state-driven economic model, and reorder the region in its favor*."[23]

2018 will be recalled as the year the rivalry was acknowledged and the gauntlet was thrown down. An exemplar of this new thinking is the statement of U.S. Vice President Pence:

> China's aggression was on display this week, when a Chinese naval vessel came within 45 yards of the USS Decatur as it conducted freedom-of-navigation operations in the South China Sea, forcing our ship to quickly maneuver to avoid collision. Despite such reckless harassment, *the United States Navy will continue to fly, sail, and operate wherever international law allows and our national interests demand. We will not be intimidated and we will not stand down.* . . . [O]ur message to China's rulers is this: *This President will not back down*.[24]

The perception that China is a bona fide threat to U.S. hegemony is not without a rational basis. Indeed, for the first time in eighty years, the

20. Joel Slawotsky, *Principled Realism: Thoughts on the New U.S. National Security Strategy*, L. END DAY (Jan. 11, 2018), http://lcbackerblog.blogspot.com/2018/01/joel-slawotsky-principled-realism.html [https://perma.cc/LYQ9-J4VS].

21. *Id.* (citing THE WHITE HOUSE, THE NATIONAL SECURITY STRATEGY OF THE UNITED STATES OF AMERICA 25 (2017)) (emphasis added).

22. A counter-argument states that U.S. strategy was in reality an effort at containment. *See* Larry Catá Backer, *Encircling China or Embedding It?*, L. END DAY (Nov. 8, 2010), http://lcbackerblog.blogspot.com/2010/11/encircling-china.html [https://perma.cc/4HUF-P5KD] (noting Chinese concerns that United States policy was aimed at containing a rising China).

23. Slawotsky, *supra* note 20 (emphasis added).

24. Michael Pence, *Remarks by Vice President Pence on the Administration's Policy Toward China*, WHITE HOUSE (Oct. 4, 2018), https://www.whitehouse.gov/briefings-statements/remarks-vice-president-pence-administrations-policy-toward-china/ [https://perma.cc/P5LM-4T6P] (emphasis added).

United States is being *effectively challenged*.[25] "From the South China Sea to the Indian Ocean and the African Continent, China is rising fast, challenging America's long dominance."[26]

The possibility of hegemonic loss is now recognized by the existing hegemon, which merely a few years ago considered itself untouchable and unequalled.[27] American officials now believe that "[n]o country presents a broader, more severe threat to our ideas, our innovation, and our economic security than China."[28]

China concedes it is now a great power and has global ambitions of leadership in the geo-strategic context. President Xi acknowledges that China's rise has immense global implications. "China should take the lead in shaping the 'new world order' and safeguarding international security."[29] China's leader has called for "a regional order that is more favorable to Asia and the world," noting that China "[b]eing a big country means shouldering greater responsibilities for regional and world peace and development."[30]

Some argue that, similar to prior hegemonic contenders who failed to dethrone the United States, China will also fail. But comparisons to prior rivals such as the Soviet Union are misplaced. In contrast to prior

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25. *See infra* notes 31–33 and accompanying text (comparing the Soviet Union as a rival to the United States).

26. Panos Mourdoukoutas, *America Begins to See the Consequences of the Past Policy Errors that Helped China's Rise*, FORBES (May 25, 2019, 2:32 PM), https://www.forbes.com/sites/panosmourdoukoutas/2019/05/25/america-begins-to-see-the-consequences-of-the-past-policy-errors-that-helped-chinas-rise/#21a98cec7981 [https://perma.cc/QG6H-A68X].

27. Just a few years ago, the United States perceived itself as the exceptional nation. *See* Barack Obama, *Remarks by the President at the United States Military Academy Commencement Ceremony*, WHITE HOUSE (May 28, 2014), https://www.whitehouse.gov/the-pressoffice/2014/05/28/remarks-president-united-states-military-academycommencementceremony [https://perma.cc/9D3V-9E2G] ("In fact, by most measures, America has rarely been stronger relative to the rest of the world. . . . Our military has no peer. . . . Meanwhile, our economy remains the most dynamic on Earth; our businesses the most innovative. Each year, we grow more energy independent. From Europe to Asia, we are the hub of alliances unrivaled in the history of nations. America continues to attract striving immigrants. . . . So[,] *the United States is and remains the one indispensable nation. That has been true for the century passed and it will be true for the century to come*.") (emphasis added).

28. Press Release, U.S. Dep't of Justice, Attorney General Jeff Session's China Initiative Fact Sheet (Nov. 1, 2018), https://www.justice.gov/opa/speech/file/1107256/download [https://perma.cc/7KCN-C4K9].

29. Zheping Huang, *Chinese President Xi Jinping Has Vowed to Lead the "New World Order"*, YAHOO FIN. (Feb. 22, 2017), http://finance.yahoo.com/news/chinese-president-xi-jinping-vowed-084654413.htm. [https://perma.cc/GQ7N-YRSP]

30. Michael Schuman, *Whose Money Will the World Follow?*, BLOOMBERG (May 14, 2015, 3:23 PM), https://www.bloomberg.com/news/articles/2015-05-14/u-s-china-rivalry-whose-money-will-the-world-follow- [https://perma.cc/34N8-W6VA].

opponents, China has masterfully integrated into the global governance architecture. China wields the world's second largest economy, has established the Asian Infrastructure and Investment Bank ("AIIB"), and is a leader in the New Development Bank ("NDB")—both potential alternative (and longer-term competitors) to the IMF and World Bank. China's Belt and Road Initiative (BRI) is a mammoth infrastructure program which, if successful, will have immense geo-strategic potential.[31] Indeed, China is astutely building a Chinese court system to resolve BRI-related disputes, potentially enabling China to influence commercial law development and become a rules-maker.[32] China's military is becoming more powerful, and its technological innovation is starting to rival the United States. China is, at various points, crossing the Rubicon to hegemonic status and has brought the prospect of a reduced role for the United States to a credible possibility.

The contrast between China and the Soviet Union is herculean: the former Soviet Union never had a robust economy, never established competing international governance institutions, and no one thought of the Ruble as a major currency, let alone a world reserve currency. The Soviets were on the outside looking in and attacked U.S. hegemony via supporting revolutionary groups, failed states and rogue regimes. In contrast, China wields the second-largest global economy by nominal GDP, is an integral part of the international trade order, has significant global governance initiatives such as the AIIB and the BRI, and envisions the Yuan as a burgeoning reserve currency.

The developments described above corroborate China as a potent and effective hegemonic rival. Unquestionably, the United States is now planning to confront and push back China's rise based upon threats to national security.[33] The struggle's present phase is an economic and technologically based confrontation for overall superiority in the global governance context. The rivalry is triggering national security concerns within the United States (and to varying degrees among U.S.-allied nations)

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31. *See* Vernan Silver & Sheridan Prasso, *Italy's Embrace of China's 'Belt and Road' Is a Snub to Washington*, BLOOMBERG (Mar. 19, 2019), https://www.bloomberg.com/news/articles/2019-03-19/italy-s-embrace-of-china-s-belt-and-road-is-a-snub-to-washington [https://perma.cc/2C8C-S2DQ] (discussing China's potential influence in Europe).

32. Jonathan E. Hillman & Matthew P. Goodman, *China's 'Belt and Road' Court to Challenge Current US-led Order*, FIN. TIMES (July 24, 2018, 9:43 PM), https://www.ft.com/content/b64d7f2e-8f4d-11e8-b639-7680cedcc421.

33. *America's New Attitude Towards China Is Changing the Countries' Relationship*, ECONOMIST (Oct. 18, 2018), https://www.economist.com/briefing/2018/10/18/americas-new-attitude-towards-china-is-changing-the-countries-relationship [https://perma.cc/VCV5-TV5R].

related to the triage of hegemonic power levers: economic,[34] military[35] and technological strength.[36] Therefore, national security considerations are now a significant driver of investment and trade policy.[37] Trade friction and investment blocking are merely the current manifestations of the rivalry. The next Part will discuss how the hegemonic contest is likely to encompass global capital markets.

## III. NATIONAL SECURITY AND CAPITAL MARKETS

Historically, with rare exceptions, states were relegated to public functions while the private market was the sphere of private economic actors. However, this dichotomy has markedly changed.[38] For example,

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34. *See* Andrea Willige, *The World's Top Economy: The US vs China in Five Charts*, WORLD ECON. F. (Dec. 5, 2016), https://www.weforum.org/agenda/2016/12/the-world-s-top-economy-the-us-vs-china-in-five-charts/ [https://perma.cc/2UUW-VLRY] (explaining that China is second in economic power, but close to surpassing the United States).

35. *See an Interactive Look at the U.S.-China Military Scorecard*, RAND, https://www.rand.org/paf/projects/us-china-scorecard.html [https://perma.cc/93E9-BBG5] (analyzing the significant rise in Chinese military power).

36. *See* ELSA B. KANIA, BATTLEFIELD SINGULARITY: ARTIFICIAL INTELLIGENCE, MILITARY REVOLUTION, AND CHINA'S FUTURE MILITARY POWER 6 (2017), https://www.cnas.org/publications/reports/battlefield-singularity-artificial-intelligence-military-revolution-and-chinas-future-military-power [https://perma.cc/V9U9-CAT9] (stating that China is rapidly approaching parity and has ambitions for supremacy in AI-driven warfare).

37. The use of the national security rationale by the United States to impose tariffs in 2018, as well as the increasing scrutiny of Chinese foreign investment globally based upon national security, all herald a more frequent resort to national security based international economic law decisions. *See, e.g.*, *Presidential Order Regarding the Proposed Takeover of Qualcomm Incorporated by Broadcom Limited*, WHITE HOUSE (Mar. 12, 2018), https://www.whitehouse.gov/presidential-actions/presidential-order-regarding-proposed-takeover-qualcomm-incorporated-broadcom-limited/ [https://perma.cc/UQX9-6W5E] ("There is credible evidence that leads me to believe that Broadcom . . . through exercising control of Qualcomm . . . a Delaware corporation, might take action that threatens to impair the *national security* of the United States. . . .") (emphasis added).

38. The traditional sharp lines of distinction between states and corporations have become increasingly blurred; states are becoming investors in private markets and in parallel, private corporations are now involved in historically public functions. *See* Joel Slawotsky, *The Global Corporation as International Law Actor*, 52 VA. J. INT'L L. DIG. 79, 84 (2012); Ru Ding, *'Public Body' or Not: Chinese State-Owned Enterprise*, 48 J. WORLD TRADE 167 (2014) (SOEs may contain both public and private characteristics). *But see* Joel Slawotsky, *Corporate Liability for Violating International Law Under the Alien Tort Statute: The Corporation Through the Lens of Globalization and Privatization*, 2013 INT'L REV. L. 1, 17 (2013) ("To be sure, there have been prior examples of corporations wielding state like power over private citizens. For example, the British East Indies Company [] was a state-controlled company that was enormously influential over India and wielded both private and public actor power.").

share ownership is available to international buyers, both private actors as well as governments. The propensity of sovereigns to enter private markets and engage in cross-border investment—including buying publicly traded shares—is a significant dynamic with critical implications: states are increasingly willing to project economic power abroad, and the immense financial power of some states trumps the traditional notions of sovereign power.

> What distinguishes this sovereign activity from its mid-20th Century form is the willingness of states not only to limit their control of internal economies, but also to invest their financial wealth outside their national borders. *In this respect, states assume the very role of the private economic actors that they once feared so much. The 21st Century is witnessing a dramatic rise in the willingness of states to project economic power both at home and in host states through the same economic vehicles that threatened the states' power in the 20th Century. . . .* Consequently, some states seem to have become, to some extent, pools of national economic wealth, *the power of which matches or exceeds their traditional sovereign power*.[39]

Large publicly traded corporations are powerful actors comparable financially to nation-states and are embedded in all facets of critical infrastructure, communications, energy, financial services, technology and other core economic sectors. Ownership of these businesses, via share acquisition, is available on capital markets. Control or influence over national champions or crucial economic sectors may potentially be an objective of government controlled buyers.[40] The connection between national security and capital markets is manifestly clear; publicly traded corporations are at the vanguard of technological innovation and revolutionary financial services.

Moreover, publicly traded companies explore, drill and market energy-critical materials and often constitute the backbone of core industrial and financial services strength. National corporate champions, strategic industrial assets and critical economic sectors are intertwined with national security. "'Strategic' industries . . . include armaments, power

39. Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 3, 11 (2010) (emphasis added).

40. *See* ALAN P. LARSON & DAVID M. MARCHICK, FOREIGN INVESTMENT AND NATIONAL SECURITY: GETTING THE BALANCE RIGHT 21 (2006) ("In certain cases, government ownership and control can create national security issues, particularly when the foreign company's decisions become an extension of the government's policy decisions rather than the company's commercial interests.").

generation and distribution, oil and petrochemicals, telecommunications, coal, aerospace, and airfreight. 'Pillar' industries . . . include[e] equipment manufacturing, automobiles, electronic communications, architecture, steel, nonferrous metals, chemicals, surveying and science and technology."[41]

In jurisdictions with publicly traded stock markets, dominating the economic high-ground can thus be accomplished through significant share ownership, which empowers the holder to exercise voting power and elect directors. Extensive shareholdings in a sector or industry can serve to influence or control that entire sector or industry. Significant shareholders may also reap secondary awards, such as close communications with senior executives and directors, visits to a corporation, and product demonstrations which can serve as vehicles to extract valuable information.

If the shareholder is a foreign government, either directly or through an intermediary that the government controls, owning significant stakes potentially empowers that sovereign to shape and influence the corporation. The ability to elect directors, direct corporate affairs and extract proprietary information can be used to further a foreign government's interests. Accordingly, obtaining economic leverage and technological prowess over an adversary through share accumulation and share voting provides a compellingly attractive alternative (with a potential benefit of profiting from such leverage and supremacy) to open military confrontation and the costs and risks of loss.

Thus, the defense of the national bastion—once conceptualized as security against military conquest—is now inextricably linked to global trade, investment policy and corporate finance, including the control of—or influence over—publicly traded global businesses particularly in critical sectors such as communications, finance, energy and technology.

In the context of the hegemonic rivalry, economic superiority is a critical factor. Economic power translates into influence as well as profits, and leveraging economic engagement to shape global governance is crucial to both China and the U.S. This is exemplified by China's attempt to engage U.S. allies, bringing them within China's BRI and thus being allied with Chinese financial interests. "In a move certain to cause consternation among American officials and leaders of the European Union, Italy appears poised to help China extend its vast global infrastructure push deeper into Western Europe, part of Beijing's sweeping plan to advance its economic

41. *See* Ding, *supra* note 38, at 187 (arguing that Chinese policy aims for sole ownership and absolute state control over strategic sectors such as weapons, energy, power generation, and communications and to have majority state ownership of "pillar" industries such as steel, chemicals, technology, manufacturing, autos, and equipment manufacturing).

interests and influence around the world."[42]

Along with financial stability—and inextricably linked with it—are the national security ramifications of emergent technologies such as AI, 5G, robots and space exploration.[43] Dominating powerful emergent technologies will likely crown the hegemonic winner for two reasons: One, the offensive capabilities, *even in the non-military context*, are potentially devastating. The power to shut down an adversary's electricity, water, and critical infrastructure, destabilize financial markets, interfere in elections and cause other permutations, all offer effective and efficient paths to virtually conquer or seriously degrade a strategic enemy.[44] Cyber-attacks are already causing substantial damage.[45]

Moreover, from a military perspective, technological supremacy could pave the path to an overwhelming victory by: (1) infiltrating another sovereign's military weapons systems to shut them down; (2) deploying twenty-four-hour fighting robot soldiers requiring no food, rest or questioning of any directive; or (3) hacking into communications and intelligence data.

Two, emergent technologies will result in huge new industries and profitable sectors, greatly enriching the sovereigns that can commercialize and exploit economically these new technologies. As an exemplar, the WEF estimates that AI will add nearly $16 trillion to Global GDP by 2030.[46] Reaping the lions' share of this vast, newly created wealth will be the leaders in AI. Therefore, dominating these new powerful technologies is critical in the context of the hegemonic rivalry for both reasons outlined above.

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42. Jason Horowitz & Jack Ewing, *Italy May Split with Allies and Open Its Ports to China's Building Push*, N.Y. TIMES (Mar. 6, 2019), https://www.nytimes.com/2019/03/ 06/ world/europe/italy-ports-china.html [https://perma.cc/3YQW-8VU2] (noting allies such as Italy may be tempted to partner with China).

43. *See* Slawotsky, *supra* note 9, at 233 ("[N]ational security is not only military preparedness; national security encompasses a wide range of important bulwarks in defence of the good of the nation such as peace, prosperity, and stability. New technology inspired dual-use civilian/military product applications . . . increasingly cross into the realm of legitimate national security.").

44. Defensive capabilities will become increasingly crucial, as well.

45. *See* Nicole Perlroth & Scott Shane, *In Baltimore and Beyond, a Stolen N.S.A. Tool Wreaks Havoc*, N.Y. TIMES (May 25, 2019), https://www.nytimes.com/2019/05/25/us/nsa-hacking-tool-baltimore.html [https://perma.cc/7EUH-SK7S] ("For nearly three weeks, Baltimore has struggled with a cyberattack by digital extortionists that has frozen thousands of computers, shut down email and disrupted real estate sales, water bills, health alerts and many other services.").

46. Ross Chainey, *The Global Economy Will Be $16 Trillion Bigger by 2030 Thanks to AI*, WORLD ECON. F. (June 27, 2017), https://www.weforum.org/agenda/2017/06/the-global-economy-will-be-14-bigger-in-2030-because-of-ai/ [https://perma.cc/5KRK-BVFQ].

In the past, concerns related to obtaining leverage over another sovereign's economic and technological power via controlling corporate assets would be relatively modest to non-existent since virtually all economic players and investors were private actors. Governments by and large were involved in public-actor functions only. Under the private actor system, it is the profit motive—divorced from any ideological interests or political agenda—that controls the decision of investment. However, governmental ownership is a transformative factor, as there is a risk that governments will invest for reasons that are not necessarily solely for profit.

It is crucial to understand that these challenges affect not merely the main protagonists, but third-party nations as well. The rivalry for global supremacy between China and the United States is a global battleground impacting numerous states. Capital markets are inter-connected, emerging technology is developed in numerous jurisdictions, and access to energy resources and capital for development are available in various nations. Therefore, both China and the United States will need to tap their allied nations for these resources and block the other from benefitting from these third-nations.

Exemplars are China's attempts to bring EU nations into the BRI, have nations use the Yuan as a means of trade settlement and induce a potential post-Brexit United Kingdom to be economic partners. For its part, the United States has lobbied allies to ban Huawei's 5G, join in freedom of navigation exercises, and exercise caution regarding Chinese investor motivations. Therefore, other nations will also need to address the national security implications of shareholdings held by foreign governments.

Generally speaking, there are two primary risks proximately caused by sovereign investment not motivated for profit: (1) national security threats and (2) lackluster corporate governance. While described separately, corporate governance is closely related to national security; the concerns are overlapping because poor governance will inherently lead to less efficiency and productivity, lackluster economic performance, and adverse effects to financial stability—all essential aspects of national security.

### *A. National Security Concerns*

Anxieties over foreign government controlled investors trigger national security concerns caused by concerns that decisions are motivated either proximately or in part to achieve strategic governmental objectives.[47] "[H]ost countries cannot summarily assume that [foreign-government] investments will *never* be guided by political objectives or that the management of [foreign-government buyers] will *never* be motivated by 'nationalistic considerations' deviating from conventional wealth maximization."[48]

Foreign government shareholders may wish to advance the government's geo-political agenda.[49] Strategic considerations such as economic, military and political partnerships, rather than pure market forces, may play a prominent role in business decision-making at state-owned economic actors.[50]

Even among allies, national security concerns are raised by foreign government controlled entities buying shares in other nations' corporations.[51] At a minimum, large corporations can be influential and, if under the influence or control of a foreign government, can promote a state's interest.[52]

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47. *See* Jonathan Soble, *Why the U.S. Fears a Chinese Bid for Westinghouse Electric*, N.Y. TIMES (Apr. 7, 2017), https://www.nytimes.com/2017/04/07/business/us-china-toshiba-westinghouse.html?_r=0 ("Westinghouse is believed to have been targeted by Chinese spies. If a Chinese entity were to buy the company, China could obtain secrets without the cloak and dagger.").

48. Julien Chaisse, *Demystifying Public Security Exception and Limitations on Capital Movement: Hard Law, Soft Law and Sovereign Investments in the EU Internal Market*, 37 U. PA. J. INT'L L. 583, 594 (2015).

49. *See* Larry Catá Backer, *The Emerging Normative Structures of Transnational Law: Non-State Enterprises in Polycentric Asymmetric Global Orders*, 31 BYU J. PUB. L. 1, 17 (2016) (arguing that corporations can be deployed to advance state goals).

50. *See* Steven T. Kargman, *Venezuela Needs Debt Restructuring*, INT'L ECON., Fall 2018, at 58, 61, http://www.kargmanassociates.com/Venezuelan/Venezuelan_Debt_Res tructuring.pdf [https://perma.cc/QQ35-XPBR] ("Both China and Russia may, however, have broader non-financial considerations at play when considering how much more deeply to get involved in Venezuela on a financial basis. They may weigh possible considerations such as advancing their geopolitical/strategic objectives, establishing or expanding a footprint (whether commercial/economic, military, or otherwise) in Latin America, securing long-term supplies of natural resources, and so forth.").

51. *See* Toby Sterling, Tim Hepher & Sudip Kar-Gupta, *Air France-KLM Shares Slump on Surprise Dutch Stake Buy*, REUTERS (Feb. 27, 2019), https://www.reuters.com/article/us-netherlands-air-france-klm/air-france-klm-shares-slump-on-surprise-dutch-stake-buy-idUSKCN1QG0XM [https://perma.cc/66TX-P6PU] ("Shares in Air France-KLM fell sharply as the Dutch government amassed a 14 percent stake in the airline to counter French influence, in a surprise move highlighting tensions over the company's strategic direction.").

52. *See* Rachel Brewster & Philip J. Stern, *Introduction to the Proceedings of the Seminar on Corporations and International Law*, 28 DUKE J. COMP. & INT'L L. 413, 420 (2018), https://scholarship.law.duke.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1526&context=djcil [https://perma.cc/MX9B-YBYJ] ("[L]arge multinational corporations may have greater expertise in understanding international law, particularly as compared to

Such concerns are magnified with respect to China since China's economic model is innately different than the Western model. In China, "manifestation of the party-state in its role as controlling shareholder" is of critical importance.[53] The Chinese government is directly involved in all economic sectors; state capitalism is manifested in the dominance of government-controlled businesses. In most, if not all Chinese corporations, CCP members are embedded in the management of the business.[54]

> Chinese government control of its economy remains sweeping and is increasing rather than fading away. An economic plan outlined by President Xi reserves the " . . . Communist Party of China leadership over all forms of work in China." . . . [T]he assets controlled by the hundred largest centrally administered Chinese state-owned enterprises have risen sharply to $10.4 trillion—a more than ten-fold increase since 2003. The total value of China's 51,000 state owned enterprises is about $29.2 trillion, according to the OECD. For comparison, the annual GDP of the United States in 2017 was about $19.4 trillion.[55]

Governmental ownership is also fundamentally different than being controlled by private economic actors. Businesses will naturally seek to obtain the favor of a powerful entity which wields the power to prosecute, grant waivers, lobby other nations, and design subsidies. Thus, there is a real risk that a corporation may seek advantage by advancing the interest of the state.

> [E]xtensive state intervention in the economy, weak formal institutions to check state power, and the pervasive influence of

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developing states, and use this expertise as a means of resisting and reshaping global regulatory development.").

53. Li-Wen Lin & Curtis J. Milhaupt, *Bonded to the State: A Network Perspective on China's Corporate Debt Market*, 3 J. FIN. REG. 1, 15 (2017).

54. *See also infra* notes 106–108 and accompanying text (discussing how even an ostensibly private business such as Huawei may in fact be controlled by the Chinese government).

55. Greg Mastel, *China Without a Private Sector*, INT'L ECON., Spring 2019, at 8, 46, http://www.international-economy.com/TIE_Sp19_Mastel.pdf. *But see* Bloomberg News, *No More Bailouts? China's New Approach to Bank Stress*, WASH. POST (Aug. 9, 2019, 8:06 PM), https://www.washingtonpost.com/business/no-more-bailouts-chinas-new-approach-to-bank-stress/2019/08/09/08170e20-ba5d-11e9-8e83-4e6687e99814_story.html [https://perma.cc/67JU-3BTZ] ("Several lenders have fallen into deep trouble this year, with others -- perhaps many -- expected to follow. What's different is that China seems to have thrown out the old playbook of injecting state funds into struggling lenders to keep them alive. *If that proves to be the case, it would represent another shift for the country toward more market-oriented practices.*") (emphasis added).

> the Communist Party—encourages all firms to seek rents from the state by cultivating ties to party and government organs *and by aligning their business models with the policy objectives of the Party-state.*[56]

In addition, the *raison d'être* of the Chinese state-owned enterprise (SOE) is the advancement of the CCP's objectives, thus amplifying the customary "state-ownership" concerns: "SOEs are exactly established to execute national strategic goals."[57] Therefore, concerns regarding the true motivation of Chinese buyers has increased in recent years. Illustrating this concern was Canada's blocking of a Chinese investment based upon this factor.

> Intelligence agencies in both Canada and the USA have warned that companies owned or partly owned by the Chinese government are not merely profit-seeking operations; they are also prone to passing on information or technology to Beijing and making business decisions that could conflict with Canadian interests but serve the agenda of the authoritarian Communist Party of China.[58]

Moreover, while Western nations have been attempting to lower governmental profiles in the economy, China is moving in a different direction. Notwithstanding Western demands to reform China's governance model by reducing the state's role, state-control is increasing and CCP representatives are increasingly embedded inside presumably private corporate actors.[59] Claims that an ostensibly private market actor,

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56. Lin & Milhaupt, *supra* note 53, at 22 (emphasis added).

57. *See* Qingjiang Kong, *Emerging Rules in International Investment Instruments and China's Reform of State-owned Enterprises*, 3 CHINESE J. GLOBAL GOVERNANCE 57, 73 (2017) ("SOEs are exactly established to execute national strategic goals.").

58. Robert Fife & Steven Chase, *Trudeau Cabinet Blocks Chinese Takeover of Aecon over National Security Concerns*, GLOBE & MAIL (May 23, 2018), https://www.theglobeandmail.com/politics/article-ottawa-blocks-chinese-takeover-of-aecon-over-national-security/ [https://perma.cc/9XTZ-8D2P] (emphasis added).

59. *See* Frank Tang, *China Ignoring US Demand for Trade War Reform by Reinforcing State-directed Economic Model*, SOUTH CHINA MORNING POST (July 13, 2019, 8:30 PM), https://www.scmp.com/economy/china-economy/article/3018120/china-ignoring-us-demandtrade-war-reform-reinforcing-state [https://perma.cc/RZV4-9RHH] ("The consolidation of state-owned enterprises has also touched local government-owned firms, especially those in resources, port and overcapacity industries. In the first half of this year, controlling stakes in at least four listed firms, including Hainan Strait Shipping and Maanshan Iron & Steel, have been shifted from local governments to the SASAC. Also on Monday, filmmaker Huayi Brothers Media joined the growing ranks of leading private firms that have set up Communist Party cells within their organisations. Similar party organs have been established in more than 1.5 million non-public corporations nationwide, official data showed.").

Huawei, is not subject to governmental control have been questioned.[60] In addition to "pure" national security related concerns, traditional corporate governance concerns also exist with governmental share ownership and are inter-related to security issues.

### *B. Corporate Governance Concerns*

China's corporate governance model shares some similarities with Western models. For example, Chinese law requires independent directors,[61] and businesses are encouraged to make a profit. Therefore, in a sense, China's model may be considered simply another version of governance. After all, "[t]here's not just one market economy model. It is even different among developed countries. . . ."[62]

However, China's model is inherently different from the model in Western nations since, as noted above, the state is often the controlling or dominant stakeholder. "This Party-state-centric networking phenomenon, in our view, is a distinguishing characteristic of Chinese state capitalism."[63] And controlling ownership is a fundamentally transformative concept in corporate governance. Controlling owners may directly lead to control-agency conflicts or extraction of corporate knowledge that impinges on national security. A controlling owner's self-interest may collide with the interest of minority shareholders and significantly impact the directors' and managers' decisions. This is no different than a controlling owner engaging in conduct that benefits the controlling shareholder at the expense of the minority shareholders or other stakeholders. The extraction of benefits which are substantially more advantageous to the controlling owner is an endemic governance problem.

Significant shareholders may reap significant secondary awards, such as close communications with senior executives and directors, visits to a

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60. *See infra* notes 106–108 and accompanying text (discussing whether Huawei is subject to government control).

61. *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, CHINA SEC. REG. COMMISSION art. I(3) (Aug. 16, 2001), http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69191.html [https://perma.cc/U8RA-Q2W9] ("All domestically listed companies shall make necessary amendments to the articles of association in accordance with the requirements set in the Guidelines and appoint qualified persons to be independent directors.").

62. *See* Tang, *supra* note 59 ("Li Yiping, a professor of economics at Renmin University, defended China's growth model, saying it already had characteristics in common with market economies, including corporate entities with clear ownership, market mechanisms that played a decisive role in resource allocation, and a role for government to provide necessary public services and development guidance.")

63. Lin & Milhaupt, *supra* note 53, at 33.

corporation and product demonstrations—all manifestations of a classic control-agency corporate governance issue.[64] The ability to elect directors, direct corporate affairs, and extract proprietary information can be used to further a foreign government's interests.

For profit-seeking controlling shareholders, it is all about prioritizing their own economic interests. But controlling, foreign-government shareholders may be interested in prioritizing the state's interests. Significantly, prioritizing the state usually does not lead to superior financial results.[65]

> [D]espite the fact that [privately-owned enterprises] are more profitable than the state-owned/linked issuers . . . [p]roceeds of bond issues by state-owned/linked issuers have been used largely to finance construction, real estate, infrastructure, and mining. Bond issues by [privately-owned enterprises] have financed a broader spectrum of industrial sectors. . . . The regulatory competition that has partially fuelled explosive growth in bond issues, therefore, has principally benefitted state actors.[66]

Corruption at government-owned and controlled entities is known to lead to inefficiencies and a lack of productivity. Government-owned corporations are known to be inefficient, distort economic performance and create financial instability risks. "Recent experience has shown that State-Owned Enterprises (SOEs) can be an important source of concerns in at least three areas: market functioning, public finances and financial

64. *See* Zohar Goshen & Assaf Hamdani, *Majority Control and Minority Protection*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 450 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) (noting the numerous benefits that accrue to important shareholders).

65. *See* Lin & Milhaupt, *supra* note 53, at 33–34 ("The state capitalist approach has fostered tremendous growth in the issuance of corporate debt instruments, but it is not obvious that the consequences are favourable for China. The very entities that are underserved by the banking system and equity markets—POEs and SMEs—have benefitted the least from development of the corporate bond market. Instead, benefits have disproportionately flowed to the state sector: in fact, the principal role of the corporate bond market has been to *supplement* the loan market as a privileged financing channel for SOEs. It has played this role by providing even lower cost financing to SOEs than is available in the loan market and by creating a means of circumventing bank lending limits to favoured SOE borrowers. Meanwhile, the rapidly developing shadow banking system (discussed below), illustrates the limitations of the corporate debt market as a financing channel for SMEs. In short, instead of developing a competitive bond market with diverse products serving multiple classes of credit-worthy issuers, the Chinese government's approach has been to prioritize SOE interests in a tightly managed market that is simultaneously massive in scale and seriously underdeveloped institutionally.").

66. *Id.* at 22–23.

stability."[67]

Generally, state-owned or controlled entities are beset with a lack of productivity and endemic corruption.[68] For example, persistent corruption issues in Brazilian SOEs highlight the risk of governmental involvement in private corporations.[69] Thus, the potential problems when the state is a large investor are not just national security; there are traditional, corporate governance conflicts of interest as in any corporation with a dominant or controlling shareholder. There is widespread agreement that EU SOEs must be reformed to address general governance problems, market inefficiencies and risks to economic stability. China itself has acknowledged the crucial need to reform its inefficient SOEs.[70]

Therefore, even assuming, *arguendo*, that foreign-government shareholders will not leverage their holdings to transfer technology to their home governments, poor corporate governance by itself risks financial stability and constitutes a threat to national security.[71] Financial stability is a crucial objective of sovereigns, and lackluster corporate governance presents a serious risk to financial stability.[72]

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67. EUROPEAN COMM'N, STATE-OWNED ENTERPRISES IN THE EU: LESSONS LEARNT AND WAYS FORWARD IN A POST-CRISIS CONTEXT 5 (2016), https://ec.europa.eu/info/sites/info/files/file_import/ip031_en_2.pdf. [https://perma.cc/EV4N-MNS9]

68. *See* Steven T. Kargman, *Venezuelan Debt* Conundrum, Int'l Econ., Spring 2019, at 38, http://kargmanassociates.com/TIE(Spring'19)--S.Kargman--VenezuelanDebtConundrum.pdf [https://perma.cc/F245-9E6L] (discussing the dismissal of professional managers at a Venezuelan SOE, their replacement with politically connected personnel and the resulting severe adverse effects on the business).

69. *See* MARCELO PADUA LIMA ET AL., GLOBAL LAW - LEGAL ANSWERS FOR CONCRETE CHALLENGES 122 (Maria Lucia Labate Mantovanini Padua Lima & José Garcez Ghirardi eds., 2018) (using Petrobras as an example of corruption issues in SOEs and stating that "supplier firms and operators in the Petrobras drilling process 'coincidentally' have as shareholders some of the same construction & contractor enterprises").

70. *See* Wendy Leutert, *Challenges Ahead in China's Reform of State-Owned Enterprises*, 21 ASIA POL'Y 83, 86 (2016), https://www.brookings.edu/wp-content/uploads/2016/07/Wendy-Leutert-Challenges-ahead-in-Chinas-reform-ofstateowned-enterprises.pdf [https://perma.cc/AUG3-6HEC] ("The Xi Jinping administration has identified the reform of state-owned enterprises (SOE) as an essential step in the structural transformation of China's economy.").

71. Good corporate governance is essential for financial stability.

72. *See* Guido Ferrarini, *Understanding the Role of Corporate Governance in Financial Institutions: A Research Agenda* 15 (European Corp. Governance Inst., Working Paper No. 347/2017, 2017), https://ecgi.global/sites/default/files/working_papers/documents/347-2017.pdf [https://perma.cc/2YEC-MFRV] ("Governments and regulators rely on corporate governance as a complement to financial supervision, which explains why regulation is on the rise in this area. In brief, regulation requires boards of directors and their risk committees to oversee the undertaking and management of risks by financial institutions. Board members of financial institutions are subject to regulatory duties, which specify their

The serious risk to financial stability is exemplified by a "mountain of bad loans" on the books of China's state-owned banks which is proximately caused by China's state-capitalism corporate governance.[73]

> China's banks may have a flood of bad loans waiting in the wings. Not that you'd know it from looking at *official levels* for 2018, which suggest the problem was broadly contained. The reality is that newly soured debt was coming through the front door as fast as banks could shovel it out the back.[74]

The potential scale of the problem is staggering:

> China's central bank, concluding its first review into industry risks, said in November that about one in 10 of the nation's 4,000 banks received a "fail" rating. . . . Jason Bedford, a UBS Group AG analyst who had flagged the problems at Baoshang and Jinzhou, says China's smaller banks face a potential capital shortfall of 2.4 trillion yuan ($340 billion). He estimates the size of assets "in distress" held by a broader universe of Chinese lenders at 9.2 trillion yuan -- about 4% of the commercial banking system and nearly 10% of gross domestic product.[75]

Being foreign government controlled entities, state-owned banks may implement the foreign government's interest of providing credit even if the borrowers should not have qualified. Losses at state-owned banks may be tolerated as a trade-off to advance a governmental interest. In contrast, such losses would be unacceptable in a profit-seeking governance architecture.

> Chinese lenders are sitting on more than 2 trillion yuan ($295 billion) of soured loans after flooding the financial system with cheap credit for years to prop up economic growth. . . . Bad loans may keep piling up as the government pushes banks to lend more to risky small and private businesses to reinvigorate the

monitoring tasks and the ways in which they should perform the same in the interest of financial stability.").

73. *See* Christopher Balding, *China's Banks Have a Hidden Wave of Bad Debt*, STRAITS TIMES (Mar. 18, 2019, 9:52 AM), https://www.straitstimes.com/business/banking/chinas-banks-have-a-hidden-wave-of-bad-debt [https://perma.cc/SLR2-DYK4] ("These issues may require backstopping by the People's Bank of China to succeed. The central bank last month swapped 1.5 billion yuan of its one-year bills for perpetual bonds, the first use of a new tool aimed at increasing market acceptance of the securities and encouraging commercial lenders to sell more.").

74. *Id.* (emphasis added). Moreover, official disclosures may be subject to nuanced "massaging" for either domestic or global consumption.

75. Bloomberg News, *supra* note 55.

economy.[76]

If a foreign government invests in the financial services sector and has a motivation to direct loans to borrowers that ordinarily do not qualify, financial stability is at risk. There is a real risk of some lenders becoming "wiped out" as a result of unwise lending practices. Indeed, the risk of allowing China's banks to cause financial instability has led China to increasingly intervene.[77] "[E]arly last year . . . all lenders were forced to reclassify loans overdue for more than 90 days as non-performing. The move soon led to a *record* quarterly surge in soured debt and *wiped-out* capital at some small lenders."[78]

And while China's regulators recognize the moral hazards of state capitalism,[79] China is reluctant, for good reason, to allow market forces to cause severe damage to financial stability, underscoring that stability is a national security issue.[80] By no means is this a criticism of China. Western nations are also grappling with moral-hazard questions. Even the United States, the quintessential shareholder-value private market model, has engaged in state capitalism. For example, to avoid a collapse of "TBTF"[81]

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76. *China to Impose Stricter Policy on Bad-Loan Recognition*, BLOOMBERG (May 6, 2019), https://www.bloomberg.com/news/articles/2019-05-06/china-is-said-to-impose-stricter-policy-on-bad-loan-recognition [https://perma.cc/57FX-8P6Y] [hereinafter *China to Impose Stricter Policy*].

77. *See China to Buy Stake in Another Troubled Regional Bank: Report*, BUS. TIMES (Aug. 9, 2019, 1:55 PM), https://www.businesstimes.com.sg/banking-finance/china-to-buy-stake-in-another-troubled-regional-bank-report [https://perma.cc/H59C-Y25X] ("If confirmed, it would be the third rescue of a regional lender engineered by authorities in less than three months. Hengfeng, based in China's Shandong province, declined to immediately comment.").

78. *China to Impose Stricter Policy*, *supra* note 76.

79. *See* Shuli Ren, *Why China Has Chickened Out of Another Bank Seizure*, BLOOMBERG (July 28, 2019, 11:19 PM), https://www.bloomberg.com/opinion/articles/2019-07-29/why-china-has-chickened-out-of-another-bank-rescue [https://perma.cc/D9FU-5H6R] ("The PBOC tried to do the right thing with the Baoshang takeover. But now, fearful of market jitters, the central bank is chickening out. Instead, China has resorted to the old trick of a national team rescue, which does little to break the implicit guarantee of state support."); *see also* Nathaniel Taplin, *Another Month, Another Chinese Bank Bailout*, WALL ST. J. (July 26, 2019, 8:12 AM), http://www.wsj.com/articles/another-month-another-chinese-bank-bailout-11564142953 ("To calm things down, the central bank not only injected massive amounts of cash into the banking system but also walked back its initial tough stance. A central bank-affiliated newspaper reported that 99.98% of Baoshang's corporate creditors were being fully repaid.").

80. *See* Taplin, *supra* note 79 ("Beijing dislikes bailing out state companies—particularly banks—but can't seem to kick the habit.").

81. *See* Eric Dash, *If It's Too Big to Fail, Is It Too Big to Exist?*, N.Y. TIMES (June 20, 2009), https://www.nytimes.com/2009/06/21/weekinreview/21dash.html?partner=rss&emc=rss (describing how the term "too big to fail" was coined in the 1980s to argue that the

American banks and prevent contagion of financial instability, the U.S. entered the financial markets to rescue important financial institutions.[82] Free-market economies are certainly subject to the fluctuations and systemic risk of a free market, but there is no reason to add an additional threat to financial stability. Wide-scale, foreign-sovereign ownership of financial services institutions poses financial stability risks not merely from a national security standpoint, but from the potential misdirection and instability caused by poor corporate governance. If foreign-government buyers can influence financial institutions to make business decisions that benefit endemically under-performing state actors, then there is a substantial risk to financial stability.

## IV. FOREIGN GOVERNMENT INVESTORS

Foreign government controlled sovereign wealth funds (SWFs) are major stock market investors and have the capacity to control large swaths of economic activity. SWFs are already buying shares in publicly traded companies. "CIC invests in a wide range of financial products globally, including public equity, fixed income, alternative assets and cash and others. Public equity refers to equity investment in listed companies."[83]

Banks and other vital financial services enterprises, such as investment banks, are attractive targets of foreign adversaries.

> Nation states, either directly or working through proxy actors, have already demonstrated a willingness and capability to target global financial services infrastructure. North Korean cyber attacks against the financial sector, for instance, are highly connected to the U.S. sanctions regime; Pyongyang has circumvented sanctions and funded its nuclear program through, among other things, a series of heists using SWIFT, a global messaging system, against the Bank of Bangladesh in 2016 and Taiwan's Far Eastern Bank in 2017. The Iranian DDoS attacks against the U.S. financial sector between 2011 and 2013 and the North Korean attack against South Korean banks in 2013 are other notable examples. Beyond criminal entities, the

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government must prevent a bank—if it is too large—to fail and therefore damage the wider economy).

82. Such as Citibank, AIG, and auto companies. *See also* Joel Slawotsky, *Reining in Recidivist Financial Institutions*, 40 DEL. J. CORP. L. 280 (2015) (discussing reasons such as the revolving door, little risk of prison and profits dwarfing the fines imposed as encouraging reckless conduct).

83. *Portfolio Structure*, CHINA INV. CORP., http://www.china-inv.cn/chinainven/Investments/Portfolio_Management.shtml [https://perma.cc/NL7D-NGRM].

> actors targeting financial institutions are highly capable states, such as Russia, China, Iran, and North Korea, or proxy actors enabled by these governments.[84]

As an alternative to cyber-attacks, foreign states may opt to gain a foothold in the banking sector, thus providing extraordinary leverage and potential influence in another economy. By controlling financial services companies as shareholders, states can direct lending activities towards certain sectors and can have influence over significant sums of capital. Moreover, "the reality is that U.S. banks, in many respects, are already enforcement arms of U.S. foreign policy."[85] Major shareholders are empowered to elect directors who in turn hire the officers. It would be sensible to presume that legal due diligence with respect to foreign sovereign shareholders may be lackluster at best and at worst stonewalled. This may simply be a corporate governance conflict of interest. One need only examine the repeated serial misconduct of financial institutions to appreciate that engaging in illegal activities such as money laundering, if directed or encouraged by significant shareholders, is a reasonably likely occurrence.[86] Furthermore, the risk that foreign government shareholders may seek to influence a U.S. financial institution is probable given the global nature of many such institutions (i.e., these financial services companies have operations overseas and may need the goodwill of foreign governments). It is one thing to seek the good graces of a government and quite another when that government's representatives are in key corporate positions.

State-owned foreign banks have already expanded overseas by investing in financial institutions located in other jurisdictions. "Chinese banks established themselves in the country or acquired shares of Brazilian or international banks already operating in Brazil."[87]

Over the long-term, foreign sovereign control over companies through influence, election of directors or shareholder activism can substantially

84. Borghard, *supra* note 10.

85. *Id.*

86. *See* Slawotsky, *supra* note 82, at 316 ("The criminal behavior of the financial services industry is not limited to a specific area of misconduct. To the contrary, corrupt behavior is widespread and envelops a wide array of conduct. Iconic financial institutions involved in serious wrongdoing include: JPMorgan ($13 billion); BNP ($10 billion); Citigroup ($7 billion); HSBC ($1.9 billion); Standard Chartered ($667 million); ING ($619 million); Credit Suisse ($536 million); Lloyds TSB Group ($350 million); and Barclays ($298 million).").

87. CHINA-BRAZ. BUS. COUNCIL, CHINESE INVESTMENTS IN BRAZIL 8 (2017), https://www.cebc.org.br/sites/default/files/investimentoschinesesnobrasil2016_en.pdf. [https://perma.cc/YR48-5LPW]

impact the host nation.[88] "States and corporations are now capable of deploying forces in the field—sometimes states hire corporations that serve as mercenary armies that protect its own operations as well as those of the institutions of the state from sub-national and supra-state threats."[89]

Shared ownership of critical corporations by foreign governments enables foreign governments to exercise influence and possible control over another state, or alternatively at a minimum, become embedded in vital economic sectors. Deployment of corporate power is a potential security threat inasmuch as domestic financial stability, technological prowess, and critical industries can be threatened. Therefore, corporate share ownership and national security are now inextricably linked.

Further incentivizing foreign governmental share purchases, the acquisition of shares on the open market is generally "quieter" than media announcements of a full take-over, a joint venture or a large private investment. For example, China's Ant Financial sought to buy MoneyGram in a large transaction,[90] but the deal was blocked by CFIUS on national security concerns. But Ant was able to, and indeed did acquire, small stakes in global companies which jointly may result in significant foreign influence in the global financial services sector.[91] The accumulation of shares may in fact be completely without notice, particularly if, for example, the number of shares is below the reporting threshold of a sovereign's securities regulations. As such, buying shares as opposed to large deals or ventures—which are likely to be scrutinized—is likely to become more common.

Conversely, control and ownership of important corporations can also

88. Larry C. Backer, *Sovereign Investing and Markets-Based Transnational Rule of Law Building: The Norwegian Sovereign Wealth Fund in Global Markets*, 29 AM. U. INT'L L. REV. 1, 92–94 (2013); *see also* Joel Slawotsky, *Sovereign Wealth Funds as Emerging Superpowers: How U.S. Regulators Should Respond*, 40 GEO. J. INT'L L. 1239, 1255 (2009) (discussing ways in which sovereign wealth funds pursue shareholder activism).

89. Catá Backer, *supra* note 49, at 50.

90. *See* Greg Roumeliotis, *U.S. Blocks MoneyGram Sale to China's Ant Financial on National Security Concerns*, REUTERS (Jan. 2, 2018, 3:36 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 [https://perma.cc/J4G7-Y34Z] ("The MoneyGram deal is the latest in a string of Chinese acquisitions of U.S. companies that have failed to clear CFIUS.").

91. *See* John Jannarone, *China's Ant Financial to Buy $100 Million of Brazil's Stone Shares After IPO*, YAHOO FIN. (Oct. 22, 2018), https://finance.yahoo.com/news/china-ant-financial-buy-100-203140637.html [https://perma.cc/62TQ-ANEV] ("Chinese fintech firm Ant Financial has agreed to buy $100 million of shares in Brazilian digital-payments company StoneCo (ticker: STNE), adding to a list of high-profile buyers that have taken interest in the IPO slated to price this week at a valuation of up to $6.2 billion.").

be used defensively; a state's purchase of shares can be a measure employed to thwart losing industrial and technological superiority, or to defend economic strength.[92] In one example, the Finish Government—through a sovereign investment fund—acquired a stake in Finnish national champion Nokia.[93]

In another example, Germany is planning to acquire stakes in national industrial champions.

> Germany could take stakes in companies to prevent foreign takeovers in some key technology areas, Economy Minister Peter Altmaier said on Tuesday, presenting a new industrial strategy he said was necessary for the country's cohesion. The pivot to a more defensive industrial policy is driven by German concerns about foreign—particularly Chinese—companies acquiring German know-how and eroding the manufacturing base on which much of Germany's prosperity is built.[94]

Governments are likely to increase investments in stock markets as the nascent hegemonic rivalry becomes increasingly linked to economic and technological supremacy, both as an offensive tactic as well as defensive tool.

Therefore, a vital issue arising from the intersection of national security and publicly traded shares is to what extent sovereigns wish to limit other nations' investments in domestic stock markets and whether a lower threshold of disclosure can identify such investments. This heightened concern over shareholder ownership needs to be balanced so as to avoid protectionism and limiting the ability of domestic businesses to attract investment capital. However, in light of the hegemonic rivalry and burgeoning national security concerns, updating regulations is an essential defensive measure taken to thwart losing industrial and technological superiority.[95]

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92. *See* Reuters, *Germany Ready to Buy Stakes in Automakers, Other Companies to Protect Them*, AUTOBLOG (Feb. 5, 2019, 2:30 PM), https://www.autoblog.com/2019/02 /05/germany-buy-stakes-automakers-protection/ [https://perma.cc/96MC-2HAN] (discussing how Germany is acquiring shares to prevent a foreign government from controlling corporations).

93. *Finnish Government Buys Stake in Nokia*, FIN. TIMES (Mar. 13, 2018, 12:41 PM), https://www.ft.com/content/8a6741b8-26a9-11e8-b27e-cc62a39d57a0 [https://perma.cc/2ZY4-PN43].

94. Reuters, *supra* note 92.

95. *See* Sterling, Hepher & Kar-Gupta, *supra* note 51 ("Shares in Air France-KLM fell sharply as the Dutch government amassed a 14 percent stake in the airline to counter French influence, in a surprise move highlighting tensions over the company's strategic direction.").

## V. UPDATING SECURITIES REGULATION: DISCLOSURE OF OWNERSHIP

While envisaged as enabling the free flow of transparent information and informing company management and market regulators, the disclosure regime can now also serve to alert sovereigns of threats to national security. Militating strongly in favor of heightened disclosure is the fact that it is plausible that foreign government ownership of publicly traded shares is vastly underestimated. Many shareholdings are unknown and undisclosed. "Importantly, the available figures underestimate the true size and scope of China's ambitions in Europe . . . [N]ot included: greenfield developments or stock-market operations totaling at least $40 billion. . . ."[96]

In many jurisdictions a buyer must disclose the acquisition of 4.9% of the shares of a public company.[97] For example, in the United States, the Williams Act obligates disclosure of a 4.9% holding within 10 days and was designed to "close a significant gap in investor protection under the Federal securities laws by requiring the disclosure of pertinent information."[98] Interestingly, the background to this statute was in fact concern over a foreign buyer seeking shares in domestic U.S. corporations.[99]

To evade U.S. filings, foreign governmental entities could buy small

96. Andre Tartar, Mira Rojanasakul & Jeremy Scott Diamond, *How China Is Buying Its Way Into Europe*, BLOOMBERG (Apr. 23, 2018), https://www.bloomberg.com/graphics/2018-china-business-in-europe/ [https://perma.cc/G7KF-86JS] (emphasis added).

97. *See* 15 U.S.C. § 78m(d) (2018) (requiring public disclosure upon ownership of 5% of a public company's shares); *see also* OECD, DISCLOSURE OF BENEFICIAL OWNERSHIP AND CONTROL IN LISTED COMPANIES IN ASIA (2016), https://www.oecd.org/daf/ca/Disclosure-Beneficial-Ownership.pdf [https://perma.cc/B983-WCDF] (stating that numerous nations, including in Asia, have the 5% rule). *Compare* Jeffrey Roberts, *UK Shareholder Activism: A Toolbox for 2014*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Mar. 2, 2014), https://corpgov.law.harvard.edu/2014/03/02/uk-shareholder-activism-a-toolbox-for-2014/ [https://perma.cc/V8AX-VG5S] (describing the UK's requirements of 3% or 5%), *with* ISRAELI GOV'T, SELF ASSESSMENT ACCORDING TO METHODOLOGY FOR ASSESSING THE IMPLEMENTATION OF THE OECD PRINCIPLES ON CORPORATE GOVERNANCE (2008), http://www.isa.gov.il/Download/IsaFile_7411.pdf [https://perma.cc/K2X9-JSB] (describing Israel's 5% requirement), *and* ALLENS, THE ALLENS HANDBOOK ON TAKEOVERS IN AUSTRALIA (2019), https://www.allens.com.au/globalassets/pdfs/sectors-services/ma/takeovers-handbook.pdf [https://perma.cc/2B2J-59GZ] (describing Australia's 5% requirement).

98. 113 CONG. REC. 854 (daily ed. Jan. 18, 1967) (statement of Sen. Williams).

99. Mariana Pargendler, *The Grip of Nationalism on Corporate Law* 31 (ECGI Working Paper Series in Law, Working Paper No. 437/2019, 2019), https://ecgi.global/sites/default/files/working_papers/documents/finalpargendler1.pdf [https://perma.cc/C7NS-SQHM] ("It is revealing, however, that the enactment of the Williams Act of 1968—the only piece of U.S. federal legislation targeting hostile takeovers to date—had the foreign takeover threat against Columbia Motion Pictures as its poster child for the perils of unregulated acquisition markets.").

stakes in companies—essentially flying under the radar—and acquire less than 4.9% of the shares without reporting.[100] Furthermore, modest share purchases among several like-minded foreign governmental entities could, when combined, present an intriguing method of acquiring a dominant or even controlling influence over a publicly traded company.

Generally, the regulatory response is to treat buyers working as a "group" jointly. Accordingly, two or more persons who have agreed to act together are treated as a single purchaser and their several ownership stakes are aggregated.[101] Thus, two foreign governmental entities individually owning 2.5% will be obligated to file a disclosure statement if they are working together as a group.[102] The controlling inquiry in determining whether a group is formed is whether two or more parties acted in concert with the specific "purpose of acquiring, holding, or disposing of securities."[103] Notwithstanding the fact a group may be found even if no formal agreement is created,[104] foreign government buyers are likely to

100. *But see* 15 U.S.C. § 78m(f) (2018); 17 C.F.R. 240.13f (2018) (stating that all institutional investment managers of funds in excess of $100 million are subject to the disclosure provisions of section 13(f) of the Securities Exchange Act, which requires quarterly disclosure of major holdings.) However, 13F is not always relevant nor adhered to. *See, e.g.*, David Barboz & Keith Bradsher, *China Lists $9.6 Billion in Shares of U.S. Companies*, N.Y. TIMES (Feb. 8, 2010), https://www.nytimes.com/2010/02/09/business/global/09invest.html [https://perma.cc/V2H8-SXJT] (reporting that Chinese SWF did not report on 13F until 2010). In addition, in some nations the lack of transparency may result in creative structuring enabling investment managers to "manage less than $100 million," thereby obviating the 13F disclosure requirement. Yet even more significantly, 13F is only applicable to institutional managers—mutual funds, hedge funds, trust companies, pension funds, insurance companies and registered investment advisers. If the foreign governmental entity buying the shares is not one of these types of managers (i.e., it is an ordinary business), the 13F disclosure is irrelevant.

101. 15 U.S.C. § 78m(d)(3) (2018) ("When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for the purposes of this subsection.").

102. *Id.*; *see also* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance* 28–38 (Ctr. for Law and Econ. Studies, Colum. Univ. Sch. of Law, Working Paper No. 521, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2656325 [http://perma.cc/EJT2- 8PFX] (discussing "wolf-pack" tactics and stating that "if three 'persons' each acquire 2% of the stock in a target company and their relationship makes them a 'group', their shares are aggregated by Section 13(d), which treats them as a single 'person' who must file a Schedule 13D").

103. 15 U.S.C. § 78m(d)(3) (2018); *see also* CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 284 (2d Cir. 2011) ("[T]wo or more entities do not become a group within the meaning of section 13(d)(3) unless they 'act as a . . . group for the purpose of acquiring . . . securities of an issuer.'")

104. CSX Corp., 654 F.3d at 283–84 (holding that without evidence supporting that members of the alleged group reached an understanding for the specific "purpose of either

employ sophisticated legal avoidance tactics with counsel advising how to avoid the trappings of forming a "group."

Another tactic to evade "group action" is by imitating hedge fund and other activist investors in conduct known as wolf-pack investing.[105] Wolf-pack investing has become a routine stratagem, particularly by hedge funds, to take on a stake and obtain transformational corporate changes, including the break-up of a company. The tactic is a successful model where similar-minded institutions do not conspire, but often acquire stakes in a company in the same general time frame in order to extract benefits for themselves. Foreign governmental investors might engage in this conduct as well. Wolf-pack investing could potentially be employed for strategic motivations as well (i.e., diminishing the relative strength of a rival's industrial or technological sector). While wolf-pack investing is permissible under existing securities regulation, the injection of national security is a factor that may alter the legality of multiple government investors so acting. This potential should be addressed by securities regulators.

### *A. Defining Foreign Governmental Investors*

A crucial preliminary issue is defining the trigger for "control" for purposes of securities regulation. How should control be conceptualized when the share buyer is potentially a foreign government controlled entity? The question is complicated given some jurisdictions' lack of transparency or different conceptualizations of ownership. Private corporations may in fact be under the ultimate influence and direction of a foreign government. In addition, there may simply be a lack of disclosure in home nations, thus clouding the true structure. Alternatively, there may be intentional obfuscation and evasion. Therefore, bright line tests may constitute an ineffective marker of foreign governmental control.

A foreign government owned entity may be one with even a relatively modest percentage of share ownership or even "zero" share ownership. Indeed, with respect to China for example, "the majority share of state is not a determinative factor as to the 'meaningful control' of the government

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acquiring, holding, voting or disposing of securities[,]" it will be difficult to prove a group has been formed).

105. *See* Joel Slawotsky, *Hedge Fund Activism in an Age of Global Collaboration and Financial Innovation: The Need for a Regulatory Update of United States Disclosure Rules*, 35 REV. BANKING & FIN. L. 275, 279 (2015) (describing hedge fund activism via wolf-pack investing).

and much less to the requirement of 'governmental authority.'"[106]

Illustrative of the problematic nature of understanding the ownership structure of foreign corporations is Huawei, whose shares are not publicly traded and therefore is ostensibly a purely private market actor. Huawei states that "Huawei is an independent, privately-held company. We are not owned or controlled by, nor affiliated with the government, or any other 3rd party corporation."[107]

Yet Huawei's connections to the Chinese Government are unquestionable.[108] Whether those ties result in control is certainly a plausible scenario. Although Huawei's shares are evidently 100% owned by a holding company, the holding company is 1% owned by Huawei's founder and 99% owned by a trade union committee which may simply be a proxy for, or in fact, a government organ. "Given the public nature of trade unions in China, if the ownership stake of the trade union committee is genuine, and if the trade union and its committee function as trade unions generally function in China, then Huawei may be deemed effectively state-owned."[109]

Therefore, defining foreign government control over a buyer may be more complicated than merely examining the percentage ownership. While bright-line tests are important, opaque financial disclosures or purposeful disguising of governmental links may render a narrow set of specific benchmarks a failed identification system. Regulators will need to review disclosures (or the lack thereof) of investments in the context of these factors.

### *B. Suggested Modifications for Updated Regulation*

While addressing all of the issues raised is beyond the scope of this Article, several suggestions are made with respect to foundational issues. The key is a balance because attracting investors is crucial to economic health. Blanket protectionism should be avoided, but naïve policy in which critical sectors are bound to end up in a foreign adversary or competitor's hands risks a potentially disastrous national security violation.

106. Ding, *supra* note 38, at 179.

107. *Who Owns Huawei?*, HUAWEI, https://www.huawei.com/en/facts/question-answer/who-owns-huawei [https://perma.cc/Z8XP-Y6NA] (last visited Dec. 23, 2019).

108. Raymond Zhong, *Who Owns Huawei? The Company Tried to Explain. It Got Complicated*, N.Y. TIMES (Apr. 25, 2019), https://www.nytimes.com/2019/04/25/technology/who-owns-huawei.html [https://perma.cc/4ZMV-9L2A].

109. Christopher Balding & Donald C. Clarke, *Who Owns Huawei?* (Apr. 17, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3372669 [https://perma.cc/RQT6-3MXQ].

(1) Control needs to be conceptualized as the power to direct a company either through voting or via another means. Directing the company is essentially the policy making and implementation of the business. If the entity's directors or officers are elected, appointed or need to be "approved" by a governmental entity or organ, governmental control exists. As the U.S. SEC has noted, "the fact that officers and directors have the ability to directly or indirectly influence the management and policies of an issuer will generally render officers and directors unable to certify to the requirements" necessary to file as a passive investor.[110]

Empowerment to control may arise from a variety of sources, such as being a director, manager, shareholder, a direct or indirect parent entity, or by other means being enabled to control, direct, or supervise a business. Therefore, foreign government owned or controlled entities should be defined broadly and include any entity with *any* of the following attributes constituting control: the extent of direct or indirect government ownership; government veto power over any transactions; government ability to appoint any directors, executives, managers of the entity or any other power that would indicate the reasonable likelihood *of governmental influence and ability to direct the entity*. The definition should avoid any bright-line tests and must be sufficiently broad to be liberally inclusive. Otherwise, the definition risks easy governmental manipulation to evade the entity being defined as a foreign government owned or controlled shareholder.

(2) Securities laws should establish a requirement that any foreign government owned or controlled entity be required to report share purchases of 1% or more of any publicly traded company. The disclosure should be made immediately or within one day of acquisition. This requirement is designed to be a strict reporting threshold to alert regulators and national security monitors that a company, or perhaps a specific industry or economic sector, has been targeted by foreign governments. The disclosure should at a minimum: identify the name, address and citizenship, place of organization of the buyer; the amount of the securities beneficially owned and total beneficial ownership percentage; the source and amount of funds provided, or any other consideration, financial or otherwise, used to purchase the shares and disclose whether voting rights are held solely by the reporting persons or shared with any other party and identify the same.

110. Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, U.S. SEC. & EXCHANGE COMMISSION (July 14, 2016), https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm [https://perma.cc/C969-6S4F].

Further disclosure should be mandatory if any material change ensues to the filed report, including additional purchases of 0.5% of the shares of the company.

(3) The United States should establish a list of industries, economic sectors or specific companies for which foreign governmental share ownership is capped at a specific percentage or possibly banned. For example, while precluding foreign governmental ownership of defense contractors may be sensible, a total ban on investing in auto manufacturers may hinder obtaining vital investment capital. In the latter example, perhaps limiting each foreign government to a 4% stake, and permitting up to a 10% total stake by unrelated governments, may offer a more balanced approach.

(4) A presumption should exist that multiple foreign government owned buyers from the same nation are acting as a group. This is sensible inasmuch as the ultimate owner is the same foreign government. A question arises as to whether the presumption should be rebuttable, and if so, under what circumstances. Given the sensitive nature of specific sectors and the fact that some sectors which may not be sensitive might become so in the future, a prudent approach might be to have the presumption irrefutable at least with respect to specific sectors.

(5) The United States should issue a rule whereby foreign governments and government-controlled buyers are required to formally disclose all public shareholdings on a quarterly basis. This disclosure will serve to alert regulators and national security agencies of patterns of ownership in particular companies or economic sectors. This may be helpful in the context of domestic investment screening regimes, such as the United States' CFIUS mechanism. This will also eviscerate the potential of foreign government share buyers not coming within a disclosure regime such as the United States' 13F rule. Regulatory bodies should also regularly cross-check and exchange information with allied nations to avoid "stock exchange shopping" whereby foreign adversaries may seek to gain influence and control in industries and sectors by investing in jurisdictions with a more lenient regulatory architecture.

## VI. CONCLUSION

The overall power of a sovereign is now substantially magnified by deploying economic might and technological prowess, as opposed to purely military capabilities. The willingness of nations to enter private markets and engage in cross-border investment is an important and transformative dynamic with immense implications. Sovereigns are empowered through shareholding to control corporations, and thus "conquer," or to substantially influence and control another sovereign's political governance, industrial strength and economic future.

Therefore, as control over infrastructure, technology and other crucial economic sectors may be vested with other states through foreign government controlled vehicles such as state-owned enterprises or sovereign wealth funds, business and economics become more inextricably linked to national security. State-owned entities have already entered the global markets and, as shareholders, have the potential capacity of controlling large swaths of economic activity. Over the long-term, foreign sovereign control over companies through friendly influence or shareholder activism can substantially impact the host nation. Obtaining economic leverage and technological prowess over an adversary through share accumulation and share voting provides a compellingly attractive alternative (with a potential benefit of profiting from such leverage and supremacy) to open military confrontation and the costs and risks of loss.

Indeed conquest, once conceptualized as a traditional, military-based attack involving human soldiers, fighter jets and tanks, is now achievable through election interference, hacking and cyber-attack on crucial infrastructure and other technologically based virtual operations without the need to cross a border. Technology can also play a pivotal role in a military confrontation. Robot soldiers can potentially replace human soldiers and physically invade another nation. Viruses could potentially cause power plants to explode or even cause military arsenals in an enemy nation to self-destruct. Hacking could enable an adversary to shut down defenses.

Given that threats to national security are no longer limited to pure military perils, defending national security will become increasingly interconnected with developing, controlling and exploiting technological innovation, as well as preserving domestic financial stability and core economic strength. Nations will need to evaluate these concerns and determine whether share ownership by foreign governments poses national security risks warranting a re-evaluation of shareholding regulation. While foreign investment review procedures such as the United States' CFIUS can serve as important vetting mechanisms, such regimes are focused on large transactions; share purchases will generally not be on the radar.

Therefore, securities regulation in the United States should be updated to reflect the transformational developments in emerging technology and threats to financial stability, both directly and indirectly, implicating national security concerns particularly in the context of the hegemonic rivalry. Foreign governmental entities purchasing shares should be more strictly monitored to ensure core economic sectors and emergent technology are protected. Legitimate governmental investors should not object to heightened disclosure and reporting requirements.