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The regulation of foreign direct
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THE REGULATION OF FOREIGN DIRECT INVESTMENT IN THE UNITED STATES OF AMERICA

TRADE NEGOTIATIONS OFFICE

GOVERNMENT OF CANADA

AUGUST 7, 1987

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The Regulation of Foreign Direct Investment In the United States of America

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The Regulation of Foreign Direct Investment

In the United States of America

EXECUTIVE SUMMARY

The United States monitors foreign investment under several statutes. The Agricultural Foreign Investment Disclosure Act and the International Investment Survey Act impose data reporting requirements. The Committee on Foreign Investment in the United States (CFIUS), an inter-agency Committee created in 1974, has powers to monitor and review investments made by foreigners, foreign governments or corporations controlled by governments which may have implications for U.S. national interests.

The U.S. federal government directly and indirectly restricts foreign investment in many "national interest" sectors, including the maritime, aviation, broadcasting and telecommunications, energy, certain natural resource, and defence sectors. In addition, many states impose some conditions on foreign ownership, particularly in real estate, insurance, mining and utilities.

The increasing flow of foreign direct investment into the United States is generating increased attention and concern within the U.S. This concern was expressed most recently by both the U.S. Administration and the U.S. Congress in the case of the attempted acquisition of a computer chip manufacturing company (Fairchild) by a Japanese multinational electronics firm (Fujitsu). It is also reflected in various amendments to U.S. trade legislation currently before the U.S. Congress which would impose stricter reporting requirements on foreign investors and provide the President with the explicit authority to restrict foreign investment in cases where the national interest is impaired by the investment.

A. Transportation

1. Aeronautics

1.1 Introduction:

There are significant restrictions on foreign participation in the U.S. aviation and aeronautics industry. The Federal Aviation Act states that in regulating the aviation industry the Civil Aeronautics Board (CAB) is to "facilitate adaption of the air transportation system to the present and future needs of the domestic and foreign commerce of the United States . . . and the national defense." The CAB is also to act in such a manner as to strengthen "the competitive position of United States air carriers to at least assure equality with foreign air carriers, including the attainment of opportunities for United States air carriers to maintain and increase their profitability, in foreign air transportation."

1.2 Aircraft Registration Requirements:

Under the Federal Aviation Act, only aircraft properly registered in the United States may transport passengers or cargo between points within the United States. (Foreigners may engage in "foreign air transportation," or the transportation of persons or property from outside the United States and its territories into the United States, in accordance with U.S. laws, regulations or treaties.)

Under the Act, an aircraft is eligible for registration in the United States under two different scenarios. First, a United States citizen or an individual citizen of a foreign nation who has been admitted for permanent U.S. residence may register an aircraft. The Act defines a U.S. citizen as:

(1) an individual who is a citizen of the U.S. or of one of its possessions; or

(2) a partnership, as long as each of its members is a United States citizen; or

(3) a corporation or association that is organized under the laws of the United States or of any State, provided that the president, two thirds of the board of directors and the other managing officers are individual citizens of the United States. Further, United States citizens must control at least seventy five percent of the voting interest in the corporation.

Second, an aircraft is eligible for registration if it is owned by a foreign corporation (that is, a corporation that does not qualify as a U.S. citizen) that is lawfully organized under the laws of the United States or of an individual State, so long as the aircraft is not registered under the laws of any foreign country and so long as the aircraft is primarily used in the United States. Under regulations of the Federal Aviation Administration, an aircraft is primarily used in the United States if for every six month period at least sixty percent of the flight hours of the aircraft are accumulated in the United States.

1.3 Acquisition of Control of a U.S. Carrier:

The Federal Aviation Act also prohibits any foreign air carrier or person controlling a foreign air carrier to acquire control "in any manner whatsoever" of any citizen of the United States "substantially engaged" in the business of aeronautics. Under the Act, whenever any person owns or controls in any manner ten percent or more of the voting stock or capital of an air carrier, it is presumed to be in control of the corporation, unless the Justice Department finds otherwise.

2. Marine

2.1 Introduction:

Some of the most substantial barriers to foreign investment in the United States relate to the maritime industry. The rationale behind the onerous restrictions on foreign participation in the maritime industry is the protection of national security. Section 1 of the Merchant Marine Act of 1920 states that: "It is necessary for the national defense and for the proper growth of its foreign and domestic commerce that the United States shall have a merchant marine of the best equipped and most suitable types of vessels sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency, ultimately to be owned and operated privately by citizens of the United States." This concern for the protection of national security through the maintenance of a strong merchant marine industry has led to restrictions on foreign participation in the coastal and foreign shipping trade of the United States, restrictions on foreign investment in the shipping construction industry, and restrictions on transfers of interests in U.S. flag vessels to non-U.S. citizens. The following discussion identifies the most significant impediments to foreign participation in each of these activities.

2.2 Barriers to Foreign Participation in the Coastal, Intercoastal and Inland Waters Trade:

Section 27 of the Merchant Marine Act of 1920, known as the Jones Act, generally prohibits foreign entry or operation in the U.S. coasting trade. The Act states: "No merchandise shall be transported by water, or by land and water, on penalty of forfeiture of the merchandise (or an equivalent monetary amount) between points in the United States, including Districts, Territories, and possessions thereof embraced within the coastwise laws, either directly or via a foreign port, or for any part of the transportation, in any other vessel than a vessel built in and documented under the laws of the United States and owned by persons who are citizens of the United States . . . ." The restrictions on engaging in U.S. coastal and domestic shipping trade fall into three categories: documentation requirements, citizenship requirements and construction requirements.

2.2.1 Documentation Requirements:

Subtitle II of the Shipping Act (46 U.S.C. 12102) (formerly known as the Vessel Documentation Act)provides that a vessel of at least five tons that is not registered under the laws of a foreign country is eligible for U.S. documentation if the vessel is owned by:

(1) an individual who is a citizen of the United States; or

(2) an association, trust, joint venture, or other entity-

(A) all of whose members are citizens of the United States; and

(B) that is capable of holding title to a vessel under the laws of the United States or of a state; or

(3) a partnership whose general partners are citizens of the United States, provided that United States citizens own the controlling interest in the partnership; or

(4) a corporation established under the laws of the United States or of a State, as long as its chief executive officer and the chairperson of its board of directors are citizens of the United States and as long as the directors who are U.S. citizens constitute a majority of the number of directors necessary to establish a quorum; or

(5) the United States Government; or

(6) the government of a State.

Under regulations issued by the U.S. Coast Guard and Department of Transportation, the only vessels that are exempt from documentation requirements are: vessels of less than five tons; vessels that do not operate on the navigable waters of the United States; and non-self-propelled vessels that are otherwise qualified to engage in the coastwise trade. (46 C.F.R. 67.01-7). Except for Great Lakes licenses and registry, where specific provision is made for trade with Canada, only a vessel eligible for documentation is eligible for registry and appropriate endorsements authorizing the vessel to be employed in the coasting trade. Accordingly, with certain exceptions, the effect of these documentation eligibility requirements is to close the U.S. coastal and intercoastal trade to foreign participants.

2.2.2 Citizenship Requirements:

Section 27 of the <u>Merchant Marine Act</u> requires that vessels engaged in the coasting trade be owned by U.S. citizens. Under the applicable regulations, an individual is a "citizen" if he is a native-born, naturalized, or derivative citizen of the United States, or otherwise qualifies as a U.S. citizen. Section 2 of the <u>Shipping Act</u> of 1916 provides that a business is a U.S. citizen for the purposes of vessel documentation when:

-- U.S. citizens hold at least a 75 percent ownership interest in the firm; and

-- in the case of a corporation, it is organized under the laws of the United States, and the chief executive officer and the chairman of the board are United States citizens and alien membership on the board is no greater than a minority of the number of directors required to constitute a quorum of the board.

Moreover, the seventy-five percent ownership requirement for a corporation is met only if:

-- the title to 75 percent of the stock is vested in U.S. citizens free from any trust or fiduciary obligation in favor of any person who is not a U.S. citizen; and

-- 75 percent of the voting power of such stock is vested in U.S. citizens; and

-- there are no contractual agreements or other understandings whereby more than twenty-five percent of the voting power may be exercised on behalf of a non-U.S. citizen.

U.S. courts have strictly construed the citizenship requirements for corporations. In Central Vermont Transp. Co. v. Durning, 294 U.S. 33 (1934), the Supreme Court upheld the seizure by a U.S. customs officer of merchandise being transported to New York City by a Maine corporation, Central Vermont Transportation Corporation (CVTC). The stock of CVTC was owned by another U.S. corporation, which in turn, was owned by a Canadian corporation. The Court held that CVTC did not meet the citizenship requirements of the law.

2.2.3 Construction Requirements:

Under the Merchant Marine Act of 1920, a vessel that was built outside of the United States may not engage in the coasting trade. Further, a ship originally documented under U.S. law but subsequently rebuilt cannot engage in the coastwise trade unless the entire rebuilding was done in the United States or its possessions. Thus, Canadian corporations generally may not build a vessel for use in the U.S. coastal trade.

2.2.4 Special Exceptions:

Although the documentation, citizenship and construction requirements in most circumstances bar Canadian citizens and companies from participation in the United States coastal trade, there are a few special exceptions. For example, a Canadian corporation may transport merchandise by vessel between points within the United States, including Alaska, when such merchandise as part of its journey also moves over rail lines that the Interstate Commerce Commission regulates, as long as these lines connect with Canadian rail lines. Further, the prohibition on foreign participation in coastal trade does not become

effective on the Yukon River until completion of the Alaska Railroad and until the Secretary of Transportation finds that U.S. citizens will furnish adequate facilities for proper transportation and handling of traffic along the Yukon River. The Merchant Marine Act of 1920 also allows the transportation of empty cargo vans, empty lift vans, empty barges, and empty tanks when foreign owners of a vessel use such containers in connection with their foreign trade cargo. However, this exception is only applicable if the country of the foreign vessel registry extends reciprocal treatment to U.S.-regulated vessels.

Another exception to the general prohibition on foreign participation in the coastal trade is available to a corporation engaged primarily in a manufacturing or mining industry in the United States. Vessels of such a corporation may engage in the coasting trade of the United States if:

- a majority of the officers and directors of such corporation are citizens of the United States;
- not less than ninety percent of the employees of such corporation are United States residents;
- the aggregate book value of the vessels owned by the corporation does not exceed ten percent of the aggregate book value of the corporation's assets;
- the corporation purchases or produces in the United States at least 75 percent of the raw materials used or sold in its operations.

Even if a corporation meets these requirements, however, it cannot participate in fishing activities in U.S. coastal waters. Further, it cannot transport merchandise or passengers for hire except as a service for a parent or subsidiary corporation.

2.3 Restrictions on Participation by Foreign Entities in Salvaging, Dredging and Towing Operations in U.S. Coastal and Intercoastal Waters:

Closely related to the restrictions on foreign participation in the coastal shipping trade of the United States are restrictions on foreign participation in salvaging, dredging and towing operations in U.S. waterways. These restrictions are similar to the documentation requirements for participation in U.S. coastal trade. The Foreign Dredge Act of 1906 provides that "A foreign-built dredge shall not, under penalty of forfeiture, engage in dredging in the United States unless documented as a vessel of the United States." Salvage operators face similar barriers. Generally, foreign vessels may not engage in salvage operations in the coastal or intercoastal waterways of the United States. Violation of this prohibition can lead to forfeiture of the offending vessel. The only exceptions to this ban are if a treaty authorizes such activity or if the Commissioner of Customs determines that no suitable U.S. vessel exists to participate in the salvage operation.

In the same manner, U.S. law effectively bans the use of towing vessels that are not owned by a U.S. citizen and documented as a U.S. vessel. The only exceptions to this general constraint are treaty authorization of such towing or the towing of a vessel in distress.

2.4 Foreign Trade Restrictions:

U.S. law also imposes barriers on foreign ownership of U.S. flag vessels engaged in foreign trade. Documentation and citizenship requirements are similar to those for coastal trade, except that U.S. citizens need hold only a controlling interest (equity and voting) in the corporation, rather than the 75 percent equity interest required for vessels operating in coastal trade. (U.S. flag vessels engaged in foreign trade do not have to be built in the United States and may be documented provided they meet U.S. ownership requirements.)

2.5 Transfer Restrictions and Restrictions on Foreign Investment in the U.S. Shipbuilding Industry:

A further restriction in the maritime laws affecting foreign investment in the United States are the vessel transfer laws. The Shipping Act of 1916, as amended, prohibits the sale, mortgage, lease, charter or delivery of a U.S. flag vessel to any person who is not a U.S. citizen, unless approved by the Secretary of Transportation. Similarly, it is unlawful to transfer, or place under foreign registry or flag, any interest in a U.S. flag vessel if a U.S. citizen owns the vessel and if the vessel is documented under U.S. law. In making a determination whether to approve such transfers, the Secretary of Transportation exercises wide discretion.

In the event of war or a national emergency, the Shipping Act of 1916 provides for comprehensive governmental jurisdiction over transfers to foreign registry of vessels that are registered under U.S. law. Upon penalty of forfeiture, the Act prohibits both U.S. citizens and corporations organized under the laws of the United States or of any individual state, from transferring or placing under any foreign registry or flag, any vessel that such person or corporation owns in whole or in part. The Act also bans the sale, mortgage, lease, charter, or delivery of any interest in a vessel owned by a U.S. citizen and of any interest in a vessel documented under U.S. law to non-citizens during times of war or national emergency. Further, the Act prohibits the sale, mortgage or lease of any shipyard, dry dock, shipbuilding or ship-repairing plant or facility during time of war or national emergency. Generally, these sections of the Act are very expansive. For example, the national emergency that President Truman declared upon the commencement of hostilities in the Korean War remained in effect until 1978.

2.6 Restrictions on Foreign Participation in U.S. Fisheries

The investment issues for foreign investors in the United States fisheries sector have the same complexion as those in Canada. The policy concern is resource management but the policy instruments relied upon have implications for direct foreign investment in the sector. In Canada, the ability of a foreign investor to obtain licenses is constrained, and the particular concern is how to prevent licenses being obtained by foreign investors through acquisitions of domestic processing companies owning licenses. The same concern is manifest in the U.S. fishing industry, however, the focus is on vessel documentation requirements.

2.6.1 Fishery Conservation and Management Act:

The Fishery Conservation and Management Act of 1976 generally forbids foreign fishing in the fishery conservation zone. It also bars fishing by foreigners for anadromous species and fishing for Continental Shelf fishery resources beyond the fishery conservation zone unless the Coast Guard issues a permit to a foreign fishing vessel. If the United States has entered into an international fishery agreement with the nation with which the fishing vessel is registered, or if the Secretary of State and Secretary of Commerce are satisfied that such nation extends reciprocal fishing privileges to the United States, then the Coast Guard will issue a permit to the fishing vessel.

The Act defines "foreign fishing" as fishing by a vessel that was not built in the United States and that is not documented under U.S. law. The Act defines the "fishing conservation zone" generally as an area 200 nautical miles from the U.S. coastline. The Act defines the "continental shelf" as the seabed and subsoil of the submarine areas adjacent to the coast, but outside the area of the territorial sea of the United States, to a depth of 200 meters. This area may be "extended" when the depth of the adjacent waters allows exploitation of the natural resources of such areas. Finally, the Act defines "anadromous species" as species of fish that spawn in fresh or estuarine waters of the United States and migrate to ocean waters.

U.S. law also prohibits a foreign-flag vessel from landing a catch of fish taken on board on the high seas. Similarly, such a vessel may not land products from the processing of fish or fish products taken on board on the high seas. Exceptions to the general ban exist in the event of treaties or conventions to which the United States is a party.

2.6.2 Fishing Vessel Documentation Requirements:

Fishing vessels that have not been issued a permit must meet the documentation requirements of the Shipping Act. This requirement raises several issues, but the key ones from an investment perspective are the implications of this requirement for a foreign-owned or controlled company or a U.S. company with foreign stockholders that:

(a) seeks to enter the fish harvesting sector through directly acquiring documented vessels or;

(b) seeks to purchase another corporation that owns U.S. documented vessels as part of its assets.

The relevant documentation requirements depend upon the nature of the proposed activity. The range of requirements for harvesting activity, for example, could include the following:

-- a fisheries license if the activity is only fish harvesting within the fishery conservation zone and the landing of a catch in a U.S. Port; such a license requires the vessel to be U.S. owned and built;

-- coastwise trade documentation if a harvesting vessel carries cargo between two points in the U.S. territorial sea or to United States ports; and

-- foreign trade documentation if the fish or other cargo is to be carried to a foreign port or if all of the fishing activities take place beyond the fishery conservation zone.

The documentation and relevant ownership and control requirements for each of these situations constrains the form of foreign investment in the United States. In particular, foreign investors must take care to comply with the U.S. citizenship and equity control criteria of the _Shipping Act_ to ensure that U.S. documentation of a fishing vessel is possible.

2.6.3 Acquisition of Documented Fishing Vessels:

As pointed out by Yaream (1978), if it can be shown that the transaction constitutes a transfer of vessels, then the _Shipping Act_'s supplemental citizenship requirements could be invoked. However, it also appears that if the transfer of vessels can be shown to be incidental to the sale of a corporation then the _Shipping Act_'s vessel transfer provisions may not be applicable. One American commentator has argued, however, that:

> As a practical matter, this issue has not been crucial.... Foreign controlled corporations have routinely applied for and received approval for these transactions from the Secretary of Commerce. When such an application for transfer is made, the Secretary refers it to the Maritime Administration (MARAD), which seeks clearance from several other departments before making a recommendation. Traditionally, MARAD relies upon the advice of the National Marine Fisheries Service when the application involves a fishing vessel. From 1971 to 1976, the Secretary approved each of the 1,014 applications for transfer of a U.S. owned and U.S. documented vessel to a foreign controlled U.S. corporation... Even if the Shipping Act restrictions were to apply in some way to future transactions, U.S. documented fishing vessels still could be operated by U.S. corporations if foreign investors held less than a majority interest.

There is at least one documented case, however, where a Canadian company wishing to own and operate fishing vessels in U.S. waters found it necessary to incorporate under U.S. law and ensure that more than 50 percent of its Board of Directors were American citizens.

3. Rail:

In the United States there are no special restrictions on foreign investment in the rail sector.

B. <u>Energy and Mineral Resources</u>

Introduction:

Restrictions on foreign participation in the development of energy and mineral resources in the United States vary somewhat depending on the specific resources being exploited. A foreign or foreign-controlled enterprise may not acquire rights-of-way for oil and gas pipelines across onshore federal lands, or leases, or interest therein for mining coal, oil and gas or certain other minerals on federal lands (other than the continental shelf), which may be held only by United States citizens, business associations, or municipalities. Citizens of a foreign country may hold interests in onshore mineral leases or permits indirectly through stock ownership or control, but are prohibited from such involvement if the foreign investor's home country denies similar or like privileges to U.S. citizens or corporations. The application of this reciprocity provision to Canada is detailed below.

1. Onshore Oil and Gas and Other Leasehold Minerals:

Section 1 of the Mineral Leasing Act of 1920 provides that:

> Deposits of coal, phosphate, sodium, potassium, oil, oil shale, gilsonite . . . or gas, and land containing such deposits owned by the United States . . . and lands within the naval petroleum and oil-shale reserves, except as hereinafter provided, shall be subject to disposition in the form and manner provided by this chapter to citizens of the United States, or to associations of such citizens, or to any corporation organized under the laws of the United States, or of any State or Territory thereof, or in the case of coal, oil, oil shale, or gas, to municipalities. Citizens of another country, the laws, customs or regulations of which deny similar or like privileges to citizens or corporations of this country, shall not by stock ownership, stock holding, or stock control, own any interest in any lease acquired under the provisions of this chapter.

The Naval Petroleum Reserve Production Act of 1976 imposes similar limitations and reciprocity requirements on leases covering naval fuel reserves.

The Bureau of Reclamation regulations implementing the Mineral Leasing Act mirror the requirement that foreign citizens may only hold interests in mineral leases through stock ownership or control. See, e.g., 43 C.F.R. 3102.1, 3102.2 (1986) (oil and gas); 43 C.F.R. 3502.1, 3502.2-3, 3502.2-4 (1986) (solid minerals other than coal and oil shale). The regulations generally require reporting of citizenship of entities holding more than 10% of the stock or controlling interest in a corporation or other business association. These citizenship reports permit the Bureau of Reclamation and Interior Department to enforce the Leasing Act's reciprocity requirements.

Marans and Rushch (1984) have emphasized that neither the legislative history nor administrative interpretations of this provision support a view that individuals or corporations of a foreign country will be considered qualified under the 1920 Act only if that foreign country grants United States investors mineral leasing privileges that are fully reciprocal ("essentially identical [to] those embodied within the Act"): " . . . Instead, the Department of the Interior has devised a set of criteria that it applies to determine whether a particular foreign country has laws, customs, or regulations that deny United States investors similar or like privileges and that

therefore disqualify investors of that country from holding lease interests under the 1920 Act." As documented by Szabo (1985), in their most recent form, these criteria emerged in the context of the 1981 takeover bid by Joseph E. Seagram and Sons, Inc. (Seagram) of Montreal for St. Joe Mineral Corporation (St. Joe) and Conoco, Inc. (Conoco). In these cases, the takeover targets requested that Canada's reciprocal status be reviewed.

After the takeover battles had been completed, the Secretary filed a notice in the Federal Register soliciting public comments on whether Canada should be determined to be a non-reciprocal nation pursuant to Section 1 of the Mineral Lands Leasing Act of 1920. On February 2, 1982, the Secretary of the Interior reaffirmed Canada's status as a reciprocal nation and approved a new and more formal procedure for administering the alien ownership provision of the Mineral Lands Leasing Act. (Szabo: 1984.)

The Secretary's 1982 decision that Canada was a reciprocal nation under the Mineral Lands Leasing Act was based on a February 2, 1982 memorandum by the Associate Solicitor for Energy and Resources. The memorandum proposed the following interpretation and application of the "reciprocity" provision:

- In determining whether "like and similar" privileges are extended by a certain country to U.S. citizens, the Secretary must determine that the country allows U.S. citizens or corporations to own, hold or control stock in the foreign country's corporations. If so, the country is presumed "reciprocal." However, the investment opportunity must be meaningful and U.S. citizens must be allowed to invest in corporations that own interests in the foreign country's minerals or acquire beneficial interests in the minerals from its public lands.

- If the Secretary finds that the foreign country limits investment opportunities to a certain and definable percentage, that percentage may be "mirrored" in his implementation of the reciprocity provision. Thus if a country limits to 50 percent the foreign ownership in a corporation holding mineral leases, then the Secretary could refuse to issue leases to a U.S. corporation that is more than 50 percent owned by citizens of that country.

- A country need not be determined to be "non-reciprocal" merely because the country has nationalized parts of the mineral resources industry, such that the country's own citizens cannot own interests in the nation's minerals from public lands. Therefore, although Great Britain has nationalized its coal industry, federal coal leases can still be issued to U.S. corporations that are partly or wholly owned by British citizens.

- Finally, the Secretary may make the "reciprocity" determination on a mineral-by-mineral basis such that a nation may be reciprocal with respect to coal leases, for example, but "non-reciprocal" for crude oil.

In considering the status of Canada under these criteria, the U.S. Department of the Interior paid specific attention to the provisions of the Canada Oil and Gas Production and Conservation Act. Although the provisions of COGA would affect the opportunity for economic return to U.S. investors, the Secretary concluded that the provisions of the Act did not alter the privilege of U.S. investors to acquire an interest in Canadian oil and gas resources through stock ownership.

Following the Seagram case, the United States also established a new procedure for implementation of the alien ownership provision. See Procedures for Administering Certain Alien Ownership Provisions of the Mineral Lands Leasing Act of 1920, 47 Fed. Reg. 27622 (June 25, 1982). This new procedure contains the following provisions:

- The Department of the Interior no longer maintains a list of "reciprocal" nations whose citizens may own interests in federal onshore mineral leases. Rather, each Bureau of Land Management state office will maintain a list of non-reciprocal nations.

- The new procedures allow the Department to dismiss "meritless" petitions and to request public comments only in those instances where additional information concerning the laws, customs and regulations of the nation in question is needed; and

- The determination of reciprocity status is made by the Assistant Secretary for Land and Water Resources with the concurrence of the Solicitor of the Interior.

It should also be noted that if a third party, such as a disappointed junior bidder, believes that a lease under the Mineral Leasing Act of 1920 has been issued directly to a foreign citizen, association, or corporation or to a United States corporation in which a citizen association, or corporation of a non-reciprocal country holds an interest, the third party may not institute judicial proceedings to challenge the issuance of that lease. U.S. federal courts have held that only the U.S. federal government has standing to institute litigation to challenge the qualification of a foreign citizen or corporation to hold leases or interests therein under the 1920 Act. (Marans and Rushch: 1984.) Therefore, implementation and enforcement of alien ownership provisions is generally an administrative and governmental process.

2. Offshore Development of Oil and Other Minerals:

The Offshore Continental Shelf Lands Act (OCSLA) governs offshore development of certain energy resources and minerals on the continental shelf beyond the three-mile territorial limit of coastal states. The OCSLA imposes no citizenship requirements on mineral lessees. Regulations of the Department of the Interior implementing the OCSLA provide for the issuance of mineral leases to U.S. citizens, resident aliens, or U.S. corporations. The Department of Interior apparently takes the position that as long as a U.S. corporation owns the lease, the nationality of stockholders is immaterial. See R. Goodman, "Federal and State Disclosure Requirements and Restrictions in Connection with U.S. Acquisitions by Foreign Purchasers," 21 Real Property, Probate and Trust Journal, 623, 633 (1986).

3. Uranium:

In general, a foreign individual or corporation is not prohibited from applying for a specific license to mine nuclear source material, including uranium, or from owning shares in a United States corporation that applies for such a license pursuant to Section 67 of the Atomic Energy Act of 1954. However, the legislation clearly provides sufficient discretion to allow denial of such a license. The Nuclear Regulatory Commission, under Section 69 of the 1954 Act, is prohibited from: "licensing any person to transfer or deliver, receive possession of or title to, or import into or export from the United States any source material if, in the opinion of the Commission, the issuance of a license to such person for such purpose would be inimical to the common defense and security or the health and safety of the public."

The utilization and production of U.S. nuclear materials by foreign individuals and companies is prohibited under the Atomic Energy Act. Under Section 2133(d) of the 1954 Act as amended, the Nuclear Regulatory Commission is prohibited from issuing a commercial license for utilization or production facilities to: "...any person for activities which are not under or within the jurisdiction of the United States, except for the export of production or utilization facilities under terms of an agreement for cooperation arranged pursuant to Section 2153 of this title..." No license may be issued to an alien or any corporation or other entity if the Commission knows or has reason to believe it is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government. In any event, no license may be issued to any person within the United States if, in the opinion of the Commission, the issuance of a license to such person would be inimical to the common defense and security or to the health and safety of the public.

No threshold test in defining foreign ownership, control, or domination is provided for in the Act. However, administrative rulings on the application of this provision by the Atomic Energy Commission, prior to its abolition in 1974, and by the NRC after 1974, indicate that a foreign entity may in practice be allowed to hold a substantial, but non-controlling interest in facilities so long as precautions have been taken to ensure that the foreign entity will not acquire control over those facilities. (Marans and Rusch: 1984.)

Uranium, thorium, and other important nuclear materials found on the offshore continental shelf have been reserved for the use of the United States, and are therefore not presently available for development.

4. Electricity:

In the United States, foreign ownership of nuclear-fired electrical generation facilities is prohibited under Section 2133 of the Atomic Energy Act. Hydroelectric power is regulated under provisions of the Federal Power Act.

Under the Federal Power Act, the Federal Energy Regulatory Commission is authorized to issue permits or licenses for the purpose of constructing, operating, and maintaining dams, reservoirs and other project works necessary or convenient for the development and improvement of navigation and for the development, transmission, and utilization of power. Section 4(e) of the Act limits the issuance of such permits or licenses to U.S. citizens, associations of such citizens, corporations organized under

the laws of the United States or any state thereof, states and municipalities. Although Section 4(e) does not prohibit a foreign national or corporation from owning stock in U.S. corporations qualified to hold permits or licenses, the FERC has the discretion to include considerations of foreign ownership when deciding on the licensing of a particular project. Applicants for a license must file a statement of citizenship, but the regulations do not require the applicant to report alien stockholders. No application under Section 4(e) has been rejected because of foreign ownership of the applicant corporation.

5. Geothermal Power:

The Geothermal Act of 1970 authorizes the Secretary of the Interior to grant leases to U.S. citizens, associations of U.S. citizens and corporations formed in the U.S. to develop geothermal power. The statute and regulations do not bar domestic corporations with alien shareholders from investing in geothermal power. In contrast to the Federal Power Act, however, the regulations promulgated under the Geothermal Act permit the Bureau of Land Management to obtain the names and addresses of members or shareholders holding more than 10% of the association or corporation. The Geothermal Act is significant insofar as more than 50 percent of the geothermal reserves are located on lands within the possession of the federal government or in which the federal government has reserved rights. (Goodman and Saunders: 1985.)

C. Communications

Introduction:

The U.S. communications sector is regulated at both the federal and state levels within the United States. The most important regulation of foreign ownership of telecommunications facilities occurs at the federal level. This regulation is carried out by the Federal Communications Commission (FCC). There are two main federal regulatory sources: statutory restrictions and FCC policies. State commissions are responsible for the regulation of intra-state communications. The state commissions control telephone service, leased facilities, traffic and tariffs for all the other communications services at an intra-state level, but these powers can be preempted by the FCC.

1. Federal Legislation

1.1 The Communications Act:

Section 310(a) and (b) of the Communications Act of 1934, as amended, provides:

(a) Grant to or holding by foreign government or representative

The station license required under this chapter shall not be granted to or held by any foreign government or the representative thereof.

(b) Grant to or holding by alien or representative, foreign corporation, etc.

No broadcast or common carrier or aeronautical en route or aeronautical fixed radio station license shall be granted to or held by:

(1) any alien or the representative of any alien;

(2) any corporation organized under the laws of any foreign government;

(3) any corporation of which any officer or director is an alien or of which more than one-fifth of the capital stock is owned of record or voted by aliens or their representatives or by a foreign government or representative thereof or by any corporation organized under the laws of a foreign country;

(4) any corporation directly or indirectly controlled by any other corporation of which any officer or more than one-fourth of the directors are aliens, or of which more than one-fourth of the capital stock is owned of record or voted by aliens, their representatives, or by a foreign government or representatives thereof, or by any corporation organized under the laws of a foreign country, if the Commission finds that the public interest will be served by the refusal or revocation of such license.

Section 310(a) contains a flat prohibition against granting any license to use radio spectrum to any foreign government. The FCC has no discretion here. This prohibition is relatively unimportant because it is limited to foreign governments or their representatives.

Section 310(b) is the more important provision on foreign ownership. It applies only to four types of radio spectrum licenses: broadcast (mass audience radio and television stations), common carrier, aeronautical en route, and aeronautical fixed. The last two types of licenses are esoteric, relatively unimportant and will not be discussed further.

Before discussing broadcast and common carrier licenses, the structure of Section 310(b) should be noted. First, foreign ownership restrictions apply to only those types of licenses named in Section 310(b). There is a vast array of business uses of radio spectrum, licensed by the FCC, for which there are no foreign ownership restrictions. These include microwave licenses for general business use of microwave spectrum which has not been reserved by the FCC as "common carrier" microwave spectrum.

The Section 310 prohibitions apply only if the foreign entity has to obtain an FCC license, which may not be necessary. For example, a foreign entity might lease capacity from an American licensee. A particular technology -- such as fiber optics -- may not require radio spectrum and licensing. The FCC may have decided a particular activity -- such as leasing or purchasing a satellite transponder -- is not a licensed activity. In each case, the limited coverage of Section 310(b) does not reach the activity.

In addition to prohibitions only applicable to "broadcast" or "common carrier" station licenses, Section 310(b) grants some discretion to the FCC. The FCC is allowed no discretion with respect to Section 310(b)(1-3) -- these are flat prohibitions. However, Section 310(b)(4) allows the FCC to permit corporate holding structures which in effect could overcome the rest of the statutory prohibitions. The FCC has not yet done so but its current policies are trending somewhat in that direction.

1.2 Federal Communications Commission Policies:

1.2.1 Broadcast (radio and television) station licenses:

There is no indication that the FCC will exercise the statutory discretion available to it to allow foreign ownership of American radio or television stations. In fact, the FCC recently took action against a television licensee who was alleged to have concealed its foreign ownership.

If there were not political considerations, the general regulatory philosophy of the FCC might support such foreign ownership of radio and television stations by entities of friendly countries, particularly since there are no such restrictions on foreign ownership of American newspapers, cable systems, or satellite- delivered programming networks. The FCC views radio and television stations to be operating in highly competitive markets -- a further reason the FCC might in the future accept some foreign ownership of radio and television stations.

1.2.2 Common Carrier Station Licenses:

The FCC's attitude toward foreign ownership of common carrier station licenses is somewhat more relaxed than its attitude toward foreign ownership of radio and television stations. The FCC has exercised the discretion available to it under Section 310(b)(4) in limited cases, allowing foreign ownership or control beyond that which under Section 310(b)(4) can occur without specific FCC approval.

The most recent general indication of the FCC's attitude toward foreign ownership of common carrier licenses is its Notice of Inquiry and Proposed Rulemaking in CC Docket No. 86-494 concerning "Regulatory Policies and International Telecommunications," the text of which was released on January 30, 1987. There, among other things, the FCC asked for comment "on whether we can, and should, consider the adoption of a general policy favoring grants of microwave licenses to foreign-owned companies whose governments have fully 'opened' their telecommunications markets to U.S. service providers"; and on "the desirability of allowing certain foreign-owned telecommunications entities to hold microwave licenses for common carrier services."

A critical premise of this FCC proceeding is that "reciprocity" should be a determinant of whether the FCC issues common carrier licenses to foreign entities, or otherwise allows them to participate in American markets.

1.2.3 Cable Television:

The 1974 amendments to the Communications Act rendered its prohibitions inapplicable to cable television relay services. However, the FCC determined that the intent of the amendments was not to exempt cable television from the prohibition on alien control and began to promulgate regulations prohibiting alien control similar to those concerning other wireless communications. In 1976, the FCC terminated its rulemaking, deeming it premature in light of the small percentage of alien ownership and the developing nature of the industry. At present, the issue of alien ownership of cable television is undecided.

1.2.4 The Communications Satellite Corporation:

The U.S. Communications Satellite Act of 1962 established a communications satellite corporation (COMSAT), deemed to be a common carrier within the meaning of section 3(h) of the Communications Act of 1934, as amended.

Section 303 of the Act covers Directors and Officers. Section 303(a) states that the Corporation shall have a board of directors consisting of individuals who are citizens of the United States. Section 303(b) extends this citizenship restriction to officers of COMSAT.

Section 304 of the Act governs financing of the Corporation and effectively limits stock ownership by foreigners in the Corporation to no more than an aggregate of 20 percent of the Corporation's equity.

3.2 State Restrictions:

Certain communications engaged in by common carriers become subject to limitations on entry under state law, although some limitations apply to all out-of-state corporations, both alien and domestic. For example:

Alaska: No telegraph or cable company owned, controlled or operated by aliens or by any foreign corporation or government may be established in Alaska.

Connecticut, Indiana,Mississippi, Rhode Island: prohibit all telephone and telegraph companies not incorporated or domesticated under state law.

Illinois: No franchise, license, or other authorization may be granted to an out-of-state telephone or telegraph company except for its activities in interstate commerce.

D. Financial Services

Introduction:

Canadians are generally accorded treatment comparable to their U.S. counterparts under federal and state banking, insurance, investment management, securities and commodities futures laws. The few instances of discrimination fall into two main categories: unavailability of regulatory exemptions that may be claimed by certain U.S. nationals, and restrictions on foreign ownership or control.

1. Banking:

A dual federal-state law framework regulates bank operations. Under this framework, a Canadian bank or bank holding company may establish a subsidiary, branch or agency in the United States either under federal law with the approval of the Comptroller of the Currency, or under state law with the approval of the appropriate state regulatory authorities. In addition, both federal and state law affect the operations of subsidiaries, branches and agencies of foreign banks (that is, banks headquartered outside the United States). Fiduciary activity in the U.S. is generally covered by the regulatory framework for banking.

Branches and Agencies - Under the International Banking Act of 1978 (the "IBA"), a Canadian bank may establish and operate a branch or agency under the same circumstances and with the same powers as a national bank. Foreign branches and agencies are subject to the same reserve requirements for their deposits as are national and state-chartered banks. These reserve requirements may be different than those imposed by Canadian law. The IBA also gives foreign branches and agencies the same branching rights as are given to national banks, subject to those restrictions imposed by applicable state law. In this connection, a few states continue to prohibit or restrict foreign bank ownership of banks organized under their law.

Under the IBA, a minority of the members of the board of directors of a national bank subsidiary of a foreign bank may be non-U.S. citizens, provided that the prior approval of the Comptroller of the Currency is obtained. Some states, however, have laws that require the majority of directors of state banks to be U.S. citizens and also residents of that state.

Acquisitions - A Canadian bank holding company may acquire a United States bank or bank holding company under the Bank Holding Company Act of 1956, as amended (BHCA), with the prior approval of the Board of Governors of the Federal Reserve System (Federal Reserve Board). In considering an application, the Federal Reserve Board considers a number of factors, including the capital adequacy of the acquiring banking organization and the banking organization being acquired. In this connection, the applicable capital requirements that may be imposed by the Federal Reserve Board under its capital adequacy guidelines may be different than those imposed by Canadian law; however, these requirements would be the same as those imposed on U.S. bank holding companies.

A Canadian person may acquire control over a U.S. bank under the Change in Bank Control Act under the same conditions and terms as U.S. persons. However, the U.S. bank regulatory agency approving such an acquisition may require such person to give commitments not required by U.S. citizens, including a consent to the jurisdiction of the United States, and an agreement to make its books and records open for examination in the United States.

Interstate Banking - A majority of the states have enacted some form of interstate banking statutes, which permit banking organizations located in one state to acquire banking organizations located in another state. Many of these interstate banking laws are regional laws, which permit acquisitions only among banking organizations located within the states included within the region. These regional interstate banking laws would affect Canadian banks with operations in a state not located in the defined region in the same manner as a U.S. bank holding company not located within the defined region. However, some states also specifically preclude acquisitions by a foreign bank even if its home state is in the defined region.

The regional interstate banking laws of some states and the District of Columbia define a "regional bank holding company" that is eligible to make an acquisition in that state as a bank holding company that holds a majority of its deposits within the region. While the purpose of these provisions is to prevent "leap frogging" by a bank holding company located outside of the region by acquiring a bank within the region, these laws also could be interpreted to have the effect of discriminating against a foreign bank holding company which has a majority of its deposits outside of the United States.

Non-Banking Activities - Subsidiary banks, branches and agencies of Canadian bank holding companies are subject to the non-banking provisions of the BHCA and must obtain approval from the Federal Reserve Board prior to engaging in any nonbanking activity in the United States. Such subsidiary banks, branches and agencies also are given the same nonbanking powers as U.S. banks.

Under the Glass-Steagall Act, banks generally are prohibited from underwriting or dealing in securities of corporate issuers. The restrictions of the Glass-Steagall Act are made applicable to branches and agencies of foreign banks under the IBA. However, these restrictions currently do not apply to the operations of Canadian banks that take place entirely outside of the United States.

While prohibited from underwriting or dealing in corporate securities, banks in the United States, including subsidiary banks, branches and agencies of foreign banks, may engage in other securities activities. For example, banks and bank holding companies and their subsidiaries may underwrite and deal in obligations of the United States Government, general obligations of state and local governments, and certain types of municipal revenue bonds. They also may engage in transactions involving money market instruments such as bankers acceptances and certificates of deposit. Banks and bank holding companies in the United States -- including foreign banks -- also may engage in discount brokerage, may offer investment advice, and may privately place debt and equity securities.

2. Commodity Futures and Options:

The regulatory scheme in this area is one principally of federal law, comprised of the Commodity Exchange Act and attendant Commodity Futures Trading Commission (CFTC) regulations. Foreign commodity futures can be sold in the United States. Currently, the sale of foreign commodity options in the United States is banned. The CFTC, however, is considering amendment of its regulations to permit the sale of foreign options in the United States in the near future.

3. Insurance:

Insurance is regulated by state law in the United States. As a general rule, alien insurers are required to satisfy more stringent admission standards than are imposed on insurers formed outside the state but within the United States.

State insurance laws govern actions of alien companies, whether direct or indirect through subsidiaries or affiliates formed in the United States. The standards imposed range from capital and deposit requirements to demonstration of successful operations in other jurisdictions.

Specific examples of restrictions are:

(a) Special capital and/or deposit requirements for non-U.S. insurers (California, District of Columbia, Georgia, Hawaii, New Jersey, Indiana, Maryland, Minnesota, Maine, Nevada).

(b) All, or a majority of directors must be U.S. citizens (Florida-majority, Georgia- majority, Indiana-all, Louisiana-all, Pennsylvania-2/3, Utah-all, Washington-75%).

(c) All, or a majority of incorporators must be U.S. citizens (Alaska-majority, Arkansas- majority, Florida-majority, Georgia-2/3, Indiana-majority, Louisiana-all, Montana- majority, Nevada-all, New Mexico-2/3, New York-majority, Oklahoma-2/3, South Dakota-all, Washington-all, Wyoming-majority).

(d) A certificate of authority may not be granted to an insurer controlled by the government of another country (North Carolina, North Dakota, Tennessee).

(e) In 35 states, a reciprocity provision applies. It stipulates that non-state and/or foreign insurers are subject to the same "obligations" as those in force in that state or country (Alabama, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Vermont, Virginia, West Virginia, Wyoming).

(f) Miscellaneous provisions:

(i) Florida - "A non-U.S. insurer (except a Canadian) is limited to 10% of its U.S. surplus to U.S. policyholders per risk."

(ii) New York - "Non-U.S. insurers must comply with special regulations and can obtain a license only if a New York insurer may do so in the former's home country."

(iii) Oklahoma - "A non-U.S. insurer must file an annual statement, sworn to by the principal U.S. representative, reflecting the insurer's U.S. financial condition."

(iv) Wisconsin - "A non-U.S. insurer must have five years experience in his own country or prove that his formative term in Wisconsin will be sound."

E. Corporate Investment and Organization -- Federal Reporting Requirements and State Restrictions:

Introduction:

The following section highlights a number of areas of federal and state law that present general obstacles to corporate foreign investment in the United States. While these laws do not bar foreign investment per se, the foreign investor must comply with these provisions to insulate himself from liability under U.S. law. These provisions fall into three categories: State level legislation respecting mergers and acquisitions; reporting requirements at both the federal and state level; and state laws mandating U.S. citizen participation in the governing structure of a corporation.

1. State legislation respecting Mergers and Acquisitions:

1.1 Introduction

The constitutional authority of states to regulate takeovers of firms engaged in interstate commerce has for some time been an area of considerable legal uncertainty. However, in April of 1987, the U.S. Supreme Court addressed the constitutional issues involved and upheld legislation passed by the state of Indiana regulating hostile takeovers. More than 22 states have laws targeted at the regulation of hostile takeovers of corporations with significant interests within those states. This legislation does not discriminate between domestic and foreign investors although it has had an important impact of major Canadian investors in the United States.

The most frequently cited rationales for legislation regulating the conditions under which hostile takeovers can be made is the need to ensure the rights of shareholders are protected and that corporate raiding, including such associated activities as the payment of greenmail, are discouraged. A significant political force encouraging the passage these laws, apart from the lobbying efforts of the incumbent management of a takeover targets, has been the desire of local communities and interest groups to protect themselves from potential economic dislocation resulting from a successful takeover. From this perspective, state takeover legislation may be viewed as analogous to the intent of foreign investment regulation in other countries: the protection of local industry and local interests.

1.2 Examples of State Legislation Regulating hostile takeovers:

1.2.1 Ohio and Goodyear Tire

The impetus for passage of the Ohio takeover legislation in late 1986 was the attempted acquisition of Goodyear Tire of Akron, Ohio, by Sir James Goldsmith, the Anglo-French financier. After buying 11.5 percent of Goodyear's shares in early November, 1986, Goldsmith informally offered to buy the rest of the company's stock through a tender offer. To fend off Goldsmith, Goodyear attempted to boost its stock price above his offer by putting most of its non-tire assets up for sale and buying back stock.

The Ohio Legislature had been considering changes to its corporations code throughout 1986. However, the pressure to strengthen the ability of Ohio firms to resist takeovers was clearly related to the Goodyear case both in terms of its timing and strength of the anti-takeover provisions. The political stakes during the takeover battle were high. Local sympathy for Goodyear was strong given that the company accounted for 10 percent of Akron's work force and 16 percent of its tax base. Business Week reported that: "Summit County's 511,000 residents didn't have to wait to hear Goodyear Chairman Robert E. Mercer decry Goldsmith as a "foreign invader" to start voicing such feelings." The drive against Goodyear, which culminated in the passage of the Ohio law, included lobbying by county and Goodyear officials, a letter writing campaign to legislators by concerned citizens, and an inquiry by a Congressional committee.

On November 22, 1986, the Ohio legislature passed a new Ohio corporation statute amending the Ohio corporation codes. With the passage of the statute, directors of a corporation incorporated in Ohio were provided more leeway for, among other things, broadening the considerations they could take into account in resisting takeovers. The amendment provided that takeover resistance is consistent with the directors' fiduciary duties if it is based on a consideration of: "the long-term as well as the short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation." The statute expressly allowed the use of "poison pill" takeover defenses (defenses which increase the acquisition cost of the company to the potential acquisitor) through March of 1987. Goldsmith subsequently abandoned his bid for Goodyear, citing the new Ohio law as a main reason for ending his takeover attempt.

1.2.2 Indiana and First City Financial Corporation

The impetus for passage of the Indiana takeover legislation in early 1986 was the attempted acquisition of Arvin Industries of Columbus, a major U.S. manufacturer of automotive parts, by the Belzberg family of Canada (operating through First City Financial Corporation of Vancouver).

Arvin had first established facilities in Columbus in 1931 and was able to draw on this historical connection during the takeover battle with the Belzbergs. As reported by the Wall Street Journal: "Arvin is the kind of company that chambers of commerce adore... When the Belzbergs loomed, the town fathers believed a takeover would shatter the town's long, cozy relationship with Arvin. And it raised the specter of a fate local residents dreaded: Columbus a mere branch-plant town."

On December 3, 1985, the Belzbergs informed Arvin's management that it had amassed a 4.9 percent shareholding and was considering buying the remaining shares through a tender offer. One of the responses of Arvin's management was to have their legal counsel draft a law to be placed on the state senate's order paper by a state senator opposed to the takeover. The bill was officially declared emergency legislation and was passed as the first item of business in the new session of 1986. After further amendments to the new legislation during the spring of 1986, the Belzberg's dropped their takeover attempt. Arvin did not repel the takeover attempt without incurring some costs. Under an agreement between the two companies, Arvin purchased a Belzberg-owned tire-valve company and the Belzberg's Arvin shares. Nevertheless, Arvin's management claimed the new laws were instrumental in helping them retain control of the company.

The Indiana Control Acquisition Chapter, as the anti-takeover laws are formally known, gives shareholders in companies incorporated in the state the right to decide whether a new buyer can vote. The Chapter allows a corporation chartered in Indiana and having specified levels of shares or shareholders within the State to opt into the Act's protection. The Act provides that the acquisition of "control shares" in such a corporation (shares that, but for the Act, would bring the acquiring entity's voting power to or above any of three thresholds: 20 %, 33 1/3 %, or 50%) will not include voting rights unless a majority of all pre-existing shareholders agree at their next regularly scheduled meeting that voting rights are included. The Indiana Act was quickly challenged by Dynamics Corporation of America, a Connecticut electronics firm which was attempting to buy CTS Corporation, an Indiana company. As discussed in section 1.3, below, the case eventually reached the Supreme Court which upheld the law in a decision of April 21, 1987.

1.2.3 North Carolina and Dominion Textiles

In April of 1987, Dominion Textiles Inc. of Montreal (Domtex), in partnership with Asher Edelman of New York, made a $60 a share offer directly to the management of Burlington Industries. Burlington is a textile manufacturer incorporated in Delaware but with 40 of its 83 plants located in North Carolina. Burlington is the largest employer in North Carolina.

The board of Burlington refused to respond to the offer and the Domtex-Edelman partnership subsequently launched a $67 tender bid. In the months that followed, the Domtex-Edelman partnership encountered: extensive litigation initiated by Burlington; a competing bid by BI-MI Holdings (a company organized by the Morgan Stanley Group); a request to the Securities and Exchange Commission by state senators for a full investigation of the takeover attempt; a hearing on the takeover attempt before the Banking, Housing and Urban Affairs Committee of the U.S. House of Representatives; the introduction (but not passage) of a bill in the U.S. Senate providing for a moratorium on hostile takeovers; and the introduction and passage in the North Carolina General Assembly of new legislation regulating hostile takeovers.

The need to protect the interests of the local community and workforce was frequently cited by opponents of the Domtex-Edelman takeover bid as the reason to pass legislation that would help Burlington management retain control of their company. For example, during hearings held by the U.S. Senate's Banking Committee in May of 1987, Senator Sanford (D-North Carolina) stated that:

> Perhaps the most alarming problem posed by hostile foreign takeovers is the shift of productive resources, especially jobs, that occurs when a foreign company takes over an American firm. These foreign firms have no inhibitions about shifting jobs and manufacturing resources from American plants to their foreign operations, especially in industries where, for many reasons, excess capacity exits. It is unfortunate when one set of American workers loses its jobs in a takeover to another group of Americans; it is nothing short of tragic when these jobs leave this country for good. ....That is why I have introduced the Hostile Foreign Takeover Moratorium Act today. The act recognizes that firms like Burlington, which compete vigorously, innovate boldly, and support their communities, are too valuable to be lost to corporate raiders, foreign or domestic.

Similar sentiments were current during the debate in the North Carolina General Assembly on the Control Hostile Takeovers Act. The Act was passed by the Assembly on May 13, 1987 and provides for the regulation of the acquisition of control of corporations in which North Carolina has a substantial interest by reason of incorporation or otherwise. Essentially, the Act contains the same provisions as found in the Indiana legislation previously described. Section 55-94 of the Act states:

> Voting Rights. --(a) Control shares acquired in a control share acquisition shall have no voting rights unless such rights are granted by resolution adopted by the shareholders of the issuing public corporation.
>
> (b) To be approved under this section, the resolution must be adopted by the affirmative vote of the holders of at least a majority of all the outstanding shares of the corporation (not including interested shares) entitled to vote for the election of directors...

The Domtex-Edelman partnership argued that these provisions, as well as certain amendments to other North Carolina corporate legislation, were an unconstitutional burden on interstate commerce. As described below, the constitutional issue was addressed in the U.S. Supreme Court decision of April, 1987. In the event, however, the Domtex-Edelman partnership dropped its bid for Burlington on June 24, 1987. At that time, a U.S. District Court prohibited the partners from proceeding with their tender offer after agreeing with Burlington's request for a trial over the company's contention that Domtex used illegal insider information during the takeover attempt.

1.3 The Supreme Court Decision: CTS Corp. v. Dynamics Corporation of America

In CTS v. Dynamics Corporation, the U.S. Supreme Court considered the contention by Dynamics that the Indiana Control Acquisition Chapter was inconsistent with provisions and purposes of the federal Williams Act (setting out certain conditions for the consummation of tender offers) and that it violated the Commerce Clause of the U.S. constitution by depriving nonresidents of the opportunity to accept tender offers from nonresidents. Lower court decisions had found in favour of CTS, an Indiana company subject to a takeover attempt by Dynamics. However, the Supreme Court reversed the lower court rulings. According to the Supreme Court, the Act's limited effect on interstate commerce was justified by the State's interests in defining attributes of its corporations' shares and in protecting shareholders. In the Court's opinion, the Indiana law enhanced the rights of shareholders, not incumbent management, though helping them organize themselves to consider the value of the hostile bid.

In a recent analysis of the Supreme Court decision in CTS, Herzel and Shepro (1987) have suggested that the importance of the Indiana anti-takeover statute and the Supreme Court decision has declined sharply due to the high probability that the state of Delaware will not enact similar legislation (Delaware is by far the most important state for the incorporation of large publicly-held companies in the United States). A central reason for the reluctance of Delaware to follow Indiana in enacting new hostile takeover provisions, apart from the substantive concerns respecting the wisdom of eroding the effectiveness of of existing, non-statutory takeover defenses, is the possibility of the passage of federal legislation making the Indiana and other similar state statutes redundant.

Prompted by the publicity surrounding a number of recent hostile takeovers, as well as certain tangential concerns about insider trading, there have been several bills introduced on both sides of Congress attempting to address the securities issues at play. In certain respects, the various bills before Congress are broadly similar, requiring earlier notification of acquisitions that might become a takeover effort, expand the information to be disclosed to the regulators, the target company's shareholders and the general public on what the acquisitor's intentions are, and to provide more time for target shareholders to consider the offer. In other respects, they differ significantly to the extent that they preempt existing state legislation in the field of securities law. In light of the less than enthusiastic support of the U.S. Administration for any of these bills, the outcome of the various Congressional initiatives is uncertain. The state takeover laws, therefore, remain of concern to Canadian investors interested in acquiring U.S. firms through hostile takeover offers.

2. State Law Incorporation Requirements:

Individual states sometimes restrict the extent to which foreign citizens may participate in the corporate governing structure of a corporation organized under the laws of those states. Some states have enacted restrictions on the situs of shareholders meetings and meetings of boards of directors. To offer just a few examples of such restrictions, in Colorado U.S. citizens must act as the incorporators of the corporation. In Massachusetts, stockholders meetings must be held within the state. In Hawaii, at least one member of the board of directors must be a resident of the state; otherwise, the board cannot function. Other states have similar restrictions. While these requirements do not block foreign investment, they do create special obstacles for foreign investors. However, the general trend among the States is to repeal or lessen the stringency of these requirements.

3. Federal Antitrust Reporting Requirements:

In addition to compliance with the general requirements of the U.S. antitrust laws, under the Hart-Scott-Rodino Act both parties to a merger or acquisition must give notification of the merger to the Justice Department's Antitrust Division and the Federal Trade Commission at least thirty days prior to the proposed transaction. This requirement applies to domestic as well as foreign parties. Although exceptions exist to the advance notification guidelines, generally such reporting is required when:

(1) the acquiring corporation has either total assets or annual sales of one hundred million or more; or

(2) the corporation that is being acquired has total assets or annual net sales of at least ten million or more, if the corporation has manufacturing operations. If the corporation has no manufacturing operations, then the requirement is simply assets of at least ten million; and

(3) the transaction would lead to the acquiring corporation holding at least fifteen percent of the acquired corporation's voting stock or total assets; or the transaction would result in the acquiring corporation holding voting stock or assets that exceed fifteen million.

4. Securities Laws:

The securities laws of the United States establish reporting requirements in other situations. For example, anyone who acquires at least five percent of a corporation's equity securities must report this acquisition to the Securities and Exchange Commission. The investor must disclose his residence and citizenship and the nature of his beneficial ownership, as well as the background, residence, and citizenship of any associates who beneficially own or have a right to acquire any of the securities.

5. International Investment Survey Act:

Under the International Investment Survey Act of 1976, the Commerce Department may require foreign investors to disclose the extent of their activity in the United States. For example, every five years the Commerce Department conducts a "Benchmark Survey" of foreign direct investment in the United States. Foreign firms may be required to furnish information on the balance sheet of parents and subsidiaries, income statements, and information regarding trade between a parent and a subsidiary. The Commerce Department conducts a similar "Benchmark Survey" every five years to monitor foreign portfolio investment in the United States. Failure to furnish such information can result in both civil and criminal prosecution.

6. Proposed Federal Legislation Respecting Foreign Investment Reporting Reuirements:

Legislation now pending in Congress as part of the trade bill would impose significant new reporting and registration requirements on foreign investors. Under this proposed legislation, foreign investors who hold a "significant interest" in a U.S. entity would have to disclose, among other information, their identity, nationality, the date they acquired the U.S. property or interest, and the price they paid. "Significant interest" would be defined as (i) five percent or more of any U.S. company with assets of over $3 million or sales over $12 million, or (ii) five percent or more of several U.S. companies with combined assets of over $10 million or combined sales over $40 million. In addition, any holding valued at over $10 million would be considered "significant" regardless of the foreign investor's ownership share.

If the foreign investor has a "controlling interest," the registration requirements would be even more extensive. A "controlling interest" is defined as twenty-five percent or more of a U.S. business with assets in excess of $20 million or sales in excess of $20 million. In these circumstances, the foreign investor would have to file an English translation of any public financial disclosures required in his home country. Moreover, the foreign investor would have to provide audited financial reports and other data on his U.S. business enterprises, including: (i) a balance sheet and income statement; (ii) a statement of sales, assets, operating income, and depreciation by industrial segment; (iii) a list of all U.S. facilities by location; (iv) a list of the directors and officers with their nationalities; (v) disclosure of any related business transactions of any director; and (vi) a record of any litigation in which the business is involved.

All existing foreign interests would have to register within 180 days after the Secretary of Commerce issued regulations implementing this provision. New foreign investments in U.S. entities would have to be registered within 30 days of the investment. Failure to comply with the proposed registration requirements would expose foreign investors to civil penalties of up to $10,000 per week for each week that the filing is late and criminal penalties of up to one year imprisonment, or both. In addition, the provision would impose a criminal fine of $10,000 for each violation.

The Administration opposes this legislation and it is uncertain whether it will be enacted.

F. Land

Thirty U.S. states restrict non-resident foreigners or foreign corporations from owning land. Most of the restrictions do not apply to resident aliens in the United States.

The state restrictions vary in the extent to which they discriminate against foreigners. Some states, such as Hawaii, restrict the acquisition of certain state lands by aliens. Other states restrict the acquisition of land generally or agricultural land specifically, but some states, such as Maryland, may limit their restrictions to enemy aliens. Indiana and other states restrict the amount of acreage that may be held. Finally, states such as Minnesota prohibit alien ownership or acquisition of land, but also generally have exceptions to those prohibitions. In some states (e.g., Iowa, Minnesota, Missouri, North Dakota, and South Dakota), restrictions apply to non-resident foreigners as well as U.S. and foreign corporations. At least one state, Wyoming, imposes reciprocity requirements on the acquisition by foreigners of interests in land.

Some state restrictions date back to statutes from the nineteenth or early twentieth centuries. Many of these old laws are not strictly enforced. Since 1977, eight states adopted new or tightened existing restrictions on non-resident foreigners owning real estate.

Three general rationales are put forward by the United States in the OECD for restricting foreigners from owning land in the United States: non-resident foreigners can gain control of a basic domestic resource; foreign bidding significantly raises the price of farm land, subsequently depriving U.S. farmers of the opportunity to purchase farm land at a reasonable price; and foreign corporate purchasers threaten the continued use of agricultural land for family farming.

G. The Defense Sector

1. The Industrial Security Program

1.1 Introduction:

The stated objective of the U.S. Defense Industrial Security Program (DISP) is: "to assure the safeguarding of classified information in the hands of U.S. industrial organizations, educational institutions, and all organizations and facilities used by prime and subcontractors." (ISR 1-100)

The legal basis for the program is the National Security Act of 1947 (50 U.S.C. 401-412) and Executive Order No. 10865. The National Security Act states that: "It is the intent of Congress . . . to provide for the establishment of integrated policies and procedures for the departments, agencies, and functions of the Government relating to the national security." Executive Order No. 10865 requires the Secretary of Defense, among others, to prescribe regulations with such specific requirements, restrictions and other safeguards as he deems necessary to protect classified information in the context of the bidding on, negotiation, award, performance and termination of defense contracts, or relating to other releases to U.S. industries of information that the Department has the responsibility to safeguard.

The intentions of the National Security Act and Executive Order 10865 are carried out through the Industrial Security Regulation (ISR) issued under authority of the Secretary of Defense. The ISR requires a contractor to obtain personnel and facility security clearances to engage in defense work which involves the use of classified information. No such clearances are required if a contractor deals only with unclassified material. The nature of these clearances is detailed in the administrative policies and guidelines found in the ISR, the Industrial Security Manual for Safeguarding Classified Information (ISM) and the Industrial Security Operating Manual (ISOM). ISM interprets the Industrial Security Regulation for defense contractors and is part of the basic contract between the government and those contractors who require access to classified information to perform government contracts.

1.2 Facility Security Clearances Under DISP:

If a U.S. contractor requires access to classified information in order to perform tasks or services essential to the fulfillment of a defense contract (which may be let by any U.S. government agency enumerated in the Regulation, including the Army, Navy, Air Force, the General Services Administration and the Departments of State, Commerce, Treasury, Transportation, Interior, Agriculture, Labor, and Justice among others), an administrative determination must first be made that the contractor's facility is eligible for access to classified information. (2-102) (The Energy Department has its own facility clearance regulations, which apply to

classified information and certain nuclear-related activities.) The key locations of administrative decision making for the purposes of determining eligibility for a Facility Security Clearance (FCL) are as follows:

(a) The Deputy Under Secretary of Defense (Security Policy) has overall responsibility for policy guidance and management oversight of the DISP.

(b) The Defense Supply Agency is the purchasing arm of the Department of Defense under whose general auspices the Security Program is carried out.

(c) The Director, Defense Investigative Service, is responsible for administering the DISP, including coordination of all regional operations.

(d) Regional Directors, Industrial Security, are responsible for Cognizant Security Offices in designated regions to which application for a facility clearance is made. All relationships between procuring agencies and a contractor on industrial security matters are generally coordinated by a Cognizant Security Office except as provided for in the Industrial Security Regulation (e.g. international operations and National Security Agency (NSA) operations).

(e) The NSA has general responsibility for specialized communications security and the production of specialized foreign intelligence. In relation to the Industrial Security Program, the Industrial Security Regulation allocates responsibility for "Sensitive Compartmented Information" to the NSA. The regulation is unclear as to whether responsibility for facility clearances are also transferred to the NSA for compartmented information, although a strict reading of the ISR would suggest this is the case.

1.3 Treatment of U.S. Facilities that Are Foreign Owned, Controlled or Influenced (FOCI)

The general policy for determining eligibility for Facility Security Clearances in situations where U.S. facilities are foreign owned, controlled or influenced (FOCI) is set out in section 2-201 of the ISR:

a. A facility shall be considered under FOCI when a reasonable basis exists to conclude that the nature and extent of FOCI is such that foreign dominance over the management or operations of the facility may result in the compromise of classified information or impact adversely the performance of classified contracts.

b. A facility that is owned, controlled, or influenced by a foreign national or a commercial or governmental entity from a Communist country or a country overtly hostile to the United States will not be eligible for a FCL.

c. A facility that is owned, controlled, or influenced by foreign interests other than those included in b above may be eligible for a FCL, provided action can be taken to negate effectively or reduce associated FOCI risks to an acceptable level.

Determinations of FOCI are made on a case-by-case basis. Such determinations are highly fact intensive. Ten factors are specified in the ISR for determining the existence of FOCI for the purposes of executing the FOCI policy:

a. Foreign interest ownership or beneficial ownership of 5 percent or more of the organization's securities;

b. ownership of any foreign interest in whole or in part;

c. management positions held by foreign interests such as directors, officers, or executive personnel;

d. foreign interests control or influence or are in a position to control or influence the election, appointment, or tenure of directors, officers, or executive personnel of the organization;

e. contracts, agreements, understandings, or arrangements with foreign interests;

f. indebtedness to foreign interests;

g. any income derived from Communist countries, countries overtly hostile to the United States, or income in excess of 10 percent of gross income from other foreign interests;

h. 5 percent or more of any class of the entity's securities are held in "nominee shares," in "street names," or in some other method that does not disclose the beneficial owner of equitable title;

i. interlocking directors with foreign interests; or

j. any other factor that indicates or demonstrates a capability on the part of the foreign interest to control or influence the operations or management of the business organization concerned.

The ISR provides that the Cognizant Security Office (CSO) shall review each case to determine the relative significance of each factor and may grant or continue a FCL when there is a favorable finding by the Director of Industrial Security. If the CSO finds that a firm is ineligible for a FCL or that additional action may be necessary to nullify or negate the effects of FOCI, the firm in question is requested to submit a plan of action to preclude the foreign interest from access to classified information.

Four general mechanisms may (depending on circumstances) be available to a firm wishing to neutralize the effects of FOCI: (1) obtain a security assurance that may be available under provisions of a reciprocal industrial security agreement between the United States and the relevant foreign country; (2) insulate the facility from the foreign interest by transferring legal title in the foreign interest's stock to a U.S. trustee or by conveying the voting rights of their stock to proxy holders; (3) using a board resolution to certify that the foreign interests shall be excluded from access to the facility's classified information and from any position that would allow it to affect adversely the performance of classified contracts; and (4) negotiate a Special Security Agreement among the U.S. firm, the foreign interest, and the Defense Department. Such an agreement usually will contain provisions to neutralize FOCI. Special Security Agreements have only been negotiated in very rare circumstances.

1.4 Application of the Industrial Security Program to Canadian Investors:

Section 2-205 (d) of the ISR notes that the Department of Defense has entered into reciprocal industrial security agreements with certain of its allies:

These agreements establish arrangements whereby a contractor facility located in either signatory country, which under the ownership, control, or influence of an entity from the other country may be declared eligible for access to classified information. This arrangement also provides for the clearing of foreign nationals who occupy a position required to be cleared in connection with the issuance of a FCL. FCL action is based on the receipt of an assurance from the government of the country from which the FOCI emanates that the parent firm has been cleared to the necessary level under that government's security laws and procedures. Since clearance actions in such cases rely, in part, on the investigative and clearance procedures of the other signatory government, such reciprocal agreements are negotiated only with countries whose security laws and procedures are substantially equivalent to those of the United States

In 1952 Canada and the U.S. signed an Industrial Security Agreement (amended in 1963 and 1985) which provides for certain industrial security procedures for transmission of releasable classified information and reciprocal contractor facility and personnel security clearances. However, the type of contracts not covered by the agreement are as important as the type of contracts covered. The agreement covers classified contracts placed or entered into by or on behalf of the Government of Canada in Canada or the United States and by the Government of the United States in Canada or the United States. The Agreement explicitly does not apply:

(1) In the case of contracts involving access to information that would not be releasable under applicable national disclosure policies; or

(2) In the case of firms under the ownership, control or influence of a third party country (exceptions are allowed on a case-by-case basis).

With respect to (1) above, little is known about the coverage and implications of the U.S. National Disclosure Policy (NDP). The basic document describing NDP (NDP-1, September 9, 1981 last updated June 22, 1984) is not subject to foreign disclosure, hence details of its provisions remain unknown. NDP calls for a "foreign disclosure review" to be undertaken prior to the release of classified data to

foreign governments. Similarly, a foreign disclosure review is called for with regard to unclassified information when it is related to a classified program or project. The criteria used in making the disclosure decision vary by country.

In addition to these exceptions, the U.S. Industrial Security Regulation Section 2-117 explicitly exempts contracts containing a number of categories of information -- including information which has not been specifically authorized for release to the government of the signatory country involved -- from coverage by reciprocal industrial security agreements.

The U.S. Defense Industrial Security Program, as detailed above, serves as a barrier to Canadian investors in the following ways:

1. A Canadian investor, as a practical matter, is unable to establish new production facilities in the United States for the purpose of executing contracts involving:

   * classified information falling outside the 1952 Industrial Security Agreement and Joint Certification Program;

   * classified information as enumerated in Section 2-117 of the Industrial Security Regulation; and

   * classified or unclassified information falling within the U.S. National Disclosure Policy and judged non-releasable.

   Generally, a FCL is required of a firm before it can submit a tender for a given procurement, but the FCL may not be available because the information necessary to submit a tender and execute the contract falls outside the Canada-U.S. Industrial Security Agreement, within the U.S. National Disclosure Policy, or within one of the exemptions to the Canada-U.S. Industrial Security Agreement enumerated in the Industrial Security Regulation.

2. A Canadian investor may be effectively prevented from investing in existing U.S. companies in possession of a FCL for contracts involving the aforementioned categories of classified information. If Canadian investment is made in such a case, the U.S. company may be subject to a re-evaluation of its existing FCL and runs the risk of losing its FCL as a result of becoming a company under FOCI.

2. International Emergency Economic Powers Act

The President is authorized to exercise vast powers to regulate the U.S. economy under the International Emergency Economic Powers Act (IEEPA). Section 1701(a) of IEEPA provides that its authority "may be exercised to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States." The President's powers are described in Section 1702(A):

(A) investigate, regulate or prohibit -

i) any transactions in foreign exchange;

ii) transfers of credit or payments between, by, through, or to any banking institution, to the extent that such transfers on payments involve any interest of any foreign country or a national thereof;

iii) the importing or exporting of currency or securities; and

(B) investigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest; by any person, or with respect to any property, subject to the jurisdiction of the United States.

In recent years, IEEPA has been used to freeze foreign government assets (Iran, Libya) and prohibit trade (Iran, Libya, Nicaragua). Although by its terms it appears that IEEPA could be used to block an investment from a U.S. ally such as Canada, it has never been publicly suggested that it would be.

H. The Committee on Foreign Investment in the United States (CFIUS):

In the early 1970s the U.S. Administration and Congress became increasingly concerned with the level of foreign investment in the United States (both direct and portfolio). During 1974, several Congressional committees held investigatory hearings in the area. This first policy review process found no reason to change current U.S. investment policy. However, it did lead to the enactment, in October of 1974, of the Foreign Investment Study Act. The Act required the U.S. branches and the U.S. subsidiaries of foreign parent companies of a certain size to file quarterly reports with the Department of Commerce giving information on the amount of their investment in the United States.

A second congressional policy review took place during 1975 as a result of the continuing inflow of petrodollars from OPEC to the United States. The 1975 policy review again concluded that existing U.S. law adequately protected U.S. interests. Nevertheless, the second review led to the passage, in 1976, of new legislation to monitor foreign investment in the United States (the International Investment Survey Act). However, this congressional action was preceded by action taken by the executive branch.

In May of 1975, President Ford signed Executive Order 11858. The Executive Order established a Committee on Foreign Investment (CFIUS) composed of assistant secretary level representatives from the Departments of State, Treasury, Defense, and Commerce, as well as the Assistant to the President for Economic Affairs and the Executive Director of the Council on International Economic Policy. CFIUS is chaired by the Treasury Department. According to the Executive Order, CFIUS has continuing responsibility within the Executive Branch for monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment. In particular, the committee:

* arranges for the preparation of analyses of trends and significant developments in foreign investments in the United States;

* provides guidance on arrangements with foreign governments for advance consultations on prospective major foreign governmental investments in the United States;

* reviews investments in the United States which, in the judgment of the Committee, might have major implications for U.S. national interests;

* considers proposals for new legislation or regulations relating to foreign investment as may appear necessary; and

* submits recommendations and analyses to the National Security Council and to the Economic Policy Board (now the "Economic Policy Council").

The Executive Order also directs the Secretary of Commerce to undertake a number of investment monitoring functions including "the close observation of foreign investment in the United States."

CFIUS has, however, no legal authority to block foreign investments in the United States. In fact, as U.S. law now stands, the President has no established authority to block foreign investments.

The role and influence of CFIUS has generally been downplayed by the U.S. government. For example, the Department of Commerce 1984 Report on International Direct Investment describes the responsibilities of CFIUS in detail including its mandate to enter into intergovernmental consultations on any investments of concern. Yet in the same report, the Department asserts that: "Screening and approval procedures vary significantly among countries. In some countries, such as the United Kingdom and the United States, there are no formal screening or approval mechanisms."

I. Fujitsu-Fairchild: A Case Study

Introduction:

The U.S. Administration's 1983 International Investment Policy Statement claimed that: "We provide foreign investors fair, equitable and non-discriminatory treatment under our laws and regulations. We maintain exceptions to such treatment only as are necessary to protect our security and related interests and which are consistent with our international legal obligations." The exceptions, rationalized on the grounds of national security, cover a significant portion of the American economy.

As discussed in earlier sections, in the marine sector, closure of the U.S. coasting trade to foreign participants and foreign investors is ensured through provisions of the Shipping Act and section 27 of the Merchant Marine Act. The rationale for the U.S. citizenship requirements for ownership of a U.S. flag vessel is that a U.S. controlled merchant fleet must be available in times of national emergency or war. In the communications sector, the Communications Act of 1934 prohibits foreign ownership of the basic telecommunications infrastructure, and even of operations generally considered peripheral to the network. The rationale for the prohibition is, again, that of national security. Other sectors restricted on the grounds of national security include petroleum and mineral resources and atomic power development and operation.

Even where there is no formal legal authority, the U.S. government has recourse to a number of informal policy instruments and processes to discourage, restrict, or otherwise regulate foreign investment in other industries it considers vital to U.S. national interests. This is demonstrated in the case of Fujitsu-Fairchild.

Background:

Fairchild Semiconductor Inc. is a wholly owned subsidiary of Schlumberger Limited. Fairchild produces semiconductors and various other microprocessor products at facilities in California, Washington and Maine. The company's book value is about $500 million. Fairchild, a successful company during the 1970s, has been in a slow decline for a decade. The company was especially hard hit by the recession that the semiconductor industry experienced in 1984-85. Fairchild's decline occurred despite the fact that its parent company, Schlumberger Limited, reportedly supported Fairchild to the amount of $1.0 billion since the time it purchased the company in 1979.

Schlumberger Limited is the wholly owned U.S. subsidiary of the French owned and controlled company of the same name. The French parent is active in oil production. The main line of business for Schlumberger U.S. is oil field and drilling services.

U.S. Department of Defense (DoD) contractors purchase between 30 and 40 percent of Fairchild's total output of high-speed computer circuitry and semiconductors; purchases worth over $100 million annually to Fairchild. Fairchild's semiconductor specialty is high speed "logic" devices, particularly Application Specific Integrated Circuits (ASICs) of a type known as Emitter-Coupled Logic (ECL). Despite its participation in a growth market (through the mid-1980s), Fairchild experienced continuing losses on its operations.

Schlumberger privately began looking for buyers for Fairchild in 1985. In October of 1986, Fujitsu Ltd. expressed interest in purchasing the company. Fujitsu is a Japanese multinational manufacturer of computers and data processing systems, telecommunications systems and equipment, semiconductors and other advanced electronic components. In 1985 Fujitsu had consolidated assets of $6.8 billion, consolidated net sales of $6.1 billion, and consolidated net income of $352 million (U.S.). Fujitsu operates in the United States through its subsidiaries, Fujitsu America, Fujitsu Systems of America, American Telecom Inc., and Fujitsu Microelectronics Inc.

In October of 1986, Fujitsu signed a letter of intent with Schlumberger to acquire 80 percent of Fairchild for $200 million. Shortly thereafter, Fujitsu announced plans to merge its U.S. subsidiary Fujitsu Microelectronics Inc. into Fairchild and to invest $400 million in the new operation over two years. The plan called for Fujitsu to acquire Fairchild by the end of January 1987. The proposal immediately generated concern within the U.S. Administration, the U.S. Congress, and elements of the U.S. semiconductor industry.

The U.S. government review of the proposed acquisition of Fairchild by Fujitsu followed two tracks: an antitrust review by the Department of Justice and consideration of the transaction's impact on the U.S. "national interest" by CFIUS.

Fujitsu and Fairchild notified the U.S. Justice Department's Antitrust Division of their merger plans in early November 1986 as required by the Hart-Scott-Rodino pre-merger notification statute. After an initial 30- day review of the proposed merger's potential anti- competitive effect, the Department of Justice issued a "second request" seeking more information from the companies about the market in which they operate. Some observers viewed this request as based not on concerns about the deal's anti-competitive impact, but rather as a way of slowing down the merger so that the CFIUS "national security" review would have additional time to be completed.

While the antitrust proceedings were taking their course, the Fujitsu-Fairchild case was brought before CFIUS. Staff representatives from the Departments of State, Treasury, Defense and Commerce, the Council of Economic Advisors, and the U.S. Trade Representative met to review the potential national security and other effects of the merger. Representatives of other interested agencies (such as the CIA, the NSC, OMB and the White House Science Advisor's Office) were also invited to attend and to comment on the possible implications of the merger.

The staff-level CFIUS meetings continued from November through January. The issues of concern were debated and narrowed, but no consensus on an Administration position was reached. Additional meetings at the Deputy Assistant Secretary level, then at the Assistant Secretary level, and finally at the Under Secretary level were held, but again no single position was settled upon.

Administration opponents of the merger (particularly Secretary of Commerce Baldrige and USTR Yeutter) stepped up their public attacks on the transaction in early March. The pressure from other domestic semiconductor makers to keep the Japanese out of the U.S. market also mounted as time passed.

On March 16, 1987, two days before the Cabinet-level Economic Policy Council was to take up the issue, officials of Schlumberger's head office in New York announced that Fairchild would not be acquired by Fujitsu. The statement cited "rising political controversy in the United States that made it unlikely that the sale of Fairchild could be completed in a reasonable time." The exact sequence of corporate decision-making within Schlumberger and Fujitsu leading up to the announcement is not known. It appears from press reports, however, that Fujitsu, in the face of opposition from at least some elements of the U.S. government, decided to back away from the deal.

The Position of Key Actors:

The U.S. Administration did not have an opportunity to take a formal position on the proposed merger because the acquisition was abandoned before CFIUS made any recommendations on the case. However, top Administration officials had made their views known:

* Secretary of Commerce Malcolm Baldrige publicly opposed the sale stating that control by the Japanese of a company so central to the United States high technology industrial base was unacceptable.

* U.S. Trade Representative Clayton Yeutter tied his concerns with the Fujitsu purchase to his problems in getting the Japanese to abide by the U.S.-Japan semiconductor agreement and to open up Japan to U.S. supercomputers.

* Defense Secretary Casper Weinberger never publicly opposed the sale, but a number of DoD officials objected to the transaction on the grounds that it would leave Japan in control of a major supplier of computer chips for the military and therefore threatened the defense industrial base.

* Secretary of the Treasury James Baker III argued against any action to block the sale on the grounds that it ran counter to the long-standing U.S. policy of "open investment" and would undercut U.S. efforts in the MTN to bring down investment barriers.

Congress did not directly take up the Fujitsu case, but congressional opposition to the takeover did emerge. Senator Exon (D-Nebraska), a member of the Senate Foreign Relations Committee, wrote directly to President Reagan arguing that the sale should be blocked because: "It is imperative for our national defense and overall security that we maintain our existing advantages over the numerically superior forces our potential enemies possess." Senator Metzenbaum (D- Ohio), Chairman of the Senate Judiciary Subcommittee on Antitrust and Monopoly, directed his opposition to the attention of the Justice Department, stating in a letter to the Antitrust division that the sale: ". . . may reduce domestic competition in the manufacture and sale of super-computers [an industry in which] . . . it is essential that the United States remain at the forefront."

The U.S. electronics industry viewed the controversy in the larger context of its deteriorating competitive position with Japanese manufacturers. It provided information and support to the government opponents of the acquisition. Leading industry spokesmen such as Wilf Corrigan of LSI Logic and Robert Noyce of Intel frequently spoke out against the merger. The Semiconductor Industry Association (SIA) also worked hard to undermine the proposed merger. Finally, the behind-the-scenes opposition of Cray -- the nation's leading maker of supercomputers and a major Fairchild customer -- raised a spectre of national security damage (Cray computers are heavily used by the U.S. intelligence agencies) that Fairchild and Fujitsu never overcame.

The Fujitsu-Fairchild case illustrates the type of outcome which can occur at the nexus of U.S. trade-investment-defense interests. The following paragraphs examine the case from this perspective and illustrate how the national security rationale so frequently cited by the United States can be put to uses which have little to do with defense objectives but much to do with trade and special interest group objectives.

The Trade Context:

The worldwide semiconductor industry suffered a serious recession in the 1985-86 period. Worldwide shipments fell 16 percent, but this decline was felt unevenly. Shipments for both Japan and Europe fell only 5 percent, reflecting the strong Japanese consumer electronics market and the diversity of the European market. In the United States, however, production was down 24 percent and consumption off 30 percent (Standard and Poors: 1987). Despite the recession, semiconductor capacity continued to expand dramatically on a worldwide basis. During 1984, over $6 billion dollars (U.S.) was invested by chipmakers in plant and equipment while another $4.5 billion was invested in 1985.

During 1984 the U.S. Semiconductor Industry Association filed a Section 301 complaint against the Japanese. Dumping charges against eight Japanese companies were also filed during 1985. In the same year, the U.S. Department of Justice began investigating allegations of predatory practices and the ITC considered a petition for a ban on imports of certain Japanese chips and products containing them. In this context the Japanese and American governments signed, on July 31, 1985, an agreement intended to open the Japanese market to U.S. companies (through doubling the share of U.S. semiconductor sales in the Japanese market from 9.8 percent to 20 percent), and providing for export price undertakings by the Japanese not

only for the U.S. market but for third countries as well. In particular, the Japanese government agreed to monitor costs and prices of semiconductors exported to the United States and seek to prevent Japanese firms from dumping semiconductors in countries where the two nations competed. In return for Japanese concessions, the U.S. industry agreed to drop charges of unfair trade practices against Japanese firms.

The existence of the Semiconductor Agreement and its implementation, however, has not resolved the semiconductor trade issues between the two countries. According to a January 1987 analysis by Standard and Poors:

* The prices charged by Japanese firms in the U.S. for certain types of semiconductors (DRAMs) have increased dramatically while prices of products for which American companies have large market shares in the United States have moved only slightly;

* In the sector of the U.S. market in which U.S. firms held a 50 percent share (EPROMS) prices are virtually unchanged, even though the fair market value established by the U.S. Department of Commerce for the specific product under the Semiconductor Agreement was pegged at $8-10, versus about $4.50 before the agreement;

* U.S. customers for DRAMs are threatening to go offshore for lower priced chips claiming that their systems have become less competitive because offshore competitors have been able to buy DRAMs at pre-agreement prices on the gray markets of third world countries; and

* Japan is alleged to have continued dumping of certain types of chips in third countries and this is leading to chips continuing to enter the United States at less than fair market value.

In late October of 1986, the USTR formally complained to the Japanese Ministry of International Trade and Industry about alleged continued dumping of EPROMs in the United States and Asia. The USTR relied on pricing data supplied by the U.S. Semiconductor Industry Association which indicated that Fujitsu, Hitachi, NEC and Toshiba were selling in the United States at the same "dumping prices" as before the semiconductor trade agreement was signed. The planned acquisition of Fairchild by Fujitsu was therefore considered by the USTR within the broader context of the semiconductor trade irritants in which Fijitsu was a key player.

The alleged abuse of the semiconductor agreement was not the only issue of concern to the USTR and the Department of Commerce. There was also the broader issue of the trade deficit with Japan in high technology products and the general competitive position of the U.S. computer industry. The trade problems in this sector were highlighted in October of 1986 in a report prepared for the Joint Economic Committee of the United States Congress (Finan, Quick and Sandberg: 1986). The report concluded that recent trade trends indicated the United States had not been maintaining, much less increasing, its position in high-technology trade and that:

> The evidence collected from the U.S. trade data suggests that in some high-technology sectors, the U.S. technical and engineering work force may have lost its competitiveness and that the once dominant qualitative advantages of the U.S. R&D base may have been significantly narrowed. As a result, a complex international division of activity is emerging in some high-tech sectors, as U.S. firms seek to maintain their competitive position vis-a-vis their foreign-based competitors. Whether such steps that maintain U.S. high-tech firms' competitiveness benefit the overall U.S. economy in the long run is an important question.

The Defense Context:

Table 1 (below) shows the top six suppliers of ECL chips to DoD contractors in 1986:

Table 1

	Company	Estimated Sales ECL to DoD	Country of Control
(1)	Motorola	$180 million	U.S.
(2)	Fujitsu	$125 million	Japan
(3)	Fairchild	$ 75 million	France
(4)	Hitachi	$ 75 million	Japan
(5)	Signetics	$ 45 million	Holland
(6)	Siemans	$ 40 million	Germany

The takeover of Fairchild would therefore still have left only one U.S. company as a major supplier to U.S. Department of Defense contractors, although a strict sole-source dependency would not have been created. The defense implications of foreign chip dependency were, nevertheless, being closely scrutinized by the DoD at the very time of the attempted acquisition of Fairchild by Fujitsu.

During the summer of 1986 two independent reviews of the implications of U.S. dependency on foreign semiconductor manufacturers were initiated. First, the Defense Science Board of the U.S. Department of Defense set up a special study group to report on the national security implications of the U.S. semiconductor industry's competitive position and the U.S. reliance on foreign chipmakers. A draft of the Defense Science Board study was in circulation in September of 1986 and the final report was made public on February 12, 1987. A second study covering the same subject matter was also commissioned by the National Security Council. A third study undertaken by the National Science Foundation, a U.S. government agency, examined, among other topics, the effects of U.S. dependency on Japanese semiconductors and other advanced microelectronics.

Each of these reports recommended that the U.S. federal government take steps to support the U.S. computer chip industry. The Defense Science Board group gave detailed consideration to a proposal from U.S. semiconductor companies for the establishment of a Semiconductor Manufacturing Technology Institute. The report recommended that the Institute be jointly funded by the Department of Defense ($200 million) and eligible U.S. companies ($250 million). Only those companies with "beneficial ownership in the United States" would be allowed to join the Institute. The National Security Council study is also reported to have recommended financial support for the industry. According to the New York Times, the NSC study warns:

> ... of dire effects for the American economy from dependence on Japan for chips. The report contends that, if Japanese companies wanted to withhold chips from the American market they "could be in a position to impede the ability of the U.S. to compete in almost any area of manufacturing." The report adds that "evidence already exists" that Japanese companies are withholding some chips.

The National Science Foundation asserted that U.S. national security could be impaired if Japan developed and commercialized certain technologies before the United States and then refrained from making them available until Japanese industry had profited fully from their commercial applications.

Conclusions:

While national security issues were at play in the U.S. government response to the takeover of Fairchild, it would appear that the central factors were the relationship of the takeover to the trade and competitive interests of the U.S. electronics industry as previously discussed. In effect, through their public opposition to the takeover, members of the U.S. Administration and Congress were identifying the semiconductor industry as a strategic sector off-limits to substantial control by foreign investors. They were also sending a signal to the Japanese about the need to uphold the U.S.-Japan Semiconductor Agreement and to open the Japanese market to U.S. products (particularly supercomputers).

As a strategic sector, the semiconductor industry required targeted policies relating to trade and investment. Such policies as the sponsorship of a U.S. industry government research institute for supercomputer development were only beginning to be implemented in late 1986. A high-profile takeover of a U.S. company in the sector may or may not have had adverse consequences for national security. However, it definitely would have had adverse consequences for the perceived support of the U.S. government for a beleaguered domestic industry suffering severe import competition. In such circumstances, formal (antitrust) and informal (CFIUS) policy instruments were brought to bear to discourage the acquisition. Although the issue of whether and how to block the acquisition was never faced fully by the U.S. Administration, the United States might well have taken steps to prevent the takeover. For example, the Defense Department could have threatened to reject future Fairchild bids for defense related procurements. Further pressure could have been brought to bear on Fujitsu through the medium of the U.S.-Japan semiconductor trade consultations or other trade negotiations.

The case of Fujitsu-Fairchild is an example not only of the means by which foreign investment can be restricted in the United States, but also as an example of how the national security rationale can serve other objectives aside from those of defense policy. The acquisition of Fairchild by a Japanese company was seen by a number of senior U.S. trade officials as a precursor of future foreign acquisitions in the U.S. semiconductor industry and other high-technology sectors. Such issues appear from press reports to have been of particular concern to Commerce Secretary Baldrige. Despite the Commerce Secretary's opposition, as well as similar concerns voiced by other cabinet officers, it is quite possible the President would not have tried to block the acquisition. Thus, in spite of the heated rhetoric related to the acquisition, there was a good probability that the acquisition by Fujitsu could have been completed.

Canadian investors in the United States to date have generally not been subjected to the type of restrictive actions experienced by Fujitsu. There is no reason to believe, however, in the absence of an agreement on investment that Canadian investors will be immune from such actions in the future.

ANNEX

The U.S. Net International Investment Position: Summary of Changes and Outstanding

U.S. Assets Abroad and Foreign Assets in the U.S. at Year end 1986 - Millions of U.S. Dollars

LINE	TYPE OF INVESTMENT	POSITION 1985[r]	CHANGES IN POSITION IN 1986 (decrease (-)) ATTRIBUTABLE TO: CAPITAL FLOWS (A)	PRICE CHANGES (B)	EXCHANGE RATE CHANGES (C)	OTHER CHANGES (D)	TOTAL (A+B+C+D)	POSITION 1986[p]
1	**Net International investment position (line 2 less line 12):**	(111,882)	(117,404)	(28,139)	8,865	(15,004)	(151,682)	(263,564)
2	**U.S. assets abroad**	949,371	95,982	8,704	11,768	2,063	118,517	1,067,888
3	U.S. official reserve assets:	43,185	(312)	-	5,670	(26)	5,331	48,516
4	U.S. Government assets, other than official reserve assets:	87,657	1,920	-	(124)	(5)	1,791	89,448
5	U.S. private assets:	818,527	94,374	8,704	6,222	2,095	111,395	929,922
6	Direct investment abroad:	229,748	28,047	-	-	2,095	30,142	259,890
7	Foreign securities:	112,833	3,302	8,704	6,222	-	18,228	131,061
8	Bonds:	72,994	2,561	2,274	2,328	-	7,163	80,157
9	Corporate stocks:	39,839	741	6,430	3,894	-	11,065	50,904
10	U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns:	28,583	3,986	-	-	-	3,986	32,569
11	U.S. claims reported by U.S. banks, not included elsewhere:	447,363	59,039	-	-	-	59,039	506,402
12	**Foreign assets in the U.S.:**	1,061,253	213,386	36,843	2,903	17,067	270,199	1,331,452
13	Foreign official assets in the U.S.:	202,502	34,698	3,597	-	-	38,295	240,797
14	Other foreign assets in the U.S.:	858,615	178,689	33,246	2,903	17,067	231,904	1,090,655
15	Direct investment in the U.S.:	184,615	25,053	-	-	(339)	24,714	209,329
16	U.S. Treasury securities:	83,636	8,275	4,045	-	-	12,320	95,956
17	U.S. securities other than U.S. Treasury securities:	202,628	70,802	29,201	2,903	-	102,906	309,534
18	Corporate and other bonds:	82,495	53,779	2,917	2,903	-	59,599	142,094
19	Corporate stocks:	124,133	17,023	26,284	-	-	43,307	167,440
20	U.S. liabilities to unaffiliated foreigners reported by U.S. non-banking concerns:	29,375	(2,791)	-	-	73	(2,718)	26,657
21	U.S. liabilities reported by U.S. banks, not included elsewhere:	354,497	77,350	-	-	17,333	94,682	449,179

Source: U.S. Department of Commerce

Notes: [p] Preliminary. [r] Revised.

1. Represents gains or losses on foreign currency-denominated assets due to their revaluation at current exchange rates
2. Includes changes in coverage, statistical discrepancy, and other adjustment to the value of assets.

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