CHINESE STATE CAPITALISM AND THE HOLDING FOREIGN COMPANIES ACCOUNTABLE ACT

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INTRODUCTION

In an age of unicorns that “[m]ove fast and break things,”¹ Chinese startup Luckin Coffee Inc. (“Luckin Coffee” or “Luckin”) moved at exceptional speed. Founded in October 2017, the Chinese Starbucks-equivalent grew from a single Beijing location to nearly 4,400 self-operated stores, over 1,600 partnership stores, and about 1,100 Luckin Coffee “EXPRESS” machines in over 220 cities in China by the end of 2021.³ Yet while the company was achieving tremendous growth—quickly overtaking Starbucks as the leading coffee chain in China—company management attempted to make the company appear even more successful through a series of fraudulent financial statements. Among other things, company executives created a “fake operations database,” altered bank records, and engaged in sham sales designed to create the appearance of faster growth, while simultaneously hiding their misconduct from regulators and their own finance department.⁴ The company overstated its revenues by 27% in the second quarter of 2019, and by 45% in the third quarter of 2019, while also understating its net losses for those quarters by 15% and 34%, respectively.⁵

Luckin provided these false statements in earnings calls with investors

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1. This “motto” is attributed to Mark Zuckerberg, Facebook CEO, who used it as a guiding principle for managing Facebook in its early days. See generally JOHNATHAN TAPLIN, MOVE FAST AND BREAK THINGS: HOW FACEBOOK, GOOGLE, AND AMAZON CORNERED CULTURE AND UNDERMINED DEMOCRACY (2018).
5. Id. at 2.
and in filings with the U.S. Securities and Exchange Commission (“SEC”), including offering documents for its 2020 initial public offering of $418 million in stock and its convertible bond issuance of $446.7 million. However, some investors were suspicious, and a “cryptic email” sent to numerous short sellers in January, 2020, warned that a “new generation of Chinese Fraud 2.0 has emerged,” with “[c]ompanies that start off as fundamentally and structurally flawed business model [sic] that evolves into fraud.” The email offered to share customer receipts and videos from Luckin locations, and included an eighty-nine-page report about the company that the anonymous sender suggested could be published under the name of one of the short sellers. Carson Block, an investor and founder of Muddy Waters LLC, posted the report on Twitter on January 31, 2020.

The stock price hardly moved after the posting, with much of the information in the report seemingly having already been impounded into the market price before it was broadly disseminated. But the stock took a tumble several weeks later as new information emerged and the full extent of the scandal began to take shape. Among other things, investigations later revealed that Luckin executives engaged in conflicted transactions, such as the sale of vouchers for tens of millions of cups of coffee to companies tied to Luckin’s controlling shareholder and chairman, Charles Lu.

Luckin Coffee’s fraud was a large but not unusual kind of corporate scandal. Similar (and even larger) accounting scandals contributed to the bursting of the Dot-Com Bubble in 2000, including frauds at HealthSouth, Tyco, WorldCom, and Enron. As a result of these scandals, Congress passed the Sarbanes-Oxley Act of 2002, which imposed a series of measures designed to ensure that corporate financial statements are accurate and fairly present the financial position of the company. Part of these regulations included the creation of a new quasi-governmental regulator, the Public Company Accounting Oversight Board (“PCAOB”), which was designed to scrutinize the auditors who themselves scrutinize the financial statements of public companies. For the PCAOB to properly perform its work in

6. Id. at 1.
8. Id.
protecting against accounting frauds, it must have access to the information that the auditors used to perform their audits.

The PCAOB’s access requirement brings the PCAOB in conflict with recently enacted Chinese law and policy, which not only limits what Chinese companies can share with external parties but also formally prohibits their cooperation with the PCAOB.\textsuperscript{12} In response to China upping the ante in a high-stakes game of sovereignty over financial regulation, the United States recently played its strongest hand: the SEC, at the direction of Congress, blacklisted Chinese companies listed on U.S. securities exchanges, threatening them with expulsion from U.S. securities markets unless the Chinese government allows access to the PCAOB. The blacklisting regulation, promulgated under the Holding Foreign Companies Accountable Act (“HFCAA” or “the Act”), includes not only suspect companies like Luckin Coffee but also any company headquartered in China and operating under Chinese law. Further, preventing accounting fraud is only part of the purpose of the HFCAA, and a fulsome understanding of the Act requires consideration of the political, economic, and regulatory context from which the Act emerged.

The HFCAA gambit seems to have been successful, as Chinese regulators recently agreed to allow PCAOB officials review audit records in Hong Kong—though some practitioners are skeptical that the agreement reached between Chinese and U.S. regulators will ultimately hold.\textsuperscript{13} Much is at stake because, while the HFCAA helps protect investors against accounting frauds of the type Luckin is alleged to have committed, the effects of the Act are subtler and more far-reaching, and the Act’s purpose in blacklisting foreign companies is as much (if not more) about foreign policy as it is about investor protection.

This Essay examines market blacklisting—a term the Essay uses to describe extraordinary government restrictions that limit a corporation’s ability to trade freely in U.S. markets—as a regulatory tool used to deny the benefits of U.S. markets to Chinese firms. Analyzing and recharacterizing the recently enacted HFCAA as a foreign-policy-oriented regulation, this Essay argues that jarring and serious accounting frauds such as Luckin’s are not the most important—or even primary—target of the Act. While capital markets blacklisting operates in opposition to the traditionally open posture of U.S. financial markets, blacklisting can also serve to achieve strategic foreign policy goals. In particular, the passage of the HFCAA demonstrates

\textsuperscript{12} See infra Part II.

that, in response to recent Chinese investment activity, the United States increasingly considers its financial markets as a rivalrous national resource and is becoming less willing to share that resource with its greatest economic competitor.

I. BLACKLISTING AS A REGULATORY POLICY

Blacklisting is often used by the U.S. government to enforce regulations and implement important governmental priorities. Consider, as an example, President Biden’s Executive Order on Ensuring Adequate COVID-19 Safety Protocols for Federal Contractors, which aimed to promote “economy and efficiency in Federal procurement by ensuring that the parties that contract with the Federal Government provide adequate COVID-19 safeguards” for their workers. The order, which was eventually enjoined as a result of numerous suits by state governments, required government contracts to include a clause (and for general contractors to include a clause in any subcontractor agreements) that the contractor or subcontractor would, for the duration of the contract, comply with all guidance for contractor or subcontractor workplace locations published by the Safer Federal Workforce Task Force. Among other things, the guidance provided by the Task Force generally required COVID-19 vaccination of contractor employees, and compliance by contractor employees and visitors with masking and physical distancing requirements. Contractors that failed to implement the standards would be subject to blacklisting by government contracting officers.

Blacklisting is also used in capital markets, and the HFCAA is not the first, or only, blacklist maintained by the SEC. The SEC also publicizes a list of companies that falsely claim to be registered, licensed, or located in the United States in their solicitation of investors. The “Public Alert:
Unregistered Soliciting Entities” (“PAUSE”) program, initiated in 2007, was developed to combat boiler-room operations and “advance fee” schemes in which fraudsters impersonate legitimate U.S. brokerages by, for example, using the same or similar names and addresses of legitimate brokerages, making false references or claims to endorsements from governmental agencies and international organizations (and according to the SEC, sometimes even impersonating agencies or organizations), or by claiming endorsements from governmental or international organizations that do not exist but appear official or legitimate.20

Another well-known example of blacklisting is the Department of the Treasury’s “Specially Designated Nationals and Blocked Persons List” (“SDN list”). Entry onto the SDN list typically follows an executive order designating a country, particular individuals, or particular business entities as subjects of U.S. sanctions, which typically prohibit U.S. persons from transacting with blacklisted entities by blocking or freezing U.S.-based or -controlled property of the blacklisted entity.21 In the case of recent sanctions against Russia, for example, President Biden ordered Treasury to block the assets of any person designated by Treasury as having operated in “technology sector or the defense and related materiel sector of the Russian Federation economy, or any other sector of the Russian Federation economy as may be determined by the Secretary of the Treasury.”22 The order also blacklisted anyone known to have engaged in “malicious cyber-enabled activities,”23 election interference, the undermining of democratic processes, corruption, assassination, deceptive or structured transactions that are designed to circumvent sanctions, or any other activities that “undermine the peace, security, political stability, or territorial integrity of the United States, its allies, or its partners.”24 The recent Russian sanctions also have extensive individual reach, with the prohibitions covering any current or former leader, official, and senior executive officer of the Russian government (including


21. As the Department of the Treasury explains, “[t]itle to the blocked property remains with the target, but the exercise of powers and privileges normally associated with ownership is prohibited without authorization from [the Office of Foreign Assets]. Blocking immediately imposes an across-the-board prohibition against transfers or dealings of any kind with regard to the property.” Frequently Asked Questions, U.S. DEP’T TREASURY, http://www.home.treasury.gov/policy-issues/financial-sanctions/faqs [http://perma.cc/4WVG-Q335].


23. Id.

24. Id.
any political subdivisions); any person or entity that engaged in the nefarious activities described above; and any spouse or adult child of any person whose property is blocked under the order.25

Blacklists have been a favored tool across U.S. administrations for responding to the actions of political and economic rivals—Russian policies and activities in particular. In addition to President Biden’s recent order, other blacklisting sanctions include the Countering America’s Adversaries Through Sanctions Act (“CAATSA”);26 the Global Magnitsky Human Rights Accountability Act;27 the Sergei Magnitsky Rule of Law Accountability Act of 2012;28 the Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014 (“SSIDES”);29 and the Ukraine Freedom Support Act Of 2014 (“UFSA”).30 The latest blacklisting sanctions are thus another salvo in a long-running financial cold war with the Russian Federation.31

II. BLACKLISTING UNDER THE HFCAA

Notwithstanding the prominence of other recent blacklisting efforts, the HFCAA may ultimately have the most significant economic and political impact. The origin of the Act is tied to the implementation of the Sarbanes-Oxley Act of 2002 and the work of the PCAOB in establishing rules and oversight mechanisms to govern the auditing of public companies.32 Among the PCAOB’s duties are requirements to register accounting firms that audit public companies; establish “auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers”;33 conduct inspections of registered auditors; conduct investigations and disciplinary proceedings concerning auditors; and generally enforce

25. Id.
31. Describing the sanctions in the language of war reveals some tension in the way that international law treats economic sanctions—are they an act of war, or should they be thought of as a kind of governance mechanism that protects the international order but is not itself considered a use of force? Note, in this respect, that the U.N. charter does not treat economic sanctions or economic coercion as a prohibited use of force. See Tom C.W. Lin, Financial Weapons of War, 100 MIFF. L. REV. 1377, 1413 (2016) (citing Michael Gervais, Cyber Attacks and the Laws of War, 30 BERKELEY J. INT’L L. 525, 551 (2012)).
33. Id.

The PCAOB’s obligations persist even when a public company is a foreign entity and its audit work is performed by auditors based in the entity’s home country. To facilitate its inspection and enforcement processes, the PCAOB typically enters into formal cooperative arrangements with local regulators. For example, the PCAOB entered into a cooperation agreement with the Financial Services Agency of Japan (“FSA”) under which each party agreed to share documents relating to auditors that fall within the regulatory jurisdiction of the FSA and the PCAOB and to provide mutual assistance in reviewing auditors’ work, internal controls systems, and quality control procedures.

The HFCAA itself is a slender, four-page act that has immense consequences for foreign firms, particularly U.S.-listed Chinese firms. The HFCAA amends the Sarbanes-Oxley Act of 2002 to require the SEC to disclose the identity of each company that, with respect to the preparation of the audit report on the company’s financial statements, retains a registered public accounting firm that has a branch or office located in a foreign jurisdiction that does not allow the PCAOB to “inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction.” To translate the act’s effect more bluntly, the SEC is required to name foreign companies—for reasons described below, read this as

34. The Free Enterprise Fund brought suit against the Public Company Accounting Oversight Board (“PCAOB”), arguing that the Sarbanes-Oxley Act of 2002 violated the Constitution and the separation of powers doctrine by giving broad powers to the PCAOB while limiting the President’s ability to appoint or remove board members. The Supreme Court held that “protection from removal is contrary to Article II’s vesting of the executive power in the President. The President cannot ‘take Care that the Laws be faithfully executed’ if he cannot oversee the faithfulness of the officers who execute them.” The Supreme Court left the remaining regulatory structure intact, however. See Free Enter. Fund v. Pub. Co. Acct. Oversight Bd., 561 U.S. 477, 484 (2010).

35. Audit work for U.S.-listed foreign companies is performed not only by local offices of the “Big Four” public accounting firms (Deloitte, Ernst & Young (“EY”), PricewaterhouseCoopers (“PwC”), and Klynveld Peat Marwick Goerdeler (“KPMG”)) but also by locally based audit firms. In 2021, for example, fifteen local, PCAOB-registered firms performed audits of 192 China- and Hong Kong–based companies. See YJ Fischer, Dir., Off. of Int’l Affs., Resolving the Lack of Audit Transparency in China and Hong Kong: Remarks at the International Council of Securities Associations (ICSA) Annual General Meeting (May 24, 2022) (transcript available on U.S. Securities and Exchange Commission website), http://www.sec.gov/news/speech/fischer-remarks-international-council-securities-associations-052422
[http://perma.cc/YA9P-2WM6].


Chinese companies—that are producing financial statements not subject to full PCAOB supervision.\(^{39}\) This lack of supervision is due to the fact that, according to the PCAOB, “PRC authorities have taken positions that render the Board unable to inspect or investigate completely registered firms headquartered in mainland China and Hong Kong.”\(^{40}\) If the SEC determines that a company has three consecutive non-inspection years, the SEC must “prohibit the securities of the covered issuer from being traded (i) on a national securities exchange; or (ii) through any other method that is within the jurisdiction of the [SEC] to regulate, including . . . ‘over-the-counter’ trading of securities.”\(^{41}\)

Rather than accept a “de facto double-standard compliance system,”\(^{42}\) in which Chinese companies listed in the United States are not subject to the same degree of audit oversight as other listed companies, the HFCAA requires the PCAOB to provide a report of any PCAOB determinations that it is unable to completely inspect or investigate registered public accounting

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\(^{39}\) As its mission has been explained by the PCAOB itself.

To restore investor confidence after several high-profile corporate fraud and accounting scandals in the early 2000s, Congress established the PCAOB to carry out a critical mission: overseeing the audits of public companies that avail themselves of U.S. capital markets (“issuers”) to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. To advance that mission, Congress directed the PCAOB to (1) inspect PCAOB-registered public accounting firms that regularly provide audit reports for issuers and (2) investigate potential violations of certain laws, rules, and professional standards by those firms and their associated persons. For over fifteen years, inspections and investigations have been key facets of the PCAOB’s operations and oversight.

\(^{40}\) The PCAOB asserts that PRC authorities assert that they must review audit work papers and related information before the PCAOB may access them during an inspection or investigation and that such access can be provided only under a cooperative agreement. Facing similar legal requirements in other jurisdictions, the PCAOB, over the course of more than a decade, has entered into bilateral agreements with more than 20 foreign authorities and has utilized cooperative arrangements to fulfill its inspection and investigation mandates without compromising U.S. statutory requirements. Yet to date, PRC authorities persistently have taken positions that prevent the finalization of or performance under cooperative agreements. As a result, the Board currently is unable to inspect and investigate completely firms headquartered in mainland China or Hong Kong.

\(^{41}\) Holding Foreign Companies Accountable Act § 2(i)(3)(A), 134 Stat. at 1064 (punctuation omitted).

\(^{42}\) Bu, supra note 2, at 511. The PCAOB’s description of the problem is similar:

By putting U.S. and non-U.S. registered firms on equal footing, Congress established a level playing field worldwide with respect to PCAOB oversight. But that playing field currently is not level. Although the PCAOB has conducted oversight activities in over fifty jurisdictions and currently has over 850 non-U.S. registered firms, authorities in a limited number of jurisdictions have denied the PCAOB the access it needs (and receives elsewhere) to conduct inspections and investigations. Limitations on the PCAOB’s oversight of firms that not only have registered voluntarily with the PCAOB but also have chosen to audit issuers deprive investors and the public of the benefits of the PCAOB’s work.

HFCAA DETERMINATION REPORT, supra note 39, at 2.
firms headquartered in a foreign jurisdiction because of a position taken by one or more authorities in that jurisdiction.\textsuperscript{43}

Wading through these provisions, the HFCAA is revealed as not so much a response to any particular scandal—such as the highly publicized Luckin scandal\textsuperscript{44}—as rather the escalation of a long-running regulatory, or even ideological, dispute: the United States sought to regulate companies accessing its markets, including through regulating the accounting firms that audit these companies; China resisted the application of these laws in China on the grounds of maintaining its sovereignty and protecting its national security,\textsuperscript{45} years of negotiations ultimately failed to produce any workable cooperation agreement; China enshrined its position in statutory revisions; and the United States responded by potentially prohibiting access to U.S.-regulated capital markets. As of July 2022, the SEC had blacklisted over 150 Chinese companies,\textsuperscript{46} essentially forcing China to acquiesce to PCAOB review.

From the Chinese perspective, it is not difficult to see why its government officials had resisted PCAOB audits and why the HFCAA is not viewed by Chinese officials as merely an investor protection regulation. Many Chinese firms are publicly traded but state-controlled enterprises. And, as Qingxiu Bu explains, China has argued that allowing the United States to enforce U.S. laws in China would “violate [Chinese] sovereignty

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\textsuperscript{43} Rule Governing Board Determinations Under the Holding Foreign Companies Accountable Act, PUB. CO. ACCT. OVERSIGHT BD. 17 (Sept. 22, 2021), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket048/2021-004-hfcaa-adopting-release.pdf?sfvrsn=f6d7b78_4 [http://perma.cc/D7LN-FCHE]. In making this determination, the PCAOB assesses “[i]ts ability to select engagements, audit areas, and potential violations to be reviewed or investigated”; its access to (and ability to retain) any document or information in the possession or control of the audit firm; and its ability to conduct inspections and investigations in a manner consistent with its rules and authority. See id. at 27. The PCAOB makes these assessments by considering, among other things, the laws, statutes, regulations, and rules of the relevant jurisdiction; whether the PCAOB (or the SEC) and the jurisdiction have entered into any agreement regarding the conduct of inspections and investigations; and the PCAOB’s experience with respect to the foreign authority’s other conduct relative to PCAOB inspections or investigations. Id. at 29.

\textsuperscript{44} While the Holding Foreign Companies Accountable Act (“HFCAA” or “the Act”) may not be a direct response to the Luckin scandal, Luckin nevertheless reinforced the position of the Act’s proponents that Chinese companies should not be allowed access to U.S. capital markets unless they fully comply with U.S. law, including by allowing the PCAOB to conduct audits.

\textsuperscript{45} See Roger Creemers, National Security Law of the People’s Republic of China, Digichina (July 1, 2015), http://www.digichina.stanford.edu/work/national-security-law-of-the-peoples-republic-of-china [http://perma.cc/NK2E-X9XM] (providing translation of a national security law passed by the Chinese government establishing “national security examination and supervision structures and mechanisms, to conduct national security examination of foreign investments that influence or may influence national security, specific goods or core technologies, online information technology products and services, construction projects involving national security affairs, as well as other major affairs and activities” and requiring citizens and organizations to keep state secrets they learn of confidential).

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and risk[] disclosure of state secrets.”

To secure its control over Chinese firms and Chinese state secrets embedded within those firms, recent revisions to Chinese security law prohibit other countries’ regulators, including quasi-public groups such as the PCAOB, from “directly carry[ing] out investigation and evidence collection within the territory of the People’s Republic of China.” Further, any information necessary to evaluate the effectiveness of an audit is likewise restricted, as “no entity or individual shall provide documents or materials related to securities business activities to other countries or regions” without the consent of the securities regulatory authority under the State Council (and it is this feature of Chinese law which ultimately puts into question full compliance with the PCAOB review requirement). The following Part clarifies and expands on the foreign policy purposes of the HFCAA.

III. FOREIGN POLICY MASKED AS DOMESTIC POLICY

While the HFCAA has been presented as an investor-protection act, the law is better understood as part of a broader political and economic struggle between China and the United States. Specifically, the following sections will argue that the HFCAA is intended to deny access to U.S. capital markets to a political and economic competitor offering a state capitalist economic model. Although the title of the HFCAA indicates its application to “foreign companies” generally, the legislative history of the Act and regulatory context in which it was formulated make clear that the Act is directed at China specifically. In the first instance, as a prominent law firm has noted, the HFCAA acts as a means to “address the U.S. government’s long-standing concerns with the limitations on the PCAOB’s ability to access China-based auditors imposed by the Chinese government based on Chinese laws governing the protection of state secrets and national security.” But more broadly, the HFCAA is designed to protect against state capitalism generally, and appears designed to respond to Chinese President Xi Jinping’s more muscular control of both state-owned and privately-held Chinese enterprises specifically. The focus on China, rather than merely on investor protection generally, can be seen through the legislative history of the Act, the language of the Act, and the broader regulatory context in which the Act was

47. Bu, supra note 2, at 510.
49. Id.
developed. Each of these are discussed in turn.

A. LEGISLATIVE HISTORY

The purposes of the HFCAA—and whether it is primarily about investor protection or focused as much or more on China as an economic and political competitor—are revealed in the legislative history of the Act. For its part, the SEC treats the rule as purely an investor-protection mechanism, consistent with the SEC’s own mandate. As the SEC adopted final rules implementing the HFCAA, SEC Chair Gary Gensler noted the bipartisan support for the Act, and stated that the SEC’s final rule “gets to the heart of the SEC’s mission to protect investors”:

We have a basic bargain in our securities regime, which came out of Congress on a bipartisan basis under the Sarbanes-Oxley Act of 2002. If you want to issue public securities in the U.S., the firms that audit your books have to be subject to inspection by the Public Company Accounting Oversight Board (PCAOB).

On the other hand, the HFCAA clearly has a political function. In fact, the HFCAA represents a significant change in policy in response to Chinese investment—the United States is treating market access and market liquidity as a rivalrous resource and is not willing to share that resource with its greatest economic rival. Although stock markets would normally be considered “anti-rival” goods that improve their value as they gain more users—with more firms and more investors generally resulting in increased securities liquidity that benefits all users of the markets—the U.S. government must also consider two potential negative effects from the listing of Chinese firms on U.S. markets.

The most obvious, of course, is the danger that poor quality accounting practices will result in losses for U.S. investors and decrease the overall quality of the market in general. This concern may be fairly characterized as a domestic policy concern, as it is focused on investor protection and, on its face, does not suggest a political motivation for the legislation.


53. Id.
Another potential negative effect, however, is that the listing of Chinese firms on U.S. markets presents a policy conundrum for U.S. regulators. On the one hand, U.S. regulators seek to maintain an open market. Free and open markets have practical benefits, but they also make an important political statement about the viability of the capitalist-based international economic order that the United States helped create through the post–World War II Bretton Woods agreements. On the other hand, Chinese firms represent a form of state capitalism that does not assign the same value to free markets; in this sense, while allowing the listing of foreign firms (including Chinese firms) signals that U.S. markets are the world’s leading capital markets, state capitalism presents a challenge to the economic system underlying those capital markets. This nuanced view of the tradeoffs in allowing access to Chinese firms is apparent in the floor statement of Kentucky Representative Andy Barr:

The United States has the most robust and advanced capital markets in the world. They provide access to capital for some of the most innovative businesses, and create an avenue for investors of all levels to save for retirement and plan for their futures. It follows that companies from around the globe flock to the U.S. capital markets to fund their businesses; and the U.S. is happy to be the destination for these firms. However, to play in our markets, companies need to play by our rules; and Chinese firms listed on American exchanges are the worst and most frequent offenders. Gone are the days when we can sit idly by and let Chinese firms, many with strong ties to the Chinese Communist Party [“CCP”], participate in our markets at the expense of protection for everyday investors.

The phrase “with strong ties to the Chinese Communist Party” contextualizes the concern with Chinese investment as political and not merely about poor quality audits. Rep. Anthony Gonzalez similarly noted that “the Holding Foreign Companies Accountable Act is designed to prevent companies based in China and certain other jurisdictions from taking advantage of our deep and liquid capital markets while avoiding the scrutiny that comes with inspection of their financial statement audits.”

54. As described by John Ikenberry, Bretton Woods created an entirely new type of open system—something that the capitalist world had not seen before. The Anglo-American agreements established sophisticated rules that would attempt to reconcile openness and trade expansion with the commitments of national governments to full employment and economic stabilization. At its heart, the Bretton Woods accord was an unprecedented experiment in international economic constitution building. G. John Ikenberry, The Political Origins of Bretton Woods, in A RETROSPECTIVE ON THE BRETTON WOODS SYSTEM: LESSONS FOR INTERNATIONAL MONETARY REFORM 55, 55 (Michael D. Bordo & Barry Eichengreen eds., 1993).
56. Id. at H6033 (statement of Rep. Anthony Gonzalez).
some members of Congress, the HFCAA seems to protect investors while also serving a foreign policy goal of protecting U.S. markets from Chinese state capitalism as exercised by the CCP. This subtext is made apparent through the language of the Act, as detailed in the following Section.

B. LANGUAGE OF THE ACT

The Act has several provisions which provide for heightened scrutiny of state-owned or state-controlled firms. First, the Act requires each blacklisted company to “submit to the [SEC] documentation that establishes that the [company] is not owned or controlled by a governmental entity in the foreign jurisdiction.”57 Second, blacklisted companies must also disclose the percentage of company shares owned by governmental entities in the foreign jurisdiction in which the company is incorporated, whether governmental entities in the audit firm’s jurisdiction have a controlling financial interest in the company, the name of each official of the CCP who is a member of the board of directors of the company, and whether the company’s articles of incorporation contain “any charter of the Chinese Communist Party.”58

State capitalism, especially as practiced by the CCP, presents inherent risks for other investors. The core governance question presented by publicly listed, state-controlled entities is whether the controlling government will use the firm for political purposes, take advantage of government regulatory powers and information flows to engage in anticompetitive behavior, or threaten other countries’ national security through strategic behavior, including through merger and acquisition activity.59

State-owned entities (“SOEs”) serve both political and economic purposes and are a common feature of every nation’s economy. Even predominantly market-based economies, such as the United States, have numerous state-owned or state-sponsored firms that deliver public goods not otherwise provided through ordinary market forces.60 But state control can present negative externalities in at least two significant dimensions. First, state ownership can impact other investors who may be assuming that the

58. Id. § 3(b)(5), 134 Stat. at 1065–66.
59. Some of these concerns have also been raised in response to sovereign wealth fund investment activity. See, e.g., Robert M. Kimmitt, Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy, FOREIGN AFFS., Jan.–Feb. 2008, at 121–24 (arguing that sovereign wealth funds may not invest on commercial grounds consistent with free market principles).
60. See generally KEVIN R. KOSAR, CONG. RSLCH. SERV., FEDERAL GOVERNMENT CORPORATIONS: AN OVERVIEW (2011) (providing an overview of government corporations—agencies established by Congress to provide public goods or services and produce revenues that cover their costs).
public listing of the firm suggests that the firm will be operated according to standard commercial principles. The purpose of the particular corporation is ultimately a question of corporate law and governance, and potentially an issue of securities regulation as it relates to the disclosure of the risks of government influence. Second, government ownership may impact the host country because the state-controlled firm may be used as a tool that harms the host country. Some of the risks presented by state control may be overtly nefarious. As noted above, the firm may be used to acquire sensitive technologies, for example, and weaken the national security of the host country. Firms may also present risks through practices that may be considered typical when conducted by a private company but present heightened risks when the firm is controlled by, influenced by, or otherwise connected to a government.

Private Chinese firms have provoked considerable concern for their ties to the CCP. For example, TikTok’s 2021 U.S. privacy policy change drew the attention of users, regulators, and the media when they recognized that the policy allowed TikTok to “share all of the information we collect with a parent, subsidiary, or other affiliate of our corporate group.” This means that TikTok may share data with ByteDance, its parent company, which in turn may share data with the Chinese government without a user’s consent “if ‘the data relates to national security, national defense, public security, or public health’ or to ‘meet the requirements of relevant laws, regulations, procedures, and judicial proceedings.’” As there are no clear standards with respect to what may constitute a risk to Chinese national security, national defense, or public security, the policy, in the view of a cybersecurity analyst, “effectively boils down to what the state wants, the state gets.”

As Curtis Milhaupt and Wentong Zhang have noted, the boundary between government and private firms generally is often “more porous than conventional analysis assumes” because of the exercise of government control rights and interventions through taxation, regulation, and subsidization. This is particularly the case in China, where many firms have a mixed-ownership model in which shares are held by both the government and private investors. But regulating firms based on government control

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62. Id. (quoting ByteDance’s privacy policy).
63. Id.
65. Id. at 673 n.28 (“The three main categories of shareholders of publicly listed firms in China are the state, institutional shareholders (also known as legal person investors), and individual investors,
over the shares through direct ownership does not capture the nuances of Chinese state influence over firm behavior. Firms that are directly owned by the Chinese government and operated as defined SOEs\textsuperscript{66} are often governed loosely: the Chinese government collects “little or no dividends,” has little control over management compensation practices, and regularly fails to implement major operational and policy decisions.\textsuperscript{67}

On the supposed “private” side of the public/private divide, China’s private firms do not operate autonomously from the state; Milhaupt and Zhang note that large private firms in fact “bear striking resemblance to SOEs along the dimensions typically thought to distinguish state-owned firms from the private sector: ready access to state power and largesse, proximity to the regulatory process, and little autonomy from discretionary state intervention in business judgment.”\textsuperscript{68} Most of the largest private firms in China are led by controllers who are or were members of central or local party-state political organizations.\textsuperscript{69} The Chinese government also directly subsidizes some private firms and exercises “extralegal control” through government-influenced industrial trade groups or through “interviews” with government officials in which private firm managers are often persuaded to adapt business practices to align with government policies.\textsuperscript{70}

Review of audits by the PCAOB would potentially have the effect of clarifying the mechanisms of government influence in China, and Congress and regulators perhaps intend that by forcing disclosure, if only to the PCAOB, the CCP would be encouraged to reduce ties or decrease its influence with Chinese firms trading on U.S. capital markets. In turn, a move away from the state capitalist model would reduce the likelihood that such influence—as well as any state secrets contained within the firms—would be divulged to U.S regulators. Because state capitalism is core to President


\textsuperscript{68} Id. at 683 (describing the subsidization of Geely Automotive and Huawei, both ostensibly private companies operating in strategic economic sectors and receiving significant government support).

\textsuperscript{69} Id. at 684 (finding that “ninety-five out of the top one hundred private firms and eight out of the top ten Internet firms whose founder or de facto controller is currently or formerly a member of central or local party-state organizations such as People’s Congresses and People’s Political Consultative Conferences”).

\textsuperscript{70} Id. at 687 (describing the role of regulators such as the National Development and Reform Commission (“NDRC”) in prodding, and sometimes ordering, regulated firms to comply with governmental policies).
Xi Jinping’s political and economic ambitions for China, however, China has thus far refused to accept the U.S. position, and indeed took an adversarial position by prohibiting firms to cooperate with the PCAOB.

C. REGULATORY CONTEXT

The HFCAA is just one of several recently proposed bills that have been specifically designed to manage risks related to Chinese investment. The House’s 2020 China Task Force Report, for example, finds that “[a]s a result of the U.S.’ openness to business and entrepreneurship, PRC companies have access to U.S. capital and investment markets. All these companies are connected to the CCP in some manner and many are complicit in human rights abuses.” Chinese direct investment in the United States was particularly high in 2016 and 2017, and the task force’s report (as well as the regulations described below) was in part a response to concerns arising from Chinese investment in the United States. As shown in Figure 1 below, Chinese investment has risen dramatically in recent years, and U.S. regulatory responses have been commensurately intense (and indeed have already appeared to have a significant, negative impact on Chinese investment).

71. See, e.g., Barry Naughton, Six Factors Behind China’s Shift to “Grand Steerage,” in CHINESE STATE CAPITALISM: DIAGNOSIS AND PROGNOSIS 3, 3 (Scott Kennedy & Jude Blanchette eds., 2021) (describing how “Chinese policymakers have made a dramatic turn away from the market reforms that dominated policy through the turn of the twenty-first century and toward an ambitious embrace of government steerage and pervasive intervention in the (still market-based) economy”).
73. Id. at 78.
74. Id. at 3–4.
Figure 1. Chinese FDI in All U.S. Industries from 2006–2020 (in Billions)


The report recommends, in addition to the HFCAA, supporting SEC reforms to “improve disclosures relating to emerging market investment risk, including the risks of investing in the PRC;” considering additional legislation requiring “the SEC to assess whether it is appropriate for PRC issuers to disclose information regarding certain support provided to, or received by, the government of the PRC, as well as senior positions held at the issuer by members of the PRC government or the CCP”;76 considering “legislative proposals regarding the risks of investing in PRC companies in retirement accounts” (such as restricting the federal Thrift Savings Plan from investing in any security “that is listed on exchanges located in jurisdictions where the PCAOB is unable to inspect registered accounting firms – which would include companies listed on PRC exchanges”);77 and considering


77. McCaul, supra note 72, at 79, 104. This measure has been proposed in the Taxpayers and Savers Protection Act. Taxpayers and Savers Protection Act, H.R. 6614, 116th Cong. (2020).
legislative proposals\textsuperscript{78} to “examine capital flows to PRC entities that threaten U.S. national security.”\textsuperscript{79}

Among the most significant China-focused regulations is the recent modernization of U.S. foreign investment rules in 2018 through the Foreign Investment Risk Review Modernization Act (“FIRRMA”),\textsuperscript{80} which refined the investment review process managed by the Committee on Foreign Investment in the United States (“CFIUS”). Although the regulation applies to all foreign investment, the FIRRMA revisions were unmistakably designed to respond to Chinese investment practices.\textsuperscript{81} And while the substantive provisions of FIRRMA do not specifically prohibit Chinese investment, the legislation’s impetus is revealed through special reporting obligations applicable to Chinese investment. Under FIRRMA, the Secretary of Commerce must prepare a report on total direct investment from China, including a breakdown on “government and non-government investments, including volume, sector, and type of investment within each category.”\textsuperscript{82}

A foreign policy purpose similar to the HFCAA is seen in the legislative history in FIRRMA as well. Rep. Sherman stated,

Foreign investment in the United States often benefits us. We should encourage and welcome foreign investments that create jobs for American workers. But when a firm absorbs innovative American technology and an innovative American company and then transfers the know-how and the jobs, often to China, we may have a problem.\textsuperscript{83}

\textsuperscript{78} McCaul, supra note 72, at 79; see Summary of H.R.8407 - Protecting National Security in Financial Investments Act, CONGRESS.GOV, http://www.congress.gov/bill/116th-congress/house-bill/8407 [http://perma.cc/7GZ8-C7V5] (requiring the SEC to “determine whether issuers of securities must disclose investments in certain persons reasonably believed to be involved, or to pose a significant risk of being or becoming involved, in activities contrary to the national security or foreign policy interests of the United States.”).

\textsuperscript{79} McCaul, supra note 72, at 79. With respect to “proposals to examine capital flows to PRC entities that threaten U.S. national security,” the report also notes potential amendments to another government blacklist, the Department of Commerce’s Bureau of Industry and Security’s Entity List. Id. at 79. The Entity List “publishes the names of certain foreign persons – including businesses, research institutions, government and private organizations, individuals, and other types of legal persons - that are subject to specific license requirements for the export, reexport and/or transfer (in-country) of specified items.” CBC FAQs - 1. What Is the Entity List?, BUREAU INDUS. & SEC., http://www.bis.doc.gov/index.php/cbc-faqs/faq/281-1-what-is-the-entity-list [http://perma.cc/BTD4-ZXNM].


\textsuperscript{81} As Covington & Burling partner David Fagan notes, “[w]hile no express reference is made to China in the substantive provisions of FIRRMA, the clear intent of the legislation is to give CFIUS greater visibility into a range of Chinese investment in the United States, and in turn the legislation likely will limit somewhat the totality of Chinese investment in the United States.” Mercy A. Kuo, CFIUS and China: The FIRRMA Factor, DIPLOMAT (Oct. 17, 2018), http://www.thediplomat.com/2018/10/cfius-and-china-the-firrma-factor [http://perma.cc/G4J6-XUM5].

\textsuperscript{82} § 1719(b)(2)(E), 132 Stat. at 2200.

The problem is ultimately a political issue and not merely a disagreement over government intervention in private markets. Chinese investment is treated differently not only because of China’s state capitalist system but also because of China’s preeminent status as a geopolitical rival.

CONCLUSION

Foreign company blacklisting is likely to continue to play an important role in U.S. policy and to help shape domestic policy, such as through the protection of investors, employees, or consumers. The HFCAA shows that blacklisting can also play an important foreign policy role. While the HFCAA is undoubtedly an important investor-protection regulation, it also serves to deny Chinese state capitalism the benefits of U.S. markets unless China is willing to bend to the demands of the PCAOB. Whether they will ultimately accept these demands, as seemingly promised by the recent agreement between U.S. and Chinese regulators, will be seen in the coming weeks and years. For now, the HFCAA highlights the tension inherent in maintaining open markets: market access and liquidity can be used to challenge the principles on which the market itself is based. U.S. capital markets, and federal regulation of those securities markets, are designed to improve the efficient allocation of resources in an economy.\(^84\) That efficiency arises from the dispersed, individual decision-making of thousands of separate trading decisions made by investors around the world. A state-capitalist system, by definition, shapes the allocation of capital. For U.S. policymakers, then, market access to state capitalists presents a conundrum in that it provides the liquidity of a large private market system to market actors operating within a system based on state control of the economy, as opposed to a market-driven economy.

As must be acknowledged, however, the U.S. economy is not free from significant nudges by state and federal governments. While scholars have underlined concerns with running government like a business,\(^85\) a less-studied problem is the pressure applied to corporations to run their businesses like a government. This is reflected in the discussion of corporations as micro-democracies in which shareholders stand in as citizens of the corporate state.\(^86\) It is also reflected in direct governmental interventions wherein corporations are co-opted to enact governmental

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\(^84\) See generally James J. Park, Rule 10b-5 and the Rise of the Unjust Enrichment Principle, 60 DUKE L.J. 345 (2010) (describing various perceptions of the purpose of securities regulation, including informational and allocational efficiency).


\(^86\) For a discussion and criticism of this position, see Usha Rodrigues, The Seductive Comparison of Shareholder and Civic Democracy, 63 WASH. & LEE L. REV. 1389 (2006).
policies. This is the case, for example, with the SEC’s proposed rules on climate change disclosures, which require corporations to produce disclosures that may not be material to the corporation itself but are intended to provide disclosure network effects that may benefit the market as a whole. In the case of the SEC’s new climate change rules and in the context of COVID-19 or labor law blacklisting, the government is exercising its power as the regulator of capital and labor markets to effectively exert control over market access not only to ensure proper functioning of the market itself, but also to advance other political goals.

For both domestic and foreign policy reasons, Congress and agency regulators shape markets in a variety of ways that suggest that Chinese state capitalism and U.S. market capitalism are not diametrically opposed, but exist on a continuum of government influence. Even if the differences between the systems are not as stark as is often assumed, however, the HFCAA makes clear that U.S. legislators and regulators view Chinese state capitalism and policies in the same ways that they view other states. The chicken-or-egg problem suggested in the dynamic between states and markets—that is, whether a liquid capital market could develop independent of the state, or whether the state is ultimately the architect of the market and allows corporate activity to flourish by concession—was debated in Citizens United v. Fed. Elections Comm’n, 558 U.S. 310 (2010), although in his dissent Justice Stevens acknowledged that “[w]e have long since held that corporations are covered by the First Amendment, and many legal scholars have long since rejected the concession theory of the corporation.” Id. at 432 (Stevens, J., concurring in part and dissenting in part). Taisu Zhang and John Morley’s recent research suggests, however, that the “business corporation can only emerge with robust institutional support from a sufficiently modern state, in the form of legal enforcement, dispute resolution, and information sharing” and that “modern state-building is necessary to the success of the modern corporation because the legal arrangements that enable corporations require uniform enforcement.” Taisu Zhang & John Morley, The Modern State and the Rise of the Business Corporation, 132 YALE L.J. 1970, 1974 (2023). Assuming that Zhang and Morley are right that the state is essential to the creation of the corporate form, however, does not necessarily imply that the corporate form should exist to serve the political purposes of the government; the creation of the corporate form, the limited liability that attends the form, and robust capital markets that result from the utility of the corporate form already represent a public good through the generation of economic activity. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, Limited Liability and the Corporation, 52 U. Chi. L. Rev. 89, 97 (1985) (arguing that “society as a whole, receives benefits from limited liability” and the corporate form).

Linking back to corporate blacklisting designed to achieve domestic policy goals, described in Part I, we also recognize that the United States similarly uses channels of influence—and sometimes direct regulation—to encourage companies to implement governmental policies. The blacklisting of domestic companies serves an important policy function in pushing companies to act in areas where, for example, the executive branch has not been explicitly empowered to act. The irony of some government blacklisting efforts, then, is that it connects corporate governance with government interests in much the way that Chinese firms and the Chinese government are linked. Although the channels of influence may be different, in each case ostensibly private enterprise is used to serve governmental ends. In this respect, then, the disputes over Chinese access to U.S. markets may not represent merely an issue of investor protection, nor even an ideological competition between free markets and state-controlled markets, as both governments operate on a continuum between free markets and state control (though the United States is decidedly more toward the “free market” pole of the continuum). Instead, regulations like the HFCAA reveal a more complex contest in which the incumbent hegemon is attempting to manage the growth of a great economic and political rival.

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capitalism as not merely a difference in degree, but in kind. And, most importantly, the state capitalism practiced by the United States’ chief economic and political rival is viewed as a potent threat that should not be strengthened through the market access and liquidity provided by U.S. stock markets.