

WASHINGTON LEGAL FOUNDATION
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January 24, 2008

Ms. Gay Hartwell Sills
Staff Chair
Committee on Foreign Investment in the United States
Office of International Investment
Department of Treasury
1500 Pennsylvania Avenue, N.W., Room 4201 NY
Washington, DC 20220

Re: CFIUS Investigation of Proposed Acquisition of 3Com Corp.

Dear Ms. Sills:

The Washington Legal Foundation (WLF) is writing to express its extreme concern over the proposed acquisition of 3Com Corp. by a group that includes Huawei Technologies. While WLF strongly supports the free flow of capital as a vital component of U.S. economic strength, we believe that the 3Com Corp. acquisition -- as currently structured -- raises grave national security concerns.

WLF urges the Committee on Foreign Investment in the United States (CFIUS) not to approve the transaction unless the purchasers agree to divest themselves of those portions of 3Com Corp. engaged in highly sensitive national security work. In particular, WLF urges CFIUS to require the divestiture of TippingPoint, the 3Com division that deals with the U.S. military.

WLF recognizes that any time the U.S. government steps in to block foreign acquisition of U.S.-based assets, there is a danger that the move will send a signal that the U.S. is hostile to foreign investment and will provide other nations with an excuse to raise barriers to U.S. investments. Nonetheless, the potential compromise of U.S. national security interests is simply too great to ignore in this instance. Moreover, allowing the deal to go through without restructuring could trigger a significant public reaction (similar to the reaction that followed approval of Dubai Ports World's acquisition of terminal operations at major U.S. ports) that could result in significant new restrictions on investments.

I. Interests of the Washington Legal Foundation

The Washington Legal Foundation is a public interest law and policy center headquartered in Washington, D.C., with supporters in all 50 states. WLF regularly appears

before federal and State courts and administrative agencies to promote economic liberty, free enterprise, and a limited and accountable government. In particular, WLF has regularly supported efforts to reduce barriers to the free flow of capital across international borders.

WLF also strongly supports efforts to promote and protect U.S. national security. It repeatedly has supported the Executive Branch in opposing judicial challenges to measures designed to protect the nation from those who seek to do us harm. *See, e.g., American Civil Liberties Union v. National Security Agency*, 493 F.3d 644 (6th Cir. 2007). WLF recognizes that these two goals -- ensuring the free flow of capital and the protection of national security interests -- will occasionally come into conflict. Resolution of such conflict requires recognition of the importance of both goals and the need to reach accommodations based on the specific facts surrounding each such conflict.

WLF has no direct financial interests in the proposed acquisition of 3Com, nor does it have any financial ties to business rivals who might oppose the proposed acquisition.

II. The Proposed 3Com Corp. Acquisition

WLF obviously does not have access to the detailed information regarding the proposed 3Com Corp. acquisition that is available to CFIUS. As we understand the proposed deal from publicly available accounts, Huawei Technologies has teamed up with Bain Capital Partners (Bain) to make a \$2.2 billion takeover bid for 3Com. Huawei's initial stake would be 16.5 percent, with the right to increase that share to 21.5 percent. Bain has stated that Huawei would not have any operational control over 3Com.

Acquisition of 3Com includes acquisition of its substantial military-related work with the U.S. Department of Defense (DoD). 3Com's TurningPoint division supplies intrusion prevention technology to DoD, designed to prevent intrusions into vital telecommunications systems maintained by DoD. Obviously, such intrusions raise vital national security concerns. Nor are such intrusions merely hypothetical; DoD believes that the Chinese military conduct a massive cyber-attack on its systems in June 2007, an attack that temporarily shut down DoD systems. The technology supplied by 3Com plays a vital role in efforts to prevent such attacks in the future.

III. Huawei Technologies

Huawei Technologies, headquartered in China, is undoubtedly one of the world's leading telecommunications companies. Its total 2007 sales exceeded \$15 billion. Given the vital role that foreign investment plays in the health of the American economy, there is every reason to encourage investments by Huawei in U.S.-based assets.

This particular investment raises national security concerns, however, because of the considerable uncertainty that surrounds Huawei's corporate status. Huawei is controlled by Ren Zhengfei, a wealthy Chinese businessman. He reportedly owns 1% of outstanding Huawei shares, and just who owns the remaining shares is far from clear. Zhengfei contends that Huawei is 100 percent employee-owned; but there is at least some basis for concern that the Chinese government and/or the People's Liberation Army either own or have significant control over Huawei. The Rand Corporation, for example, reports that Huawei has "deep ties" with the Chinese military. Zhengfei himself is a former officer in the People's Liberation Army.

Moreover, Huawei has had a history of sharing its technology with enemies of the United States. The CIA has reported that in 2000, Huawei -- in violation of a United Nations embargo -- sold fiber optics equipment to Iraq for the purpose of upgrading Iraq's military technology. Huawei also maintained business dealings with the Taliban regime in Afghanistan. And of course, Huawei's business dealings with the Chinese military -- which Huawei insists are not all that extensive -- are troublesome in light of the 2007 Chinese cyber attack on the United States.

IV. Implications of the 3Com Acquisition for U.S. National Security

Huawei would be only a minority owner of 3Com if the proposed acquisition is allowed to go through. Bain asserts that Huawei would not obtain any operational control over 3Com, and WLF has no basis for doubting that assertion.

But WLF finds it hard to believe that Huawei -- which is in the process of rapid international expansion in the telecommunications field -- is involved in the proposed acquisition solely because it intends to remain a passive investor in 3Com (which has been unprofitable for quite some time). Gaining access to 3Com technology must have played a significant role in its decision.

That technology includes the most advanced intrusion-prevention technology, used by DoD to prevent cyber attacks of the sort it experienced in June 2007. An enemy of the United States bent on engaging in such attacks would greatly desire access to such technology; knowledge of the defenses employed by DoD would enhance an enemy's ability to circumvent those defenses. According to DoD, China has been responsible for such attacks in the past, and there is every reason to believe that it may attempt more attacks in the future. Given the uncertain relationship between Huawei and the Chinese government and/or military, there are significant reasons for concern that any military-related technology to which Huawei gains access would eventually make its way into the hands of the Chinese government/military.

V. Proceedings Before the CFIUS

According to a news article in the November 30, 2007 *Washington Times*, the U.S. Director of National Intelligence has determined that the proposed acquisition of 3Com represents a threat to national security. WLF understands from other news accounts that the CFIUS in early January 2008 commenced a 45-day investigation under § 721(b)(2)(A) of the Defense Production Act of 1950 (DFA) of the proposed acquisition. Such 45-day investigations are triggered only after CFIUS has determined that one of the criteria set forth in DFA § 721(b)(2)(B)(i) have been met -- in this case, one presumes, a CFIUS determination that "the transaction threatens to impair the national security of the United States and that threat has not been mitigated during or prior to" the initial 30-day review. DFA § 721(b)(2)(B)(i)(I).

WLF is concerned that CFIUS not take any action that signals a xenophobic aversion to foreign investment in the United States. China currently is one of the world's leading source of overseas investment capital, and WLF would oppose any action that would signal that Chinese capital is no longer welcome. Nonetheless, the national security concerns outlined above are not simply the product of fevered imaginations. No amount of promises from Bain can assure that 3Com intrusion-protection technology will not make its way into Huawei's possession; and once there, there is little reason to think that the technology could not easily makes its way into the hands of the Chinese military.

WLF believes that CFIUS can demonstrate its twin commitment to free flow of capital and to national security by approving the 3Com acquisition subject to the requirement that Bain divest itself of 3Com's TippingPoint division. The proposed acquisition to date has not received significant public attention. However, approval of a transaction that could facilitate the Chinese army's acquisition of our latest intrusion-protection technology would likely prompt a massive public outcry rivaling the outcry that followed the Dubai World Ports acquisition in 2006. Such a reaction would be virtually inevitable, given that 2008 is a Presidential election year. The 2006 ports incident led to the adoption of the Foreign Investment and National Security Act of 2007 (FINSAs), which strengthened congressional oversight of the CFIUS review process. WLF is fearful that a repeat of the 2006 incident would lead to calls for even greater oversight -- and the inevitable politicization of virtually all investment-approval decisions. CFIUS would do itself and the entire business community a tremendous favor if it prevented such a scenario by blocking Huawei from obtaining ownership over any portion of 3Com that engages in the production of advanced intrusion-protection technology.

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VI. Conclusion

The Washington Legal Foundation respectfully requests that the CFIUS not approve the proposed 3Com acquisition in its current form, unless and until all national security concerns have been fully addressed. Unless CFIUS has access to non-public information that eliminate such concerns -- AND UNLESS IT IS WILLING TO RELEASE SUCH INFORMATION PUBLICLY AT THE CONCLUSION OF ITS INVESTIGATION -- WLF requests that CFIUS not approve the acquisition of 3Com unless Bain commits to the divestiture of 3Com's TippingPoint division.

Respectfully submitted,

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