S. HRG. 109–805

A REVIEW OF THE CFIUS PROCESS FOR IMPLEMENTING THE EXON-FLORIO AMENDMENT

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

ON

THE IMPLEMENTATION OF THE EXON-FLORIO PROVISION BY THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS), WHICH SEEKS TO SERVE U.S. INVESTMENT POLICY THROUGH REVIEWS THAT PROTECT NATIONAL SECURITY WHILE MAINTAINING THE CREDIBILITY OF OPEN INVESTMENT POLICY

OCTOBER 6 AND 20, 2005

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A REVIEW OF THE CFIUS PROCESS FOR IMPLEMENTING THE EXON-FLORIO AMENDMENT

THURSDAY, OCTOBER 6, 2005

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will now come to order. Senator Sarbanes will be here as soon as he can.

This morning, we are meeting to hear testimony on the role of the Committee on Foreign Investment in the United States. This hearing was to include representatives from the Federal agencies that comprise that Committee, commonly known by its acronym, CFIUS. Unfortunately, some of those agencies were not able to present their cases here today, nor were they prepared to do so on September 29, when this hearing was originally scheduled. It is the Banking Committee's hope that we will be able to hear from those agencies in the very near future, as no examination of the process by which foreign acquisitions of U.S. companies are reviewed for potential national security implications can be complete without their testimony.

Neither the public nor the agencies that comprise CFIUS should be under any misunderstanding about this Committee's position on the current process. Evidence and analysis indicates that improvements are needed. The extent to which changes are warranted, however, is unclear. The current process for reviewing proposed acquisitions remains excessively murky. It is too opaque to allow for the appropriate level of Congressional oversight into a process established by Congress with passage in 1988 of the Exon-Florio Amendment to the Defense Production Act. That is why Congress has repeatedly tasked its investigative arm, the Government Accountability Office, GAO, to conduct studies on this subject.

The process by which the CFIUS reviews proposed foreign acquisitions for national security implications may remain too opaque, and the Committee understands and acknowledges the legitimate need for the protection of proprietary information. We have enough insight, though, from anecdotal information emanating from press accounts of individual cases, GAO reports dating from 1992, and

Committee research, to hold firm the belief that improvements to the current system are warranted.

I would like to note my concerns regarding the difficulties the Committee has encountered in arranging for the relevant Federal agencies to appear to address the GAO report. While I recognize that protection of proprietary information is important, and that there are sensitivities involved with Congressional oversight of a body created by Executive Order, Congress has a legitimate need to scrutinize the efforts of agencies of the Federal Government responsible for national security.

This morning, GAO will testify as to its findings. We will hold another hearing at which Federal agencies will again be asked to appear to comment on these findings.

The GAO report is not trivial in its implications. It suggests that implementation of the Exon-Florio Amendment may not protect national security. It discusses the need to address the distinctions component agencies make in how they define "national security," a term deliberately left vague so as not to overly constrain the review process. It discusses problems with the current timeline that arise when agencies with a national security focus lack adequate time to collect and analyze intelligence on foreign corporations and the governments that may back them. It discusses the very difficult issue of when companies withdraw their paperwork from CFIUS review, either at their suggestion or on their own initiative.

And it addresses the issue of transparency. The Treasury Department may believe that the process is sufficiently transparent as it currently exists. This is the U.S. Senate Committee with jurisdiction over the process in question, and we most certainly do not agree with Treasury.

With us here today to speak to their findings are Katherine Schinasi, Managing Director for Acquisition and Sourcing Management, U.S. Government Accountability Office, and Ms. Ann Calvaresi Barr, Director of Industrial Base Issues for the GAO.

Ladies, welcome to the Committee. Your written statements will be made part of the record. We know this is a very important study, and you take as much time as you wish. Who wants to go first?

STATEMENT OF KATHERINE SCHINASI, MANAGING DIRECTOR, ACQUISITION AND SOURCING MANAGEMENT; ACCOMPANIED BY: ANN CALVARESI BARR, DIRECTOR, INDUSTRIAL BASE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. SCHINASI. I will. Thank you, Mr. Chairman.

Thank you for the opportunity today to appear before the Committee to discuss GAO's work on the Committee on Foreign Investment in the United States, and as you noted, I am accompanied by Ann Calvaresi Barr, who directed our most recent report, which was done at the request of this Committee and issued on September 28. I will submit my full statement for the record and take this opportunity to summarize my remarks.

But before I turn to the findings in our most recent review of CFIUS, I would like to put that review in the broader context of GAO's reporting on the process. Our knowledge of this CFIUS proc-

ess is both broad and deep. Our recent review builds on and incorporates knowledge gained during more than a dozen evaluations, which, as you noted, date back to the early 1990's.

Recommendations we made in earlier reports, in 2000, and again in 2002 were directed toward improving the CFIUS process. For example, we recommended that all member agencies have access to data needed to assess risk. We also made recommendations to improve company compliance with agreements that are negotiated as the basis for CFIUS approval. The agencies have made some changes based on our recommendations, and we have seen some improvements in the process.

In responding to a draft of our most recent report, however, the Treasury Department, which indicated that its comments reflected the position of all CFIUS agencies, disagreed with our findings and recommendations. I would be happy to address the specifics of the Treasury Department's comments in response to your questions, but let me state for the record that Treasury's assertions, both in their comments and in later press interviews first, assume a policy position that is not in the report. We deal with the CFIUS process, not the policies inherent in CFIUS decisions. Second, the Treasury comments are not substantiated with any opposing evidence. And third, they apparently do not actually reflect the position of all CFIUS agencies, as evidenced by the fact that there are no Administration witnesses at the hearing today.

Let me also add that the Department of Justice provided independent comments, which we have appended to our report, as is our practice, that reflect a different position than that provided by Treasury. Further, let me suggest that the actions taken by the CFIUS agencies subsequent to our providing them a draft of our reported findings and recommendations might be seen as a further indication that significant disagreements exist within the CFIUS member agencies.

As we state in our report, our review of case files and our discussions with officials at both the staff and policy levels reveal fundamentally differing views about what constitutes a threat to national security, what criteria should be used to go to investigation, and the sufficiency of time to address potential risks. Any interagency process, by its very nature, is messy, as each agency is included in the process to ensure that their competing and sometimes conflicting positions receive full vetting.

The overwhelming majority of foreign transactions bring benefits to the U.S. economy, but the Exon-Florio Amendment was established to ensure that those limited number of transactions, which do pose a threat to national security, are identified and mitigated to the fullest extent possible.

And now, let me turn to a summary of our report. First, let me address the differing views of the scope of Exon-Florio among committee members on how risk is defined. The statute establishing the Exon-Florio provision lays out a number of factors that can be considered in defining a threat to national security, but that issue is not addressed in implementing regulations. Our finding is based on the practices we observed in going through the different case files.

Some members view national security threat as one that is tied to export controls, classified contracts or specific derogatory intelligence. Other members' expanded definition includes the vulnerabilities that can result from foreign control of critical infrastructure or critical inputs to the defense systems because of the potential for longer term harm. Why does this matter? Well, for example, in one proposed acquisition, DoD raised concerns about the security of its supply of specialized integrated circuits, which the Defense Science Board has identified as essential to a number of defense systems such as unmanned aerial vehicles.

However, some committee members, including the Department of the Treasury, the Council of Economic Advisers, and the Office of Science and Technology Policy, argued that DoD's was an industrial policy concern and as such fell outside the scope of Exon-Florio. As a result, an enforcement provision between the acquiring company and the Departments of Defense and Homeland Security was removed from the ensuing agreement. In removing the provision, the committee eliminated the President's authority under Exon-Florio to divest a company that has not complied with the agreement, thereby weakening its impact.

The second type of disagreement that we saw in reviewing the cases occurs when the committee decides whether or not to initiate an investigation, which is the second period of fact-finding laid out in the statute. The CFIUS chair applies a standard that there must be evidence that a credible threat exists, and no other laws are appropriate or adequate to deal with it. This is also the criteria that ends an investigation with a finding to the President. Other agencies, which, in our case review, included the Departments of Justice, Defense, and Homeland Security argue that the purpose is in fact to determine whether or not a credible threat exists. So using that as a reason to go into an investigation seems counterintuitive.

A third area of disagreement revolved around whether there is a sufficiency of time to assess potential risks. Most initial reviews of company-notified transactions are completed in the legislated 30-day time frame, either because the transactions do not pose a risk to national security, the transactions are adequately covered by other laws, or the committee quickly reaches an agreement with the acquiring company that sufficiently mitigates any potential risk.

However, case documentation shows that Departmental staff can actually have as little as 3 to 10 days to conduct their analysis. For complicated cases, agencies may not be able to fully explore the potential risks of a transaction, and in at least one instance, an agency was unable to provide input with in the allotted time and therefore was not able to affect the decision. In its comments on our report draft, let me just note that the Department of Justice did note that any additional time to analyze cases would be helpful.

Finally, I would like to draw the Committee's attention to the practice of allowing or promoting company withdrawal of the notification of a transaction. Because of the reluctance by some CFIUS agencies to enter investigation, a point I made previously, committee members have encouraged companies to withdraw their applications to allow more time for agency assessments. As in our 2002 review, we found, again, a number of cases where companies

were encouraged or permitted to withdraw their notification of both pending and completed acquisitions. When an acquisition is pending, the Government maintains some leverage in conditioning company behavior during this period of time of withdrawal. Therefore, the additional time may be productive in mitigating risk. However, when the transaction has already been completed, the Government loses transparency of company activities and also loses the leverage provided by Exon-Florio to condition those activities. We found at least four cases where companies that withdrew refiled at a much later date or not at all.

In cases where national security issues have been raised, this is perhaps the area that provides the greatest potential for harm. Additionally, without an investigation, there is no Presidential decision to allow, suspend, or prohibit acquisitions. As you know, Mr. Chairman, it is a Presidential decision that triggers reporting to the Congress.

In closing, let me say that the recommendations we make in our report are directed to ensuring that the practices that we have found in our review do not impede the United States' ability to identify and mitigate risks that might be posed by a few select but critical acquisitions. We make our recommendations fully aware of the need to implement Exon-Florio in the context of the continuing benefits to this country of foreign investment. An open investment policy, however, need not be compromised by a reexamination of the laws and regulations of a national security structure that was established decades ago.

This concludes my summary, Mr. Chairman, and I would be happy to take your questions.

Chairman SHELBY. Thank you. This report is very detailed and very much in need, and I want to thank you and the others at GAO that worked on this. This is more than worth reading.

Ms. SCHINASI. Thank you.

Chairman SHELBY. We know a lot of the issues that come before this Committee are very complex, tedious, hard to understand, but we know they are very important, at least we think so.

I have a number of questions. The Committee on Foreign Investment in the United States, that is—CFIUS operates under a voluntary system. It only reviews acquisitions that are voluntarily submitted to it by the companies involved in the acquisition. Does the system of relying on voluntary submissions, even with the knowledge that the committee will at times contact companies and suggest they submit to review, create a vulnerability or a weakness in the system for the protection of national security? It is a voluntary deal.

Ms. SCHINASI. There are provisions under the voluntary arrangement that are not being used to the fullest extent possible, and let me give you an example: Under Exon-Florio, any agency who is a member of the CFIUS committee has the ability to notify to the committee acquisitions that it believes raise potential threats to national security. So even though the process is voluntary, there is a provision for the agencies to be proactive in doing that. What we have found is that the agencies do not always do that.

Chairman SHELBY. Are you aware, yourself, of any mergers or acquisitions that were not submitted for review but in your opin-

ion, your judgment, should have been? If you have, we would like to know.

Ms. SCHINASI. One of the problems, and you raised the issue of complexity of this process, one of the problems is you do not know what you do not know.

Chairman SHELBY. That is right.

Ms. SCHINASI. But there is nothing in our own experience that I would put in that category.

Chairman SHELBY. You have had previous GAO reviews of this. You have reviewed the implementation of the Exon-Florio Amendment and the role that the committee plays a number of times in the past, going back as far as 1992, I believe. Why is this the first time you are raising issues that get to the very heart of the process? Should something as fundamental to the process as reconciling divergent understandings of the meanings of national security have been neglected for so many years after the passage of Exon-Florio? In other words, have we forgotten what national security is and should be?

Ms. SCHINASI. I think one of the things that I would say on that is that defining and protecting national security has gotten much more difficult as threats have become more varied and diffuse and technology cycles shorter and those borders, national borders, have become less relevant for trade and investment in national security-related industries.

I think we have a context today that is very different than the one that existed either in 1988, when the Exon-Florio Amendment was passed but even more significantly when the entire national security structure was put in place. We have called for a reexamination of the basis of much of the national security structure, and I think CFIUS would clearly fall into that category.

Chairman SHELBY. Exon-Florio clearly states, and your report points this out, that a Presidential determination based upon the Committee on Foreign Investment review should be the path of last resort. From GAO's years of studying the implementation of the Exon-Florio Amendment, how do you believe that the Committee on Foreign Investment review processes fit in with other mechanisms for protecting national security? In other words, has GAO looked at the question of how Exon-Florio fits in with a broader legal or regulatory framework?

Ms. SCHINASI. Yes, Mr. Chairman. As you know, Exon-Florio was established to be a last resort, a process of last resort, and there are many other processes that we have in place, for example, export licensing or the National Industrial Security Program that deal with mitigating other threats to national security. But the problem with the way we have seen Exon-Florio implemented is that it assumes that those other processes are in fact working the way they were intended, and so, the statute says for Presidential determination, other statutes have to be both appropriate and adequate, and it is the assumption of the adequacy of those other laws that troubles me about the way some of the determinations have been made.

Chairman SHELBY. The GAO report also notes problems with agencies with national security missions have in completing their reviews, as you mentioned earlier, within the 30-day period man-

dated by law, a problem exacerbated by the fact that it is in practice a 23-day period. In response, the GAO suggests removing the distinction between the initial review and the follow-up 45-day investigation period, making it a 75-day study phase. What ramifications would you foresee if such a change were made?

Ms. SCHINASI. We are trying to accomplish two things with that recommendation. The first is to provide more time for those few cases that are complicated and require additional time for the agencies to determine potential risk. The second is to remove that designation of investigation, because the Treasury Department has been very vocal in its position that using the term investigation and making companies go through an investigation could have deleterious effects on their position in the financial community.

Chairman SHELBY. Would the culture change, perhaps?

Ms. SCHINASI. That would be something that would be a welcome outcome. I am not sure if the time, giving more time would in fact have that effect.

Chairman SHELBY. The mission is very close to the Committee and very close to the issues of regulating dual-use exports, in a sense, people said. Integral to the mission of regulating dual-use technologies, and it is explicit in the case of high performance computers, in the case of tiering, or ranking countries on a scale of threat to the U.S. national security. The European Union has been very concerned about what changes to Exon-Florio Congress might make, and I recall the case of a Dutch, clearly a benign allied company, seeking to acquire a U.S. manufacturer of semiconductor lithography, a case that was reviewed extensively by the Committee on Foreign Investment, which resulted in changes to the original acquisition.

Should the Committee on Foreign Investment in the United States apply a tiering concept in its review of proposed acquisitions where a NATO or other close ally is involved as opposed to perhaps other risk?

Ms. SCHINASI. Mr. Chairman, I would suggest that that is probably a policy call that certainly goes beyond our work and probably is better for me to stay away from.

Chairman SHELBY. Okay; Senator Stabenow, I believe you were here first.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman, very much, for holding this important hearing. We certainly understand that we need to monitor foreign investment in the United States, and I appreciate this thorough report and all of the questions that it raises that we need to address. I appreciate your efforts.

Let me first say that while we know we must protect the unintentional flow of information and technology through mergers and acquisitions that could compromise our national security, we also know, and Michigan is an example, Mr. Chairman, of a place that has been very open to foreign investment, we view ourselves as the leaders in advanced manufacturing technology and engineering and R&D and have, in fact, major new investments coming into the State, partnering with us, and we appreciate those.

But that does not take away from the need to address what we are talking about today, and particularly when we look at the recent events involving the proposed acquisition of Unocal and all of the issues that were raised, I think this is a particularly timely hearing.

Questions regarding your report: As we continue to compete in a world economy, we are clearly in a world economy right now, what major industries or sectors do you think we most likely should be looking at in terms of investigations or oversight?

Ms. SCHINASI. I think I would answer that question in the context of Exon-Florio being the last resort national security structure, and I would look not so much at industries, but I would look at those areas which are not thought traditionally to pose a threat to national security; for example, we have a number of laws and regulations in place that deal with classified information, but there is a lot that is considered sensitive but unclassified in many of the higher tech industries that could fall through the cracks, so that would be one area I would look to.

The other is in the whole communication revolution. Again, most of our traditional communications are covered by the regulatory provisions that the FCC applies and others. But all of the Internet communications and the system that are arising to support our Internet communications might be one of those other areas that would fall through the cracks, so that would be how I would focus our attention.

Senator STABENOW. You focus in your report on the fact that there are narrow definitions of what a threat is to our national security. Could you speak more to that and how you view that definition and ways in which it possibly should be expanded?

Ms. SCHINASI. I think let me first say that the flexibility that is inherent in Exon-Florio is very important, and each case needs to be considered on a facts and circumstances basis, so we are not calling for a definition of national security. You know, we need to have more flexibility than that.

That said, however, the statute itself lays out a number of factors that can be considered by the committee in its deliberations, and some of those, as we point out in the report, have to do with credible intelligence, derogatory intelligence about companies having classified contracts, a rather narrow scope. But there are other factors in the statute that deal with security of supply, technological preeminence of our industries that we believe also should come to bear in making decisions about what constitutes a threat to the national security.

And in our review of the case files that we have gone through, we have seen that those factors do not always become part of the decisionmaking process, despite the fact that some member agencies think they should be.

Senator STABENOW. So basically, you are saying that there are flexibilities within the statute, but the committee has been very narrow in terms of defining the scope of national security.

Ms. SCHINASI. That is correct.

Senator STABENOW. And is it fair to say you would recommend that they look more broadly at the factors that are in the statute?

Ms. SCHINASI. That was our recommendation.

Senator STABENOW. And then, second, with that, the committee, you indicate, has been reluctant to initiate investigations. You show some numbers. You say in your report that CFIUS recently received more than 1,580 notifications, but only 25 cases were investigated, and I know you speak to the negative connotations of an investigation, the need for a Presidential decision, and so on. Did you look also at issues related to budget and whether or not this is a question of staffing or budget, the ability to actually initiate more investigations?

Ms. SCHINASI. We did not ask that question directly, and that did not come up directly as a reason. However, one of the things that we did note was that because this is an interagency process, the accountability for doing that is not always assigned. And the guidelines give certain responsibilities to the chair.

The agencies have other responsibilities, but it is not always clear between the agencies who is supposed to be doing what, and I would guess that one of the mitigating factors in how much work the agencies do is, in fact, budget. The other thing is that it is often "other duties as assigned" for the individuals involved. It is not their primary focus.

Senator STABENOW. So is it fair to indicate or to say that you believe the committee has been too reluctant to investigate, too cautious at this point? How would you frame that?

Ms. SCHINASI. I think that for those cases where the 30-day period is sufficient to determine that there is no potential risk, and that would be the majority of those cases, we would not make the point about reluctance. But we would answer that by saying when companies withdraw their application from the CFIUS process, and there are those instances, particularly when an acquisition has already been finalized—the purchase has already gone through, the new governing structure of the company is already in place—that in those cases, trying to prevent going into investigation, we would rather see more time given to address issues that were raised concerning the acquisition rather than the opportunity for those companies to withdraw their application, because that is where you really lose transparency. You do not know what is going to happen.

Senator STABENOW. Thank you, Mr. Chairman. I am hopeful that we will have an opportunity to continue to focus on this. There are so many challenges and questions that we now face as we compete in the international marketplace, so I appreciate very much your bringing this up and your leadership in this.

Chairman SHELBY. Thank you.

Senator STABENOW. And I look forward to working with you.

Chairman SHELBY. Thank you, Senator. Senator Bayh.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. I would like to thank the witnesses for their time today and for their excellent report, Mr. Chairman. I would like to thank you for your leadership in focusing on this.

Chairman SHELBY. I could add and your leadership, too. It was you and Senator Sarbanes, me, who asked for this report together. We thought it was important.

Go ahead.

Senator BAYH. Thank you, Mr. Chairman, and I know you have been working with Senator Inhofe in trying to strike the right balance here, so I look forward to learning from this report and continuing our work together to strike the right balance, as Senator Stabenow says. This is just another manifestation of the consequences of globalization, in which we benefit from direct foreign investment in our country; we welcome foreign companies who build factories and employ Americans. But at the same time, there will be very narrow parts of our economy where our national security interests of necessity will trump our commercial concerns, and it is striking that right balance and identifying that very narrow segment that of course brings us here today and is very important. So, I thank you for your focus on this.

I have several questions. Some of them will be somewhat similar to what a couple of my colleagues asked. I hope they are not totally redundant, but let us go through them and see.

First, talking about the need for notification, why should that not be required?

Ms. SCHINASI. I think there would be a down side to having a mandatory notification, and it would perhaps get back to the resource issue that Senator Stabenow raised. The number of transactions affected could potentionally be large.

Senator BAYH. The resource issue on the part of the governmental entities involved?

Ms. SCHINASI. Yes, on the part of the Government.

Senator BAYH. This reminds me of this whole avian flu situation we are dealing with right now, where the responsibility has been spread across governmental entities. And even for those individuals who have a responsibility, it is only one of many responsibilities. Would we not solve this problem by having a single individual with adequate resources who could focus on this issue assuming that, if we were to move in that direction, would a requirement of notification not make sense?

Ms. SCHINASI. That is, again, one of those policy questions that goes beyond our works.

Senator BAYH. Let me phrase it a different way: If we were to deal with the resource question, would that remove the principal obstacle to a requirement of notification?

Ms. SCHINASI. Voluntary versus mandatory notification is something that has been an inherent question ever since CFIUS was put in place. I would want to go back and look at the number of investigations, the number of, excuse me, transactions that actually are occurring out there to be able to give you a good answer of whether or not the costs and the benefits would be in balance there.

Senator BAYH. Currently, who makes the decision about whether a notification takes place?

Ms. SCHINASI. The companies themselves.

Senator BAYH. Does it strike you as an interesting fact that the private sector would be making decisions about what affects the national security interests of our country rather than the Government?

Ms. SCHINASI. What we have called on is the agencies themselves, we have found when we looked at this issue in earlier re-

ports that, in fact, there are transactions that do pose potential threats to national security that have not been notified to the committee. And we have found that individual agencies in carrying out their own mission have information about those.

The process allows for those agencies to come forward and notify the committee. However, it is uncertain how often those agencies are doing that. So what I would like to see first is the agencies themselves to come forward and carry out that responsibility to notify the committee.

Senator BAYH. Well, I only speak for one Senator, but I think we should address this resource issue and this focus issue. This is important. When we are talking about the national security interests of the country, somebody should be in charge and be held accountable. We should not have this fall through the cracks because it is just so diffused, and people are busy with other things. I am not in favor of big, intrusive government, far from it, but when it comes to making the final call about national security matters, it probably should be the country rather than the private sector making those calls.

Ms. SCHINASI. Yes, sir, we would agree with that.

Senator BAYH. My second question, well, it is a subset of the first. Once a notification does take place, should an investigation be required? I guess it deals with the whole stigma and maybe this gets into the realm of the semantic. Maybe we need to come up with a different word here so we do not spook the market. Inquiry, maybe that sounds a little too stigmatizing, too?

Senator STABENOW. Review.

Senator BAYH. Review, excellent. Maybe we can get out our thesaurus here and come up with something that gets the job done and does not negatively impact the financial markets. If we can do that, would that resolve the down side inherent to requiring the review at that point following a notification?

Ms. SCHINASI. What we saw in our review of the cases that we looked at was that for complicated cases, and there are a number of those, there just is not enough time to establish whether or not there is a potential threat and how to mitigate that threat if, in fact, it is there. And I think it is those two things that would warrant an extended period of time. What you call it, I think is review.

Senator BAYH. So that the potential stigma from what may be an innocuous situation——

Ms. SCHINASI. That is correct.

Senator BAYH. The fact that in 30 days, what can you really do?

Ms. SCHINASI. That is correct.

Senator BAYH. Fair enough. We will work on the semantics and think about the timeframe, and if we could get those two things resolved, would that then alleviate the concerns about the requirement of a review over a more meaningful period of time?

Ms. SCHINASI. We believe so, and as importantly, we believe it would have a difference on the outcome as well.

Senator BAYH. Senator Stabenow touched on the factors that may be taken into consideration but are not required, even things like whether the acquiring company comes from a country that, for example, might be implicated in supporting terrorism or present proliferation risks for missile technology or a variety of other

things. Should those factors not be required to be taken into account?

Ms. SCHINASI. Yes.

Senator BAYH. The definition of national security, it has been, and I think Senator Stabenow touched on this as well, and you answered with regard to the recent energy situation. We had a situation in my own home State where a company was producing well more than half of the magnets necessary to make our smart bombs work. It has been acquired by a company from China.

Should things like that not be taken into account, not just whether it is a sensitive technology but whether it is an input, for example, that is critical to a national defense system or, in the globalized marketplace, access to energy supplies? I mean, this is a strategic concern. Apparently, the Chinese have decided it is a strategic concern. I would assume it is perhaps one of ours as well. Should factors like that not be required to be taken into account rather than just be merely advisory?

Ms. SCHINASI. Senator, I think when I referenced the decreasing relevance of national borders in our national security, particularly in our defense-related industries, it is in fact the underlying concern, the manufacturing processes and the technologies that we have invested billions of dollars in that give us our military superiority that probably are residing as much in the commercial sector as they are in the defense sector now, and it is exactly those that are the underlying concerns.

Senator BAYH. Take this one small example from my State. Eighty-five percent of the magnets necessary to make the smart bombs work, if that production is eventually relocated to a foreign country, does that not place our country in a position of dependency for a critical input to a weapons system that we now rely upon to a great extent?

Ms. SCHINASI. I will go back to the statute and say both of those examples are in the statute as factors to be considered. One is security of supply; another is continuing technological preeminence in the United States.

Senator BAYH. That they must be considered, or they can be considered?

Ms. SCHINASI. No, they are factors that can be considered.

Senator BAYH. Can or must?

Ms. SCHINASI. Can.

Senator BAYH. Should they not be required to be considered?

Ms. SCHINASI. The recommendations that we have made, and we have made them for Congressional consideration because the agencies have disagreed with us is that there be more guidance in what factors should be considered in making the decisions and determinations.

Senator BAYH. So your position is that they should continue to be advisory only, or they should be required to be taken into account?

Ms. SCHINASI. Our position is that we have suggested that you look at that decision again.

Senator BAYH. You are reluctant to play referee, huh?

Ms. SCHINASI. If moved into the policy, we try to maintain our——

Senator BAYH. You are the good cops? Is that the deal here? Well, we are up to the challenge, right.

[Laughter.]

Okay; I think I hear what you are saying. Again, when it comes to national security and weapons systems, it seems to me we should err on the side of ensuring supply and therefore require that these things be taken into account rather than well, maybe yes, maybe no, because it a dangerous world, regrettably.

Final thing, and this may be more attitudinal than not. It has been suggested to me that there are some on the trade side of this whole thing; some of our trading partners like to raise this whole process as an example, according to them, about how we restrain investment into our country, and they use that as a tissue with which to cover their own much more restrictive practices that prohibit American direct investment into their own economies. Anything like that come up in the course of your report?

Ms. SCHINASI. I think that is a position you will hear given by a number of the member agencies.

Senator BAYH. Our trade officials get aggravated by this, but I get back to my opening statement: Globalization can work and work well if we prepare ourselves for the globalized economy. Part of that is going to be direct investment. That can be a good thing. But when it comes to that narrow category of national security interests, I think the Nation's security has to trump our commercial concerns when it gets right down to it, and there is a legitimate reason for that.

So, I just hope that we bear that in mind in setting our priorities and trying to strike the right balance here. And again, thank you both very much, and Chairman and Ranking Member Sarbanes, thank you both.

Chairman SHELBY. Thank you, Senator Bayh.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. I want to welcome the representatives of the GAO this morning.

As I think has already been noted, last February, you, Senator Bayh, and I joined in sending a letter to the GAO, asking them to build on their earlier work and undertake a further study of the process for the implementation of the Exon-Florio Amendment, and we are very pleased to have this report, and it is very helpful to the Committee.

The questions raised there are serious ones: Substantial economic benefits can generally flow from investment and from reciprocal or multilateral agreements that permit free investment in the U.S. economies of other countries. But Exon-Florio recognizes that what is true in many situations is not necessarily true in all situations. And CFIUS has received a great deal of publicity in recent months. I am concerned about some of the way it is apparently perceived.

In June, the *Financial Times* called it an opaque Government panel, opaque. It seems to me given the importance of its work and the sensitive issues and information with which it must deal, it is important that CFIUS be as transparent as possible, thereby con-

tributing to a higher degree of acceptance of its decisions. Actually, they have not complied with the requirements in the Defense Production Act for quadrennial study for Congress for whether particular countries are engaged in a coordinated strategy to acquire U.S. companies that develop or produce critical technology. That is a requirement. It is in the statute. CFIUS seems to just be ignoring that requirement, and we ought to, I think, Mr. Chairman, take a look at that.

Chairman SHELBY. Absolutely.

Senator SARBANES. I understand that the representatives of the executive departments were invited to this hearing but were unable to appear, but we hope to have their testimony at a future hearing.

Chairman SHELBY. Absolutely. Senator Sarbanes, we have worked together on this. I was disappointed with the executive branch not appearing here today. We are going to call for another hearing. Also, Senator Inhofe, if you will yield me a little bit of your time——

Senator SARBANES. Certainly.

Chairman SHELBY. He is very interested in this issue. He has worked with all of us on it, and he would be very interested in, as he told me, testifying at another hearing before the Banking Committee if it meets with all of you—thank you, Senator Sarbanes.

Senator SARBANES. The Chairman, Senator Bayh, and I have outlined the importance of these security concerns, and we weigh economic considerations, but the security concerns, it seems to me, are the trump card when we consider these matters.

Chairman SHELBY. Should be.

Senator SARBANES. I am going to be very up front and blunt with the two witnesses. The Treasury is quoted, an unnamed official—that is the way it always happens——

[Laughter.]

Senator SARBANES. —in the *Financial Times* on September 28—it is a widely read business publication, of course, in Europe and in this country, and I am going to quote from the article, and then, I would like to address a question to you: "However, the Treasury questioned the motives"—motives—"behind the report which was requested by Mr. Shelby and others. The Chairman had observed that the GAO report underscored the need for Congress to have far better insight into the review process to ensure that national security considerations are not given short shrift." That is an issue that Senator Bayh has raised on a number of occasions here.

And I am now quoting again from the article. "An official said," this is a Treasury official, "GAO's views were well-formed before talking to Treasury, and GAO failed to ever interview other members of the CFIUS committee, including the State Department, the President's Council of Economic Advisers, and the U.S. Trade Representative. The official added GAO was selective in its interviews, excluding key Members of the Committee, and this clearly colors the report. They obviously had a viewpoint going in and were merely looking to fill in the blanks. In this regard, the report is sloppy and lacks any useful evidence to back its conclusions. The report is not worthy of GAO's reputation for thorough, unbiased analysis."

Well, first of all, I would say GAO certainly has a reputation for thorough, unbiased analysis. I do not see that that reputation is done in by this report, but since your motives have been put into question here, I thought I should put it right out front and ask you to address this unknown, unnamed——

Chairman SHELBY. Unnamed.

Senator SARBANES. Presumably not unknown but unnamed official who did this—I guess one would describe it as an anticipatory or preemptive smear job here before you even got before us to present the report. Could you address that?

Ms. SCHINASI. Senator, I welcome your question.

Senator SARBANES. Yes.

Ms. SCHINASI. What I would like to do is go through the methodology that we did use in this report, if you will have a few minutes to listen to that.

Senator SARBANES. I think it is important. I mean, this is not an idle allegation that has been made here by the Treasury Department. I must say we expect better of the Treasury, too, but anyhow, please.

Ms. SCHINASI. The work that we did that culminated in this report is a continuation of work that we began and issued a report on in 2002, so I would like to start there with what we have done. In that report, we had 18 cases that we reviewed. We started with some knowledge of the 451 cases that have been notified to CFIUS between 1997 and 2004, and from that, we selected 18 cases to look at more fully and in depth. And we went through over 1,000 documents in looking at those cases, and I wanted to make sure I said what those were.

We looked at documents that included handwritten notes of CFIUS meetings at the staff and policy level, formal minutes of policy level meetings that were chaired at the assistant secretary level; looked at communications between CFIUS members and the companies. We looked at emails between various CFIUS member agency officials and within agencies that raised their concerns. We looked at agendas and speaking notes for policy level meetings. We looked at memos to the under secretaries concerning the views of various staff levels. We looked at classified risk assessments by the CIA and DIA. We looked at final versions and drafts of the mitigation agreements and emails and memos between the Government and companies setting those agreements out. We looked at reports that the companies sent to CFIUS or member agencies in compliance with the agreements.

As you know, there are confidentiality provisions associated with CFIUS, and we scrupulously adhere to those, so I am not at liberty to talk about any individual cases. But that is to give you a sense of the documents that we looked at.

In discussing what we found in those documents, we had interviews with all of the member agencies. At that time, there were 11. That includes the Departments of Commerce, Defense, State, Treasury, and—I am sorry, I just lost one of the five there. I will come back to that. We spoke with the six Executive Offices of the President, the National Security Council, the National Economic Council, the Office of Management and Budget, the Council of Economic Advisers, and the Office of Science and Technology Policy.

So we met with all of the agencies and all of the Executive Offices of the President. That gave us the basis for our understanding of the CFIUS process. When we moved to this review, we had that understanding. We picked an additional set of cases to look at in addition to the ones that we had looked at in 2002, and we went through the case files on all of those cases as well. We had discussions with those agencies that we saw were most active in those cases, and we went back to those agencies and asked if there were other documents or other agencies that we should contact, and we were told no. In our own review, we identified the National Security Council as one of the agencies we had not preliminarily identified, and we contacted the National Security Council to ask them if they wanted to weigh in and make their views known. They declined to do that.

So the process of data gathering was very extensive and dare I say exhaustive. We have a process internally with that data, where we go through a series of fact checking and also an internal review that includes our division that looks at trade matters, our attorneys, our economists, to understand not just whether the facts are correct but whether or not the findings, the conclusions are logical. We went through that review process.

We also took our facts back to all of the agencies, and we go to Treasury as the chair of the committee and let them manage the process of checking the facts with the other agencies. And we made any changes that we needed to based on evidence that came back from the Administration. There were not a lot of changes.

And then, finally, we have a process, as you know from looking at the report, where we send out a draft of our report to the agencies to get their formal comments on our conclusions and recommendations. And as you see, the Treasury Department, which said it was speaking for all of the member agencies, sent us about 19 pages of comments. Some of those addressed issues in the report. Some of those addressed issues that were not in the report. And we have seen at least over the last three reports that we have issued that the Treasury Department comments assume that we have a policy position that is limiting the open investment policy in the United States.

Clearly, that is not true. It has not been within the scope of any of our reports, nor is it within the scope of this one. But you will see that in the back of this report that the Justice Department provided individual comments. We go through a process where we review those comments. We make changes as we believe necessary, and we answer for those where we do not believe that changes are necessary why we do not think so. That is in accordance with the procedures that we have in place for every review that we do at GAO, and those are the procedures that we followed here as well.

Senator SARBANES. What basis is there, if any, for this Treasury unknown spokesman questioning the motives of the GAO in making this report?

Ms. SCHINASI. Senator, I am afraid you will have to ask them.

Chairman SHELBY. We need to have them here to ask them.

[Laughter.]

I think that is one reason they are not here today.

[Laughter.]

Senator SARBANES. As I understand, you invited them to this hearing.

Chairman SHELBY. We have. And we have invited them for the future. We plan to pursue that. I think it is very important that they appear here before the Banking Committee. I will be surprised and shocked if they do not in the future.

[Laughter.]

Senator Bayh.

Senator BAYH. Mr. Chairman, if I could just add one minute's worth of credibility to the report. One of the cases, Senator Sarbanes, they based their report on was in my home State, a company called Magnequench. They produced 85 percent of the magnets that go into our smart bombs that you see on TV. That plant has now been closed, and the production has been moved to China.

Senator SARBANES. Are these magnets that are essential for the smart bombs?

Senator BAYH. Correct. That plant is now closed, and it has been moved to China, and this is one of the cases that they reviewed. So it is a matter of debate, but my point is simply that this is a very credible example of the kind of questions that have been raised and deserve to be addressed at a policy level. So, I commend the GAO for their report and, at least as far as I am aware of, the facts that went into it.

Chairman SHELBY. Senator Bayh, if you would yield, this is a bipartisan inquiry here. I know Senator Inhofe and I are working together. You all are working together on this, Senator Sarbanes and others.

This is not a partisan interest. This is a national security interest and an economic interest, all of it together. But as I have said before, I do not believe everything in this country is for sale. If Senator Bayh talked about earlier, if we let all of our—just do something for a dollar, for a profit, to sell something and trump national security. I thought, and I was always taught that the national security, the security of the people of this Nation, trumped everything.

Senator SARBANES. Yes, I see, Senator, maybe this has been referred to before I was able to arrive at the hearing, Senator Inhofe, in a story in the *Los Angeles Times* today said yesterday that the screening process was broken, leaving the Nation vulnerable to foreign threats. Pretty strong statement.

Chairman SHELBY. Well, from what Senator Bayh was just talking about the example in his home State, maybe it is broken, and that is why we are going to try to address it. But we need Treasury here, too, because this issue is not going to go away. We are not going to let it go away.

Senator SARBANES. Right. Treasury is the chair of the CFIUS interagency group, is it not?

Ms. SCHINASI. Yes, sir.

Senator SARBANES. And does the Secretary himself act in this chairmanship role, or has he delegated it out to someone?

Ms. SCHINASI. There is a provision to escalate issues to the Secretary, but it has for the most part been delegated down.

Senator SARBANES. And how far down has it been delegated in Treasury?

Ms. SCHINASI. The Under Secretary and the Assistant Secretary.

Senator SARBANES. I see, Under Secretary Adams, who is the one who commented on your report, is also the one who has generally acted as the chairman of the interagency group?

Ms. SCHINASI. Yes, at the policy level, yes, sir.

Senator SARBANES. Now, Treasury asserts these decisions are made by consensus by policy level officials, is that right?

Ms. SCHINASI. Yes.

Senator SARBANES. So they have no division within the group? I mean, do they ever get a case where they push it to a decision and the group is divided?

Ms. SCHINASI. Yes, Treasury refers to the process as a consensus process. The guidelines call for each agency to state their views, but there is nothing in the guidelines to talk about how disputes are resolved or whether or not they need to be resolved.

Senator SARBANES. Presumably, they have disputes within the committee when they consider matters.

Ms. SCHINASI. Yes, they do.

Senator SARBANES. Are they all of one mind, marching to one drummer all the time?

Ms. SCHINASI. No, there are many disputes.

Senator SARBANES. Many disputes within the committee. And how do they resolve those disputes? Have you been able to ascertain that?

Ms. SCHINASI. In some cases, we believe that they are not resolved. They are pushed aside but not resolved.

Chairman SHELBY. Excuse me, if you would yield.

Senator SARBANES. Certainly.

Chairman SHELBY. What happens when they are pushed aside? Are they able to sell?

Ms. SCHINASI. I will give you a couple of examples, one that I spoke about in my opening statement, where there was an agreement that had been worked out by two of the member agencies and a company about measures that the company would take to mitigate what had been seen to be potential risks to national security. And the agencies wanted to put a provision in that agreement that referenced Exon-Florio and were not able to because there was not consensus that they could put that provision in there. So that is one way that consensus works.

Senator SARBANES. Now, were you able to ascertain which of the agencies or the Departments seemed to be most rigorous in questioning these sales, in other words, most protective of the national security concerns within CFIUS?

Ms. SCHINASI. Yes; I think each agency would tell you that they have national security concerns as they come into this process, but those whose other responsibilities are more focused on national security, and those would be the Department of Defense, the Department of Homeland Security, and the Justice Department, would be those that we have seen as being the strongest proponents, for example, of using additional factors in their consideration of the potential risks, wanting more time to investigate whether there is a potential risk and having stronger mitigation agreements, stronger

agreements in place and stronger mitigation factors that are enforceable within those agreements.

Senator SARBANES. Now, Adams, in his comment on your report, Adams being the Under Secretary at Treasury, says third, the draft report states that in response to Congressional concerns, GAO met with officials from the Departments of Commerce, Defense, Homeland Security, Justice, and Treasury, which in GAO's view are the agencies that are the most active in the review of acquisitions. GAO apparently did not solicit any input from other members of GAO, such as the Department of State, the Office of the U.S. Trade Representative, nor the Council of Economic Advisers. Despite GAO's unsubstantiated assertion, these organizations, like the ones GAO did choose to meet with, are very much engaged in CFIUS review. If GAO had interviewed senior policy officials from these organizations, which reflect a broad spectrum of CFIUS membership, the Committee is confident that GAO would have gained a more informed perspective on the CFIUS process.

I am beginning to think that maybe Adams is the source of this——

[Laughter.]

Given that language, the source of this *Financial Times* story. But what do you say in response to that?

Ms. SCHINASI. I have several points.

Senator SARBANES. Good.

Ms. SCHINASI. It is not our view who is the most active. We made that determination in going through the case files and identifying those agencies which attended meetings, which had a position, which conducted their own fact finding on potential risk. So the determination of most active is not our view; it is based in fact. That is the first thing.

The second thing, we had identified on a number of these cases that had some history to them, we have had discussions with officials from all of the relevant agencies, as I had said before, and so, that *Financial Times* is not correct.

Senator SARBANES. So it is not accurate to say that you did not receive input from other members of CFIUS other than the five departments he named; is that correct?

Ms. SCHINASI. We had their positions. We did not interview during the period of time of this review all member agencies, because we did not feel that we needed to interview all member agencies. However, once the report was written and sent to the Administration for comment, we did meet with those agencies that wanted to meet with us.

Senator SARBANES. And which agencies were those?

Ms. SCHINASI. The State Department and the Special Trade Representative.

Senator SARBANES. And that was in the process of formulating your final report.

Ms. SCHINASI. Yes, sir.

Senator SARBANES. So the final report would come later in the report process than this comment from Adams; is that right?

Ms. SCHINASI. That is correct.

Senator SARBANES. And in the interim, there were discussions with those agencies, at least some of those agencies as well; is that correct?

Ms. SCHINASI. That is correct.

Senator SARBANES. Mr. Chairman, there is a lot we could pursue in this report in terms of its substance, and I want to thank the GAO for preparing it and submitting it to us, but I must say it seems to me the essential hearing that we need to have is for the executive departments and particularly the Treasury, which is the chair of this interagency committee, to come here at the witness table and give us an opportunity to examine them quite closely, which I, for one, intend to do.

Thank you very much.

Chairman SHELBY. Thank you.

First of all, I want to say again this looks to me like a very thorough, well-researched report that GAO has done, building on what you have done in the past, and on behalf of the Committee I want to thank you for that.

Ms. SCHINASI. Thank you, Mr. Chairman.

Chairman SHELBY. I have a few other questions.

Could you expand upon the process by which cases are mitigated? Have the agreed upon measures required by the committee been sufficient to protect sensitive information or technology here? You mentioned, of course, sensitivity is important, but one that was disturbing to me, the one Senator Bayh brought up, and I am sure there were worse cases.

Ms. SCHINASI. One of the findings that we had in an earlier report that we went back and looked at again in this review was, in fact, that we did not know the answer to your question. There had not been responsibility for company compliance with these agreements given to any individual agency, and there were a number of cases where there was no monitoring going on.

Chairman SHELBY. In other words if they agreed to do something, we are talking about mitigation in exchange for getting this sale approved then, there is no oversight to see that what they agreed to do, which would be in our best interests, was done.

Ms. SCHINASI. That is correct.

Chairman SHELBY. Okay.

Ms. SCHINASI. We had two issues that we raised: One, that the mitigation agreements were very vague, "best effort," for example, and we raised questions about how can you determine what is actually a best effort. And then, the second point was the one you raised about who is looking to see what is actually happening here.

Chairman SHELBY. Withdrawn proposals, on the issue of discretionary withdrawal of paperwork from the committee's review, Committee on Foreign Investment in the United States, do you know of any cases when a company withdrew its paperwork from the Committee on Foreign Investment on its own initiative and then proceeded with an acquisition that may have resulted in the transfer of military sensitive technology or knowledge?

Ms. SCHINASI. Not those exact circumstances, no, sir.

Chairman SHELBY. Will you look through the committee's record and report to us on that?

Ms. SCHINASI. Yes. During the course of our 2002 and 2004 reviews, GAO was not provided unfettered access to committee files. We were granted access to case files we requested. From the specific cases we reviewed, GAO is not aware of any committee cases where a company withdrew its paperwork on its own initiative and then proceeded with an acquisition that may have resulted in the transfer of military sensitive technology or knowledge.

Chairman SHELBY. To the best of your knowledge, in cases where the Committee on Foreign Investment in the United States' review occurred after the completion of an acquisition of a U.S. company by a foreign company, was there a transfer of technology, items of knowledge that you feel should have been prevented? If so, you can furnish this for the record.

Ms. SCHINASI. Okay.

Chairman SHELBY. Will you do that?

Ms. SCHINASI. Yes.

During our previous reviews, GAO was not given unfettered access to committee files. We do not know whether there are cases that the committee reviewed where technology or items of knowledge that should be protected were transferred. In our September 28, 2005 report, however, we describe two cases where the companies completed the acquisition before filing with the Committee and later abandoned the Committee process, leaving some member agencies' concerns unresolved.

(Excerpt from GAO, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness. GAO–05–686* (Washington, DC: September 28, 2005), pp. 16–17.)

In one case, the company filed with the Committee more than a year after completing the acquisition. The Committee allowed it to withdraw the notification to provide more time to answer the Committee's questions and provide assurances concerning export control matters. The company refiled and was permitted to withdraw a second time because there were still unresolved issues. Four years have passed since the second withdrawal.

In another case, a company filed with the Committee over 6 months after completing its acquisition of an Internet backbone company. The Committee allowed the company to withdraw the notification more than 2 years ago because the Committee was busy with another, high-profile acquisition. The Committee has not requested that the company refile even though analysts within one agency had concerns about the acquisition. As a result, the review process has never been completed. A Treasury Department official said that the member agency that has national security concerns about a particular transaction is responsible for ensuring that the company refiles. However, the Committee's guidance to member agencies specifically states that Treasury will manage activities during withdrawal by specifying time frames and goals to be achieved.

Chairman SHELBY. Do you think there are some cases there?

Ms. SCHINASI. What I do know is that there are some cases where we do not know.

Chairman SHELBY. It is what you do not know, is it not?

Ms. SCHINASI. Yes.

Chairman SHELBY. The credible evidence standard in the definition issue that you alluded to, Exon-Florio employs a standard of what we call credible evidence that harm may come to national security in the consideration of a proposed acquisition; correct?

Ms. SCHINASI. Yes, sir.

Chairman SHELBY. In GAO's assessment, has this standard provided for the discretion necessary for full consideration of the risks to national security of proposed acquisitions?

Ms. SCHINASI. Applying a standard of credible evidence before you go to an investigation precludes your ability to determine whether or not there is credible evidence.

Chairman SHELBY. Given the fact that critical infrastructure protection and energy security have been an integral part of the Defense Production Act, which involves primarily the preservation of the vital industrial base needed for national defense, national security for a number of years, why do you feel these areas may not have received the attention they should have during the Committee on Foreign Investment's review? You pointed a lot of this out in your report, but you are here in the Committee now, for the record.

Ms. SCHINASI. The way we describe it in the report is because, again, through this consensus provision that not all members agree that those should be factors that are considered in the decisions and deliberations of foreign acquisitions.

Chairman SHELBY. Senator Sarbanes, do you have any other questions? I know some of our other colleagues are going to have some for the record.

Senator SARBANES. That is for sure. The earlier report you did on CFIUS was in 2002; is that correct?

Ms. SCHINASI. That was one of the earlier ones, yes, sir.

Senator SARBANES. Right; was that the most recent earlier one?

Ms. SCHINASI. Yes.

Senator SARBANES. It is my understanding that subsequent to that report, actually, a number of your recommendations in dealing with the situation you examined were adopted by the CFIUS agencies in an effort to improve their procedures; is that correct?

Ms. SCHINASI. That is correct, yes, sir.

Senator SARBANES. At that time, you did not get this kind of demeaning response to the report, did you?

Ms. SCHINASI. No, we did not.

Senator SARBANES. That you encountered in this circumstance?

Ms. SCHINASI. No, sir, this is unprecedented.

Senator SARBANES. Do you have any inkling as to why we have gotten this what you just described as unprecedented behavior or reaction?

Ms. SCHINASI. Senator, it would only be speculation on my part, and I would ask that you ask the Treasury Department.

Senator SARBANES. Okay; all right.

Thank you very much, Mr. Chairman.

Chairman SHELBY. We appreciate your appearance, but more than that, we appreciate your diligence and your work at GAO, and we are going to follow up on this with a hearing. As I said before, it is incumbent upon Treasury to be here. We are going to give them a lot of opportunities. We will not quit until they show up.

[Laughter.]

Even if it is a Sunday hearing.

Thank you.

The hearing is adjourned.

[Whereupon, at 11:17 a.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

United States Government Accountability Office

GAO

Testimony

Before the Senate Banking, Housing, and Urban Affairs Committee

For Release on Delivery
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DEFENSE TRADE

Implementation of Exon-Florio

Statement of Katherine Schinasi, Managing Director
Acquisition and Sourcing Management

GAO-06-135T

October 6, 2005

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Highlights

Highlights of GAO-06-135T, a report to Senate Banking, Housing, and Urban Affairs Committee

DEFENSE TRADE

Implementation of Exon-Florio

Why GAO Did This Study

The 1988 Exon-Florio amendment to the Defense Production Act authorizes the President to suspend or prohibit foreign acquisitions of U.S. companies that may harm national security, an action the President has taken only once. Implementing Exon-Florio can pose a significant challenge because of the need to weigh security concerns against U.S. open investment policy—which requires equal treatment of foreign and domestic investors.

Exon-Florio's investigative authority was delegated to the Committee on Foreign Investment in the United States (Committee)—an interagency committee established in 1975 to monitor and coordinate U.S. policy on foreign investments. In September 2002, GAO reported on weaknesses in the Committee's implementation of Exon-Florio. This review further examined the Committee's implementation of Exon-Florio.

What GAO Recommends

GAO's accompanying report on Exon-Florio—*Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, GAO-05-686 (Washington, D.C.: Sept. 28, 2005)—contains matters for congressional consideration regarding Exon-Florio's coverage and needed improvements to the implementation of the law.

www.gao.gov/cgi-bin/getrpt?GAO-06-135T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine V. Schinasi at (202) 512-4841 or schinasik@gao.gov.

What GAO Found

Several aspects of the process for implementing Exon-Florio could be enhanced thereby strengthening the law's effectiveness. First, in light of differing views among Committee members about the scope of Exon-Florio—specifically, what defines a threat to national security, we have suggested that Congress should consider amending Exon-Florio to more clearly emphasize the factors that should be considered in determining potential harm to national security.

Second, to provide additional time for analyzing transactions when necessary, while avoiding the perceived negative connotation of investigation on foreign investment in the United States we have suggested that the Congress eliminate the distinction between the 30-day review and the 45-day investigation and make the entire 75-day period available for review.

Third, the Committee's current approach to provide additional time for analysis or to resolve concerns while avoiding the potential negative impacts of an investigation on foreign investment in the United Stated is to encourage companies to withdraw their notifications of proposed or completed acquisitions and refile them at a later date. Since 1997, companies involved in 18 acquisitions have been allowed to withdraw their notification to refile at a later time. The new filing is considered a new case and restarts the 30-day clock. While withdrawing and refiling provides additional time while minimizing the risk of chilling foreign investment, withdrawal may also heighten the risk to national security in transactions where there are concerns and the acquisition has been completed or is likely to be completed during the withdrawal period. We are therefore suggesting that the Congress consider requiring the Committee Chair to (1) establish interim protections where specific concerns have been raised, (2) specify time frames for refiling, and (3) establish a process for tracking any actions being taken during the withdrawal period.

Finally, to provide more transparency and facilitate congressional oversight, we are suggesting that the Congress may want to revisit the criterion for reporting circumstances surrounding cases to the Congress. Currently, the criterion is a presidential decision. However, there have only been two such decisions since 1997 and thus only two reports to Congress.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the implementation of Exon-Florio—an amendment to the Defense Production Act of 1950[1] that authorizes the President to suspend or prohibit foreign acquisitions, mergers, or takeovers[2] of U.S. companies that pose a threat to national security. As such, Exon-Florio is meant to serve as a safety net when laws other than the International Emergency Economic Powers Act[3] may be ineffective in protecting national security. As you know, implementing Exon-Florio can pose a significant challenge for the federal government because of the potential for conflict with the long-standing U.S. open investment policy. This policy recognizes the economic benefits associated with foreign investments. Accordingly, foreign investors are to be treated no differently than domestic investors.

The Committee on Foreign Investment in the United States, originally established in 1975 to monitor foreign investments, has been delegated responsibility for investigating foreign acquisitions when necessary. According to the regulations, after a company voluntarily files a notice of a pending or completed acquisition by a foreign concern, the Committee conducts a 30-day review to determine whether there are any national security concerns. If the Committee is unable to complete its review within 30 days, the Committee may either allow the companies to withdraw the notification or initiate a 45-day investigation. At the completion of the investigation, the Committee submits a report to the President, including a recommendation for action. The Committee currently has 12 members: the Department of the Treasury, which serves as Chair; the Departments of Commerce, Defense, Homeland Security, Justice, and State; and six offices in the Executive Office of the President.[4] Other agencies may be called on when their particular expertise is needed.

[1] 50 U.S.C. app. § 2170.

[2] In the remainder of this statement, acquisitions, mergers, and takeovers are referred to as acquisitions.

[3] The International Emergency Economic Powers Act gives the President broad powers to deal with any "unusual and extraordinary threat" to the national security, foreign policy, or economy of the United States (50 U.S.C. §§ 1701-1706). To exercise this authority, however, the President must declare a national emergency to deal with any such threat. Under this legislation, the President has the authority to investigate, regulate, and, if necessary, block any foreign interest's acquisition of U.S. companies (50 U.S.C. § 1702(a) (1) (B)).

[4] See appendix I for information on Committee members.

The Department of Homeland Security was the most recently added member, created as a result of the terrorist attacks of September 11th and the recognition of the new security environment in which we exist.

Over the past decade, GAO has conducted several reviews of the Committee's actions and has found areas where improvements should be made. For example, in September 2002, we reported that member agencies could improve the agreements they negotiated with companies under Exon-Florio to mitigate national security concerns.[5] While our recent work indicates that member agencies have begun to take action to respond to some of our recommendations, concerns remain about the extent to which the Committee's implementation of Exon-Florio has provided the safety net envisioned by the law. My comments today will focus on the process the Committee follows in conducting its reviews, concerns about the process, and suggestions we have made in our report on these issues.[6] It should be noted that because the law provides for confidentiality of information filed under Exon-Florio, our ability to discuss certain details of cases we examined is limited.

In summary, several aspects of the Committee's process for implementing Exon-Florio could be enhanced thereby strengthening the law's effectiveness. First, in light of differing views among Committee members about the scope of Exon-Florio—specifically, what defines a threat to national security, we have suggested that Congress should consider amending Exon-Florio to more clearly emphasize the factors that should be considered in determining potential harm to national security.

Second, to provide additional time for analyzing transactions when necessary, while avoiding the perceived negative connotation of investigation on foreign investment in the United States we have suggested that the Congress eliminate the distinction between the 30-day review and the 45-day investigation and make the entire 75-day period available for review.

Third, the Committee's current approach to provide additional time for analysis or to resolve concerns while avoiding the potential negative

[5] *GAO, Defense Trade: Mitigating National Security Concerns under Exon-Florio Could be Improved*, GAO-02-736 (Washington, D.C.: Sept. 12, 2002).

[6] *GAO, Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, GAO-05-686 (Washington, D.C.: Sept. 28, 2005).

impacts of an investigation on foreign investment in the United Stated is to encourage companies to withdraw their notifications of proposed or completed acquisitions and refile them at a later date. Since 1997, companies involved in 18 acquisitions have been allowed to withdraw their notification to refile at a later time. The new filing is considered a new case and restarts the 30-day clock. While withdrawing and refiling provides additional time while minimizing the risk of chilling foreign investment, withdrawal may also heighten the risk to national security in transactions where there are concerns and the acquisition has been completed or is likely to be completed during the withdrawal period. We are therefore suggesting that the Congress consider requiring the Committee Chair to (1) establish interim protections where specific concerns have been raised, (2) specify time frames for refiling, and (3) establish a process for tracking any actions being taken during the withdrawal period.

Finally, to provide more transparency and facilitate congressional oversight, we are suggesting that the Congress may want to revisit the criterion for reporting circumstances surrounding cases to the Congress. Currently, the criterion is a presidential decision. However, there have only been two such decisions since 1997 and thus only two reports to Congress.[7]

Background

The Exon-Florio amendment to the Defense Production Act, enacted in 1988, authorized the President to investigate the impact of foreign acquisitions of U.S. companies on national security and to suspend or prohibit acquisitions that might threaten national security. The President delegated the investigative authority to the Committee on Foreign Investment in the United States, an interagency group established in 1975 to monitor and coordinate U.S. policy on foreign investment in the United States.[8]

In 1991, the Treasury Department, as chair of the Committee, issued regulations to implement Exon-Florio. The law and regulations establish a

[7] See Appendix II for a number of cases reviewed by the Committee between fiscal years 1997 and 2004 and the disposition of these cases.

[8] Executive Order 11858 (May 7, 1975), as amended by Executive Order 12188 (Jan. 2, 1980), Executive Order 12661 (Dec. 27, 1988), Executive Order 12860 (Sept. 3, 1993), and Executive Order 13286 (Feb. 28, 2003).

four-step process for reviewing foreign acquisitions of U.S. companies: (1) voluntary notice by the companies;[9] (2) a 30-day review to determine whether the acquisition could pose a threat to national security; (3) a 45-day investigation to determine whether those concerns require a recommendation to the President for possible action; and (4) a presidential decision to permit, suspend, or prohibit the acquisition. In most cases, the Committee completes its review within the initial 30 days because there are no national security concerns or concerns have been addressed, or the companies and the government agree on measures to mitigate identified security concerns. In cases where the Committee is unable to complete its review within 30 days, the Committee may initiate a 45-day investigation or allow companies to withdraw their notifications. The Committee generally grants requests to withdraw. When the Committee concludes a 45-day investigation, it is required to submit a report to the President containing recommendations. If Committee members cannot agree on a recommendation, the regulations require that the report to the President include the differing views of all Committee members.[10] The President has 15 days to decide whether to prohibit or suspend the proposed acquisition, order divestiture of a completed acquisition, or take no action.[11]

While neither the statute nor the implementing regulation defines "national security," the statute provides the following factors to be considered in determining a threat to national security:

- Domestic production needed for projected national defense requirements.
- The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services.

[9] Notification is not mandatory. However, any member agency is authorized to submit a notification of an acquisition if the companies have not done so. To date, no agency has submitted a notification of an acquisition. Instead, member agencies have informed Treasury of acquisitions that may be subject to Exon-Florio, and Treasury has contacted the companies to encourage them to officially notify the Committee of the acquisition to begin a review.

[10] 31 C.F.R. § 800.504(b).

[11] In 1990, the President ordered a Chinese aerospace company to divest its ownership of a U.S. aircraft parts manufacturer. To date, this is the only divestiture the President has ordered.

- The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet national security requirements.
- The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country identified under applicable law as (a) supporting terrorism or (b) a country of concern for missile proliferation or the proliferation of chemical and biological weapons.
- The potential effects of the proposed or pending transaction on U.S. international technological leadership in areas affecting national security.

Differing Views of What Defines A National Security Threat and When to Initiate an Investigation May Weaken Exon-Florio's Effectiveness

Lack of agreement among Committee members on what defines a threat to national security and what criteria should be used to initiate an investigation may be limiting the Committee's analyses of proposed and completed foreign acquisitions. From 1997 through 2004, the Committee received a total of 470 notices of proposed or completed acquisitions,[12] yet it initiated only 8 investigations.

Some Committee member agencies, including Treasury, apply a more traditional and narrow definition of what constitutes a threat to national security—that is, (1) the U.S. company possesses export-controlled technologies or items; (2) the company has classified contracts and critical technologies; or (3) there is specific derogatory intelligence on the foreign company. Other members, including the departments of Defense and Justice, argue that acquisitions should be analyzed in broader terms. According to officials from these departments, vulnerabilities can result from foreign control of critical infrastructure, such as control of or access to information traveling on networks. Vulnerabilities can also result from foreign control of critical inputs to defense systems or a decrease in the number of innovative small businesses researching and developing new defense-related technologies.

While these vulnerabilities may not pose an immediate threat to national security, they may create the potential for longer term harm to U.S. national security interests by reducing U.S. technological leadership in

[12] Nineteen of these notices were refilings.

defense systems. For example, in reviewing a 2001 acquisition of a U.S. company, the departments of Defense and Commerce raised several concerns about foreign ownership of sensitive but unclassified technology, including the possibility of this sensitive technology being transferred to countries of concern or losing U.S. government access to the technology. However, Treasury argued that these concerns were not national security concerns because they did not involve classified contracts, the foreign company's country of origin was a U.S. ally, or there was no specific negative intelligence about the company's actions in the United States.

In one proposed acquisition that we reviewed, disagreement over the definition of national security resulted in an enforcement provision being removed from an agreement between the foreign company and the Departments of Defense and Homeland Security. Defense had raised concerns about the security of its supply of specialized integrated circuits, which are used in a variety of defense technologies that the Defense Science Board had identified as essential to our national defense—technologies found in unmanned aerial vehicles, the Joint Tactical Radio System, and cryptography and other communications protection devices. However, Treasury and other Committee members argued that the security of supply issue was an industrial policy concern and, therefore, was outside the scope of Exon-Florio's authority. As a result of removing the provision, the President's authority to require divestiture under Exon-Florio has been eliminated as a remedy in the event of noncompliance.[13]

Committee members also disagree on the criteria that should be applied to determine whether a proposed or completed acquisition should be investigated. While Exon-Florio provides that the "President or the President's designee may make an investigation to determine the effects on national security" of acquisitions that could result in foreign control of a U.S. company, it does not provide specific guidance for the appropriate criteria for initiating an investigation of an acquisition.[14] Currently, Treasury, as Committee Chair, applies essentially the same criteria established in the law for the President to suspend or prohibit a

[13] The regulations provide that the Committee may reopen its review or investigation and revise its recommendation to the President only if it determines that the companies omitted or provided false or misleading information (31 C.F.R. § 800.601(e)).

[14] 50 U.S.C. App. § 2170(a). Under the statute, investigations are mandatory in those cases in which the acquiring company is "controlled by or acting on behalf of a foreign government" and the acquisition could result in control of the U.S. company and could affect the national security of the United States (50 U.S.C. App. § 2170(b)).

transaction, or order divestiture: (1) there is credible evidence that the foreign controlling interest may take action to threaten national security and (2) no laws other than the International Emergency Economic Powers Act are appropriate or adequate to protect national security.[15] However, the Defense, Justice, and Homeland Security departments have argued that applying these criteria at this point in the process is inappropriate because the purpose of an investigation is to determine whether or not a credible threat exists. Notes from a policy-level discussion of one particular case further corroborated these differing views.

Allowing Withdrawal of Notifications to Avoid Investigations While Providing Additional Time May Leave National Security Concerns Unresolved

Committee guidelines require member agencies to inform the Committee of national security concerns by the 23rd day of a 30-day review—further compressing the limited time allowed by legislation to determine whether a proposed or completed foreign acquisition poses a threat to national security. According to one Treasury official, the information is needed a week early to meet the legislated 30-day requirement. While most reviews are completed in the legislatively required 30 days, some Committee members have found that completing a review within such short time frames can be difficult—particularly in complex cases. One Defense official said that without advance notice of the acquisition, time frames are too short to complete analyses and provide input for the Defense Department's position. Another official said that to meet the 23-day deadline, analysts have only 3 to 10 days to analyze the acquisition. In one instance, Homeland Security was unable to provide input within the 23-day time frame.

If a review cannot be completed within 30 days and more time is needed to determine whether a problem exists or identify actions that would mitigate concerns, the Committee can initiate a 45-day investigation of the acquisition or allow companies to withdraw their notifications and refile at a later date.[16] According to Treasury officials, the Committee's interest is to ensure that the implementation of Exon-Florio does not undermine U.S. open investment policy. Concerned that public knowledge of investigations could devalue companies' stock, erode confidence of foreign investors, and ultimately chill foreign investment in the United

[15] 50 U.S.C. app. § 2170(e).

[16] Exon-Florio's implementing regulations permit companies to request to withdraw notifications at any time up to a presidential decision. After the Committee approves a withdrawal, any subsequent refiling is considered a new, voluntary notice.

States, the Committee has generally allowed and often encouraged companies to withdraw their notifications rather than initiate an investigation.

While an acquisition is pending, companies that have withdrawn their notification have an incentive to resolve any outstanding issues and refile as soon as possible. However, if an acquisition has been concluded, there is less incentive to resolve issues and refile, extending the time during which any concerns remain unresolved. Between 1997 and 2004, companies involved in 18 acquisitions have withdrawn their notification and refiled 19 times. In two cases, the companies had already concluded the acquisition and did not refile until 9 months to 1 year. Consequently, the concerns raised by Defense and Commerce about potential export control issues in these cases remained unresolved for as much as a year—further increasing the risk that a foreign acquisition of a U.S. company would pose a threat to national security.

We identified two cases in which companies that had concluded an acquisition before filing with the Committee withdrew their notification.[17] In each case, the company has yet to refile. In one case, the company filed with the Committee more than a year after completing the acquisition. The Committee allowed it to withdraw the notification to provide more time to answer the Committee's questions and provide assurances concerning export control matters. The company refiled, and was permitted to withdraw a second time because there were still unresolved issues. Four years have passed since the second withdrawal. In the second case, the company—which filed with the Committee more than 6 months after completing its acquisition—was also allowed to withdraw its notification. That was more than 2 years ago.

Lack of Reporting Contributes to the Opaqueness of the Committee's Process

In enacting Exon-Florio, the Congress, while recognizing the need for confidentiality, indicated a desire for insight into the process by requiring the President to report to the Congress on any transaction that the President prohibited. In response to concerns about the lack of transparency in the Committee's process, the Congress passed the Byrd Amendment to Exon-Florio in 1992, requiring a report to the Congress if the President makes any decision regarding a proposed foreign

[17] In one of these cases, as discussed above, the company had previously withdrawn and refiled more than a year later.

acquisition. In 1992, another amendment also directed the President to report every 4 years on whether there is credible evidence of a coordinated strategy by one or more countries to acquire U.S. companies involved in research, development, or production of critical technologies for which the United States is a leading producer, and whether there are industrial espionage activities directed or assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies.

While the Byrd Amendment expanded required reporting on Committee actions, few reports have been submitted to the Congress because withdrawing and refiling notices to restart the clock limits the number of cases that result in a presidential decision. Since 1997, only two cases—both involving telecommunications systems—resulted in a presidential decision and a subsequent report to the Congress. Infrequent reporting of Committee deliberations on specific cases provides little insight into the Committee's process to identify concerns raised during investigations and determine the extent to which the Committee has reached consensus on a case. Further, despite the 1992 requirement for a report on foreign acquisition strategies every 4 years, there has been only one report—in 1994.

In conclusion, in recognition of the benefits of open investment, Exon-Florio comes into play only as a last resort. However, since that is its role, effective application in support of recognizing and mitigating national security risks remains critical. While Exon-Florio provides the Committee on Foreign Investment in the United States the latitude to address new emerging threats, the more traditional interpretation of what constitutes a threat to national security fails to fully consider the factors currently embodied in the law. Further, the practical requirement to complete reviews within 23 days to meet the 30-day legislative requirement, along with the reluctance to proceed to an investigation, limits agencies' abilities to complete in-depth analyses. However, the alternative—allowing companies to withdraw and refile their notifications—increases the risk that the Committee, and the Congress, will lose visibility over foreign acquisitions of U.S. companies.

Our report lays out several matters for congressional consideration to (1) help resolve the differing views as to the extent of coverage of Exon-Florio, (2) address the need for additional time, and (3) increase insight and oversight of the process. Further, we are suggesting that, when withdrawal is allowed for a transaction that has been completed, the Committee establish interim protections where specific concerns have

been raised, specific time frames for refiling, and a process for tracking any actions being taken during a withdrawal period.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or other Members of the Committee may have.

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Scope and Methodology

Our understanding of the Committee on Foreign Investment in the United States' process is based on our current work and builds on our review of the process and our discussions with agency officials for our 2002 report. For our current review, and to expand our understanding of the Committee's process for reviewing foreign acquisitions of U.S. companies, we met with officials from the Department of Commerce, the Department of Defense, the Department of Homeland Security, the Department of Justice, and the Department of the Treasury. For prior reviews we also collected data from and discussed the issues with representatives of the Department of State, the Council of Economic Advisors, the Office of Science and Technology, and the U.S. Trade Representative. Further, we conducted case studies of nine acquisitions that were filed with the Committee between June 28, 1995, and December 31, 2004. These case studies included reviewing files containing company submissions, correspondence between the Committee and the companies' representatives, email traffic between member agencies, and minutes of policy-level meetings attended by at various times all 12 Committee members.

We selected acquisitions based on recommendations by Committee member agencies and the following criteria: (1) the Committee permitted the companies to withdraw the notification; (2) the Committee or member agencies concluded agreements to mitigate national security concerns; (3) the foreign company had been involved in a prior acquisition notified to the Committee; or (4) GAO had reviewed the acquisition for its 2002 report. We did not attempt to validate the conclusions reached by the Committee on any of the cases we reviewed. We also discussed our draft

report from our current review with officials from the Department of State and the U.S. Trade Representative's office to obtain their views on our findings.

To determine whether the weaknesses in provisions to assist agencies in monitoring agreements that GAO had identified in its 2002 report had been addressed, we analyzed agreements concluded under the Committee's authority between 2003 and 2005. We conducted our review from April 2004 through July 2005 in accordance with generally accepted government auditing standards.

Appendix I: Agencies Represented on the Committee on Foreign Investment in the United States

Agencies Represented	Year Added	Lead Office Mission
Executive Departments		
Department of the Treasury (Chair)	1975	Office of International Investment: Coordinates policies toward foreign investments in the United States and U.S. investments abroad.
Department of Commerce	1975	International Trade Administration: Coordinates issues concerning trade promotion, international commercial policy, market access, and trade law enforcement.
Department of Defense	1975	Defense Technology Security Administration: Administers the development and implementation of Defense technology security policies on international transfers of defense-related goods, services, and technologies.
Department of State	1975	Bureau of Economic and Business Affairs: Formulates and implements policy regarding foreign economic matters, including trade and international finance and development.
Department of Justice	1988	Criminal Division: Develops, enforces, and supervises the application of all federal criminal laws, except for those assigned to other Justice Department divisions.
Department of Homeland Security	2003	Information Analysis and Infrastructure Protection: Identifies and assesses current and future threats to the homeland, maps those threats against vulnerabilities, issues warnings, and takes preventative and protective action.
Executive Office of the President		
Council of Economic Advisers	1980	Performs analyses and appraisals of the national economy for the purpose of providing policy recommendations to the President.
Office of the United States Trade Representative	1980	Directs all trade negotiations of and formulates trade policy for the United States.
Office of Management and Budget	1988	Evaluates, formulates, and coordinates management procedures and program objectives within and among federal departments and agencies, and controls administration of the federal budget.
National Economic Council	1993	Coordinates the economic policy-making process and provides economic policy advice to the President.
National Security Council	1993	Advises and assists the President in integrating all aspects of national security policy as it affects the United States.
Office of Science and Technology Policy	1993	Provides scientific, engineering and technological analyses for the President for federal policies, plans, and programs.

Source: GAO analysis.

Appendix II: Notifications to the Committee on Foreign Investment in the United States and Actions Taken, 1997 through 2004

Year	Notifications	Acquisitions[a]	Investigations[b]	Notices withdrawn after investigation begun	Presidential decisions
1997	62	60	0	0	0
1998	65	62	2	2	0
1999	79	76	0	0	0
2000	72	71	1	0	1
2001	55	51	1	1	0
2002	43	42	0	0	0
2003	41	39	2	1	1
2004	53	50	2	2	0
Total	**470**	**451**	**8**	**6**	**2**[c]

Source: Department of the Treasury.

[a]Acquisitions that were withdrawn and refiled are shown in the year of initial notification.

[b]Investigations are shown in the year of their notification.

[c]In both cases the President took no action, thereby allowing the transaction, and sent a report to Congress.

United States Government Accountability Office

GAO

Report to Congressional Requesters

September 2005

DEFENSE TRADE

Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness

GAO-05-686

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Highlights
Highlights of GAO-05-686, a report to Congressional Requesters

Why GAO Did This Study

The 1988 Exon-Florio amendment to the Defense Production Act authorizes the President to suspend or prohibit foreign acquisitions of U.S. companies that may harm national security, an action the President has taken only once. Implementing Exon-Florio can pose a significant challenge because of the need to weigh security concerns against U.S. open investment policy—which requires equal treatment of foreign and domestic investors.

Exon-Florio's investigative authority was delegated to the Committee on Foreign Investment in the United States—an interagency committee established in 1975 to monitor U.S. policy on foreign investments. In September 2002, GAO reported on the implementation of Exon-Florio. This report further examines that implementation.

What GAO Recommends

This report contains matters for congressional consideration regarding Exon-Florio's coverage and improvements to the law's implementation. In commenting on a draft of this report, the Secretary of the Treasury, as Committee Chair, disagreed with GAO's characterization of the Committee's process and the adequacy of insight into that process. Based on GAO's review of the process, GAO continues to believe that increased insight and oversight could strengthen the law's effectiveness.

www.gao.gov/cgi-bin/getrpt?GAO-05-686.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Ann Calvaresi-Barr at (202) 512-4841 or calvaresibarra@gao.gov.

September 2005

DEFENSE TRADE

Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness

What GAO Found

Foreign acquisitions of U.S. companies can pose a significant challenge for the U. S. government in implementing the Exon-Florio amendment because while foreign investment can provide substantial economic benefits, these benefits must be weighed against the potential for harm to national security. Exon-Florio's effectiveness in protecting U.S. national security may be limited because the Department of the Treasury—as Chair of the Committee on Foreign Investment in the United States—and others narrowly defines what constitutes a threat to national security and, along with some other member agencies, is reluctant to initiate investigations to determine whether national security concerns require a recommendation for possible presidential action. Some Committee members have argued that this narrow definition is not sufficiently flexible to protect critical infrastructure, secure defense supply, and preserve technological superiority in the defense arena. The Committee's reluctance to initiate an investigation—due in part to concerns about potential negative effects on the U.S. open investment policy—limits the time available for member agencies to analyze national security concerns. To provide additional time, while avoiding an investigation, the Committee has encouraged companies to withdraw their notification of a pending or completed acquisition and to refile at a later date. However, for companies that have completed the acquisition, there is a substantially longer time before they refile to complete the Committee's process, in some cases they never do, leaving unresolved any outstanding concerns.

In our 2002 report, GAO recommended improvements in provisions to assist agencies in monitoring actions companies have agreed to take to address national security concerns. The Committee has improved provisions on monitoring compliance, and the Department of Homeland Security is actively involved in monitoring company actions.

Agencies Represented on the Committee on Foreign Investment in the United States

Executive Departments	Executive Office of the President
Department of the Treasury (chair)	Council of Economic Advisers
Department of Commerce	National Economic Council
Department of Defense	National Security Council
Department of Homeland Security	Office of Management and Budget
Department of Justice	Office of Science and Technology Policy
Department of State	Office of the U. S. Trade Representative

Source: Executive Order 11858, as amended.

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Abbreviations

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United States Government Accountability Office
Washington, DC 20548

September 28, 2005

The Honorable Richard Shelby
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate

The Honorable Evan Bayh
United States Senate

Foreign acquisitions of U.S. companies can pose a significant challenge for the U.S. government because of the need to balance the U.S. open investment policy against the potential that an acquisition may harm national security. Under the U.S. open investment policy, foreign investors are to be treated no differently than domestic investors. In 1988, Congress passed the Exon-Florio amendment[1] to the Defense Production Act, which authorizes the President to suspend or prohibit foreign acquisitions, mergers, or takeovers[2] of U.S. companies if a foreign controlling interest might take action that threatens national security. Exon-Florio is meant to serve as a safety net to be used when laws other than Exon-Florio and the International Emergency Economic Powers Act[3] may not be effective in protecting national security.

The President delegated the investigative authority of Exon-Florio to the Committee on Foreign Investment in the United States (Committee)—an interagency committee established in 1975 to monitor and coordinate U.S. policy on foreign investment in the United States. The Committee is chaired by the Secretary of the Treasury. To provide the broadest latitude

[1] 50 U.S.C. app. § 2170.

[2] In the remainder of this report, acquisitions, mergers, and takeovers are referred to as acquisitions.

[3] The International Emergency Economic Powers Act gives the President broad powers to deal with any "unusual and extraordinary threat" to the national security, foreign policy, or economy of the United States (50 U.S.C. §§ 1701-1706). To exercise this authority, however, the President must declare a national emergency to deal with any such threat. Under this legislation, the President has the authority to investigate, regulate, and, if necessary, block any foreign interest's acquisition of U.S. companies (50 U.S.C. § 1702(a) (1) (B)).

for determining whether an acquisition presents a national security threat, neither the statute nor the implementing regulation defines "national security."

Exon-Florio establishes a four-step process for examining a foreign acquisition of a U.S. company: (1) voluntary notice by the companies, (2) a 30-day review to identify whether there are any national security concerns, (3) a 45-day investigation to determine whether those concerns require a recommendation to the President for possible action, and (4) a presidential decision to permit, suspend, or prohibit the acquisition. The law requires that the Committee report to Congress on the circumstances surrounding any acquisition that results in a presidential decision. This requirement was added in 1992 to provide Congress insight into the process.

In September 2002,[4] we reported on several weaknesses in the process used by the Committee as well as in the agreements negotiated with companies under Exon-Florio to mitigate identified national security concerns. You asked us to further examine the Committee's implementation of Exon-Florio. We also determined whether the Committee had implemented the recommendations from our 2002 report.

To understand the Committee's process for reviewing foreign acquisitions of U.S. companies, we met with officials from the Department of Commerce, the Department of Defense, the Department of Homeland Security, the Department of Justice, and the Department of the Treasury—the agencies that are most active in the review of acquisitions—and discussed their involvement in the process. Further, we conducted case studies of nine acquisitions that were filed with the Committee between June 28, 1995, and December 31, 2004. We selected acquisitions based on recommendations by Committee member agencies and the following criteria: (1) the Committee permitted the companies to withdraw the notification; (2) the Committee or member agencies concluded agreements to mitigate national security concerns; (3) the foreign company had been involved in a prior acquisition notified to the Committee; or (4) GAO had reviewed the acquisition for its 2002 report. We did not attempt to validate the conclusions reached by the Committee on any of the cases we reviewed. To determine whether the weaknesses in

[4] GAO, *Defense Trade: Mitigating National Security Concerns under Exon-Florio Could be Improved*. GAO-02-736 (Washington, D.C.: Sept. 12, 2002).

provisions to assist agencies in monitoring agreements that GAO had identified in its 2002 report had been addressed, we analyzed agreements concluded under the Committee's authority between 2003 and 2005. We conducted our review from April 2004 through July 2005 in accordance with generally accepted government auditing standards.

Results in Brief

The manner in which the Committee on Foreign Investment in the United States implements Exon-Florio may limit its effectiveness. For example, Treasury, in its role as Chair, and some others narrowly define what constitutes a threat to national security—that is, they have limited the definition to export-controlled technologies or items and classified contracts, or specific derogatory intelligence on the foreign company. Other members have argued that this definition is not sufficiently flexible to provide for safeguards in areas such as protection of critical infrastructure, security of defense supply, and preservation of technological superiority in the defense arena. In one case, some member agencies would not agree with the Departments of Defense's and Homeland Security's using the authority of Exon-Florio and the Committee as a basis for an agreement that Defense officials believed necessary to mitigate national security concerns because the concerns did not, in the opinions of these Committee members, fit this narrow definition.

In addition, the Committee is reluctant to initiate investigations because of a perception that they would discourage foreign investment—a potential conflict with U.S. open investment policy. Treasury, in its capacity as Chair, applies a strict standard in determining whether an acquisition should be investigated. The Chair has established as the criteria for initiating an investigation essentially the same criteria that the law provides as the basis for the President to suspend or prohibit the transaction or order divestiture. Those criteria are: the likelihood that (1) there is credible evidence that the foreign controlling interest may take action to threaten national security and (2) no other laws are appropriate or adequate to protect national security. Defense and other agencies have argued that since the statute applies these criteria to presidential decisions, these criteria should not be the standard for initiating an investigation. Defense officials and others have stated that the 45 days of the investigation should be used to analyze the acquisition to determine whether those criteria are met. In addition, the Committee's guidance requires member agencies to determine the likelihood of meeting the standard by the 23rd day of the 30-day review. Several officials commented that, in complex cases, it is difficult to complete analyses to meet that

standard within 23 days. To avoid the negative connotation associated with initiating an investigation, the Committee encourages companies to withdraw their notification to provide additional time, rather than proceed to the investigation phase. When companies withdraw their notifications and refile at a later date, the 30-day review period is restarted. If there are concerns, allowing a withdrawal can heighten risks, particularly when a company has completed the acquisition before notifying the Committee. For example, one company had completed an acquisition over one year before filing with the Committee, but was allowed to withdraw its notification. Four years later the company has yet to refile, despite concerns raised by some agencies about the acquisition. Further, the use of withdrawals contributes to the opaque nature of the process because very few cases reach a presidential decision, only two between 1997 and 2004, and thus very few transactions are subject to the required reporting to Congress.

In our 2002 report, we recommended improvements in provisions to assist agencies in monitoring actions companies had agreed to take to mitigate or address concerns. The Committee has improved provisions on monitoring company compliance with mitigation agreements, and the Department of Homeland Security is actively involved in monitoring agreements to which it is a party. In analyzing two recent agreements, we identified provisions that addressed our prior concerns. For example, both agreements clearly identified the offices within the Departments of Homeland Security and Justice to which the companies should report.

This report contains matters for congressional consideration to help resolve the disagreements as to the extent of coverage of Exon-Florio and to require interim protections where specific concerns have been raised, specific time frames for refiling, and a process for tracking any actions being taken during a withdrawal period in cases where the transaction has been completed.

The Department of the Treasury, as Committee Chair, provided comments on a draft of this report on behalf of all Committee members. However, the Department of Justice provided comments in a separate letter. Overall, Treasury disagreed with our characterization of the Committee's process in that the Chair believes issues are fully vetted and consensus has always been reached. During the course of our review, certain member agencies raised concerns about the Committee's process that indicated differing views among Committee members when reviewing certain cases. These differing views concerned what constitutes a threat to national security,

the sufficiency of the time allowed for reviews, and the appropriate criteria for initiating an investigation.

- In one case we reviewed where member agencies disagreed over what should be deemed a national security concern, the narrower definition—one that excludes national security concerns raised by certain member agencies—prevailed, in that the notice was withdrawn instead of the case proceeding to investigation.
- In complex cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute, case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days.
- Policy-level officials from two member agencies have indicated that the debate over the criteria for initiating an investigation remains unresolved.

The Department of Justice's comments were generally technical and we have incorporated them as appropriate. However, Justice did share the concern expressed in our report with respect to the time constraints imposed by the current process, particularly its effect on gathering and using input from the intelligence community. Justice commented that any "extension of the time available…would be helpful."

Background

In 1988, the Congress enacted the Exon-Florio amendment to the Defense Production Act, which authorized the President to investigate the impact of foreign acquisitions of U.S. companies on national security and to suspend or prohibit acquisitions that might threaten national security. The President delegated this investigative authority to the Committee on Foreign Investment in the United States. The Committee is an interagency group that was established by executive order in 1975 to monitor the impact of and coordinate U.S. policy on foreign investment in the United States.[5] The Committee is chaired by the Secretary of the Treasury, and its membership includes representatives from executive branch departments and the Executive Office of the President (see table 1). The President added the Department of Homeland Security to the Committee in 2003,

[5] Executive Order 11858 (May 7, 1975), as amended by Executive Order 12188 (Jan. 2, 1980), Executive Order 12661 (Dec. 27, 1988), Executive Order 12860 (Sept. 3, 1993), and Executive Order 13286 (Feb. 28, 2003).

reflecting an increased focus on domestic security in the aftermath of the September 11, 2001, terror attacks and subsequent global war on terror.

Table 1: Agencies Represented on the Committee on Foreign Investment in the United States

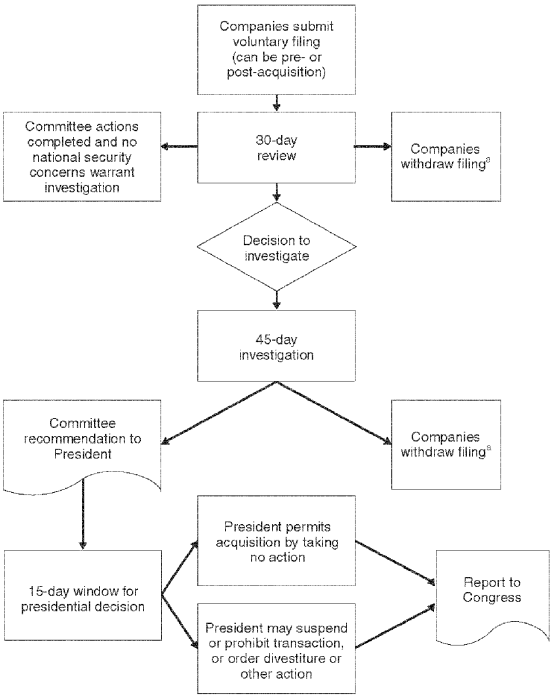
Agencies represented	Year added	Lead office mission
Executive Departments		
Department of the Treasury (Chair)	1975	Office of International Investment: Coordinates policies toward foreign investments in the United States and U.S. investments abroad.
Department of Commerce	1975	International Trade Administration: Coordinates issues concerning trade promotion, international commercial policy, market access, and trade law enforcement.
Department of Defense	1975	Defense Technology Security Administration: Administers the development and implementation of Defense technology security policies on international transfers of defense-related goods, services, and technologies.
Department of State	1975	Bureau of Economic and Business Affairs: Formulates and implements policy regarding foreign economic matters, including trade and international finance and development.
Department of Justice	1988	Criminal Division: Develops, enforces, and supervises the application of all federal criminal laws, except for those assigned to other Justice Department divisions.
Department of Homeland Security	2003	Information Analysis and Infrastructure Protection: Identifies and assesses current and future threats to the homeland, maps those threats against vulnerabilities, issues warnings, and takes preventative and protective action.
Executive Office of the President		
Council of Economic Advisers	1980	Performs analyses and appraisals of the national economy for the purpose of providing policy recommendations to the President.
Office of the United States Trade Representative	1980	Directs all trade negotiations of and formulates trade policy for the United States.
Office of Management and Budget	1988	Evaluates, formulates, and coordinates management procedures and program objectives within and among federal departments and agencies, and controls administration of the federal budget.
National Economic Council	1993	Coordinates the economic policymaking process and provides economic policy advice to the President.
National Security Council	1993	Advises and assists the President in integrating all aspects of national security policy as it affects the United States.
Office of Science and Technology Policy	1993	Provides scientific, engineering, and technological analyses for the President with respect to federal policies, plans, and programs.

Source: GAO analysis.

In 1991, the Treasury Department issued regulations to implement Exon-Florio. As shown in figure 1, Exon-Florio and the regulations establish a four-step process for reviewing a foreign acquisition of a U.S. company:

voluntary notice, 30-day review, 45-day investigation, and presidential decision.

Figure 1: The Committee on Foreign Investment in the United States' Process for Implementing the Exon-Florio Amendment



Source: GAO analysis based on 50 U.S.C. App. § 2170 and 31 C.F.R. Part 800 and case file review.

[a]At any point prior to a presidential decision, companies can request to withdraw a notification.

Notifying the Committee of an acquisition is not mandatory. However, any member agency is authorized to submit a notification of an acquisition if

the companies have not done so. To date, no agency has submitted a notification of an acquisition. Instead, when a member agency becomes aware of an acquisition that may be subject to Exon-Florio, the agency informs Treasury, as Chair, and Committee staff contact the companies to encourage them to officially notify the Committee of the acquisition to begin a review. Committee officials noted that companies have an incentive to notify the Committee prior to completing the acquisition because Exon-Florio provides the President with the authority to order companies to divest completed acquisitions found to pose a threat to national security.

Under Exon-Florio, after receiving notification of a proposed or completed acquisition, the Committee begins a 30-day review to determine whether the acquisition could pose a threat to national security.[6] The Treasury Department, as Committee Chair, forwards the notification documentation to the lead office in each of the member agencies. Lead offices forward the information to other offices within their agency. For example, the Defense Technology Security Administration, the lead office for the Department of Defense, forwards notification to 12 other offices within the department. These other offices may also forward the notification, as appropriate. In one case, the point-of-contact in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, one of the initial 12 offices, forwarded the notification to four other offices within that organization.

In most instances, the Committee completes its review within the 30 days. However, if the Committee is unable to complete its review within 30 days, the Committee may either allow the companies to withdraw the notification or initiate a 45-day investigation. If the Committee concludes a 45-day investigation, it is required to submit a report to the President containing its recommendations. If Committee members cannot agree on a recommendation, the regulations require that the report to the President include the differing views of all Committee members.[7]

Under Exon-Florio, the President has 15 days to decide whether to prohibit or suspend the proposed acquisition, order divestiture of a completed acquisition or take no action. The President may take action upon a determination that (1) there is credible evidence that leads the

[6] 50 U.S.C. App. § 2170(a).

[7] 31 C.F.R. § 800.504(b).

President to believe that a foreign controlling interest might take action that threatens to impair national security and (2) laws other than Exon-Florio and the International Emergency Economic Powers Act are inadequate or inappropriate to protect national security. Under the regulations, the President's divestiture authority, however, cannot be exercised if (1) the Committee has informed the companies in writing that their acquisition was not subject to Exon-Florio or had previously decided to forego investigation or (2) the President has previously decided not to act on that specific acquisition under Exon-Florio.[8] The Committee may reopen its review or investigation and revise its recommendation to the President if it determines that the companies omitted or provided false or misleading information.[9] In some cases, the companies will decide not to proceed with the transaction because of concerns that a presidential decision would be unfavorable. However, the President has ordered divestiture in only one case. In 1990, the President ordered a Chinese aerospace company to divest its ownership of a U.S. aircraft parts manufacturer.

Under the original Exon-Florio law, the President was obligated to report to the Congress on the circumstances surrounding a presidential decision only after prohibiting an acquisition. In response to concerns about the lack of transparency in the Committee's process, in 1992 Congress passed the Byrd Amendment to Exon-Florio, requiring a report to the Congress if the President makes any decision regarding a proposed foreign acquisition.

Companies can request to withdraw their notification at any time prior to the President announcing a decision. A Treasury official told us that the Committee generally grants withdrawal requests. After the Committee approves a withdrawal, any prior voluntary notices submitted no longer remain in effect. Any subsequent refiling by the parties is considered as a new, voluntary notice to the Committee.

[8] 31 C.F.R. § 800.601(d).

[9] 31 C.F.R. § 800.601(e).

The Committee's Implementation of Exon-Florio May Limit Its Effectiveness

The manner in which the Committee implements Exon-Florio may limit its effectiveness because (1) Treasury, in its role as Chair, has narrowly defined what constitutes a threat to national security and (2) the Committee is reluctant to initiate a 45-day investigation because of a perceived negative impact on foreign investment and a conflict with the U.S. open investment policy. As a result of the narrow definition, some issues that Defense, Homeland Security, and Justice officials believe have important national security implications, such as security of supply, may not be addressed. In addition, the reluctance to initiate the 45-day investigation compresses the time available to consider issues. This compressed time frame limits agencies' ability to complete their analysis of some cases. The Committee encourages companies to request withdrawal of their notification to provide additional time to resolve issues and to avoid the need for investigation. However, when companies that have already completed the acquisition are allowed to withdraw, there is a substantially longer time before they refile, and in some cases they never do, leaving unresolved any outstanding concerns.

Threats to National Security Are Narrowly Defined

Under the statute, the President or the President's designee may make an investigation to determine whether a foreign acquisition might threaten the national security of the United States. Neither the statute nor its implementing regulations define national security. This permits a broad interpretation of the term. The statute does provide factors to be considered in determining a threat to national security; however, consideration of these factors is not mandatory. These factors include the following:

- Domestic production needed for projected national defense requirements.
- The capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services.
- The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security.
- The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country identified under applicable law as (a) supporting terrorism or (b) a country of

concern for missile proliferation or the proliferation of chemical and biological weapons.

- The potential effects of the proposed or pending transaction on U.S. international technological leadership in areas affecting national security.

Despite the broad coverage of the factors under the statute, Treasury and some other Committee member agencies have continued to view threats to national security in the traditional and more narrowly defined sense. That is, they based their definition on a U.S. company's possession of export-controlled technologies or items, classified contracts, and critical technology; or specific derogatory intelligence on the foreign company. The Departments of Justice and Defense have applied a broader view of what might constitute a threat to national security. And since being added to the Committee, the Department of Homeland Security has begun to analyze acquisitions both in traditional terms and more broadly in terms of the potential vulnerabilities posed by the acquisition. According to Justice, Homeland Security, and Defense officials, vulnerabilities can result from foreign control of critical infrastructure, such as control of or access to information traveling on networks. Vulnerabilities can also result from foreign control of critical inputs to defense systems or a decrease in the number of innovative small businesses conducting research on developing defense-related technologies. While these vulnerabilities may not pose an immediate threat to national security, they may create the potential for longer-term harm to U.S. national security interests by reducing U.S. technological leadership in defense systems.

The agencies that favor applying the narrower, more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate the concerns being raised by the Department of Defense and others. For example, in reviewing a 2001 acquisition involving a U.S. company that produced precision optics and semiconductor manufacturing equipment, Defense and Commerce raised concerns about (a) foreign ownership of sensitive but unclassified technology used in reconnaissance satellites, (b) the possibility of this sensitive technology being transferred to countries of concern, and (c) maintaining U.S. government access to the technology. Treasury officials said that the concerns raised by Defense and Commerce were not national security concerns because they did not involve classified contracts, the foreign company's country of origin was a U.S. ally, and there was no specific negative intelligence about the company's actions in the United States.

During a more recent review, disagreement over the scope of Exon-Florio resulted in a weakening of the enforcement provisions in an agreement. The Defense Department had raised concerns about the security of its supply of specialized integrated circuits as a result of a proposed acquisition. These unique integrated circuits are used in a variety of defense technologies, such as unmanned aerial vehicles, the Joint Tactical Radio System, and communications protection devices including devices used for cryptography. A Defense Science Board task force recently noted that the functions performed by Defense-unique integrated circuits are essential to the national defense of the United States. However, in Treasury's view, the Department of Defense's concerns about its supply of integrated circuits were industrial policy concerns, not national security concerns, despite the importance of these circuits to a variety of defense technologies. Treasury, as Chair of the Committee, and several other members deemed the concerns outside the scope of Exon-Florio authority and would not allow the agreement between the Departments of Defense and Homeland Security and the companies to include any mention of the Committee. As a result, a provision that included strong enforcement language was deleted from an agreement with the acquiring company. In the absence of such language, presidential or Committee action can only result if the companies materially misrepresented information during the Committee's review. In our view, without that provision, the consequences of failure to comply with the agreement are less certain.

The Standard for Investigation Limits the Number of Investigations

The Committee has been reluctant to initiate investigations, to avoid both the negative connotations of an investigation and the need for a presidential decision. As a result, the Committee has initiated few investigations. From 1997 through 2004, the Committee received 470 notices, including 19 refilings, for 451 proposed or completed acquisitions. The Committee initiated only eight investigations during the period (see table 2).

Table 2: Notifications to the Committee on Foreign Investment in the United States and Actions Taken, 1997 through 2004

Year	Notifications	Acquisitions[a]	Investigations[b]
1997	62	60	0
1998	65	62	2
1999	79	76	0
2000	72	71	1
2001	55	51	1
2002	43	42	0
2003	41	39	2
2004	53	50	2
Total	**470**	**451**	**8**

Source: Department of the Treasury.

[a]Acquisitions that were withdrawn and refiled are shown in the year of initial notification.

[b]Investigations are shown in the year of their notification.

According to Treasury Department officials, the Committee reviews foreign acquisitions with a view to protecting national security while maintaining U.S. open investment policy, which provides for equal treatment of foreign and domestic investors. The office within Treasury that provides staff support to the Committee—the Office for International Investment—is also the office responsible for promoting the open investment policy. The Committee's goal is to implement Exon-Florio without chilling foreign investment in the United States. According to Treasury officials, being the subject of an investigation may have negative connotations for a company. If it becomes public knowledge that the acquiring company is the subject of an investigation, it may be perceived that the government views the acquisition as problematic and the stock price of the company may fall. Thus, avoiding an investigation helps maintain the confidence of investors.

Consistent with its desire to avoid investigations, the Treasury Department, as Committee Chair, applies strict criteria in determining whether an acquisition should be investigated. The criteria for initiating an investigation are the likelihood that (1) there is credible evidence that the foreign controlling interest may take action to threaten national security and (2) no other laws are appropriate or adequate to protect national security. This is essentially the same criteria provided by the statute as the

basis for the President to take action to suspend or prohibit an acquisition under Exon-Florio.[10] The Defense Department and others have stated that these criteria are inappropriate for determining whether to initiate an investigation because the 45 days of the investigation should be used to determine whether the criteria are met to inform the Committee's recommendation to the President. Exon-Florio does not provide specific guidance for the appropriate criteria for initiating a 45-day investigation. The statute merely provides that "the President or the President's designee may make an investigation to determine the effects on national security" of acquisitions that could result in foreign control of a U.S. company.[11]

Withdrawals Bypass Regulatory Time Frames

Committee guidelines require member agencies to inform the Committee of concerns by the 23rd day of the 30-day review allowed by Exon-Florio. According to one Treasury official, this time frame is necessary to meet the legislated 30-day requirement for completing a review. For some cases, particularly complex ones, the 23-day rule does not allow enough time to complete reviews and address concerns. For example, one Defense official said that, without advance notice of the acquisition, the time frames are too short to complete analysis and provide input for the Defense Department's position. Another Defense official said that to meet Treasury's deadline, analysts have between 3 and 10 days to analyze the acquisition. In one instance, Homeland Security was unable to provide input within the time frame.

When agencies have needed more time to gather information or negotiate an agreement to mitigate national security concerns, the Committee generally suggests that companies request to withdraw their notification. If the company does not want to withdraw, the Committee can initiate an investigation. Exon-Florio's implementing regulations permit the Committee to allow companies to withdraw their notifications at any time before a presidential decision.

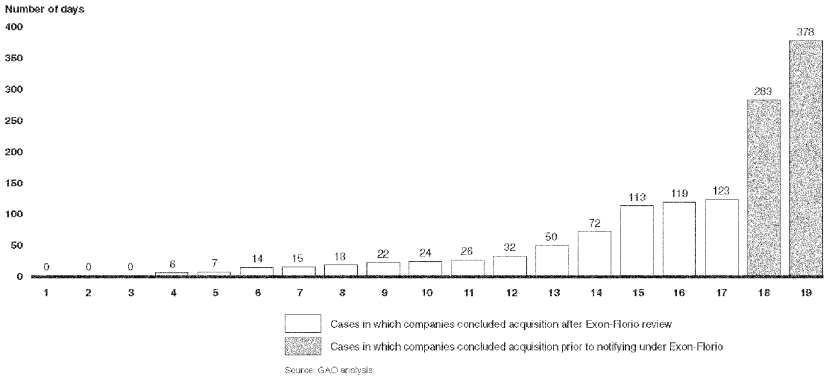
When companies have withdrawn their notification prior to concluding an acquisition, the companies have an incentive to resolve any outstanding

[10] 50 U.S.C. app. § 2170(e).

[11] 50 U.S.C. App. § 2170(a). Under the statute, investigations are mandatory in those cases in which the acquiring company is "controlled by or acting on behalf of a foreign government" and the acquisition could result in control of the U.S. company and could affect the national security of the United States (50 U.S.C. App. § 2170(b)).

issues and refile as soon as possible. However, if an acquisition has been concluded, there is less incentive to resolve issues and refile. Since 1997, companies involved in 18 acquisitions have withdrawn their notification and refiled 19 times. In one case, the company withdrew and refiled twice. In 16 cases, the acquisitions had not yet been concluded, and the time between withdrawal and refiling ranged between 0 days and 4 months (see fig. 2). In two cases, the companies had already concluded the acquisition, and 9 months and 1 year, respectively, passed before the companies refiled. In both cases, Defense or Commerce had raised concerns about potential export control issues. These concerns remained unresolved throughout the period.

Figure 2: Number of Days between Withdrawal and Refiling in 19 Withdrawn Notifications



Source: GAO analysis

In addition to cases where a company that completed an acquisition withdrew and subsequently refiled, we identified two instances in which companies that had concluded an acquisition before filing with the Committee withdrew and have not refiled. In one case, the company filed with the Committee more than a year after completing the acquisition. The Committee allowed it to withdraw the notification to provide more time to answer the Committee's questions and provide assurances concerning export control matters. The company refiled and was permitted to

withdraw a second time because there were still unresolved issues. Four years have passed since the second withdrawal.

In another case, a company filed with the Committee over 6 months after completing its acquisition of an internet backbone company. The Committee allowed the company to withdraw the notification more than 2 years ago because the Committee was busy with another, high-profile acquisition. The Committee has not requested that the company refile even though analysts within one agency had concerns about the acquisition. As a result, the review process has never been completed. A Treasury Department official said that the member agency that has national security concerns about a particular transaction is responsible for ensuring that the company refiles. However, the Committee's guidance to member agencies specifically states that Treasury will manage activities during withdrawal by specifying time frames and goals to be achieved.

In six of the eight investigations that have been undertaken since 1997, withdrawal was allowed after the investigation had begun. Withdrawal and refiling to restart the clock limits the potential negative connotation of an investigation. However, this practice also limits instances that require a presidential decision, contributing to the opaque nature of the Exon-Florio process because reporting to Congress on the results of Committee actions only occurs as a result of a presidential decision. Only two of the eight cases resulted in a presidential decision and a subsequent report to the Congress (see table 3).

Table 3: Investigations and Outcomes, 1997 through 2004

Year	Investigations[a]	Notices withdrawn after investigation begun	Presidential decisions
1997	0	0	0
1998	2	2	0
1999	0	0	0
2000	1	0	1
2001	1	1	0
2002	0	0	0
2003	2	1	1
2004	2	2	0
Total	**8**	**6**	**2**[b]

Source: U.S. Department of the Treasury.

[a]Investigations are shown in the year of their notification.

[b]In both cases the President took no action, thereby allowing the transaction.

Provisions for Monitoring Compliance Have Improved

In our 2002 report, we identified several weaknesses in the agreements that agencies negotiated with companies under the Exon-Florio Amendment. Specifically, the two agreements that we reviewed either did not specify (1) the time frame for implementing provisions of the agreement or (2) the action that would be taken if the company failed to comply within the stated time frame, thus providing no incentive for the companies to act or no penalty for noncompliance. And in one case, the company failed to meet the agreed upon time frame. In addition, the agreements did not specify which offices in Committee member agencies would be responsible for monitoring compliance with the agreements. We recommended in our 2002 report that, to ensure compliance with agreements, the Secretary of the Treasury, as Chair of the Committee, increase the specificity of actions required by mitigation measures in agreements negotiated under Exon-Florio and designate in the agreements the agency responsible for overseeing implementation and monitoring compliance with mitigation measures.

Three agreements negotiated between 2003 and 2005 contain specific time frames for actions to be taken:

- In a telecommunications agreement, the company was required to adopt and implement a visitation policy within 90 days after the agreement became effective.

- In a software agreement, the company had to adopt mandatory policies and procedures to implement the agreement within 90 days and provide copies to the government points of contact.

- In an electronics agreement, the company had to appoint a security officer and two security directors within 90 days of a vacancy to ensure compliance with the agreement, subject to approval by the Departments of Defense and Homeland Security.

Two of the three agreements also contained strong language concerning the consequences of noncompliance with the terms of the agreement. For example, these agreements stated that if the company (1) fails to comply with the terms of the agreement, (2) makes a materially false or incomplete statement, (3) increases foreign entity control, or (4) makes other material changes in circumstances, the Attorney General, the Secretary of Defense, or the Secretary of Homeland Security may raise concerns to the Committee or the President.

All three agreements also provided specific offices within the signatory agencies to which the companies are to report. For example, the telecommunications agreement designates as points of contact the Assistant Attorney General of the Justice Department's Criminal Division, the General Counsel at the Federal Bureau of Investigation, the Deputy General Counsel for Acquisition, Technology, and Logistics at the Department of Defense, and the General Counsel at the Department of Homeland Security.

The Department of Homeland Security has taken the lead on monitoring compliance for those agreements that it has signed under Exon-Florio. According to Homeland Security officials, the agency maintains compliance tables to track companies' compliance with time frames provided for in the agreements. To keep all interested parties informed, the Department sends out periodic e-mails to other agencies informing them of the status of companies' compliance efforts.

The Departments of Defense, Commerce, and Justice significantly rely on Homeland Security to monitor companies' compliance with the agreements. Homeland Security officials stated that Homeland Security Presidential Directive 7 gives the Department the authority to protect critical infrastructure assets such as telecommunications and information technology. According to a Defense official, the Department of Defense has no authority to enforce companies' compliance with agreements signed pursuant to Exon-Florio. A Commerce Department official similarly

stated that Commerce's authority is limited to enforcing compliance with export control laws. As a result, the Department of Homeland Security is the only one of the three with broad enforcement authority. Further, according to Justice officials, while Justice has authority to seek enforcement of agreements signed pursuant to Exon-Florio and to which it is a signatory, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

Conclusions

In the aftermath of the September 11, 2001, terror attacks on the United States and the subsequent war on terrorism, the nature of threats facing this country has changed. In addition to traditional threats to national security, vulnerabilities in areas such as the nation's critical infrastructure have emerged as potential threats. Exon-Florio provides the latitude for the Committee on Foreign Investment in the United States to address these threats. But the effectiveness of Exon-Florio as a safety net depends on the manner in which the broad scope of its authority is implemented. The narrow, more traditional interpretation of what constitutes a threat to national security fails to fully consider the factors currently embodied in the law. Further, the time constraints imposed on agencies to develop a position before the statutory deadline limits member agencies' ability to complete in-depth analyses. Those time constraints, together with the Committee's reluctance to initiate investigations, can result in the Committee permitting companies to withdraw their notifications. When companies withdraw after completing an acquisition, the Committee may lose visibility over the transaction, and the companies may choose not to refile.

The initial legislation provided for congressional oversight through a requirement that the circumstances surrounding any negative decision by the President be reported to the Congress. To improve congressional oversight, the Byrd amendment expanded required reporting to include the circumstances surrounding all presidential decisions. However, the Committee's reluctance to proceed to investigation, coupled with the use of withdrawal to resolve cases without the need for presidential decisions, has resulted in the circumstances surrounding only two cases being reported to the Congress since 1997. This criterion for reporting contributes to the opaque nature of the Committee's process and is limiting the information that is provided to the Congress. In addition, where companies have concluded the acquisition prior to filing with the Committee and concerns have been identified, permitting withdrawal expands the opportunity for harm to national security before the Committee takes action.

Matters for Congressional Consideration

In light of the differing views within the Committee on Foreign Investment in the United States regarding the extent of authority provided by Exon-Florio, the Congress should consider amending Exon-Florio by more clearly emphasizing the factors that should be considered in determining potential harm to national security. In addition, to address Treasury's concern with the impact of investigations on U.S. open investment policy and the member agencies' concerns with having sufficient time to address relevant issues concerning the acquisitions, the Congress should consider eliminating the distinction between a review and an investigation and make the entire 75-day period available for review. The Committee could then be required to submit recommendations to the President only if presidential action was necessary. Also, to provide more transparency and facilitate congressional oversight, the Congress should revisit the criterion for reporting circumstances surrounding cases to the Congress. For example, the Congress could require an annual report on all transactions that occurred during the preceding year. Such a report could provide the Congress with information on the nature of each acquisition; the national security concerns raised by Committee member agencies, if any; how the concerns were mitigated; and whether each acquisition was concluded or abandoned, in addition to any presidential decisions required under the statute.

In addition, in view of the need to ensure that national security is protected during the period that withdrawal is allowed for companies that have completed or plan to complete an acquisition prior to the Committee completing its work, the Congress should require that the Secretary of the Treasury, as Committee Chair, establish (1) interim protections where specific concerns have been raised, (2) specific time frames for refiling, and (3) a process for tracking any actions being taken during the withdrawal period.

Agency Comments and Our Evaluation

We provided a draft of our report to the Departments of Commerce, Defense, Homeland Security, Justice, and Treasury for comment. In responding, the Department of Treasury noted that it was providing comments on behalf of all the members of the Committee on Foreign Investment in the United States. However, the Department of Justice provided comments in a separate letter.

Overall, Treasury disagreed with our findings. At issue is our characterization of the Committee's process and the adequacy of insight into the Committee's deliberations—concerns that Treasury states have caused the Committee to question our understanding of how it operates.

Our understanding of the Committee's process is based on an extensive examination of Committee guidelines, case files, and memorandums; discussions with member agencies, including Treasury, on the process and the time frames the Committee uses to come to a decision; and a review of the laws and regulations that provide the Committee with criteria against which to assess threats to national security.

Treasury asserts that all Committee decisions are reached only by consensus among member agencies. However, during the course of our review, certain member agencies raised concerns about the Committee's process that indicated fundamentally differing views among Committee members when reviewing certain cases. These disagreements involved different views on what constitutes a threat to national security, the sufficiency of the time allowed for reviews, and the appropriate criteria for initiating an investigation. While we agree that opposing views can, and should, be vigorously debated, such a debate does not demonstrate that issues have been fully vetted or that consensus has been reached, as Treasury implies. In fact, in a number of cases, we found evidence that indicates otherwise, for example:

- In one case we reviewed where member agencies disagreed over what should be deemed a national security concern, the narrower definition—one that excludes national security concerns raised by certain member agencies—has prevailed, in that the notice has been withdrawn instead of the case proceeding to investigation.

- In complex cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute, case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days. In its comments on our draft report, the Department of Justice shared our concern with respect to the time constraints imposed by the current process. Specifically, Justice stated that "gathering timely and fully vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment. Any potential extension of the time available to the participants for the collection and analysis of that information would be helpful."

- Policy-level officials from two member agencies have indicated that the debate over the criteria for initiating an investigation remains unresolved.

Given these fundamental differences, we concluded that the extent to which issues are vetted and consensus is reached on certain cases is, at best, uncertain.

Treasury also cites Committee guidelines on withdrawals—which state that parties, not member agencies, have the authority to request a withdrawal—to dispute our position that the Committee has encouraged companies to withdraw notifications to provide additional time to examine acquisitions. Guidelines stating that certain actions should be taken do not necessarily provide evidence that such actions were indeed taken. In five cases that we reviewed, letters from the companies requesting withdrawal and/or letters from Treasury, as Committee Chair, approving the requests to withdraw cited the need for more review time on the part of the government as the reason for the withdrawal. Regardless, Treasury's detailed discussion of the withdrawal process ignores the key issue. Allowing companies to withdraw notices to provide more time for a review without initiating an investigation significantly increases the risk that companies will not refile in a timely manner—particularly in cases where the foreign acquisition has been completed—and that national security concerns will remain unaddressed. Avoiding investigations by using withdrawals also contributes to the opaque nature of the process because without an investigation there is no presidential decision and required reporting to the Congress.

Understandably, Treasury is cautious about providing details into the Committee's deliberations, given the sensitivity of the information discussed and the need to protect it. And we appreciate the challenges each case presents. However, despite Treasury's assertion that the oral briefings provided by agency members to duly authorized committees of the Congress when requested are appropriate, the fact that our review was prompted by congressional concerns about the Committee's review and investigation process suggests otherwise.

Finally, Treasury criticized our review methodology—specifically, it questioned whether we spoke to all appropriate parties. We focused on the agencies that were most active in Exon-Florio reviews, as we noted to Treasury at the beginning of our review. During our preliminary discussions and throughout the review, none of the Committee member agencies, including Treasury, raised concerns with our methodology or suggested that we contact the Department of State, the United States Trade Representative, or the Council of Economic Advisers. Our reviews of the official Committee files, located at the Treasury Department, supported our view that the Departments of Commerce, Defense,

Homeland Security, Justice, and Treasury were the most active agencies. Regardless, when it became clear to us that information from other Committee members could be germane, as was the case with the National Security Council, we attempted to contact them. In the case of the National Security Council, officials declined to meet with us. At the time we sent the draft report for comment, we were contacted by the Department of State and the U. S. Trade Representative who wanted to discuss the draft report. We met with representatives of both agencies to discuss their concern that our report did not adequately recognize the importance of open investment and was too focused on national security.

We recognize that in implementing Exon-Florio, the Committee must consider national security in the context of open investment—a challenge we point out in the opening statement of our report. However, the purpose of the Exon-Florio amendment is to protect national security in the context of U.S. open investment policy. It is how national security is protected through the Committee process that needs to be better understood. We believe that understanding can be enhanced by improved insight and oversight of the process.

The Department of Justice in its letter also provided technical comments, which we incorporated as appropriate. Treasury's letter, along with our responses to specific comments, is reprinted in appendix I. Justice's letter is reprinted in appendix II.

Scope and Methodology

To examine the process used by the Committee and its member agencies to review and investigate foreign acquisitions, we analyzed case files and discussed with Committee staff members the factors considered when cases are reviewed, the process and time frame the Committee uses to come to a decision, and the laws and regulations that provide the Committee with criteria against which to assess threats to national security.

We examined in depth nine acquisitions notified to the Committee on Foreign Investment in the United States between June 28, 1995, and December 31, 2004. We selected acquisitions based on recommendations by Committee member agency officials and the following criteria: (1) the Committee permitted the companies to withdraw the notification; (2) the Committee or member agencies concluded agreements to mitigate national security concerns; (3) the foreign company had previously notified the Committee of a prior acquisition; or (4) GAO had conducted a prior review. The objective of the case reviews was to understand and

document the Committee's and its members' approaches to and processes for reviewing foreign acquisitions of U.S. companies. We did not attempt to validate the conclusions reached by the Committee on any of the cases we reviewed.

We also obtained information about other foreign acquisitions that we did not conduct case reviews on, and we also used information on other acquisitions obtained during prior GAO reviews. We obtained and analyzed data from relevant Committee member agencies, including the Departments of Commerce, Defense, Homeland Security, and Treasury. While we were not granted access to files held by the Department of Justice, we discussed individual cases with Justice officials and obtained adequate information to meet our objectives. We also discussed the Committee's approach and process with Committee staff officials from member agencies most actively involved—namely, the Departments of Commerce, Defense, Homeland Security, Justice, and Treasury.

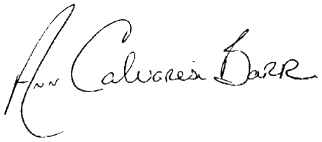
To determine whether the weaknesses in provisions to assist agencies in monitoring agreements that GAO had identified in its 2002 report had been addressed, we analyzed agreements concluded under the Committee's authority between 2003 and 2005 and compared these agreements with those GAO had previously analyzed. We discussed with Committee staff members the steps that they are taking to monitor agreements and enforce compliance.

We conducted our review from April 2004 through July 2005 in accordance with generally accepted government auditing standards.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. At that time, we will send copies of this report to the Chairman and Ranking Minority Member of the House Committee on Financial Services and to other interested House and Senate committees and subcommittees. We will also send copies to the Secretaries of Commerce, Defense, Homeland Security, and Treasury and the Attorney General. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

Please contact me at (202) 512-4841 or calvaresibarra@gao.gov if you have any questions regarding this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page

of this report. A list of major contributors to this report is listed in appendix III.



Ann M. Calvaresi-Barr
Director
Acquisition and Sourcing Management

Appendix I: Comments from the Department of Treasury

GAO's comments supplementing those in the report text appear at the end of this appendix.

UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 12, 2005

Ms. Ann Calvaresi-Barr
Director
Acquisition and Sourcing Management
U.S. Government Accountability Office
Washington, DC 20548

Dear Ms. Calvaresi-Barr:

I am responding to your letter of June 30, 2005, to Secretary Snow requesting comments on the GAO draft Report, "Defense Trade: Exon-Florio May Have Limited Effectiveness in Protecting U.S. National Security." These comments are made on behalf of all the members of the Committee on Foreign Investment in the United States (CFIUS).

See comment 1.

We believe that CFIUS has implemented the Exon-Florio provision (Exon-Florio) effectively to protect the national security. In light of this, CFIUS has a number of serious concerns with the draft Report, which, unlike prior GAO reports on CFIUS, reveals a fundamental misunderstanding of how the Committee operates. Our major concerns are summarized below.

See comment 2.

First, to the extent that the draft Report implies that Treasury or any other CFIUS agency dictates certain decisions or courses of action, it is simply incorrect. CFIUS is an interagency committee chaired by the Secretary of the Treasury. All CFIUS decisions are reached only by consensus among the CFIUS member agencies. The decisions described in the draft Report illustrate this point in that they all were agreed to by senior officials from all CFIUS agencies. The draft report seems to have focused on the vigorous debate that often occurs as CFIUS considers a proposed acquisition, not the outcome of such debates.

See comment 3.

Second, the draft Report inaccurately describes CFIUS and the Department of the Treasury as Chair in other ways. Notably, the draft Report claims that Treasury has narrowly defined "national security." To the contrary, no agency or agencies "define" national security for CFIUS. Any agency may bring forward national security concerns to have them fully considered to enable CFIUS members to reach the necessary consensus on how those concerns should be addressed. The erroneous proposition that individual agencies "define" national security for CFIUS forms the basis for the GAO's lead conclusion, "Exon-Florio's effectiveness in protecting U.S. national security may be limited."[1]

[1] Paragraph 1 of the Highlights: What GAO Found.

Third, the draft Report states that in response to congressional concerns, GAO met with officials from the Departments of Commerce, Defense, Homeland Security, Justice and Treasury, which in GAO's view are "the agencies that are the most active in the review of acquisitions."[2] GAO apparently did not solicit any input from other members of CFIUS, such as the Department of State, the Office of the United States Trade Representative, nor the Council of Economic Advisers.[3] Despite GAO's unsubstantiated assertion, these organizations – like the ones GAO did choose to meet with – are very much engaged in CFIUS reviews. If GAO had interviewed senior policy officials from these organizations, which reflect the broad spectrum of CFIUS membership, the Committee is confident that GAO would have gained a more informed perspective on the CFIUS process.

See comment 4.

Finally, it is worth noting that, while Exon-Florio requires CFIUS to analyze transactions for their effects on national security, other factors are also relevant. When Exon-Florio was enacted, Congress understood that there were already a number of effective legislative provisions to protect the national security. These ranged from laws that restrict the foreign ownership of U.S. air carriers to laws that regulate the export of sensitive technology or that restrict access to sensitive information. In recognition of these existing laws, Congress limited Exon-Florio to situations where other tools were not adequate or appropriate to deal with a national security threat. The provision is designed to be used judiciously. Using Exon-Florio in ways that were not intended would send a confusing message to our trading and investing partners around the world, could be inconsistent with our commitments under various international agreements to provide national treatment to foreign companies, and implicitly would call into question the U.S. Government's commitment to an open investment policy, all of which would damage U.S. interests – including national security interests – in the context of these agreements and commitments. Unnecessary restrictions by the U.S. on foreign investment may also encourage other governments to restrict foreign investment by U.S. firms. Indeed, all CFIUS members recognize that often there is an inherent link between national security interests and U.S. economic prosperity and that U.S. prosperity is furthered through foreign investment in the United States. Through robust debate among CFIUS members, we seek to protect national security in the context of an open investment policy that respects this critical link. We believe we have been successful. Continued congressional sensitivity to these critical national interests is especially important in today's global economy.

In addition, I have attached an appendix with additional comments on the following specific issues:

- Definition of National Security
- Standard for Initiating an Investigation
- The Day 23 Rule
- Mitigation Measures

[2] Paragraph 2 on page 2 of June 2005 GAO Report #05-686.
[3] State and USTR have written to GAO specifically to express their objections that GAO did not contact them in connection with preparing the draft report.

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- Monitoring Compliance, Enforcing Agreements, and Remedies
- Withdrawals
- Industrial Policy
- Vulnerabilities from Foreign Control Alone
- GAO Conclusion Re Amending Exon-Florio to Specify Additional Factors
- GAO Conclusion Re Eliminating the Distinction between a Review and an Investigation
- GAO Conclusion Re Revisiting the Criterion for Reporting to Congress
- GAO Conclusion Re Amending the Regulations to Provide Interim Protections
- Interagency Process

Thank you for the opportunity to comment on GAO's draft Report.

Sincerely,

Timothy D. Adams
Under Secretary for International Affairs

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Additional Comments on Specific Issues

Definition of U.S. National Security

See comment 5.

See comment 6.

There are statements[4] in the draft Report that Treasury, as Chair, or Treasury along with other Committee members, has narrowly defined what constitutes a threat to national security and that this narrow definition limits the effectiveness of Exon-Florio to protect U.S. national security. The recommendations of the Committee are informed by an extremely broad range of factors and not by the narrow definition described in the draft Report or any similarly narrow standard. Any such definition would inappropriately limit the President's necessary discretion to protect national security.

This open-ended approach allows the President maximum flexibility to respond on a case-by-case basis to the unique facts and circumstances of each case. As stated in the portion of the regulations that discusses their scope, "The principal purpose of section 721 is to authorize the President to suspend or prohibit any merger, acquisition, or takeover by or with a foreign person engaged in interstate commerce in the United States when, in the President's view, the foreign interest exercising control over that person might take action that threatens to impair the national security."[5] Only the President decides what constitutes a threat to the national security and what actions are in the interest of U.S. national security in any particular case that is sent for a determination under Exon-Florio.

See comment 7.

See comment 8.

The draft Report states that in regard to one transaction CFIUS reviewed, "[t]he Treasury Department said that the concerns raised by Defense and Commerce were not national security concerns because they did not involve classified contracts, the foreign company's country of origin was a U.S. ally, and there was no specific negative intelligence about the company's actions in the United States."[6] This statement suggests that one agency's view was somehow determinative of CFIUS's actions in this case. The comment ignores that the transaction at issue was fully investigated and extensive mitigation measures were put in place before CFIUS completed its review. Again, this illustrates that the draft Report ignores that all member agencies participate in the Committee's decision-making process and that CFIUS, as a Committee, decides whether there are threats to the national security and works closely with member agencies to develop appropriate mitigation measures.

Standard for Initiating an Investigation

See comment 9.

The draft Report repeatedly asserts that Treasury, along with some other member agencies, is reluctant to initiate investigations[7] and applies an overly strict standard in

[4] Paragraph 1 of the Highlights: What GAO Found, paragraph 3 on page 2, and paragraph 3 on page 8.
[5] 31 CFR 800.101
[6] Paragraph 2 on page 9.
[7] Paragraph 1 of the Highlights: What GAO Found. Related references are made in paragraph 1 on page 3; paragraph 3 on page 8; paragraph 2 on page 10, and paragraph 1 on page 16.

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determining whether an acquisition should be investigated.[8] The question of whether to undertake an investigation demands careful deliberation on the part of all CFIUS members, including Treasury. The reason is obvious: a 45-day investigation potentially involves the President in the ultimate decision about a foreign acquisition. If CFIUS concludes after a 30-day review that there are unresolved national security issues, then an investigation is entirely appropriate. The GAO has cited no case since the enactment of Exon-Florio in 1988 where a Committee decision not to investigate was the result of imposition of a "strict standard" for deciding whether to investigate.

See comment 10.

Treasury made available to GAO the CFIUS Guidelines which state that "Policy or Deputies CFIUS meetings are called to consider an action that may ultimately involve a Presidential decision. All agencies must be represented at the policy or deputy level and should be prepared to present their views." The Guidelines go on to state that "[i]f any agency has national security concerns regarding the transaction and policy level officials concur, a 45-day investigation is undertaken." As this indicates, Committee decisions are made on a consensus basis and the Committee's members are expected to, and do, participate in this process.

The Day 23 Rule[9]

See comment 11.

The draft Report states that "the time constraints imposed on agencies to develop a position prior to the statutory deadline limits [sic] agencies' ability to complete in-depth analyses."[10] The CFIUS Guidelines include time frames for completing the various phases of the reviews. The Guidelines state "Any CFIUS agency informs the Staff Chair as soon as possible, but in any case no later than Day 23 of a particular CFIUS review, unless extenuating circumstances prevent notice by this date, that it will request a policy level meeting to discuss the agency's request for CFIUS to undertake a 45-day investigation under the Exon-Florio provision." The purpose of the Day 23 deadline is to enable CFIUS to meet its obligations under the tight 30-day time frames of Exon-Florio. In most cases, CFIUS agencies are able to complete their reviews within the 23-day time frame; where they are not, CFIUS has been flexible enough to allow agencies as much time as possible under the 30-day time frame to complete their reviews and CFIUS has been able to identify and resolve national security concerns.

GAO's criticism also overlooks the impact Exon-Florio has on the awareness of foreign investors contemplating acquisitions of U.S. companies of the importance of national security considerations and the ways it has resulted in foreign investments being structured to avoid national security problems. Many companies filing with CFIUS undergo extensive preparation, including ensuring compliance with existing laws and regulations pertaining to national security, before they even file their notices with the Committee.

[8] Paragraph 1 on page 3, and paragraph 2 on page 11
[9] Paragraph 3 on page 11. Related reference is made in paragraph 1 on page 3.
[10] Paragraph 1 on page 16. Related references are made in paragraph 1 of the Highlights: What GAO Found; paragraph 1 on page 3; paragraph 3 on page 8, and paragraph 3 on page 11.

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See comment 12.

Mitigation Measures

The draft Report states that "[t]he agencies that favor applying the narrower, more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate the concerns being raised by Defense and others."[11] This assertion is undermined by the fact that CFIUS agencies have sought extensive mitigation measures in many more cases than they did just a few years ago. Since 1997, CFIUS agencies have negotiated at least 21 mitigation agreements in conjunction with a CFIUS review.

The mitigation agreements negotiated in conjunction with a CFIUS review vary in scope and purpose, and are negotiated on a case by case basis to address the particular concerns raised by an individual transaction. Some examples of the types of agreements are available through public sources; however, these examples in no way represent an exhaustive list of the kinds of agreements or mitigation measures that have been negotiated by CFIUS agencies. Moreover, because the facts of and issues raised by each transaction are unique, additional or varied mitigation measures will undoubtedly be required to resolve agencies' national security concerns in future transactions. A few examples of the general types of agreements that have been negotiated include:

Special Security Agreement (SSA): These agreements provide security protection to the particular aspect of the company's operation that deals with classified or other sensitive contracts.

Board Resolution: The U.S. company may be required to adopt a board resolution that certifies the foreign investor will not have access to particular information or influence over particular contracts.

Proxy Agreement: These agreements are used to totally isolate the foreign acquirer from any control or influence over the U.S. company.

Network Security Agreements (NSA): In cases in the telecommunications sector, conditions have been imposed in the context of the Federal Communications Commission's (FCC) licensing process. Transactions involving the foreign acquisition of a U.S. telecommunications company usually are subject to regulation by the FCC, which is an independent regulatory agency. The FCC has in some cases agreed to condition the transfer of licenses to a foreign company on its compliance with the NSA that CFIUS member agencies have negotiated with that company. The NSAs are public documents available on the FCC's website. Among other things, the NSAs have included numerous and varied protection measures for the security of the U.S. communications infrastructure, such as provisions relating to information storage and access and the company's ability to comply with rules, regulations and orders related to law enforcement and national security. Some of the other strong security measures that have been used in NSAs include but are not at all limited to:

[11] Paragraph 2 on page 9.

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- Personnel Screening: the acquired company may be required to implement a screening process for all personnel in positions that have access to the communications network or data associated with it.
- Outsourcing: there may be requirements that either limit the ability of the acquired company to outsource to non-U.S. companies, or impose some type of screening of personnel performing the outsourced services.
- Visitation: the acquired company may be required to implement a visitation policy that requires the appointment of a security officer in the company to review requests to visit the U.S. communications infrastructure by non-U.S. citizens.
- Routing: the company may be prohibited from routing domestic communications outside the United States except for special situations such as to avoid network disruptions.
- Security Audits: the acquired company may be required to undergo and report to Executive Branch agencies audits, potentially by third parties, of its network security practices.

Monitoring Compliance, Enforcing Agreements, and Remedies

See comment 13.

The draft report states that "The Departments of Defense, Commerce, and Justice rely on DHS to monitor companies' compliance with the agreements."[12] Justice participates in several aspects of monitoring compliance with respect to the agreements to which they are a party. Therefore, to be more accurate, this statement should read: "The Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies' compliance with the agreements."

See comment 14.

In addition, with regard to enforcement authority, the draft report states, "[T]he Department of Homeland Security is the only one of the three [agencies that often sign security agreements] with broad enforcement authority. Further, according to Justice officials, while Justice has enforcement authority in some instances, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act."[13]

We wish to clarify that the question of which agencies monitor agreements is distinct from which agencies enforce them. The Committee believes that any signatory agency has the authority to monitor the agreement, although there are differences in resources among them for this purpose. As for the separate question of which agencies have authority to enforce agreements, we would note that the Justice Department clearly has the authority to undertake enforcement actions, both on its own behalf as well as for other signatories. Justice's position is that it has the unqualified authority to enforce such agreements to which it is a signatory.

See comment 15.

Further, to avoid any possible misunderstanding, it is worth noting that it is not just Justice's Criminal Division that participates in the CFIUS process. The Federal Bureau

[12] Paragraph 5 on page 15.
[13] Paragraph 5 on page 15.

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of Investigation (FBI) has been, and continues to be, a very active and critical participant, and other components of Justice have played a role on a case-by-case basis.

See comment 16.

The draft Report also states that Treasury and several other members deleted "strong enforcement language" from an agreement with a foreign acquiring company.[14] This discussion in the draft Report actually refers to a proposed remedies provision, not an enforcement provision. As noted previously, each transaction reviewed under Exon-Florio is unique. Therefore, for each mitigation agreement, member agencies utilize the most effective mitigation measures and strongest enforcement mechanisms and remedies appropriate to the particular facts and circumstances to ensure compliance. Although we cannot provide specific comment on the individual case at issue in the draft Report, CFIUS agencies have been vigilant to ensure that there are no transactions for which compliance with mitigation measures is uncertain.

Withdrawals

See comment 17.

The draft Report states, "To provide additional time, while avoiding an investigation, the Committee has encouraged companies to withdraw their notification . . ."[15] As noted earlier, Treasury made available to the GAO the CFIUS Guidelines. The Guidelines state:

> Parties, not CFIUS agencies, have the authority to request a withdrawal. The withdrawal option is not a means to extend the time frames set by the statute. Legitimate reasons to grant a withdrawal include providing parties an opportunity to get in compliance with existing national security laws and regulations, and to provide additional information to clarify national security issues that may not necessarily warrant a Presidential determination. The CFIUS Chair, not any single member agency, communicates with the parties regarding the appropriateness of this option.

See comment 18.

CFIUS as a whole decides whether a party to a transaction may withdraw its filing, but Treasury as the Chair communicates this decision to the parties. While "the Committee generally grants withdrawal requests,"[16] CFIUS frequently specifies in its letter granting the request the conditions for the withdrawal. In cases where a withdrawal is granted because the parties are abandoning the transaction, that fact would be specified in the letter granting the request for withdrawal. Where a withdrawal is granted and a re-filing is expected, that expectation would also be stated in the letter granting withdrawal.

The GAO raises concerns about two transactions that were notified after the transactions had closed, were allowed to withdraw, and were never renotified.[17] In these cases, CFIUS granted the companies' request for a withdrawal to provide additional time to

[14] Paragraph 1 on page 10.
[15] Paragraph 1 of the Highlights: What GAO Found; paragraphs 2 and 3 on page 8; paragraph 1 on page 12, and paragraph 1 on page 16.
[16] Paragraph 2 on page 8.
[17] Paragraph 1 on page 13.

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See comment 19.

resolve specific issues. Treasury, as Chair, tracked developments on the cases and coordinated closely with the interested agencies regarding whether the companies should be urged to refile in order to resolve national security concerns. Although refiling was not deemed necessary, it should be noted that CFIUS agencies also understood that so long as action is not concluded under Exon-Florio, the President retains his authority to suspend or prohibit these transactions if he makes the findings required under the statute.

See comment 20.

Industrial Policy

The draft Report states that some members of CFIUS "argued that [CFIUS's] narrow definition of national security is not sufficiently flexible to provide for safeguards in areas such as protection of critical infrastructure, security of defense supply, and preservation of technological superiority in the defense arena."[18] As noted earlier, CFIUS considers a range of factors in assessing threats to national security, precisely because it does not want to limit the President's flexibility. CFIUS considered all of these areas in transactions it recently reviewed.

See comment 21.

Vulnerabilities from Foreign Control Alone

The draft Report states that certain CFIUS officials told the GAO that "[v]ulnerabilities can result from foreign control of critical infrastructure."[19] Although this may be the case, it is equally true that vulnerabilities can result from foreign influence in commerce in a myriad of ways other than through control, such as through contractual relationships. Yet these concerns are not addressed by Exon-Florio, which calls for a case-by-case determination concerning a particular foreign investor and a particular U.S. company. In particular, Exon-Florio requires the President to examine the credible evidence that such a foreign investor might take action that threatens to impair U.S. national security, whether or not the foreign investor intends to or actually takes such action. CFIUS recognizes that foreign control alone does not automatically constitute a threat to national security and that there can be vulnerabilities in critical infrastructure even without foreign control.

GAO Conclusion Re Amending Exon-Florio to Specify Additional Factors

The draft Report states that "[i]n light of the disagreement within the Committee on Foreign Investment in the United States with regard to the extent of authority provided by Exon-Florio, the Congress may want to consider amending Exon-Florio by more clearly emphasizing the factors that should be considered in determining potential harm to national security."[20]

The current framework provided by Exon-Florio for national security reviews allows the broadest possible latitude for CFIUS to consider foreign acquisitions of U.S. companies

[18] Paragraph 3 on page 2.
[19] Paragraph 1 on page 9.
[20] Paragraph 3 on page 16. Related references in paragraph 1 of the Highlights: What GAO Recommends, and paragraph 3 on page 3.

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that may pose national security concerns and for the President to take action as needed. The list of factors in the statute that the President "may consider" in making a determination is an open list. The President and CFIUS may and do consider other factors. Well before the creation of the Department of Homeland Security, CFIUS reviewed transactions involving critical infrastructure, including the "control of or access to information traveling on networks."[21] Since the creation of the Department of Homeland Security, CFIUS has reviewed many transactions involving critical infrastructure, which can often be important to the national security.

See comment 22.

We believe that the statute is already flexible enough to encompass domestic production necessary for homeland security as a factor that the President may consider, and CFIUS already considers it. We would be prepared, however, to consider including this factor in a list of factors the Committee may consider in the implementing regulations in order to make this more explicit.

See comment 23.

GAO Conclusion Re Eliminating the Distinction between a Review and an Investigation

The draft Report states that Congress may want to eliminate the distinction between a 30-day review period and 45-day investigation period in favor of considering the entire 75-day period as available for review.[22]

Although there are some complex transactions for which the 30-day time period poses a significant challenge to the Committee's ability to conduct a thorough and comprehensive review, CFIUS completes the vast majority of its reviews within the initial 30-day review. In fact, GAO found in 2002 that: "For the most part, the Committee on Foreign Investment in the United States is able to fulfill its responsibility to ensure that foreign acquisitions of U.S. companies do not threaten national security without resorting to investigations."[23] Of 1,560 reviews, 1,535 have been completed in the 30-day review period. Companies usually make closure of the transaction contingent on conclusion of the CFIUS review. Moreover, as mentioned earlier, companies, particularly for transactions with implications for national security, often will have already completed extensive preliminary work to comply with existing laws and regulations pertaining to national security before filing a notice with CFIUS. Although for certain transactions an extension of time available for the collection and analysis of information would ease the burden on the government, for most transactions, extending the time for review by 45 days would be unnecessary and could have a negative effect on foreign investment in the United States by extending the regulatory review process and delaying the closing of acquisitions. Such an extension also could have the unintended effect of deterring CFIUS filings in the first place, which would be contrary to Exon-Florio's national security objective.

[21] Paragraph 1 on page 9.
[22] Paragraph 3 on page 16.
[23] Paragraph 3 on page 11 of September 2002 GAO Report #02-736.

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See comment 24.

GAO Conclusion Re Revisiting the Criterion for Reporting to Congress

The draft Report states that Congress may want to revisit the criterion for reporting to Congress.[24] As provided in the Exon-Florio provision, the President sends a report to Congress with a decision. Treasury, along with other agencies with equities in any particular transaction, provide briefings to duly authorized committees of Congress whenever requested, following completion of action under the statute. Detailed unclassified reports to Congress could provide a road map for foreign acquiring companies to circumvent national security reviews under Exon-Florio. Exon-Florio has a confidentiality provision in order to protect proprietary information that companies voluntarily provide to CFIUS. Companies may not invest in the United States if they fear that proprietary information may be made public. We therefore believe that oral closed session briefings, consistent with the confidentiality provision of Exon-Florio, are appropriate. We are happy to work with the Congress on developing a reasonable periodic reporting schedule for completed reviews to give interested Members information about transactions that may be of interest and for which CFIUS could provide follow-up briefings.

We would stress the importance that any attempts to make the process more transparent to Congress, and thus more susceptible to Congressional scrutiny, should not result in any compromise to the current confidentiality afforded to companies that file under the statute. The CFIUS process is a voluntary one, and any potential procedure that might be perceived as lessening the confidentiality currently afforded to filers could result in a diminution in the number of applications the Committee receives and an erosion of the confidence companies have that their sensitive and proprietary information will be closely held. Without such confidence and the resulting full disclosure to the Committee, it will be impossible for the Committee to undertake a meaningful review of any transaction.

See comment 25.

GAO Conclusion Re Amending the Regulations to Provide Interim Protections

The draft Report recommends that "Treasury, as chair of the Committee, amend current regulations to require interim protections where specific concerns have been raised, and to establish specific timeframes for refiling along with a process for tracking any actions being taken during the withdrawal period."[25] This would apply to transactions that have closed or will close prior to CFIUS completing its review during any period when a transaction has withdrawn. CFIUS has the authority to require interim protections and has done so when it felt such protections were needed.

We stand by Treasury's comments on the 2002 GAO Report in which the same recommendation was made. Interim measures would be difficult to negotiate and would detract from efforts to complete the CFIUS review, where we believe the emphasis

[24] Top of page 17.
[25] Paragraph 1 on page 17. Related reference in paragraph 1 of the Highlights: What GAO Found, and paragraph 1 on page 3.

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should stay. Overly rigorous schedules could prevent agencies from performing a complete review.

Interagency Process

The Committee notes that the Congress deliberately created Exon-Florio to be a broad and flexible statute that would give the President the authority needed to deal with threats to our national security. Given the statute's time constraints and the natural competition of differing perspectives on the part of the CFIUS members, no one should be surprised that there are moments of friction in implementing the statute. Indeed, the Committee's discussions are frequently spirited. Nonetheless, all member agencies agree that the Committee's deliberations have been consistently collegial and professional and that in the end we achieve the results intended under the statute. The Committee, despite – and perhaps because of – its many perspectives, is ultimately united in seeking the best possible outcome for the United States and our national security. We fully expect that the Committee will continue to be effective in the future.

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The following are GAO's comments on the Department of the Treasury's letter dated August 12, 2005.

GAO's Comments

1. Our understanding of the Committee's process is based on an extensive review of Committee guidance and case files and structured interviews and discussions with member agencies, including Treasury. Further, except where changes in Committee make-up and proceedings have occurred since 2002, our discussion of the laws and the Committee's process is consistent with our 2002 report.
2. As we point out in our evaluation of agency comments in the report, certain member agencies raised concerns that indicated fundamental disagreement among members when reviewing certain cases. Given these fundamental disagreements, we concluded that the extent to which issues are vetted and consensus is reached on certain cases is, at best, uncertain.
3. To analyze cases notified to the Committee and determine whether threats to national security exist, each agency effectively operationalizes its own definition of national security. The implication that individual agencies do not apply a definition is unrealistic.
4. We agree that Exon-Florio should be used judiciously as a safety net when laws other than Exon-Florio and the International Emergency Powers Act may not be effective in protecting national security—a point we make in the opening paragraph of our report. However, in cases where Committee members disagree on whether Exon-Florio applies, we have found that a more narrow definition of national security often takes precedence or the companies are allowed to withdraw their notification to avoid investigations. Treasury's rather lengthy discussion in its comment letter on the need to protect U.S. open investment policy underscores our concern.
5. In numerous case documents GAO reviewed, the definitional bounds agencies used in considering national security concerns are apparent. Some agencies followed routine analytical processes, searching specific databases related to export controls, acquisition history, and critical technology information—sources that would reveal whether the foreign acquisition involved any export-controlled technology or item or classified contracts, or whether there was specific derogatory intelligence on the foreign company. Other agencies prepared specific vulnerability or threat assessments that have their own methodological parameters. The debate among Committee members on each notification is fueled by these differing definitions.

6. We agree that, taken in total, member agencies consider a broad range of national security factors when cases are analyzed. We also agree that anything other than the broad consideration of a range of national security factors by the Committee would inappropriately limit the President's necessary discretion to protect national security.

7. While only the President decides what constitutes a threat to national security and what actions are in the interest of U.S. national security in cases that are sent for a determination, only two cases have reached this stage since 1997. Further, only 8 of 451 cases have undergone investigations. By allowing withdrawals of notifications rather than initiating investigations, the Committee effectively pre-empts the President from using his discretion to make a determination. To this end, the Committee has defined what constitutes a threat to national security, not the President. Further, since only those few cases that go to the President for a determination require reporting to the Congress, there is little insight into the Committee's deliberations. Our review found that for specific cases, there has been significant disagreement among member agencies on what constitutes a threat to national security and what actions are in the interest of national security. In two such cases, companies were allowed to withdraw their notices, and to date, they have yet to refile, leaving the concerns unresolved.

8. Again, Treasury's response skews our finding. In two cases we reviewed, when an agency raised what it deemed a national security concern and other Committee members did not agree, the narrower definition of national security—which excludes the concern raised—prevailed, in that the notice was withdrawn instead of the case proceeding to investigation. Regardless, the case Treasury refers to was cited in our 2002 report as an example of an agreement in which nonspecific language made the agreement difficult to implement. For example, to mitigate a concern about access to technology, the agreement required a "good faith effort" to divest a subsidiary. When the company divested part, but not all, of the subsidiary—citing lack of interested buyers as the rationale—government officials could not determine whether the company's efforts were made in good faith because the agreement did not include criteria defining what actions would constitute a good faith effort. In addition, the agreement contained no consequences for failure to comply with the monitoring terms of the agreement within the stated time frames, and as we noted, the company failed to meet the terms of one provision. Given this outcome, it is unclear how Treasury can assert that "extensive mitigation measures were put in place" or how this case exemplifies

that all member agencies participate in the Committee's decision-making process.

9. We agree that the decision to undertake an investigation demands careful deliberation on the part of all Committee members. However, in two cases we reviewed, documentation shows that in determining whether to initiate an investigation, Treasury, as Committee Chair, applies essentially the same criteria that the Exon-Florio amendment directs the President to use to decide whether to take action to suspend or prohibit a transaction. While Treasury states that an investigation is entirely appropriate if national security issues remain unresolved at the end of the 30-day review period, we found that rather than initiating an investigation, the Committee commonly allows companies to withdraw their notifications and refile at a later date to provide more time for review. Our report has not cited cases where a Committee decision not to investigate was the result of the application of an overly strict standard for deciding whether to investigate because where we noted the application of this standard, the companies withdrew their notice.

   Further, by applying the Presidential decision-making criteria at the conclusion of the 30-day review, the Committee effectively preempts the President's opportunity to make a determination. In a 2004 case, documentation from a policy-level meeting shows that the appropriateness of applying these criteria in Committee deliberations was debated; the debate was not resolved at the time, and officials from two separate agencies told us that the debate continues. The implementing regulations for Exon-Florio make no distinction between the activities the Committee undertakes during the review and investigation periods—other than preparing a report to the President at the end of an investigation—and provide no criteria for determining when to initiate investigation. It is, in part, for this reason that we are proposing that the entire 75-day period be available for analyzing cases, if needed. Eliminating the distinction between the review and investigation periods would help ensure that sufficient time is available for thorough analyses of cases and that the presidential decision-making criteria are only applied by the President.

10. Guidelines requiring that certain actions be taken do not provide evidence that such actions were indeed taken. For example, in one 2004 case we reviewed, after a policy-level decision to initiate an investigation was made, some Committee member agencies, including the Chair, placed calls to corporate counsel informing them of the pending investigation and advising that their clients withdraw their

notices. Because the companies withdrew, an investigation was never initiated.

11. As stated in our report, we understand that the purpose of the 23-day rule is to enable the Committee to meet its obligations under Exon-Florio's statutory time limits for 30-day reviews. For the majority of cases where national security concerns either do not exist or agency members agree that concerns are addressed by other laws, the 23-day rule may help facilitate the closure of cases before the expiration of the 30-day review period. However, in complex cases—cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute—case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days. In five cases that we reviewed, letters from the companies requesting withdrawal and/or letters from Treasury, as Committee Chair, approving the requests to withdraw cited the need for more review time on the part of the government as the reason for the withdrawal. In one such case, an electronic message we reviewed cited the Committee's workload on another high profile case as the reason that the Committee sought to have a notice withdrawn. In that case, the transaction had already been completed and the company had requested withdrawal on day 23, before agencies completed their analysis to determine whether to request an investigation. Because the company never refiled a notice, the national security concerns identified by two member agencies have not been further examined. Further, it should be noted that in its comments, the Department of Justice said that any additional time that could be made available to collect and analyze information needed to conduct a thorough and comprehensive national security assessment would be helpful.

12. We have acknowledged the use of mitigation agreements[1] in our current report as a major tool used by the Committee. In fact, we point out that the more recent mitigation agreements have addressed several of the problems with such agreements that we noted in our 2002 report. However, strengthening or increasing the number of mitigation

[1] GAO recently issued two reports that have identified vulnerabilities when the government uses some of the remedies noted by Treasury: one, overseeing contractors under foreign influence and two, ensuring classified information is protected. (GAO, *Industrial Security: DOD Cannot Ensure Its Oversight of Contractors under Foreign Influence Is Sufficient*, GAO-05-681 (Washington, D.C.: July 15, 2005); GAO, *Industrial Security: DOD Cannot Provide Adequate Assurance That Its Oversight Ensures the Protection of Classified Information*, GAO-04-332 (Washington, D.C.: Mar. 3, 2004).

agreements does not ensure that all national security concerns raised by member agencies are sufficiently examined. Further, the particular passage cited by the Under Secretary is not disputing that mitigation agreements are often negotiated but rather is pointing out that there is not agreement on when these mitigation agreements are needed. As we reported, agencies that apply the more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate or address the concerns raised by other Committee members.

13. We have revised our report to reflect that the Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies' compliance with the agreements.

14. We did not mean to imply that Justice does not have the authority to undertake enforcement actions and have clarified that in the report.

15. We agree that the Federal Bureau of Investigation and other Justice Department components have been and continue to be a very active and critical participant in the Committee's process. We also acknowledge there are other Committee agency components that are also critical to the process such as the Bureau of Industry and Security in the Department of Commerce; the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics–Industrial Policy, and the Central Intelligence Agency. Committee member agencies use many internal resources as part of their process.

16. A remedy is defined as a legal means of preventing or redressing a wrong or enforcing a right. A Defense official confirmed that the provision in question that was deleted from the agreement stated that if the company (1) fails to comply with the terms of the agreement, (2) makes a materially false statement, (3) increases foreign entity control, or (4) makes other material changes in circumstances, the Attorney General, the Secretary of Defense or the Secretary of Homeland Security may raise concerns to the Committee or the President. Without having this provision, it is unclear what remedy will be available to the Committee and its member agencies to enforce this mitigation agreement.

17. Despite what is stated in the guidelines, in practice the Committee has allowed companies or parties to withdraw their notices to provide member agencies additional time to complete their analyses or to negotiate mitigation measures. Documentation from Committee files shows that 12 of the 20 withdrawals we identified that have been granted since 1997 to companies that intended to continue the

acquisition were granted to allow member agencies to either negotiate mitigation agreements, continue obtaining information from the companies, or otherwise continue analyses.

18. Of the 26 letters granting withdrawal that we reviewed, only three explicitly stated conditions for the withdrawal: in two cases, the companies were abandoning the transaction; in the third, the company agreed to divest its U.S. acquisition.

19. We recognize that the President retains the authority to take action if the Committee's review is not completed. However, our review of case files does not support the Under Secretary's assertion that Treasury, as Chair, tracked developments on the withdrawn cases that were notified after the transactions were closed. Further, it is unclear how Treasury could conclude that refiling is unnecessary in these cases, given that the withdrawals were granted to provide additional time to resolve specific concerns raised by other agencies. For example, in one case, a Treasury official told us that she was unaware that the Department of Defense had concerns. By not having the companies refile, Defense's concerns were not fully vetted. In another case, a Defense official provided documentation indicating that the Defense Department's position remained that conditions should be imposed on the transaction. In our view, refiling serves two purposes: (1) it provides assurances to the companies that action will not be taken at a future date and (2) it permits Committee member agencies to ensure that no national security concern was overlooked.

20. The documentation we reviewed clearly showed that Treasury and Defense have different views of what constitutes a threat to national security. For example, in one case, Treasury officials wrote three separate memos stating that in Treasury's view, Defense and Commerce Department concerns about (a) foreign ownership of sensitive but unclassified technology used in reconnaissance satellites, (b) the possibility of this sensitive technology being transferred to countries of concern, and (c) maintaining U.S. government access to the technology were not national security concerns.

21. We agree that vulnerabilities can result from a variety of things not addressed by Exon-Florio. We merely provided examples of the kinds of vulnerabilities that may result from foreign control. We were not addressing the universe of vulnerabilities, only some of those addressed by Exon-Florio, the subject of our report.

22. We agree that Exon-Florio provides broad latitude for the Committee to consider whether foreign acquisitions constitute a threat to national

security. Our concern is how Exon-Florio is being implemented. Given the internal disagreement among Committee members and the lack of transparency as to how disagreements are resolved, we believe that additional guidance from the Congress would be beneficial.

23. We recognize that, in most instances, 30 days is sufficient to conclude reviews. If Exon-Florio were amended, then we expect that the Committee could manage the process so that the vast majority of cases would continue to be completed within 30 days. However, Exon-Florio is to be used when other laws are inadequate—in short, to act as a safety net. The ability to complete "a vast majority" of reviews in 30 days is not relevant to Exon-Florio's importance as a safety net. Moreover, as we point out in our report, some agency officials have stated that 30 days is insufficient in complex reviews. The Justice Department, in its official comments, stated that any potential extension of the time available to the participants for the collection and analysis of information from the intelligence community would be helpful (see page 2 of Justice Department comments in app. II).

    Treasury officials have pointed out that being the subject of an investigation may have negative connotations for a company, and that the Committee tries to avoid initiating investigations. By eliminating the distinction between investigations and reviews, this negative connotation and the potential impact on investment would no longer exist.

    The Under Secretary expressed concern that extending the time frames would deter filings but did not explain the basis for his concern. However, the Committee need not rely solely on voluntary filings. The implementing regulations state that "any member of the Committee may submit an agency notice of a proposed or completed acquisition to the Committee through its staff chairman if that member has reason to believe, based on facts then available, that the acquisition is subject to section 721 and may have adverse impacts on the national security. In the event of agency notice, the Committee will promptly furnish the parties to the acquisition with written advice of such notice."[2]

24. The Congress has made numerous efforts to conduct oversight of the Committee's activities—first in the original Exon-Florio legislation by requiring a report when the President prohibited an acquisition, and

[2] 31 C.F.R. § 800.401(b).

again in 1992 by passing the Byrd Amendment to require a report when the President makes any decision regarding a foreign acquisition. In addition, in requesting our review, the Senate Banking Committee cited the "opaque nature" of the Exon-Florio process as a reason for its request, which suggests that the Committee on Foreign Investment in the United States has not been successful in keeping the Congress adequately informed. We agree that the confidentiality afforded to the companies under Exon-Florio should not be compromised. However, subsection (*c*) of the statute provides that the confidentiality provisions "shall not be construed to prevent disclosure to either house of Congress or to any duly authorized committee or subcommittee of the Congress." Therefore, we stand by our suggestion that the Congress may wish to revisit the congressional reporting requirement.

25. As we stated in our 2002 report, the regulations should not call for negotiating interim measures, but rather for the Committee to use its authority to impose them as a condition of withdrawal where the transaction has been completed or will be completed during the withdrawal period. Further, as we state in our report, "the Committee's guidance to member agencies specifically states that Treasury will manage activities during withdrawal by specifying time frames and goals to be achieved." Because Treasury has declined to implement our recommendation, we are including our recommendation as a matter that Congress may wish to consider.

Appendix II: Comments from the Department of Justice

U.S. Department of Justice

Criminal Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

July 25, 2005

Mr. Norman J. Rabin, Managing Director
Homeland Security and Justice
Government Accountability Office
Washington, DC 20548

Dear Mr. Rabin:

This is to provide the Department's comments on your draft report, entitled "Exon-Florio May Have Limited Effectiveness in Protecting U.S. National Security." We would like to thank the Government Accountability Office (GAO) for examining the issues covered by the draft report and for providing the Department the opportunity to comment on its contents.

We have several points of clarification. First, at page 15, in the final paragraph, the draft report states that "The Departments of Defense, Commerce, and Justice rely on DHS to monitor companies' compliance with the agreements." The Department of Justice does participate in several aspects of monitoring compliance with respect to the agreements to which we are a party; therefore, to be more accurate, this statement should read: "The Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies' compliance with the agreements."

In addition, in the final paragraph beginning on page 15, after noting the positions of the Departments of Defense and Commerce that they lack authority to enforce security agreements signed pursuant to Exon-Florio, the draft report states:

> As a result, the Department of Homeland Security is the only one of the three with broad enforcement authority. Further, according to Justice officials, while Justice has enforcement authority in some instances, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

The Department of Justice's position is that any signatory party to an agreement entered into pursuant to Exon-Florio has the authority to enforce that agreement – and certainly the Department of Justice has the unqualified authority to enforce such agreements to which it is a signatory. For that reason, the last sentence should read:

> Further, according to Justice officials, while Justice has authority to seek enforcement of agreements signed pursuant to Exon-Florio and to which it is a

signatory, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

The draft report includes a formal recommendation that the Department of the Treasury amend the regulations of the Committee on Foreign Investment in the United States (CFIUS) to ensure that companies that withdraw an initial filing are tracked and required to refile according to a specific time frame. The Department of Justice suggests that, if this recommendation is adopted, any implementing language be crafted in such a manner that it does not inhibit or in any way discourage initial filings.

The draft report also makes other, informal suggestions for revising the CFIUS process through both regulatory and legislative changes to Exon-Florio. The Department of Justice requests that any attempts to make the process more transparent to Congress, and more susceptible to Congressional scrutiny, not in any way impede the current confidentiality afforded to companies that file under the statute. The CFIUS process is a voluntary one, and any potential procedure that might be perceived as lessening the confidentiality currently afforded to filers could result in a diminution in the number of applications the Committee receives and an erosion of the confidence companies have that their sensitive and proprietary information will be closely held. Without such confidence and the resulting full disclosure to the Committee, it will be impossible for the Committee to undertake a meaningful review of any transaction.

The Department shares the concern expressed in the draft report with respect to the constraints imposed by the time limits of the current process. In particular, gathering timely and fully-vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment. Any potential extension of the time available to the participants for the collection and analysis of that information would be helpful.

The Department also wishes to clarify that, as far as we know, the Committee as a body has not been a party to any of the national security agreements that have been negotiated to date. Rather, the national security agreements are comprised of commitments from individual agencies with specific equities at stake, and only those individual agencies are parties to the agreements. The consideration for the agreements is that the party agencies will not object to the transaction in the CFIUS process. The agreements do not bind the Committee as a whole or the agencies who are not parties.

Finally, to avoid any possible misunderstanding, we want to point out that it is not just the Department's Criminal Division that participates in the CFIUS process. The Federal Bureau of Investigation (FBI) has been, and continues to be, a very active and critical participant, and other components of the Department have played a role on a case-by-case basis. The draft report notes, at page 9 in the first full paragraph, that since the Department of Homeland Security joined the Committee, both the Departments of Defense and Homeland Security "have begun to analyze acquisitions both in traditional terms and more broadly in terms of the potential vulnerabilities posed by the acquisition." For the sake of clarity, it should be noted that, for some time before

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the Department of Homeland Security joined the Committee, the Department of Justice and the FBI had been analyzing proposed transactions in the "broad terms" referred to in the report and expanding the Committee's analytical approach.

Thank you for your consideration of these comments. Please do not hesitate to contact us if you would like additional assistance regarding this matter.

Sincerely,

Laura H. Parsky
Deputy Assistant Attorney General

cc: Mr. Thomas Denomme, Assistant Director
Mr. Gregory Harmon, Senior Analyst

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Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contact

Ann M. Calvaresi-Barr, (202) 512-4841

Acknowledgments

In addition to the contact named above, Thomas J. Denomme, Assistant Director, Allison Bawden, Gregory K. Harmon, Paula J. Haurilesko, Karen Sloan, John Van Schaik and Michael Zola made key contributions to this report.

Related GAO Products

Defense Trade: Mitigating National Security Concerns under Exon-Florio Could Be Improved. GAO-02-736. Washington, D.C.: September 12, 2002.

Defense Trade: Identifying Foreign Acquisitions Affecting National Security Can Be Improved. GAO/NSIAD-00-144. Washington, D.C.: June 29, 2000.

Foreign Investment: Implementation of Exon-Florio and Related Amendments. GAO/NSIAD-96-12. Washington, D.C.: December 21, 1995.

Foreign Investment: Foreign Laws and Policies Addressing National Security Concerns. GAO/NSIAD-96-61. Washington, D.C.: April 2, 1996.

(120338)

A REVIEW OF THE CFIUS PROCESS FOR IMPLEMENTATING THE EXON-FLORIO AMENDMENT

THURSDAY, OCTOBER 20, 2005

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:05 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

This morning, the Banking Committee continues its examination of the implementation of the Exon-Florio Amendment and the role of the Committee on Foreign Investment in the United States.

In February 2004, Senator Sarbanes, Senator Bayh, and I asked the Government Accountability Office, GAO, to examine the process through which the Committee on Foreign Investment in the United States reviews proposed foreign acquisitions for potential national security implications.

On October 6, GAO presented the Banking Committee with its findings. It was GAO's conclusion that the system is flawed and that improvements can and should be made. Beyond GAO's findings, the Banking Committee is concerned about its inability to conduct appropriate levels of oversight of a process shielded for largely legitimate reasons from public view.

As the public's representatives, the Congress, invested with authority by the U.S. Constitution to regulate interstate commerce, Congress has a need to know. As the Committee of primary jurisdiction in the U.S. Senate, the Banking Committee has a responsibility to ensure that the process receives the appropriate scrutiny.

This is not to suggest this morning that a fundamental transformation of the manner in which the Committee on Foreign Investments operates is due; on the contrary, I am confident that the requisite fixes will be relatively painless for all of those involved if we work together.

But it has become apparent that fixes may be warranted, including in the areas of mandating components of national security that must be considered in any review, far greater sharing of information with the Congressional Committee of oversight than heretofore has been the case, less reliance on withdrawals from the review process for cases with potential problems, and more time for agen-

cies to study individual cases without incurring the risk of undermining the Nation's policy on foreign direct investment.

The Committee approaches its review of Exon-Florio with full awareness that the issue of foreign direct investment is not one to be taken lightly. Foreign direct investment is a vital component of U.S. economic growth, and the principle of reciprocity is an integral part of our economic policy.

The Banking Committee is further aware that the leading foreign investors in the United States are among our closest allies and friends. We are cognizant of the concerns expressed by the European Union regarding the chilling effect on economic ties of changes in Exon-Florio that unduly impede investment flows.

But lost in the mist surrounding the Committee's review of Exon-Florio is the very serious issue of acquisition of U.S. corporations that design and manufacture military sensitive technologies by countries with less benign motivations than some of the friends and allies that I referred to above or by countries with weak export control systems, where a risk of diversion is present.

Preservation of the U.S. defense industrial base, protection of the resources vital to our future economic well-being and protection of our critical infrastructure are legitimate areas of concern. Congress, I believe, needs to be comfortable with all of these considerations that are integral to the process by which proposed foreign acquisitions are reviewed by the Committee on Foreign Investments. That level of comfort is currently nonexistent.

A Tuesday article in *The Hill* newspaper mentioned the concern among the business community that the Committee's efforts at strengthening what it seems as a flawed process will have serious ramifications for international trade and investment. The article noted the concern among some lobbyists over the recent French uproar over PepsiCo's potential takeover of Dannon, the prize French-owned yogurt company. Please be assured here today, with all due respect to the market fluctuations that accompany takeover bids, the issues in question here are of far greater importance than yogurt and involve a very small percentage of foreign acquisitions.

The Banking Committee, I feel confident in stating, will take no actions that impede international investment. But national security should never, ever be subordinated to commercial interests. The Committee on Foreign Investment has a mandate to review acquisitions for national security implications, not for potential retaliatory measures by foreign governments and not with an eye toward market reactions.

Exon-Florio states that the Committee may consider defense industrial base requirements, and the Defense Production Act is explicit in its emphasis on critical infrastructure protection and energy security. These areas, the GAO report suggests, are given inadequate attention. Preservation of the Nation's open investment policy, not addressed in Exon-Florio, is given measurable emphasis.

The Committee will hear this morning from a high level panel of Government officials representing the Federal agencies comprising the Committee on Foreign Investment. It was our intention to hear from this panel during the October 6 meeting. That did not occur. I must add here that it is disappointing that two of the agen-

cies failed to submit prepared statements in advance of today's hearing, which is unusual in this Committee.

Following that panel, we will hear testimony from two eminent experts on Exon-Florio: Patrick Mulloy, who is no stranger to this Committee, of the United States-China Economic and Security Review Commission and David Marchick, a Partner at Covington and Burling, with long Government and private sector experience in the area of international trade and investment.

But before we begin, we are pleased to have testifying this morning one of our colleagues, Senator James Inhofe of Oklahoma. Senator Inhofe has been very active in seeking to reform the process by which foreign acquisitions of U.S. companies are reviewed.

Senator, we would welcome you, and do you want to make an opening statement, Senator Schumer?

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman, and I want to thank you and Senator Sarbanes for moving so quickly to hold a second hearing on this important issue. One of the greatest principles in the United States is that FDI, foreign direct investment, occurs freely without discouragement from the Federal Government, and that happens in about 99.9 percent of the cases.

But even with that rate of success, we still have some concern, since there are some areas in need of greater Congressional oversight. CFIUS gained a lot of attention a few months ago when CNOOC made an $18 billion bid to take over Unocal. Many of us knew before, and others learned more recently, that CFIUS plays an extremely important role and may be the last stop-gap measure to ensure that our U.S. national security interests are protected, which, in some extreme cases, may mean recommending that the President block a foreign direct investment deal.

But I would argue one of the greatest problems with CFIUS is the narrow definition of what is encompassed in the term national security. Members of CFIUS in the past have strictly used the term national security to apply to potential investment deals which pertain to military goods, national security sensitive technology, in addition to other goods we need for our national defense.

I agree that any direct foreign investment deal that hinders the United States' ability to protect our national security interests in a traditional sense should be closely examined, but I believe the recent GAO report requested by you, Senator Sarbanes, and Senator Bayh, Mr. Chairman, hit the nail on the head when they said that the Committee absolutely defines the definition too narrowly.

One of the most important missing pieces of the puzzle pertains to our country's ability to protect against deals that hinder our economic security interests. And in this new global world, economic security is every bit as important as national security. Economic security is a U.S. national security issue. That is a fact. Our economic interests should be aligned with our military security interests, and that definition should be broadened, and I am prepared to amend Exon-Florio to do just that.

The other major issue I have with CFIUS is the issue of reciprocity. On trade issues, the thing I have been most active in is my work on currency manipulation, but I have a much longer history

from my days in the House on the issue of reciprocity, when Japan was investing, their financial companies were investing here, but we could not invest in Japan, which greatly hurt American companies, and we passed legislation or moved it through the House that changed all that.

Today, it is the fact that the United States and China's relationship is more of a narrow, one-way street than a multilane interstate highway in all industries. I released a report a few months ago on the unfair trade practices used by China to keep United States companies from directly investing in order to gain market access to China. You cannot invest in this industry; you can only invest 9 percent in that industry, and which industries do they keep us out of, American firms? Owning the most strategic industries, the industries where we have the greatest advantage, the industries where we have the greatest technology.

I did not oppose CNOOC, Mr. Chairman. I was not one of the 41 Senators who signed the letter. But I did attach an amendment saying that we should get a report on whether China would allow a United States company to buy the Chinese Unocal in a similar position. They obviously would not.

I should note that this hurts our economic intellectual property. It hurts the advantages that we have. China has a lot of advantages in trade. They have lower cost labor. They have an increasingly well-educated work force. But we have advantages, and that is our intellectual property and our know-how and ability how to do things in financial services and high tech and communications, and we are blocked, American firms are blocked from investing.

One other point I would make, Mr. Chairman: Our companies do not say a peep about it, because they are part of the game. They will say hey, if we make a fuss, we will not even be allowed to buy the 9 percent that they are allowing us to buy, so we are quiet. And what is happening is our big multinational companies do not have the same interests as America has. Their interest, understandably, is to their shareholders. That is what it should be.

But our interest on this Committee has to be to the best for America. And so, I propose to expand the President's criteria under which he can act to exercise his authority under Exon-Florio to block a foreign acquisition of a U.S. corporation to include a provision on reciprocity. We cannot buy there? Why should they be allowed to buy here?

And I am interested in hearing the witnesses' comments on these issues, and I am going to ask you with unanimous consent, Mr. Chairman, my entire statement be read into the record, and if could get a week for the witnesses to respond in writing, because I will not be here to be able to—

Chairman SHELBY. Without objection, so ordered.

Senator SCHUMER. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I would like to thank you for holding today's hearing on the CFIUS process for implementing the Exon-Florio Amendment.

I was fortunate to serve with you when you chaired the Intelligence Committee, and so, I share many of your concerns regarding national security. That concern was further reinforced when I sat on the Armed Services Committee with one of our witnesses we have here on the first panel, Senator Jim Inhofe.

While I am a strong advocate for economic growth and business opportunities, it cannot come at the expense of our national security. More than ever, we are recognizing new vulnerabilities and the shifting nature of war and terrorism. We must be more vigilant than ever in more ways than ever to keep our Nation safe and strong. The new global economy has brought with it increased opportunities. We must carefully evaluate those opportunities to determine what is in the country's best interests.

CFIUS and the Exon-Florio Amendment is one way in which we can do that. I appreciate this opportunity to examine the current functioning of the process to determine what is and is not working. I look forward to working with my colleagues to find the appropriate balance between commerce and national security.

Thank you, Senator Inhofe, for coming to be a witness today, and I also thank the other witnesses for being here today, and I look forward to your testimony.

Chairman SHELBY. Senator Inhofe, your written testimony will be made a part of the hearing record in its entirety. I want to welcome you again to the Banking Committee. You proceed as you wish.

STATEMENT OF JAMES INHOFE,

A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator INHOFE. Thank you, Mr. Chairman.

I chair the Committee on Environment and Public Works, and we are having a hearing simultaneously, so with your permission, I would like to make a statement and then be excused.

Chairman SHELBY. Absolutely.

Senator INHOFE. And I would also say, observe, that my very good friend on panel two, David Sampson, and I have worked together for many years, and I commented to him when I came in that this was the first time we had disagreed on anything and that everyone has the right to be wrong once. I am looking forward also to making sure that you get the full testimony of Pat Mulloy. I was with two other people from the China Commission last night. They have done great work.

Mr. Chairman, I have to say, I know this is not zeroing in on one country. The CFIUS process affects all negotiations, all relationships, but this first came to my attention when my service on the Senate Armed Services Committee drew me to the conclusion that we had some real serious problems with China.

During the drawdown of the military in the 1990's, we had the experience that there are great threats out there that we were not really going to be prepared to handle. At the same time, China, specifically between the years of 1990 and 2002, increased their weapons procurement program by 1,000 percent. So, I have been concerned about this, and that is when CFIUS came to my attention.

It began last April when I delivered four speeches on the floor. I am sure you were there. They were each one one hour speeches, Mr. Chairman.

Chairman SHELBY. I was there for part of one.

[Laughter.]

Senator INHOFE. I think you were. As a matter of fact, you were stuck in the chair, as I recall, at one time.

[Laughter.]

But I have been concerned about this for some time, and when the Magnequench came along, and they made the acquisition in China and then piecemeal, it was moved back to China, and I would like to read from part of the speech that I made on the floor at that time referencing this, because I think it is pertinent today. I said,

> I believe that CFIUS does not have a broad enough conception of U.S. security. I understand that Representatives Hyde, Hunter, and Manzullo expressed similar views in a January letter to the Treasury Secretary John Snow and chairman of CFIUS. One example of CFIUS falling short is with Magnequench International, Incorporated. In 1995, Chinese corporations bought GM's Magnequench, a supplier of rare-earth metals used in the guidance system of smart bombs. Over 12 years, the company has been moved piecemeal to mainland China, leaving the United States with no domestic supplier of neodymium, a critical component of rare-earth magnets. CFIUS approved this transfer.

Senator Schumer talked about the CNOOC. I was a party the letter that was objecting to that. At the time, it was very similar. These rare metals, in the case of Magnequench, are used for smart bombs. It is something we have to have. There is a closely related metal that was owned by—there is only one mine in the United States that had it, and that was owned by Unocal, and of course, CNOOC was trying to buy, at that time, Unocal. I really believe that when they withdrew their offer, it was mostly due to the pressure of some of the comments that were made people on this Committee as well as on the Senate Armed Services Committee.

So, I think that there is very definitely a national security issue here. I also testified before the United States-China Commission on July 21. Of course, you are going to hear from someone on that Commission in a few minutes. I explained my concerns with the CFIUS process. At the time, I had introduced an amendment to the Defense authorization bill that would have made some of the necessary changes. Now, we know what has happened in the Senate to the Defense authorization bill, and because of that, I have introduced a standalone committee bill which is before your Committee.

Over the past few months, I have pointed out that the CFIUS process has ignored some major issues which threaten our national security, and the GAO has recently issued a report on CFIUS that is right in line. That was referred to both by you, in your opening statement, and by Senator Schumer.

I would, however, like just to read just one quote out of that report. It says they have "limited the definition to export control technologies or items classified contacts or specific derogatory intelligence on foreign companies." I am aware of at least one instance where the Department of Defense and Homeland Security believed national security was at risk, but they were overruled because the threat did not meet the narrow definition set forth by Treasury. The language that I have proposed in this bill requires CFIUS to

investigate transactions of national security concern, including economic and energy security.

The length of the period of review: Right now, presently, they have a 30-day that is allotted for CFIUS for a determination as to whether or not the acquisition should take place. In my legislation, I have increased that to 60 days, and I think everyone now agrees that 30 days is not adequate. The Justice Department, a member agency of CFIUS, agrees with this stating, quoting now, "gathering timely and fully vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment. Any potential extension of time available to the participants of the collection of that information would be helpful."

I think if you just look at it and realize that there have been 1,520 notifications investigated. They have only investigated, out of 1,520, 24. That is all. And only one was actually stopped by the President. That has to say the system is broken. It does not work. Some say that this extremely low number is because there are many opportunities for compensation to alter the nature of their acquisition, that they are more right than they realize.

Well, here is one of the problems that you have. In this system, a company can come back, and if it looks like it is going to be stalled; they can merely take it out and make some changes and put it back in at their leisure, and it is not a disciplined approach. We do not have Congressional oversight, and I think Congressional oversight is an effective tool to fix this problem.

My bill that I introduced requires unclassified quarterly submissions of acquisitions that have occurred over a 90-day period with a classified section that includes dissenting views, the findings of the review process to be reported to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services. A layover period of 10 days after a transaction is allowed to proceed, during which time a resolution of the disapproval can be introduced in Congress. The power of the Chairman of the ranking committee of oversight should be intact.

So in conclusion, I would say that the current CFIUS process is more than opaque. It clearly is broken, and it is up to the Congress to fix it. I look forward to what this hearing will reveal and hope that we have the courage to act on what we learn. A vital part of the understanding of this issue is a comprehensive analysis of this that have occurred, and I have two questions along this line that I am requesting be submitted to the witnesses if not answered here can be answered for the record. If you would do that for me, Mr. Chairman, I would appreciate it.

Chairman SHELBY. Be glad to. What are the questions, Senator?

Senator INHOFE. They will be submitted to you.

Chairman SHELBY. Okay; you will submit them.

Senator INHOFE. Thank you very much for the opportunity to be here.

Chairman SHELBY. Thank you, Senator Inhofe. I know you have to chair another Committee that you are the Chairman of, and we appreciate your work very much in this area.

Senator INHOFE. Thank you.

Chairman SHELBY. Our first panel, if you will make your way to the table, we have Robert Kimmitt, Deputy Secretary of the Treas-

ury; David Sampson, Deputy Secretary of Commerce; Robert McCallum, Acting Deputy Attorney General, Department of Justice; Stewart Baker, Assistant Secretary for Policy, Department of Homeland Security; E. Anthony Wayne, Assistant Secretary for Economic Affairs, Department of State; and Peter Flory, Assistant Secretary of Defense for International Security Policy.

Gentlemen, I want to welcome all of you on behalf of the Committee. All of your written testimony will be made part of the record, and Secretary Kimmitt, we will start with you to sum up your points you want to make before the Committee.

STATEMENT OF ROBERT M. KIMMITT
DEPUTY SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Mr. KIMMITT. Thank you, Mr. Chairman.

Mr. Chairman, Senator Allard, Senator Hagel, good morning. Thank you for this opportunity to testify. As the Chairman mentioned, I am Robert Kimmitt, Deputy Secretary of the Treasury since August of this year.

This morning, I am speaking on behalf of the Administration and the Treasury Department and the Committee on Foreign Investment in the United States, and I am very pleased to be joined by my colleagues representing the member agencies of CFIUS.

Mr. Chairman, we regret the delay in scheduling this hearing, but in light of the significance of the issues we are discussing, we thought it was important both substantively and procedurally for officials from the policy levels of the CFIUS agencies to testify.

As you noted, 2 weeks ago, the Committee heard from the GAO regarding its most recent report on CFIUS. We appreciate the time and resources that GAO dedicated to this report, and although we do not agree with all of the assertions in the report, we do recognize the need to review current CFIUS policies and operating procedures, especially those mentioned in the GAO recommendations.

The witnesses here this morning will endeavor to explain the current process in order to reassure this Committee, the Congress, and the American public that CFIUS is committed to protecting our national security.

Mr. Chairman, we wholeheartedly agree with your recent comment that national security cannot take second place to purely economic considerations. Throughout my years of government service, starting with combat duty in Vietnam 35 years ago, continuing through 8 years of service on the National Security Council staff, I have based my career on the belief that protecting and advancing national security is a Government official's highest priority.

Let me assure you that my colleagues and I fully appreciate the national security concerns voiced by the Members of this Committee and other Members of the Congress. In my view, the concept of national security includes both traditional foreign policy and defense criteria and also economic considerations. Indeed, we believe that there is an inherent link between our national security interests and a strong U.S. economy that facilitates free and fair trade, market-based exchange rates, and the free flow of capital across borders.

An open investment policy, as your opening statement, Mr. Chairman, makes clear is a central pillar of U.S. international eco-

nomic policy, because foreign investment in the United States enhances competition, provides capital, improves productivity, and creates jobs, over 5 million nationally.

Additionally, picking up on Senator Schumer's point, promotion of an open investment policy at home enables us to advocate for similar opportunities for U.S. companies to invest and expand abroad.

As an interagency group, CFIUS provides a forum for discussion and, yes, debate among members representing 12 different executive departments and offices. In addition, important agencies that are not formal members of CFIUS such as the FBI and offices under the Director of National Intelligence play a critical role, either by providing CFIUS with intelligence on international acquirers or by advising CFIUS on counterintelligence and foreign espionage. Further, the Departments of Energy and Transportation have actively participated in the consideration of transactions that have an impact on the industries under their respective jurisdictions.

The give and take among members leads to a comprehensive examination of transactions from all relevant agencies. There is a natural competition of differing perspectives on the part of CFIUS members, and vigorous debates and constructive friction among members helps CFIUS ultimately determine the best possible outcome for our national security. If consensus cannot be reached, Mr. Chairman, then the President must make the final determination regarding national security.

As I noted at the outset, the new senior CFIUS team is involved in an effort to improve the process, drawing on your comments, the recommendations of GAO, and suggestions I have received from agency colleagues. First, we believe that CFIUS requires high level attention from Treasury and the other members, and the departmental representation at today's hearing is an important indication of our common commitment in this regard.

Second, when meeting at the deputies' level, I will chair CFIUS, while the Under Secretary of Treasury for International Affairs or his designee will represent the Treasury Department during consideration of a particular transaction. We think that this change will enable me to manage the process to ensure that all viewpoints are identified and given the same equal, careful consideration.

Third, we are looking carefully at ways to allow more time to assemble the information needed to develop agency positions during the CFIUS review process, especially, Mr. Chairman, for that small number of cases that your opening statement makes clear raise legitimate national security concerns.

Last, and picking up on your important point regarding the Congress' oversight role, we support the idea of enhancing the transparency of the CFIUS process through more effective communication with Congress, while recognizing our shared responsibility to avoid the disclosure of proprietary information that could undermine a transaction or be used for competitive purposes. We are very open to suggestions on ways to improve the transparency of the process such as more regular reports to Congress and Congressional briefings.

Mr. Chairman, we are at a time of both challenge and opportunity for our national security interests. Through an improved CFIUS process, we will continue to protect our national security in the context of an open investment policy that recognizes the critical link between national security and economic prosperity.

I thank the Committee for this opportunity to testify, and I look forward, after my colleagues' statements, to your questions.

Chairman SHELBY. Mr. Sampson.

STATEMENT OF DAVID A. SAMPSON
DEPUTY SECRETARY, U.S. DEPARTMENT OF COMMERCE

Mr. SAMPSON. Mr. Chairman, Senator Allard, Senator Hagel, on behalf of Secretary Gutierrez, I want to thank the Committee for this opportunity to appear before you today. As you know, the Department of Commerce has been a member of the Committee on Foreign Investments in the United States since the panel was created in 1988.

CFIUS reviews are carried out by our Exon-Florio working group. The International Trade Administration chairs the group and coordinates departmental responses to CFIUS. ITA brings to the table extensive knowledge from private industry, from technological capabilities of individual companies to market positions and future prospects. This enables ITA to look at things in the bigger picture when assessing both the commercial and national defense implications of foreign acquisitions.

Other members of our working group include the Bureau of Industry and Security, the Technology Administration, the Economic and Statistics Administration, the National Telecommunications and Information Administration, and the Office of General Counsel. As a CFIUS member, a key part of our work is identifying any business transactions with perceived national security implications and when appropriate requesting a review and subsequent action by CFIUS.

We have a formalized process that requires members of our working group to report any potential acquisitions by foreign companies that may be of interest to CFIUS, especially those that involve smaller or privately held U.S. firms that may not have been reported widely in the media.

In addition to the International Trade Administration, Commerce's Bureau of Industry and Security is a key player in the CFIUS process. It assesses the national security, defense industrial base and export control implications of all proposed foreign acquisitions of U.S. companies that are under CFIUS review. The goal is to ensure that the U.S. defense, industrial, and technology base will not be compromised by foreign acquisitions.

As a part of this process, the Bureau of Industry and Security determines whether the parties to an acquisition have violated U.S. export control laws and whether significant sensitive technology is being acquired. The Bureau evaluates a foreign company's plans for managing its compliance with U.S. export control laws, and it works closely with the Departments of Defense, Justice, and Homeland Security as well as the intelligence community in assessing whether national security would be compromised as a result of foreign access to key U.S. firms. For example, if an acquisition were

in the telecommunications industry, we would determine the security implications for the Nation's communications infrastructure.

Finally, Mr. Chairman, let me say that we believe that while the CFIUS process is working well, we realize there are opportunities to improve it, and we look forward to working with you in that effort. I look forward to answering your questions at the appropriate time.

Chairman SHELBY. Secretary Baker.

STATEMENT OF STEWART BAKER
ASSISTANT SECRETARY FOR POLICY,
U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. BAKER. Thank you, Mr. Chairman, Members of the Committee. I represent the newest member of CFIUS, and I will try to be the briefest, if you will allow me to submit my prepared remarks.

Chairman SHELBY. Your prepared remarks will be made part of the record.

Mr. BAKER. Many thanks.

When we joined the Committee, we certainly noticed that timing was certainly an issue that we had to be concerned about.

We have done two or three things in the context of CFIUS that I think have eased many of the concerns we had. We now do research well in advance on potential mergers and acquisitions and takeovers that may come before CFIUS. So well before any filing has been made, we have already begun to do the research and share that with other CFIUS members.

Also, we have worked hard to encourage a practice that I think sophisticated companies and sophisticated counsel have begun to adopt pretty widely, which is coming in early and providing briefings well before they have made any filings to let CFIUS members know what the transaction is and to try to get some feel for what the CFIUS issues might be. That is a practice that we think should be encouraged. And finally, on the mitigation of the national security concerns, we have looked very hard at that, and one of the concerns that we had was that we should focus very hard on actually enforcing those agreements, making sure that there is a consistent and aggressive approach to enforcement. We have devoted a lot of resources to that, all of that inside the context of the existing statute, which is quite flexible, and I agree with Deputy Secretary Kimmitt: We can do a lot inside the context of this statute to make it work well.

Chairman SHELBY. Secretary Wayne.

STATEMENT OF E. ANTHONY WAYNE
ASSISTANT SECRETARY, BUSINESS AND ECONOMIC AFFAIRS,
U.S. DEPARTMENT OF STATE

Mr. WAYNE. Thank you very much, Mr. Chairman, Senators Allard, and Hagel. It is a great pleasure to be here and talk about the role of the Department of State in the Committee on Foreign Investment in the United States.

I think as you all know, a key part of the mission of the Department of State is to create a more secure, democratic, and prosperous world for the benefit of the American people and our friends

and partners internationally, and we see the work that we do in support of the Exon-Florio statute as a very important part of that, and we take that mission and that job very seriously.

We bring to the CFIUS process the expertise and experience that we have in dealing with international economic issues as well as national and international economic security policy. And as you yourself said, Mr. Chairman, these are mutually reinforcing.

Security and prosperity are interdependent, and when one is lacking, the other will be undermined in time. We believe that our internal processes in the Department of State ensure that each and every CFIUS case receives careful scrutiny from a wide range of offices. We in the Bureau of Economic and Business Affairs take the lead in coordinating this effort, but we work with the Bureau of Political and Military Affairs, the Bureau of International Security and Nonproliferation, the Bureau of Diplomatic Security, the Bureau of Intelligence and Research, the Office of the Legal Advisor, and the appropriate regional bureaus.

We also bring other experts in as needed, so we try to get an overarching view of both the economic and the security and the geopolitical aspects behind each and every case, and of course, in this, we rely tremendously on the expertise of our embassies overseas, so we can really understand what is the context, political and economic, of the particular case that is brought together.

We rely on our colleagues, who have responsibilities on defense, trade, and nonproliferation, and those who are working to fight terrorist financing and to counter terrorism. We think that just to note that, of course, the Department, like many of our colleagues, have security interests that extend well beyond CFIUS. In our case, the Arms Export Control Act and its implementing regulations and the International Traffic in Arms Control regulations, the role we have there, give the State Department independent authority to regulate the export of defense articles and services and provide for criminal and civil penalties, whether a company operating in the United States, a U.S. company, is foreign-owned or not if these provisions of these two key statutes are violated.

And pursuant to that, we do manage a registration system of all manufacturers, exporters, and brokers of defense articles and services and track foreign ownership as a part of this process. And we bring those elements into any CFIUS review process where we are asked to participate.

All CFIUS members here, I think, share the goal of assuring that no transaction reviewed by CFIUS leads to a compromise of national security, and although confidentiality requirements and other factors prevent me or my colleagues from going into specific cases in an open hearing, I can assure you that in my experience, the process has enabled the U.S. Government to take appropriate action to address potential threats when they have arisen.

Now, as you said, Mr. Chairman, preserving both economic security and prosperity in a post-September 11 world is a pretty complex challenge, but it is critical that we do it right, that we learn, that we adapt, that we get smarter and better in doing it. The belief in an open investment policy is essential to our economic prosperity, and that is a longstanding belief that goes back to the very origins of our republic and has been borne out by the facts.

The U.S. openness to foreign investment has helped make the United States the world's most successful economy, which in turn provides the wealth and technology needed to support the world's most powerful and best equipped military that ensures our security.

Therefore, as you said, Mr. Chairman, and as Secretary Kimmitt said, we have welcomed, and we continue to welcome foreign investment. In fact, I think your State and the other States represented by the Senators here have profited significantly from foreign investment coming into the United States, creating well paying jobs.

The free flow of capital also makes the rest of the world economically stronger. It creates opportunities overseas for U.S. investors. And this is not just sound economic policy, but it is also part of our international obligation in many cases. We have enshrined the principle of providing foreign companies operating in the United States the same treatment U.S. companies receive in investment treaties and trade agreements signed with many foreign companies.

Our openness and the benefits it has provided for us have been very effective in encouraging others around the world to emulate us, to open their own markets, and with my colleagues at Commerce, Treasury, USTR, and at the State Department, we work very hard on a regular basis to seek to remove the discriminatory investment barriers in other markets and to put in place strong protections for American investors and their investments overseas.

In conclusion, the Department of State believes that Exon-Florio and its implementation by CFIUS have strengthened our national security while avoiding unnecessary and detrimental restrictions on our open investment policy. I think as you know, Mr. Chairman, the President and Secretary Rice have instructed all of us at the State Department as well as my colleagues in other agencies to make sure that we are doing everything possible to protect the national security of the United States and the American people and to promote the kind of global economic policies, including open investment regimes, that will maximize U.S. prosperity, and I want to assure you that we take this mission very seriously.

Thank you very much. I look forward to the opportunity to answer your questions.

Chairman SHELBY. Thank you.

Secretary Peter Flory.

STATEMENT OF PETER C.W. FLORY
ASSISTANT SECRETARY,
INTERNATIONAL SECURITY POLICY,
U.S. DEPARTMENT OF DEFENSE

Mr. FLORY. Mr. Chairman, Members of the Committee, thank you for the opportunity to appear today to discuss the impact of Section 21 of the Defense Production Act, better known as the Exon-Florio Amendment on National Security.

Mr. Chairman, it is a particular pleasure to be here. I have spent many hours on hearings on related subjects with you on the other side of the table and during your time as Chairman of the Intelligence Committee. I am pleased to be before you today.

Chairman SHELBY. Also with Senator Allard.

Mr. FLORY. And Senator Allard indeed and Senator Inhofe as well. Different perspective but also happy to be here.

Sir, I just would echo what you said at the beginning. National security cannot take second place. This is something we in the Defense Department feel very clearly, and I know my colleagues here all have the same feeling.

Foreign investment is a good thing for the country; in many cases, it is good for the defense industry. It helps us maintain the viability and diversity of our supplier base. But it is important that in dealing with foreign investment that we protect the technology, the industrial base, and the security of the critical infrastructures we rely on to carry out our mission and to keep our war fighters second to none. So again, this is somebody that we at DoD take very seriously, and I know all of my colleagues today have the same view.

Just to give you some perspective on the particular role of the Defense Department in the CFIUS process, when it comes to reviewing a foreign acquisition of a U.S. company that has been proposed, there are a number of factors that the Defense Department looks at before taking a position. Some of these, although not necessarily all, the significance of the technologies that are possessed by the firm, are they state-of-the-art or otherwise militarily critical; the importance of the firm to the defense industrial base; possible security risks that might be posed by a particular foreign firm, for example, is it controlled by a foreign government? If so, by which government? Does the firm have a record of export control violations or other troublesome transactions? Whether the company to be acquired is part of the critical infrastructures upon which we rely. And, can any potential national security concerns posed by a proposed transaction be mitigated and eliminated by the application of risk mitigation measures either under the Defense Department's own regulations, through the CFIUS process, and negotiations through the parties?

Within the Department of Defense, there are a number of offices and agencies that have a part to play in this decisionmaking together with the military services. I will just hit some of the main ones. The Defense Technology Security Administration, DTSA, which works under me in the Office of the Under Secretary of Defense for Policy, plays a leading role as our representative on CFIUS and is responsible for the management, coordination, and formulation of the Department's position on CFIUS cases. The Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, AT&L, determines if a U.S. company involved, for example, provides a service or a product that is critical technology and evaluates the transaction's impact on the defense industrial base.

The Office of the Assistant Secretary of Defense for Networks, Information, and Integration, better known as NII, performs vital technical reviews of filings that involve critical information and telecommunications infrastructures. It does this in cooperation with agencies such as the National Security Agency and the Defense Information Systems Agency.

And the Office of the Under Secretary of Defense for Intelligence, in cases involving defense contractors performing classified work, it is the Office of the Under Secretary of Defense for Intelligence, USDI, that assesses whether the Defense industrial security regulations are adequate to mitigate potential national security concerns that might arise as a result of foreign control of U.S. defense contractors.

Mr. Chairman, that concludes my opening statement. I look forward to your and the Committee's questions.

Chairman SHELBY. Robert McCallum, Acting Deputy Attorney General on behalf of the Department of Justice.

STATEMENT OF ROBERT D. McCALLUM, JR.
ACTING DEPUTY ATTORNEY GENERAL,
U.S. DEPARTMENT OF JUSTICE

Mr. MCCALLUM. Mr. Chairman, Senator Allard, and Senator Hagel, I appreciate the opportunity to be here and to discuss the Department of Justice's role in implementing the Exon-Florio Amendment.

The Department of Justice has worked diligently within CFIUS to implement Exon-Florio effectively to protect national security interests, and the effective implementation of Exon-Florio is obviously critically important to the Department's national security mission, and it is a responsibility I want to assure all Members of the Committee that all members of CFIUS take very seriously.

To fulfill its mission to defend the interests of the United States to ensure public safety and to prevent crime, the Department of Justice has set goals to strengthen its counterintelligence capacities, with a focus on protecting sensitive U.S. information and technology relating to national defense and critical infrastructure and to protect the Nation's communications systems by preventing and combatting cybercrime and protecting the privacy of U.S. communications.

Currently, the Federal Bureau of Investigation has as its second and third highest priorities to protect against foreign intelligence operations and espionage and to protect against cyber-based attacks and high technology crimes.

The Department must ensure that it has the necessary tools and resources to accomplish its mission and to meet these goals, and nothing is more important to our arsenal than the ability to conduct lawful electronic surveillance without risking interference by foreign entities and the premature or unauthorized disclosure of targets of surveillance.

The Department of Justice is using all of its traditional techniques and resources to address national security risks. Exon-Florio is a very important national security tool to protect national security. Through its involvement in the CFIUS process, the Department of Justice has carefully examined potential threats to national security posed by specific foreign acquisitions of U.S. businesses, and where appropriate, we have developed measures to mitigate those risks.

Along with other interested member agencies of CFIUS, the Department of Justice has negotiated numerous security agreements to mitigate potential threats to national security caused by those

transactions. These security agreements are typically the result of negotiations between companies involved in the transaction and those CFIUS member agencies whose national security responsibilities are implicated.

In addition to the Department of Justice, the Departments of Homeland Security and Defense are often parties to these agreements. These agreements vary in scope and purpose, depending on the facts of each particular transaction and are negotiated on a case-by-case basis to meet the particular national security interest that is at issue. For transactions that involve the communications sector, these agreements are often negotiated in conjunction with Executive Branch review of applications submitted to the Federal Communications Commission.

Along with the Department of Homeland Security, the Department of Justice plays a key role in monitoring and enforcing the security agreements to which it is a party. The Department has brought together its diverse resources to address the complex issues raised by a variety of transactions coming before CFIUS. The Department's Criminal Division has the primary responsibility at a policy level for CFIUS matters, and it closely coordinates the involvement of various Department components in that process. These components include the FBI, which both coordinates with the intelligence community and provides operational and analytical support in the areas of counterintelligence, critical infrastructure protection, privacy protection, and electronic surveillance.

The Computer Crime and Intellectual Property Section is involved and provides expertise relating to the United States communications systems, cybercrime, and privacy protections. It is the Office of Enforcement Operation and the Narcotics and Dangerous Drug Sections which provide expertise related to electronic surveillance issues as well.

The Counterespionage Section provides legal guidance on counterintelligence issues. The Office of Intelligence Policy and Review assists with intelligence community coordination, and the Counterterrorism Section assists in reviewing transactions that may implicate terrorist concerns. In addition, the Antitrust Division has provided support and input in appropriate cases regarding competition issues, and the Office of the Chief Information Officer has provided assistance on occasion in technology matters.

By bringing all of these diverse resources and this extensive expertise to bear, the Department, we believe, has maximized its ability to participate in the effective implementation of Exon-Florio.

Again, I would like to thank you, Mr. Chairman, and the Committee Members for your interest in ensuring that Exon-Florio is used as effectively as possible and for giving the Department the opportunity to explain its role with respect to this important national security safeguard.

The Department of Justice is keenly aware of the significance of its responsibilities under Exon-Florio, and we have and continue to work diligently to meet those responsibilities. The Nation's security and the safety of our citizens are always the Department's highest priority, so I thank you for allowing me to be here, and I will be happy to try and answer your questions.

Chairman SHELBY. Thank you. I thank all of you.

Each of you has had the opportunity to study the GAO report. The concerns raised in that report, according to the Treasury-led interagency response, are largely misplaced. Information gleaned from press accounts of individual cases over the years, previous work performed by GAO on this issue, and Committee research, however, all point to a system in need of improvement.

I understand that there has been considerable effort made to ensure that each of the Government officials testifying today supports the status quo, and Secretary Kimmitt, you are in particular aware of the Committee's concerns with statements attributed to Treasury Department personnel questioning the professionalism of GAO as well as its methodologies and findings. For the record here, I would like each of you to share with the Committee your views on whether there are improvements to the current system that should be implemented. Otherwise, the Committee would be led by this panel to believe that the system is perfect.

Secretary Kimmitt.

Mr. KIMMITT. Mr. Chairman, I will first start by saying that the views that were attributed to an unnamed source in a single newspaper about the GAO report are neither my views nor the Department's views. As I said in my comments, there are some assertions made in the GAO report that I would take exception with. I will mention one.

Chairman SHELBY. Okay.

Mr. KIMMITT. But on balance, I think they try to do a very professional job, and particularly, when one looks at their recommendations, it is a good starting point for our continuing discussions on improvements to the process.

I would note that GAO has been involved in this process ever since the process has existed. They have a wealth of information on this, and while we might not agree on everything, I am open to talking to anybody who has good ideas, especially in an area as important as protecting the national security.

Chairman SHELBY. But you do not think the system is perfect, is it?

Mr. KIMMITT. The system is not perfect. No system is perfect, Mr. Chairman.

Chairman SHELBY. Do you think this one is close to perfect?

Mr. KIMMITT. This one? No, I do not think it is close to perfect. I think that there is an opportunity in every governmental process, frankly, and in every business process to look for ways every day to make the process better and adapt to the new realities.

Chairman SHELBY. We are focusing on this process now.

Mr. KIMMITT. Right, so let us focus on this one.

I would say that in the three areas that the GAO recommendations talked about, I think that is a very good starting point for our discussion. One would be transparency. National security processes, as you know very well, and your two colleagues know well from their service both on this Committee and elsewhere, tend to be somewhat opaque, but I think we can certainly have a much better line of communication with the Congress on the CFIUS process.

Chairman SHELBY. Do you believe that the Committee of jurisdiction, which is this Committee, should know what is going on? To carry out the act that we have oversight responsibilities for?

Mr. KIMMITT. Exactly. As you said and as I picked up in my comments, I think that we have an obligation to help you live up to your oversight responsibilities. We both have an obligation to discharge our responsibilities.

Chairman SHELBY. Right.

Mr. KIMMITT. We will strike a balance.

I think we need to find a better way to communicate more frequently, more fully with you; also, all of my colleagues long before this hearing was scheduled have told me that the timing was a problem. I think that we have to look for ways, and I think Secretary Baker's comment about what we can do even before the formal filing to begin a process is good.

Chairman SHELBY. Sure.

Mr. KIMMITT. And then, I think it was correct for the GAO to point to the question of definition of national security, but that is the one place I have to take major exception with a point that they made and, frankly, that Senator Schumer made, this notion that somehow Treasury has narrowed the definition of national security.

I have been in this business for 30 years. I have not yet seen a definition of national security. It is a dynamic concept that defies static definition. For example, we would all agree that national security and challenges thereto are vastly different today than they were pre-September 11.

I think the way to ensure that the most current and comprehensive view of national security is taken into account in each transaction is to have the agencies at this table and others who are charged with developing and protecting the national security of the United States are at the table and have a fair opportunity to put those views on the table.

That is why the Department of Homeland Security is a member now and was not before, because its important responsibilities are integral to the national security, and last, at the same time, picking up on my first point, I think it is very important for us to learn from both what GAO has said, what the Committees of jurisdiction, especially, have said should be factors taken into account. But again, if you tried to define national security, I promise you, the day you define it, it will be out of date. It is a dynamic concept that I think you would want us, just as you do, to look at it in light of the facts and circumstances both of the transaction in front of us and the world in which we live.

Chairman SHELBY. Secretary Sampson, do you have any comment?

Is it perfect?

Mr. SAMPSON. It is not perfect.

This is the fourth GAO report. I found the report, which I read, to be professional in nature and scope. I think, first of all, there is a need for the leadership of CFIUS, at the highest levels, to be engaged. I think we are making that commitment to you by our presence here today and our discussions with each other.

The points that I would make with respect to the GAO report that I found did not resonate with my experience was that some-

how, Treasury either imposed a definition upon the agencies; that has certainly not been our experience at Commerce. And particularly with the Bureau of Industry and Security, that raises issues with respect to control of products involved in a transaction, the export of technical data, or the maintenance of an adequate defense industrial base.

And the other point that I thought may have missed the mark to some degree is a connotation that the very robust dialogue and debate that occurs within CFIUS is somehow indicative of a system not working or that Treasury is trying to squelch that. I find that robust debate to be a sign that each agency feels fully empowered to bring their equities to the table and that resolution is achieved on a consensus basis, or else, the decision goes forward to the President.

And so, those would be my observations about the report, but clearly, there is opportunity for improvement in the area of communication with Congress.

Chairman SHELBY. Secretary Baker, do you have a comment?

Mr. BAKER. Yes, I will certainly join the parade of people who think that the process is not perfect. But I would also say that it is a very flexible statute. Many of the procedures have evolved over time. Secretary Kimmitt has suggested another one in which he would chair the committee to allow a fair umpire for a debate that can go forward with Treasury expressing its own views.

All of the procedures that I talked about for improving the insight into transactions well in advance of a filing are things that are well within the scope of the current statute. So, I would suggest that in fact there are improvements that are possible, but they can take place within the context of this statute.

Chairman SHELBY. Secretary Wayne.

Mr. WAYNE. In part to echo my colleagues, but I think what we have seen over the past several years is that as our sense of national security has expanded, especially in the post-September 11 era, the Committee has worked hard to adapt to those new challenges, to learn new ways of interacting.

Chairman SHELBY. Sure.

Mr. WAYNE. And part of that vigorous debate that we have had is really showing the health of the process and the flexibility of working through these issues as we go forward, because there is no doubt that we are looking much wider now at implications than we might have in the past. And the statute does allow that flexibility. This kind of discussion and the kind of debate spurred by the GAO report is healthy in that process, and we will work with you to make it better.

Chairman SHELBY. Well, we are all for trade, but should we subordinate our national security, Secretary Flory, in any way to economic interests?

Mr. FLORY. Mr. Chairman, we should not subordinate our national security to anything. I think it is a fair point, as others have pointed out, that economic security is an element of national security, but we know what we are talking about here.

Chairman SHELBY. We are talking about two different things here, now, I understand that. My emphasis is national security. We know we have to buy and sell. We trade and all of this. That is

given, and we should not hide behind national security on something as long as there is reciprocity out there in the world with our partners.

Mr. FLORY. No, sir, I agree completely with that statement.

With respect to the GAO report, I think it has made a very valuable contribution. I think that one of the things you see here today is a high level of attention and a high level of commitment to work across the membership of the CFIUS to look at the comments of the GAO, to review them and see what changes in policies and procedures are required, as Secretary Kimmitt has committed to do.

I think this is a good thing. I think it would have been a smart thing to do even if there had not been a GAO report. Having a GAO report helps focus attention on seizing these problems early. I know. I have been working this process for 2 months. We have not had a CFIUS case in that time, so Secretary Kimmitt and some others are also relatively new to their jobs.

Chairman SHELBY. But you are not new to the issue.

Mr. FLORY. I am not new to the issue, sir, not at all, no. We were looking at very similar issues a few years ago. But I have found it valuable, because as I say, it has focused attention, it has focused attention at a very high level. It has achieved a commitment to grapple with the issues raised by the GAO report and others that we may find. I think people are approaching this in a very constructive and open-minded sense.

I would make one comment beyond that on the report that I think is potentially misleading.

Chairman SHELBY. You are referring to the GAO report.

Mr. FLORY. The GAO report, yes, sir. The tone of the report suggests that the failure to block more transactions, the failure either to get to the President more transactions or for the President to actually veto more transactions is in itself a symptom of the weakness of the process. I do not know for a fact that it is, or it is not, but I do tend to think that the purpose of the——

Chairman SHELBY. But you are not telling us the process is perfect.

Mr. FLORY. No, sir. I did not want to bore you with another assertion.

Chairman SHELBY. Do not do that.

Mr. FLORY. But for the record, I do not think that the process is perfect. But what I do think is that the purpose of the process is to make sure that any transaction that goes forward is one that meets our national security requirements.

Chairman SHELBY. Absolutely.

Mr. FLORY. And if that can be done through negotiation and risk mitigation, which appears to be what has happened in the majority of cases, that is not necessarily a bad thing. I think it is appropriate for us to scrub the process and look at it and say is there something that might have gotten through that maybe should not have?

But I think that the GAO report, maybe by seizing on that one metric that has the potential to mislead, and I think what we need to do is look at it and say, look, what we really care about here is have we made sure that any transactions that take place are ones that meet our national security needs? And if it turns out that

the answer to that is yes, then, I think I would say that at least that far, the process seems to have worked reasonably well.

Chairman SHELBY. Mr. McCallum, how does Justice's role play in this? FBI is part of Justice.

Mr. MCCALLUM. It is, it is, Senator, and just so that i can answer the first question and get into the area of boring you with the response that Secretary Flory eventually gave, we at the Department of Justice agree that the system is not perfect, and all systems can be improved. And we support Secretary Kimmitt's call for ways to look within the process to improve it.

Within the Department of Justice, as you have correctly pointed out, we do have various components, including the FBI, and the lead component for CFIUS purposes, as I indicated in my opening statement, is the Criminal Division. But we bring to bear within a coordinated effort under the leadership of the Criminal Division, the FBI, and the various other areas that I mentioned in my opening statement, Senator.

Chairman SHELBY. I am going to recognize Senator Allard first. Go ahead.

Senator ALLARD. Thank you, Mr. Chairman.

I would like to have each one of the panel members respond to this, because you all represent different Departments, but has, to your knowledge, has the current law on CFIUS come into conflict with any other existing laws?

Mr. KIMMITT. Senator, the way I would answer that is if you look at the way Exon-Florio was written. It was written to ensure that in those instances where national security concerns were raised but not addressed by other laws that it provided a backstop to ensure that no transaction went forward that would harm the national security.

So, I think we have worked very hard, and each of my colleagues mentioned laws for which they have primary jurisdiction that are also part of any acquisition process. CFIUS was really, again, created, and the Exon-Florio provision was created, really as a backstop to ensure that where other laws could not successfully address national security concerns that the CFIUS process was to step in to make sure that those were fully addressed.

Senator ALLARD. And how often, then, does the CFIUS come into play within a year, on average?

Mr. KIMMITT. On average, I think that the formal process itself is engaged probably about 50 times a year on average recently. It used to be, in the early days, in 1988, 1989, and 1990, that it was in the hundreds.

What has happened, actually, is there has developed in the legal community, the investment banking community, in the business community, an awareness of what one has to do to pass CFIUS muster. So there is an awful lot of self-correction that takes place right now. As Secretary Baker and Secretary Flory said, a lot of informal contact that takes place, including under those other jurisdictions, even before someone comes to CFIUS. In many cases, transactions just go away, because people know that there is a hurdle that they will not be able to cross.

But again, it is on average about 50 cases a year is what has been running in the last, let us say, in this Administration, 50 to 60 a year.

Senator ALLARD. Do we know how many instances where people have come in, thought they might go through the CFIUS process, but then withdraws their application?

Mr. KIMMITT. In this Administration, so if I look real quickly, one, two, three, four, five, let us say there have been 250 cases notified since the beginning of President Bush, Sr's Administration, the information I have available to me, and I am relying on people who were there long before August of this year was that there were 12 withdrawals of those 250.

Senator ALLARD. Okay; and were they, again, those were withdrawn because of the complication of the process? Is that why they withdrew?

Mr. KIMMITT. It is a very good question, Senator, and I think this was actually an issue that the GAO said in their report had two aspects to it. I think one part of the withdrawal process is to get around some of the time constraints, that you are getting close to the end of the 30-day process; either Departments need more information before they can make a decision, or the companies and the Departments need more time to work out mitigation procedures. But you have a good chance of getting that done so that you do not have to go into a formal, lengthier investigation, and that is good; that is, that it allows the time process a little bit of flexibility.

At the other side, the GAO rightfully pointed out that you have to be a little bit concerned if someone withdraws and then does not refile, particularly in the circumstance where the transaction then goes forward. Now, we have ways, and each of the Departments and agencies has responsibility for continuing to monitor transactions, whether they have been approved by CFIUS or not. But I will just tell you, having sat on boards of directors both at home and abroad, I cannot imagine in the post-Sarbanes-Oxley world, with all deference to your Ranking Member, Mr. Chairman, how any director could give the go-ahead on a transaction that had been notified, withdrawn, and then not refiled, because the President's authority to unwind that transaction is without limit if the person has not received approval of the process.

So, I actually think that that very powerful nonjudicially reviewable authority of the President to stop or unwind transactions acts as a real leavener on the process, especially in the withdrawal case but even in the voluntary notification circumstance.

Senator ALLARD. Now, there was an amendment to be proposed or possibly was proposed on the Defense authorization bill pertaining to CFIUS, and then, that has been introduced as a separate piece of legislation. Have you had a chance to review that piece of legislation as it was reintroduced as a standalone bill?

Mr. KIMMITT. I have looked at it, Senator Allard. As Senator Inhofe had said, he had put one measure in; then, because of the complexities of the Defense authorization bill, he has put in another standing bill. I think, again, what I would say is if you look at this plus the GAO report, it seems that we are coming to some of the same areas that we need to look at carefully; for example, the first thing Senator Inhofe said it does is it changes the CFIUS

review period from 30 to 60 days, so it goes back to that time question.

I think we have to think very creatively about how to give the agencies more time, but remember, about 95 percent of these cases, as the Chairman said, the vast majority do not present troubles, get cleared quite easily within the 30 days.

I think what we have to do is to find a way to get those out of the way and focus in on that small number of cases that really raise national security concerns. My concern any time in the Government is if you move something from 30 to 60 days, then, things are going to get done on day 59 rather than day 29, and I think we are going to spend more time on cases that do not raise major concerns, and we will have less time on the ones that raise concerns.

Senator ALLARD. But we still give them an opportunity to withdraw voluntarily, and then, if they do not come and reapply, it raises a big red flag out here is the way I——

Mr. KIMMITT. Again, I just cannot understand how a director could discharge her or his fiduciary responsibility to allow that to go through.

Senator ALLARD. So even though you run into time limit problems with the 30 days, then, they can withdraw, and then frequently, they come back and refile.

Mr. KIMMITT. That is my understanding of what the recent experience has been, although I would mention, as the Chairman said, you are going to have some practitioners on in the next panel. I think that would be a very good question to ask Mr. Marchick who practices in this area, because he will be able to give you that view from the point of view of somebody who has to advise the client.

Senator ALLARD. Now, those that you have turned—how many of them have voluntarily withdrawn and then come back and refiled later? Have they all done that, or have those 12 that you just mentioned just been permanently withdrawn?

Mr. KIMMITT. What I have, my statistics indicate, and again, I am operating on the basis of transactions that took place or were proposed before I took office or before most of us did. Again, in this Administration, roughly 250 cases, 12 withdrawals, 10 refilings.

And there were two that were not refiled, and I would have to, if I could, for the record, provide you additional information on those two. What I could say for the record is that if an agency raises a concern that leads to a withdrawal, I think I can speak for my colleagues in saying whether that is refiled or not, that is a concern that is going to be of continuing interest to the agency, particularly if those companies decide to go forward without the CFIUS or Presidential approval.

Senator ALLARD. Thank you.

I see my time has expired, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator Hagel.

STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Mr. Chairman, thank you. Gentlemen, welcome.

Let me ask you, Secretary Kimmitt, and I would welcome additional response if you feel compelled to do so to this question from

the other witnesses. In your opinion, your knowledge of CFIUS since its inception, has there ever been a situation where this country's national security interests have been jeopardized by CFIUS not acting to break up a foreign acquisition?

Mr. KIMMITT. Senator Hagel, not to the best of my knowledge. I was involved in this process even before Exon-Florio passed, and although I have been out of Government for 12 years, I have continued to watch this very carefully. I think I can say certainly, the view of the Treasury Department is that the answer to your question would be no, that there has never been an instance where a transaction involved in the CFIUS process compromised or undercut the national security of the United States.

And I would say, based on my reading also of not only the most recent GAO report but also their reports going back to the mid-1990's, there was never an allegation that there had been harm to the national security, but rather we needed to continue to have procedural improvements to ensure that the possibility never occurred.

Senator HAGEL. Anyone wish to add to that or take issue with Secretary Kimmitt?

Mr. FLORY. I am not aware of any incidents of that type.

Mr. KIMMITT. Thank you, Secretary. Are any of you aware of any instances where any member of CFIUS had their national security interests overruled by Treasury?

Mr. SAMPSON. No.

Senator HAGEL. No? There is not an instance that any of you can think of?

Mr. KIMMITT. Excuse me, Peter, go ahead.

Mr. FLORY. Senator, from my knowledge of the process, which is based on the GAO report, which recounts a number of debates, in a number of cases, it suggests that a national security interest was overruled.

I have talked with my staff who have been working this, and my understanding is that in any case where the Department of Defense may have had concerns, or components of the Department of Defense may have had concerns, that the eventual solution that was reached on the case had addressed those concerns. So that does not necessarily prove that in a given—an issue may have been debated and may have been debated in a fairly extensive way within the Committee, but the end results were results that we were satisfied with.

Mr. KIMMITT. And Senator Hagel, I would just note that this is a legal process based on an Executive Order that created CFIUS in 1975; updated it with Exon-Florio in 1988; then again in 1992. It is a legal process. We follow the law. At the same time, it is an interagency process, one that both you and the Chairman are very familiar with.

And the fact of the matter is there is only one decisionmaker in the national security community, and that is the President of the United States, and if anyone has a national security concern that cannot be addressed, whether it be at the staff level or the deputies' level or higher, we do not have the ability to stop it at that point. We must send it forward.

As Secretary Flory said, our goal, consistent with the open investment policy, is to try to find a way to let the transaction proceed. But each one of us has a Constitutional responsibility to make sure that we do not give an okay to a transaction that is going to harm the national security interest, and Treasury neither can narrow the definition of national security, because national security is what the Committee defines it to be, nor, can the Treasury Department keep any Cabinet secretary from taking his or her view on that national security issue to the President.

I think it is incumbent upon us to do as much as we can at the staff level, where a good 75 to 80 percent of the work will be done; that that cannot will be resolved at the policy level, but at the end of the day, if that cannot be resolved, and none of these people, I tell you, will ever give a free pass to a transaction on national security grounds, it then goes forward.

Senator HAGEL. Thank you.

Mr. MCCALLUM. Senator, on behalf of the Department of Justice, I would like to echo what has been said before in that having made inquiry, I know of no case where the Department of Justice had national security concerns with a transaction that went unaddressed.

Senator HAGEL. Thank you. It has been suggested, as you each know, that Congress be given a final approval role, at least, in the CFIUS process. What is your assessment of this proposal, and if you think that is a good idea, I would also like for you to address, then, the political dynamic that may well creep into that approval process. Start with you, Secretary Kimmitt.

Mr. KIMMITT. Oh, I was hoping that you were going to look somewhere else on that one, Senator.

[Laughter.]

Let me say this: We have a system of government that leaves to each of the three branches an important set of responsibilities. You have the legislative; we have the executive responsibilities.

I think that when it comes to national security, each of us has very important responsibilities, both individually as well as institutionally. I will defer to the Acting Deputy Attorney General on the separation of powers issues that are raised by that, because I think they are significant. What I would say is if we do a better job of staying in touch with you than we have in the past and have an idea of what the issues of concern to you are, not just procedurally but the factors, as the Chairman said, of what should be taken into account in the Committee's deliberations, and then, in the wake of that, if we are open with you and frankly more open and more frequently open with you than we have been in the past so that you can be assured that we are doing this correctly, then, I think we stay away from the more difficult Constitutional issue of the legislative branch getting involved in an executive function.

Senator HAGEL. Let me ask you a point to clarify this. So, you would not be enthusiastic about changing the approval process or Congress being involved in any final approval of a CFIUS decision.

Mr. KIMMITT. I would not, Senator, any more than I think the Justice Department would want the Congress more deeply involved in Hart-Scott-Rodino antitrust review or the FCC on communications review. You have a range of powers and authorities available to you that the CFIUS process does not touch: This hearing, your

ability at any point to call people up before you, either private sector or public sector; that, we understand. I think, though, I would say let us make these improvements to the process, let us assure you that we can handle this thing properly. Then, we do not have to get into the Constitutional debate.

Senator HAGEL. Are there any contrary opinions on the panel to what Secretary Kimmitt noted?

Thank you. I know my red light is on, Mr. Chairman.

Chairman SHELBY. Go ahead.

Senator HAGEL. May I ask another question thank you.

Chairman SHELBY. Yes, sir.

Senator HAGEL. Did the GAO interview all of your agencies before their final report? Each of you had opportunities, or representatives of your Departments were interviewed?

Mr. SAMPSON. Yes.

Mr. KIMMITT. I think, Senator, what took place, if I read the GAO response to the Treasury comments correctly, was that there were some agencies who were not interviewed during the process, but I think all agencies received a copy of the draft report before it was submitted.

I will be candid: I think it would have been good for GAO to have interviewed all of the agencies, both at the professional staff level but also engage us at the policy level. They may have had some time constraints of which I am not aware, but I think in the end, each of us did have an opportunity to comment on the report before it came forward to you.

Senator HAGEL. I am not aware of this part of the CFIUS review, so here is the question to you: Does a regular CFIUS review include bringing in outside agencies or departments within the intergovernmental process? The Department of Energy, for example, obviously energy is a critical part of our national security, and that is done on a regular basis?

Mr. KIMMITT. Yes, Senator, I mean, just as you had Senator Inhofe in before your Committee today, the only way that we work well is on an interagency basis. There are some people, as I mentioned in my opening statement, in the intelligence community whom we immediately involve in any notification to get their full intelligence on the transaction involved.

I might note that that creates a little bit of a time problem in terms of responsiveness, and we are working on that. But beyond that, any department or agency, I mentioned specifically Energy and Transportation in my remarks, but really, any department or agency who will bring a perspective to the table that will better inform us on the national security implications will be invited.

And I might say, as both you and the Chairman know, when the National Security Council meets, although technically, it just comprises the President, the Vice President, the Secretary of State, Secretary of Defense, the Chairman of the Joint Chiefs, and the Director of Central Intelligence, you will not be surprised to know that Treasury is there very frequently, Commerce, DHS, Justice, and others, and so, again, I think just as the concept of national security is a dynamic concept, the representation has to be dynamic and tied to the transaction in question.

Senator HAGEL. Mr. Chairman, may I ask one last question?

Chairman SHELBY. Go ahead.

Senator HAGEL. I appreciate your patience.

Chairman SHELBY. It is important.

Senator HAGEL. And it is this: It has been referred to this morning in various ways, but the issue of the review period being extended, could I get a quick answer from each of you whether you think that is a good idea or not a good idea?

Let us start with you, Secretary Baker.

Mr. BAKER. I think it would not be a good idea, because of, as Secretary Kimmitt suggested, we would be extending a lot of routine transactions to day 59 instead of day 29, and the impact on foreign investment and investors' expectations would be significant. And as I said earlier, there are other ways to achieve early warning about the transactions we are particularly concerned about.

Senator HAGEL. Thank you.

Mr. SAMPSON. I would fully concur with DHS.

Senator HAGEL. Thank you.

Mr. FLORY. I agree, sir.

Mr. KIMMITT. I agree both with what Stewart said, and we are going to have a meeting as early as next week to see if there are any other better ideas.

I mentioned to my colleagues, and as you know, Senator Hagel, when someone does a notification in the European Union, they also have a 30-day review process, and if they are not quite ready to go at 30 days, they just stop the clock.

Now, maybe the Europeans are cleverer than we about that, but it allows them to maintain jurisdiction, take a little bit more time to get the information. I am not sure that we have the ability to do that, but as Stewart says, I think we do have the ability to make a lot better use of the preformal notification process.

Mr. MCCALLUM. Yes, as Secretary Baker stated, for most transactions, the 30-day review period is enough, and it is that small number of transactions with complex and sensitive issues that put the stress on the resources that are available within that time period. But as I indicated previously, the Department of Justice has not seen any situation in which the national security issues were not addressed and addressed appropriately.

Senator HAGEL. Thank you.

Secretary Wayne.

Mr. WAYNE. I concur with Secretary Kimmitt and Secretary Baker and the others on this.

Senator HAGEL. Gentlemen, thank you.

Mr. Chairman, thank you.

Chairman SHELBY. Thank you, Senator Hagel.

I have a number of questions, but before this, Sarbanes is tied up in some other areas, but he has a number of questions that he would like to submit to all of you for the record, and we will keep the record open for that.

Mr. KIMMITT. Thank you, Mr. Chairman.

Chairman SHELBY. Secretary Kimmitt, you and the rest of the witnesses on this panel all operate at what we call the upper stratum of government policymaking. At the policy level, how does the Committee on Foreign Investment resolve disagreements that could be resolved at the staff level? What additional kinds of information

are brought to bear, and how are policy considerations reconciled? What kind of guidance does the White House provide in these instances? How is consensus reached? In other words, how do you work?

Mr. KIMMITT. Well, I will describe how I would like the process to work.

Chairman SHELBY. Yes. Tell us how the process works basically and how you would like for it to work.

Mr. KIMMITT. Well, I think that the way the process works right now is that the vast majority of the cases, and therefore the vast majority of the work, is done by an exceptionally capable professional staff representing not just the Departments at the table but the other six agencies involved.

Chairman SHELBY. The vast majority of cases dealing with trade and buying companies and so forth and here and abroad, direct investment is not concerned generally with national security.

Mr. KIMMITT. Right, exactly, and my point would be that I think what that staff level work has done is to develop a process that identifies very clearly as the time permits what the policy level national security questions are that need to be considered. And if they can resolve them at their level, largely by working with the companies on mitigation procedures and so forth, then, I do not think it would have to go any higher.

But certainly, before one would go to an investigation that could lead to a Presidential decision, that is where I think we, on behalf of the Cabinet secretaries for whom we work, have to have those issues brought to our attention. We have to make sure that we have the information that we need to make that critical judgment of whether the national security will be protected and discuss it in the context of the broader policy responsibilities each one of us deals with every day in other national security forums.

Again, to the extent that we can work it out there and get the companies to accept it so that we are all confident that the transaction can proceed in a manner that is not harmful to national security, I think we can get it resolved at this level. But in the end, as I said earlier, this is not a consensus-driven process in which consensus is the goal. It is a consensus-driven process that creates a presumption in favor of the person who thinks a national security question has not been answered, and if that has not been answered, it can only go forward to the President.

Chairman SHELBY. Mr. Secretary, what is the Committee on Foreign Investment's procedure for maintaining control over cases that have been withdrawn, especially those cases where an acquisition has already been completed? Because the notification to the Committee is voluntary, as I understand it, and because companies are routinely permitted to withdraw their paperwork, what mechanism is in place to ensure that acquisitions are monitored for national security implications and blocked, blocked if necessary before damage is done?

Who is responsible, in other words, for ensuring that the companies refile, and each agency has the opportunity to complete a full review? As I understand it, the guidelines state that Treasury has responsibility for setting up a timeline. In how many instances has that been done?

Mr. KIMMITT. Well, no, I think, and again, I think it was a good point made not only in your comments Mr. Chairman but also by the GAO. I think we have to watch these withdrawals very carefully. Again, the percentages, at least as I have them, would suggest that only about 5 percent of the cases notified over the past 5 years have been withdrawn, and 10 of those have been resubmitted.

So what the statistics would suggest is that 1 percent of the cases that have been notified in the past 5 years were notified, withdrawn, and then not renotified. It is a small number of cases, but going back to my earlier point, those are probably precisely the ones that we have to look at very carefully.

Although Treasury, in its role as chair of the process, sets up procedures and has to keep people generally informed of whether a company has refiled, whether the transaction has gone forward, I would defer to each of my colleagues to say how they do it, but we also look at the agency that raised the objection or agencies that raised the objections that led the company to withdraw the filing to have a continuing watch over that issue that caused the concern, with particular attention on transactions that close without coming back to CFIUS.

Chairman SHELBY. Basically, we cannot afford where national security is involved to let anything slip through or slip by.

Mr. KIMMITT. No, absolutely not. And then, again, that is why Exon-Florio is just one of the many laws available to us. It is a process that helps identify, really do a triage, a screening out, but on a going forward basis, if those companies come together and begin to operate in the United States without addressing the concern, whether it be of Justice, the Defense Department, DHS, or anyone else, I would imagine that that Department has the ability, using its existing statutes, to make life very difficult for that company, and that is why, again, it is hard for me to see how a board of directors could ever let that happen.

Chairman SHELBY. Secretary Kimmitt, the bid by the China National Offshore Oil Company to buy Unocal entailed a number of factors that may or may not have contributed to a determination by the Committee on Foreign Investments had it reached that stage. For example, there was the question of control over oil and natural gas deposits as well as concerns about deep sea mapping technologies and other sensitive technologies that we might have wanted to protect.

I know you cannot address that case in any detail, but it did bring to mind here on the Committee concerns that the Banking Committee has over how the review process, as we keep talking about it, unfolds. For purposes of paragraph B of Exon-Florio, mandating investigations in the case of state-owned or controlled entities where national security could be affected, is it your assessment that the China National Offshore Oil Company would have qualified?

Mr. KIMMITT. Again, that case both took place before I was in this position, and as you indicated, it had been withdrawn but——

Chairman SHELBY. Well, it brought a lot of this to the attention of the American people.

Mr. KIMMITT. Let us talk about the public facts. The fact is it was a state-owned company receiving concessional financing, according to reports, wanting to make an investment into a sensitive sector, sensitive by their definition, since they will not let United States companies invest in that in China.

Chairman SHELBY. Absolutely.

Mr. KIMMITT. So it would seem to me that had a case like that——

Chairman SHELBY. Reciprocity, no reciprocity.

Mr. KIMMITT. Right, had a case like that, and frankly, whether the state-owned entity was China or in another country, it would seem to me that it falls squarely within Section B, which was the Byrd Amendment in 1992.

I think the factors that you mentioned, you said they were outside the CFIUS purview; I would not think so. I would think that the Energy Department or other Departments would have brought precisely those kind of factors into play if a case put forward by a state-owned company of any nationality in that particular sector were to come before us. But in this case, as you said, Mr. Chairman, the bid was withdrawn.

Chairman SHELBY. Sure; if a case is not reviewed prior to an acquisition process being in what we call an advanced stage, does that mean that there is no consideration of the case at all? When precisely does the 30-day clock start ticking?

Mr. KIMMITT. My understanding is that under the regulations, Mr. Chairman, there is an information requirement from the parties to the transaction that has to be submitted to the Treasury Department to begin the 30-day process. Now, I think in almost every case, my experience has been, and my briefings have suggested, as Secretary Baker said, that that process of interaction begins long before that formal filing.

And I would imagine, for example, if a European manufacturer looking to make an investment into the U.S. defense industry, Treasury would not be the first to hear about that. My guess is that Secretary Flory and his colleagues would have heard about that first, because that is the customer. We are not the customer. And I think any smart company and smart advisers to companies would try to get as much done as possible before making the formal filing to help us get around the time issues that have been raised.

Chairman SHELBY. I would like to direct the next question to Acting Deputy Attorney General Secretary Flory, Secretary Baker, and Secretary Sampson.

Has the credible evidence standard that you all are all familiar with in Exon-Florio limiting when the President can use the authorities of the statute to suspend or to block a transaction been flexible enough to allow the Committee on Foreign Investment to block a transaction or to impose sufficient risk mitigation measures when needed when the foreign company in question is government owned or controlled? When that government is neither a NATO or a non-NATO major ally, how is a determination made on whether credible evidence exists that an acquisition could harm national security? What factors are used in making such a determination? Mr. McCallum, we will start with you.

Mr. MCCALLUM. Well, Senator, I think we posed a very broad and general question, and each particular case is, in fact, unique.

I think the best way for me to address that is to indicate the fact that according to the Department of Justice and those who have been involved in this process for many years, there has never been a situation that the Justice Department was dissatisfied with the mitigation issues or the mitigation activities and requirements that were instituted and agreed to. So in each one of the situations that the Department of Justice has had national security concerns, those national security concerns were, in fact, addressed. And the issue, the legal issue of credible evidence is, I guess, less one for the Committee than it is for the President, and the reason I say that is, as Secretary Kimmitt has indicated, the standards that are used within the Committee are whether any particular component or agency that is acting either as a Committee member or is invited to participate in the process asserts that there are unaddressed concerns that they have, we then send it forward.

And the Committee then, at the end of the investigation stage, will make its determination on whether or not it believes that there is credible evidence. And there is ultimately the decision to be placed before the President, and on that Presidential decision, there is no judicial review. So each case will stand on its own unique basis, if you will, given the facts and circumstances.

And I can hypothetically, as a law academic exercise, imagine transactions 10 years ago that would not have implicated national security to the same degree that they do today.

Chairman SHELBY. Secretary Flory, do you have anything to add on that?

Mr. FLORY. Senator Shelby, I do not. I indicate, as I indicated earlier, we are not aware of any cases where our concern, any concerns that we had were not ultimately addressed, whether as a function of a dispute over what constituted credible evidence or anything else.

But described by the Department of Justice, the way the process works here, I think that gives you a good idea. If DoD or Homeland Security or anybody has an issue that they think is a problem, we put that on the table, and that will get the process going, and the matter will be assessed.

Chairman SHELBY. But DoD is part of this process for a real reason, is it not?

Mr. FLORY. Absolutely.

Chairman SHELBY. And Homeland Security, the same way, and of course, Commerce is. All of you are to a point. The Justice Department says that it shares GAO's concern about the time constraints we keep talking about in the review process. It stated, Justice did, that any potential extension of time available to the participants for the collection and analysis of that information would be helpful to Justice. Where is the process in trouble? What period of time is too short for an effective completion of a comprehensive review? Should there be a one 75-day period to complete all of the Committee's business before a vote is taken to refer to the President? Does the Justice Department know of any instance where the Committee asked a corporation to withdraw an application to allow the Committee more time to finish its review?

Mr. MCCALLUM. Well, Your Honor, Senator—lawyer's habit, Your Honor.

Chairman SHELBY. I know.

Mr. MCCALLUM. Senator, I do not know of particular instances, particular cases that I can point to.

Chairman SHELBY. Could you check the record and furnish that information.

Mr. MCCALLUM. I do have general information on that, and in certain circumstances, in a small minority of cases——

Chairman SHELBY. We would like some specific information.

Mr. MCCALLUM. But the confidentiality of the filings before the Committee on Foreign Investments and——

Chairman SHELBY. We are not asking for everything.

Mr. MCCALLUM. I do understand that, but I do think I can respond on a general basis to say that there have been situations in which withdrawals did occur in order to allow both the companies involved in the transaction and the Committee itself additional opportunities to obtain information and to review that information.

So, I return to the ultimate result of all of those is that within the Department of Justice, there is no instance in and of itself or particular case in which the national security concerns were not able to be addressed and addressed adequately in the views of the Department.

Chairman SHELBY. Secretary Kimmitt, dealing with mitigation and how they are monitored, how exactly does that work? Does the Committee on Foreign Investment, send people out into the field to investigate compliance with mitigation agreements? Do any of the other witnesses after him, do you want to comment? Do you send people out in the field, and do you follow up the mitigation stuff? Do you know?

Mr. KIMMITT. Mr. Chairman, this is a response primarily for my colleagues, because the role of the Committee is to ensure that the Committee members are sufficiently satisfied by the mitigation result that the process can either be completed within the 30-day period or in some cases beyond.

But once the mitigation agreement is in place, it is the responsibility of the agency or agencies who negotiated that mitigation agreement with the parties to ensure on an ongoing basis that the party, probably now the united entity, lives up to its responsibilities, and although I will defer to my colleagues, I think they have worked out some arrangements where, for example, in the area of network security agreements, the Department of Homeland Security takes a responsibility on an interagency basis.

But in short answer to your question, the Committee does not have an ongoing responsibility in terms of effective implementation of the arrangements, but if any member of the Committee, as it follows up on it, reports to us a problem in that regard, that is an issue that could come back to the Committee.

Chairman SHELBY. Secretary Flory, do you know of any cases where an acquisition or merger was resolved through mitigation yet resulted in the loss of sensitive technology or know-how?

Mr. FLORY. No, sir, I do not.

Chairman SHELBY. Mr. McCallum, do you?

Mr. MCCALLUM. I do not, Senator.

Chairman SHELBY. Anybody?

Transparency issue. In the Department of Justice's letter to the Government Accountability Office, Justice's position stressed that should any regulations be amended to make the Committee process more transparent to Congress, those changes should not impeded the confidentiality, you refer to that, now afforded companies under the statute.

How exactly would you see that confidentiality being compromised? If it is compromised, Justice opines that it could reduce the number of voluntary applications, and that without corporate confidence in the system, meaningful reviews could not be undertaken. What, then, is the opinion of the Justice Department on the nature of these voluntary applications? Should legislation instead provide for mandatory initial filings?

Mr. MCCALLUM. Your Honor, the Department of Justice would, if there was a proposal, a particular legislative proposal for mandatory filing requirements, we would, of course, like to see the specifics of it and review it.

In general terms, though, although filings are voluntary, the Committee itself does have the power to go into and to effect transactions even if there is not a particular filing. And Secretary Kimmitt has previously indicated that there is contact between the Committee and companies that are involved in transactions in which prior to filing, there are communications, and in fact, there have been, to my understanding, through members of the Department of Justice, situations in which companies were encouraged to file or contacted and notified that the Committee thought filing was appropriate and then did so.

Chairman SHELBY. Because Exon-Florio is based on voluntary notification by the parties to a foreign acquisition, have there been any cases where you have discovered a defense-related foreign acquisition after the transaction closed and where you were concerned that any subsequent Committee on Foreign Investment Review was too late to prevent harm to U.S. national security? And do you think some defense-related foreign acquisitions are perhaps passing under that radar?

Secretary Flory.

Mr. FLORY. Mr. Chairman, I am not aware of any cases of that type. When you are talking about things that are under the radar, I guess by definition, you are talking about things that you do not see. But I am not, I certainly am not aware of any case.

I think that, as a number of witnesses have pointed out, there is a dynamic out there. There is a network out there of people who pay attention to this process and to its requirements and there is also a substantial motivation on the part of corporations——

Chairman SHELBY. But the people that should pay most attention would be your Committee, would it not?

Mr. KIMMITT. Well, and I think most people do, Mr. Chairman. Again, if a person does not avail themselves of the protection that comes to the company by subjecting themselves to our review, they leave themselves open not only to us through the President later unwinding the transaction, but it also seems to me that it would sharpen the focus of the Justice Department using the United States, the Commerce Department, using our export control laws,

any number of authorities available to the Defense Department. I am not saying that people do not do those kinds of things. I think our process is an important part of a broader mosaic of laws and regulations that are set up to make sure that our national security is protected.

Chairman SHELBY. Anybody got any other comment on that?

We thank you, gentlemen, for appearing, and we are going to keep the record open. Some Members, Senator Sarbanes included, have a number of questions for the record.

Thank you very much.

Mr. KIMMITT. Thank you, Mr. Chairman.

Chairman SHELBY. We will next hear from our third and final panel. Today, we have two experts on the history of Exon-Florio and the role of the Committee on Foreign Investment in the United States. Patrick Mulloy is a known face around the Banking Committee, having spent a good part of his life here, including as General Counsel and Chief International Trade Counsel. He has served as Assistant Secretary for Market Access and Compliance in the Department of Commerce's International Trade Administration and currently serves on the United States-China Economic and Security Review Commission.

David Marchick is a partner at the law firm of Covington & Burling, specializing in international trade and investment. He is one of the country's leading authorities on the Committee on Foreign Investment, having served on a variety of Government positions involved in international trade and foreign investment matters, including the Departments of State and Commerce. He has been active since leaving Government in advising U.S. corporations on the Committee on Foreign Investment and its review process. He has also just returned to Washington from a trip to the Caucasus in time to accommodate us here today, and for that, we are grateful.

Gentlemen, your written testimony will be made part of the record in its entirety. We appreciate your indulgence through the hearing of the first panel, second panel today. Mr. Mulloy, we will start with you. Welcome again to the Banking Committee, where you spent many years.

STATEMENT OF PATRICK A. MULLOY

COMMISSIONER, UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Mr. MULLOY. Mr. Chairman, thank you very much.

I commend you and the Committee for holding this important oversight hearing, and I am really honored by the invitation to come here and testify. I take great pride, and it is a source of enormous personal satisfaction to have served in a bipartisan manner on the staff of this Committee from 1983 to 1998.

During the period of 1987 and 1988, when the Exon-Florio provision was being formulated by the Congress, I served as the Committee's General Counsel and was directly involved in the negotiations which led to its enactment. I want to make absolutely clear, Mr. Chairman, I have no clients other than the public interest on this issue, and I have never been paid by any company of any party to advise it on CFIUS matters. I am telling you exactly what my

experience and what I get out of my experience in dealing with this.

The Committee on Foreign Investment in the United States was not established by the law Exon-Florio. That preexisted. It was put in place by an Executive Order in 1975, because a lot of the oil producing countries suddenly had a lot of new money because of the increase in oil prices, and there was a desire to understand more about waves of foreign investment that were starting to come into the country. CFIUS was set up by the President by an Executive Order.

Treasury chaired it. Commerce had a major role in actually tracking the information on what was coming into the country. So the two agencies had a key role. In the 1988 trade bill, this Committee reported major provisions dealing with exchange rates, trade promotion. We did a lot of hearings. Your provision, dealing with Toshiba and export controls, all that was in a bill formulated; we got out of the Committee and it went to the floor.

Exon-Florio was actually developed in the Commerce Committee, but when it was coming through the process, we said foreign investment, that is Banking Committee jurisdiction; we appealed to the parliamentarian. He ruled in our favor. He put us in charge of it. Senator Exon was brought in as a special conferee to work with us in formulating the final compromise.

Now, it should be noted that Treasury was absolutely opposed to Exon-Florio. They led the opposition, and in fact, they even got the President to put it on their veto list. They were going to veto the whole omnibus trade bill developed by all of the Committees in the Congress working over almost a year, and this was one of the provisions they would veto it over.

So then, we were told, work, see if we could come up with a compromise. One of the elements that they wanted out of the bill was the term essential commerce. The second thing they wanted out of the bill was they did not want—originally, it was putting the authority in the Commerce Secretary, who would make a recommendation to the President, and the President could overrule the Commerce Secretary. But they did not want Commerce getting control of this, they wanted to keep control. I think that may have driven part of their opposition. Also, they wanted the open investment climate. I think that was another thing that drove their opposition.

We finally agreed to put the authority solely in the President, and we agreed to take out the term essential commerce. The members of the conference were Senators Sarbanes, Danforth, Exon, Heinz, and Dickson. But we did then say this should then go into the Defense Production Act, because we do not want some little, narrow interpretation of national security, and the conferees put in the statute itself that they wanted the capability and capacity of domestic industries to meet national defense requirements to be considered, and they wanted the capacity of the United States to meet the needs of its national security be considered.

Okay; it goes into the law; the President signs it; and then, I am sure there were some inner workings of how that—they issued a new Executive Order putting the new authority into the hands of the pre-existing CFIUS, chaired by the Treasury Department. So

the Department that was most opposed to this new authority ended up chairing the Committee to implement it.

I think that is part of the problem. In their regulations, which they took 3 years to get out, they were the ones who put in this idea there should only be voluntary notifications, Mr. Chairman, not required; voluntary.

Let me just give you a couple other things that have happened here.

Chairman SHELBY. You take your time.

Mr. MULLOY. In 1992, this Committee held some oversight hearings on how this was being implemented, because there were out there. One of the witnesses we brought in, and it was done by Senators Sarbanes and Mack—Senator Mack was here—there was a worry that a French-controlled government company was going to buy an American defense contractor, LTV, missiles. And the Committee, Senator Mack said we do not want any foreign government to be owning U.S. defense contractors.

The head of Semitech, which was a special consortium set up by the U.S. Government to make sure that a industry-government consortium that we maintained, the semiconductor industry, because it was so essential to our national security, he came in and testified, and he told the Committee, foreign interests have targeted key U.S. technologies, and the present CFIUS law or its implementation is ineffective in presenting this.

He also voiced concern—this was very important—that CFIUS was not considering the cumulative effect of multiple foreign purchases of U.S. companies, and he urged that the chairmanship of CFIUS be moved out of the Treasury Department, into the Commerce Department, where they had people who work on technology. They have a Technology Administration in the Commerce Department. And I urge the staff, you might want to look at pages 70, 73, and 74 for that hearing. There is some really good testimony in that 1992 hearing.

Now, there were a couple of changes that Congress, in 1992, based on those hearings, put into law. First, it put into law a new provision requiring Treasury to move beyond the 30-day period into a full 45-day investigation if it was a government-controlled company that was going to do the purchase; like CNOOC, government-controlled, we would have had to under that provision do it.

Second, it said that there should be a quadrennial study done by the President, using the intelligence community: Does any country have a strategy of buying up U.S. key technologies? And that study was to be done every 4 years.

The Administration, led by the Treasury, did that report once in 1994 and never again. You look at the law; that provision is there. It is just being ignored.

Now, in the first report, they said okay, we do not find any evidence that there is a big strategy out there, but then, they add the absence of credible evidence demonstrating a coordinated strategy should not be viewed as conclusive proof that a coordinated strategy does not exist.

They went on further to say in some cases, foreign governments give indirect assistance and guidance to domestic firms acquiring companies. Also, they give them financial assistance. I urge the

staff to read that 1994 report, pages 13 and 14, pages 31 and 32. They point out specific countries that give subsidies to their companies to come here, buying U.S. key technologies, and I think if it was happening in 1994, it is going to be happening in a much more major way now, because countries like China now have huge amounts of U.S. dollars due to the fact that we have these enormous trade deficits, because Treasury, among other things, is really not enforcing the exchange rate provisions that we put in that 1988 trade bill as well to identify currency manipulators.

Okay; now, the GAO, in its most recent report, says that the mandatory investigation that the Congress put into the law in 1992 is being read out of the statute. How do they do it? They say if you do not, in the first 30 days, find credible evidence that there is inappropriate behavior, then, you do not do the 45-day, even when it is a government-controlled company. So they are essentially reading a mandatory requirement out of the law.

The second thing is that GAO says they have narrowly defined national security to export controlled technologies, classified contracts, or special derogatory intelligence on the foreign company. That is not what Congress intended. If we wanted that kind of thing, we could have put this kind of authority in the Export Administration Act, over which we have jurisdiction. We did not. We put it in the Defense Production Act, because we wanted them to look at the large industrial base issues that are so important to this country's national strength.

I think if you give an honest review of the record, Treasury Department opposed the enactment of the Exon-Florio provision and has sought to stymie its effectiveness ever since it was enacted. I know Mr. Kimmitt. I like Mr. Kimmitt. Mr. Kimmitt is unusual, in fact. Most of these Treasury people come out of the finance community, not the national security community, and they do not have quite the appreciation for technology and the importance of that for an industrial base.

The Chinese do. They even talk about the importance of building the scientific and technological base of that society. It is the highest priority. We on the China Commission, of which I am a member, and I am not testifying for the Commission, but in 2004, in our report, unanimous, bipartisan, every commissioner recommended that the chairmanship of CFIUS be transferred from the Treasury Department to the Commerce Department.

It is the culture. The culture of the Treasury Department does not work in this situation. In 1979, the Congress—you know the group in the Government that deals with dumping cases, dumping, Treasury used to have that authority. They did not implement it. In 1979, Congress took it right out of the Treasury Department and put it in the Commerce Department, because Treasury's psyche, their whole mode, their culture does not want to do these kinds of things.

Mr. Chairman, let me just sum up. There are very few rules on foreign investment. People say we have these WTO rules. On trade, we do have some, a lot. On investment, there are very few WTO rules, so we can do what we want to do.

In the WTO, there is a national security exception. The Schumer-Graham bill is based on that. He bases his bill on the national se-

curity exception. So the Committee can really look at this, and I think it is very important that they do and come up with some changes to the law that will really protect the national security interests.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Mr. Mulloy.

Mr. MULLOY. And thank you.

Chairman SHELBY. Mr. Marchick.

STATEMENT OF DAVID MARCHICK
PARTNER, COVINGTON & BURLING

Mr. MARCHICK. Thank you, Mr. Chairman. Thank you for the opportunity to be here, and I do hope that I hold the record for coming the farthest way for one of your hearings. I was in Azerbaijan yesterday, and I am sitting today, not standing.

Chairman SHELBY. I hope you slept on the plane.

Mr. MARCHICK. I slept on the plane. I also want to compliment you on your opening statement. I thought it highlighted the critical issues and had an appropriate balance, and as a result, I am going to take a big segment out of my statement and put it aside because you said the same thing, including talking about the yogurt example.

I thought I would focus on three issues: First, how CFIUS has operated in recent years; second, some of the ideas that GAO and other Members of Congress have put forth to change CFIUS, and third, some of the ideas that I would like to offer for improvements in the process that you and the CFIUS agencies can consider.

First, trends and application of the Exon-Florio Amendment: since September 11, 2001, the Bush Administration has applied greater scrutiny to transactions, has imposed tougher requirements as a condition for approval, and has enhanced enforcement of security agreements negotiated through the Exon-Florio process.

Now, Senator Inhofe mentioned the fact that the President has only formally blocked one transaction and investigated two dozen out of more than 1,500 reviews. But these statistics, Mr. Chairman, obscure the true impact of Exon-Florio. A large number of investments have been abandoned or substantially modified because of the CFIUS process. In the last 3 years alone, there have been more investigations and more withdrawals than there were during the previous 10 years combined. So scrutiny has increased. I will come back to the withdrawal question in a second.

CFIUS has also imposed tougher terms as a condition for approving transactions. You can just look at the telecommunications industry. Even foreign-owned telecommunications companies that do not hold Government contracts have been required to sign up to many of the same provisions that DoD traditionally uses for foreign-owned companies that have Government contracts that are classified contracts. In other words, CFIUS is starting to use the same mitigation methods to protect critical infrastructure as DoD has long used to protect its supply chain.

Now, on the ideas to amend Exon-Florio, let me offer some thoughts. I am concerned that a number of these changes would have the impact of chilling inward investment, blocking those investments that we do want to come to the United States and simul-

taneously encouraging other governments around the world to erect obstacles to investment abroad, and these obstacles would hurt U.S. companies more than any other country, because we are the largest investor abroad.

A few examples: The term economic security, in my view, that term is extraordinarily vague. It would be extremely hard to implement. And one could imagine that we would get into situations like the French of seeing yogurt as a strategic industry, because the yogurt lobby or some other lobby would say this is in our economic interests.

Chairman SHELBY. That is not my goal.

Mr. MARCHICK. I know it is not, sir, but it may be others'. Again, I compliment you on the balance of your statement.

Second, allowing Congress to override the President's approval of a particular transaction would place Congress in the role of a regulatory agency and create uncertainty for investors. I think it also, as the previous panel mentioned, creates some separation of powers issues and may have problems under the Chadha decision.

On timing, my view is that timelines work. As the representative from Homeland Security suggested, most this are actually prevetted with CFIUS. I would never advise a company just to file on the day that they announce a transaction. You always go through a preconsultation process, so there is a period of time before the 30-day clock starts.

On withdrawals, I think withdrawals are a healthy part of the process. I have been involved in advising a number of clients on withdrawals myself. They have come up for a number of reasons. First, we have been told the transaction is not going to be approved, and if we keep the process going, the President will reject it. Well, companies in that circumstance typically say, well, I will just withdraw rather than force the President to make a decision that would adversely affect our reputation.

Second, we have been told that CFIUS does not have enough time, so we withdraw and refile. And third, we have negotiated an agreement that successfully mitigates a national security concern, and in order to avoid a transaction going to the President, you withdraw and then refile.

I do agree with you, Mr. Chairman, that there can be improved transparency with Congress while at the same time protecting proprietary business information. We all recall the dire predictions of the 1980's about Japanese investing in the United States. These predictions occurred at a time when Japan had huge trade surpluses and a need to invest its significant foreign currency earnings, much like China does today.

Congress reacted to the concerns about growing Japanese investment by adopting Exon-Florio. Looking back, all of our fears about Japan, I think, appear to be misguided. At the same time, Exon-Florio has been a useful tool to ensure that national security is protected in the context of an open investment policy. Now, to ensure that this continues, I hope the Committee refrains from amending the statute and instead works with CFIUS to improve the way that it is implemented.

And let me just throw out very briefly a few ideas, Mr. Chairman. First, I think that the CFIUS can clarify the criteria that

they use in assessing national security issues. Your legislation, frankly, has some good ideas. I would recommend that those be put into regulations or into a statement of policy as opposed to legislation, because national security priorities change.

Second, there has to be greater transparency with Congress, while protecting proprietary information. If CFIUS does not have the confidence of this Committee and the Congress, it is not going to be effective in the way it is implemented, the Exon-Florio statute is implemented.

Third, as the representative from Homeland Security suggested, there are ways that companies and the Committee can improve the advance work before a formal filing.

Fourth, I think that there should be earlier involvement by the White House in resolving differences. Treasury cannot tell another agency what to do. Only the White House can. And earlier involvement by the White House can help resolve differences among agencies and formulate a cohesive——

Chairman SHELBY. How do we work that?

Mr. MARCHICK. Well, right now, for example, in a number of cases that I have had, which are difficult cases—most transactions sail through, frankly. I mean, you think about an auto investment in Alabama, or my daughter's favorite, a Dutch acquisition of Ben and Jerry's, they pose no problems. But for those difficult transactions, you often find differences between Justice, the security agencies, and the economic agencies, and until those differences get raised to a high enough level or until the White House gets involved, you get deadlock, and there is no movement.

So the two ways to improve that are, one, to have higher level involvement, which, frankly, your hearings have inspired, and second, to get the White House involved earlier, even before a formal investigation takes place.

We know which transactions are going to be difficult before we file them, and the agencies know. Earlier involvement, higher level involvement can avoid problems in the future and improve implementation.

Let me just close by saying two things: First, Mr. Mulloy said that he does not have any clients, and these are his own opinions. I do have clients. These are my own opinions. My clients' views are all over the map. I hope after today, I still have some clients, but I want to assure you that these are my views. And second, I just want to compliment you and your staff on the leadership you have shown, because these hearings have brought focus to the process and will improve the process just by having the hearing themself.

Chairman SHELBY. Thank you so much, Mr. Marchick.

One of the central questions at issue in the GAO report concerns the disparate approaches different agencies bring to the concept of what we call national security. It should not surprise anybody that the Office of the U.S. Trade Representative or the Department of the Treasury should bring a different perception onto the issue than the Department of Defense or Department of Homeland Security. Mr. Mulloy, you alluded to that a few minutes ago.

Mr. MULLOY. Yes.

Chairman SHELBY. Taking into account that the Committee operates under a consensus arrangement—their Committee, not this

Committee—operates under a consensus arrangement, have these differences adversely affected the ability of the Committee on Foreign Investment to carry out its mission of protecting national security?

Mr. Mulloy.

Mr. MULLOY. Here is what I see, Mr. Chairman. I have been in the executive branch. I have been in the State Department and the Justice Department, and I was a political appointee in the Commerce Department.

These agencies have cultures and interests that they represent in these processes. The problem in the export control area, we have was built in, timeframes, and you can get things up to the President. The problem with this process, as I see it, we have a credible evidence test that the President has to meet before he blocks a transaction.

They are using that test to knock out most of these transactions in the first 30 days, so we never even get to the formal investigation, because they say that you have to have credible evidence. And the way that I understand it, the Treasury, which staffs the Committee, that they are the ones that push for using that as the approach.

They have kind of knocked out this whole provision that in a government acquisition, and I do not think that things get elevated. I think that things, up until this point, and I think Mr. Marchick even referred to it, these have been handled by people who have no political legitimacy. They are not appointed and confirmed by the Congress. These things are getting knocked out at a lower level. And the authority that the Congress put in for the President is being handled by people who do not have political legitimacy.

Chairman SHELBY. There have been proposals to place the concept of what we call economic security under the realm of the issues for which a Committee on Foreign Investment review would be mandated or encouraged. Could you comment on the ramifications, Mr. Marchick, for U.S. economic competitiveness and economic growth of having transactions reviewed for concerns broader than even the broadest definitions of national security? That is not my proposal, as you know.

Mr. MARCHICK. No, I understand, Mr. Chairman, and with your permission I would like to respond to your previous question and offer some thoughts in contrast to Pat's, to Mr. Mulloy's.

As I mentioned, I think it would be very hard to implement a criteria that focuses on economic security. It is very hard to define. But a national security criterion which has and should be broadly used, broadly defined by CFIUS, can encompass those industries and those technologies that are so important for the United States' vitality and for our economic security that they do affect national security.

For example, one could think of right now with the avian flu or with other threats to our national security technologies or intellectual property that are so important that they need to be retained in the United States, that they do affect and do implicate our national security. And I think that the law as drafted now does reach those issues and should reach those issues, but broadening it to economic security, I know that is not your proposal, would just in-

vite domestic industries that do not want additional competition——

Chairman SHELBY. Well, we would have chaos in the international market.

Mr. MARCHICK. I am sorry, say it again.

Chairman SHELBY. We would have chaos out there, would we not?

Mr. MARCHICK. We would, sir. We would. I mean, if you look, right now, the French, the Russians, and Canada are all coming up with their own——

Chairman SHELBY. We would be worried about the yogurt syndrome, would we not?

Mr. MARCHICK. That is right, sir.

Chairman SHELBY. And that is something—we are not interested in that.

Mr. MARCHICK. That is right, as much as I like yogurt.

Chairman SHELBY. Absolutely.

Mr. MULLOY. Mr. Chairman.

Chairman SHELBY. Yes, sir.

Mr. MULLOY. Can I just comment briefly?

Chairman SHELBY. Go ahead.

Mr. MULLOY. In 1992, the Congress did one other change in the law. They added a provision under the factors they wanted looked at the potential impact on U.S. technological leadership in areas affecting national security.

I personally agree with what Mr. Kimmitt said. The term national security can, if you encompass what Congress tells should be included under that, I think you get essentially national economic security, because Congress has told them in the law itself, in the conference itself, the term national security is intended to be interpreted broadly, without limitation to particular industries.

I think you can take care of this problem. I just think it is the culture of the lead agency, and I think it is one other thing: The way they require agencies to really act on these things in 30 days, because they do not want to get into the 45-day. And so what happens, these agencies are enormous places. You get the notice; you farm it out; people cannot even get their views together and get them up saying I got a problem here, because the time has passed by the time the guys who really understand these things get them up to the decision makers.

I think you have a real problem with that 30-day thing in which most of these things are falling out of the process.

Mr. MARCHICK. Can I respond to that?

Chairman SHELBY. Go ahead, Mr. Marchick.

Mr. MARCHICK. Let me just respond to a few statements that Mr. Mulloy offered just to ffer a different perspective. And Pat and I have worked together for years. I have enormous respect for him. We do have a slight disagreement on some of these issues, which we have debated.

First, CFIUS is driven by consensus, but the agencies with the greatest power in a consensus-driven process are the agencies that object because of a particular national security concern that a particular agency has. And so, any agency can force a transaction to go to an investigation or be on the 30-day process. And so, there

is great deference to those agencies that do have national security concerns in order to find a way to address those concerns.

Second, I do want to take exception to one statement that Pat made about the people involved in this process do not have political legitimacy. The people who run the CFIUS process are professionals in each of their fields. At Treasury, they may be economists or lawyers. In other agencies, they are defense experts, for example, and these are exceptionally competent people. And in recent years, the Department of Justice, the Department of Homeland Security, for example, has brought in new people with new expertise, former prosecutors, intelligence officials, people with extraordinary levels of experience who are frankly tough as nails, and my partners and I have the scars to show for it because of some of the difficult negotiations we have gone through.

I do think that, as Pat said, the process would benefit from higher level involvement and higher level focus.

Chairman SHELBY. Of course, this is still a voluntary process. Should it remain a voluntary process? What happens in the case of companies that manufacture items that are on the commodity control list? Are they automatically covered under other statutes so that foreign takeover bids receive the proper scrutiny in the event that the Committee on Foreign Investments fails to discover a pending or completed transaction?

How are such cases currently handled, and is the withdrawal option abused or exploited for purposes that are not in the national security interests of this country?

And let me ask Mr. Mulloy that first. Do you want to comment?

Mr. MULLOY. No, you take it, please, and then, I will comment.

Mr. MARCHICK. I think the voluntary nature of the process is very important and should be retained, because as you said in your opening statement, 99 percent of investments do not affect national security at all.

Chairman SHELBY. But some do, and they are very important.

Mr. MARCHICK. Some do, and they should be filed, and CFIUS should be very aggressive in making sure that any transaction that might implicate national security should be filed.

A lot of the transactions, for example, other agencies have existing authority to regulate those; for example, an acquisition of a defense company that may not get a lot of press or may fall under the radar, DoD can control that company already through its existing regulations and through deciding not to award contracts to them. Similarly, the State Department, the Commerce Department, and the other agencies that are part of the export control regime have authority to ensure that there is not an illegal or inappropriate transfer of export control technologies.

On the withdrawal issue, I do not think it has been abused. I am not part of the CFIUS process, but I will tell you that no responsible counsel will ever advise their clients to withdraw and not refile if they are going to close that transaction.

Chairman SHELBY. Pat, do you have any comment?

Mr. MULLOY. Here is my point, Mr. Chairman, and I see Senator Sarbanes here. Thank you for being here, Senator. The gentleman from Semitech who came in in 1992—Semitech, again, was a joint government-industry consortium set up to maintain the semicon-

ductor industry in this country, because it was so important—he said this: Our foreign competitors are picking off our technology jewels one by one.

We did a hearing out in Palo Alto on the China Commission in April to look at high tech, what is going on? What you find out is we have a lot of young, entrepreneurial companies building very important new discoveries. They need financing, and the foreign investors can find it for them, and they maintain pretty good surveillance on what these technologies—that is why we wanted that report, the Congress wanted that report done every 4 years.

You cannot look at this one transaction at a time, as the Administration wants to do. The importance of that quadrennial report was to get a pattern and look at who is buying what in what industries in this country. And if you look at that report, even though it was done in 1994 and only once, they have very good charts showing which countries are after which industries in this country.

And so, I think this idea of the voluntary requirement, you may be missing a lot of stuff, because if you are a smaller company, maybe you do not even know about these requirements.

Chairman SHELBY. A lot of things slip by.

Mr. MULLOY. How many foreign takeovers have there been since 1988? I think there have been 1,570 filed. I would expect there are at least four or five times that many that have not been filed.

Chairman SHELBY. Senator Sarbanes, I know you have been tied up.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. I know, and I have been in another hearing, and I know we have a vote on, Mr. Chairman. But I just wanted to come to, one, thank you for holding this hearing. I think it is very important. I commend you for the oversight you are exercising. I know you have had three very good panels this morning, and I particularly wanted to thank our old friend and staff member, Pat Mulloy, for this excellent review of the history of the emergence of Exon-Florio, yes. We appreciate it very much.

Chairman SHELBY. Thank you, Senator Sarbanes.

We have to make a vote. Our time is up. Thank you.

Mr. MULLOY. Thank you for having me, Mr. Chairman.

Chairman SHELBY. The hearing is adjourned.

[Whereupon, at 12:27 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional mterial supplied for the record follow:]

PREPARED STATEMENT OF JAMES INHOFE

A U.S. SENATOR FROM THE STATE OF OKLAHOMA

OCTOBER 20, 2005

The current CFIUS process for reviewing foreign acquisitions leaves our Nation vulnerable to foreign threats. In our modern day global economy threats to our national security assume many different forms. CFIUS has not accounted for this dynamic.

My attention to the CFIUS process began last April when I delivered four speeches on China. My concern was with the growing threat China is posing to our military, economic, and energy security. While examining this issue I came across a disturbing example of China buying a United States company, Magnequench, and moving it piecemeal back to mainland China. Let me read from the floor speech I gave on April 4, 2005.

> I believe that CFIUS does not have a broad enough conception of U.S. security. I understand that Representatives Hyde, Hunter, and Manzullo expressed similar views in a January letter to Treasury Secretary John Snow, the Chairman of CFIUS. One example of CFIUS falling short is with Magnequench International Incorporated. In 1995, Chinese corporations bought GM's Magnequench, a supplier of rare earth metals used in the guidance systems of smart-bombs. Over 12 years, the company has been moved piecemeal to mainland China, leaving the United States with no domestic supplier of neodymium, a critical component of rare-earth magnets. CFIUS approved this transfer.

The United States now has no domestic supplier of rare earth metals, which are essential for precision-guided munitions. I would say that is a clear national security concern.

More recently, I was concerned with China's state-owned CNOOC attempted to buyout Unocal, a United States oil company. This demonstrates the kind of foreign acquisition that requires a deep examination in terms of national energy security.

I also testified before the United States-China Commission on July 21, 2005, explaining my concerns with the CFIUS process. At the time I had introduced an amendment to the Defense Authorization Bill that would have made some of the necessary changes. With that bill stalled, I chose to introduce the changes as a stand-alone bill (S. 1797) which has been referred to this Committee.

Over the past months, I have been pointing out that the CFIUS process has ignored some major issues which threaten our national security. The Government Accountability Office has recently issued a report on CFIUS that is right in line with this (September 28, 2005).

Non-Traditional Security Concerns

One of the biggest problems that I have been trying to draw attention to is the inadequate definition of "national security." CFIUS, under the leadership of Treasury, has chosen to define national security in the most limited of terms.

> The GAO report details how, " . . . they have limited the definition to export-controlled technologies or items and classified contacts, or specific derogatory intelligence on the foreign company."
>
> I am aware of at least one instance where the Departments of Defense and Homeland Security believed national security was at risk, but were overruled because the threat did not meet this narrow definition set forth by Treasury. The language I have proposed in the bill *requires* CFIUS to investigate transactions of national security concern, *including* economic and energy security.

Length of Review Period

The length of the review period is also of concern. Presently, there are only 30 days allotted for CFIUS to determine if an acquisition needs to enter the 45-day investigation process. Now some say that this is sufficient because if the investigating agencies need more time, CFIUS has the company withdraw and refile. Besides being intellectually dishonest, this method shows how interrupted and inconsistent the process is. I believe we need to extend the review process to a maximum of 60 days.

The Justice Department, a member agency of CFIUS, agrees with this, stating, "gathering timely and fully vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment. Any potential extension of time available to the participants for the collection of that information would be helpful."

Withdrawn Acquisitions

CFIUS has received over 1,520 notifications and investigated only 24. Of those, only one acquisition has been stopped by the President.

Now some say this extremely low number is because there are many opportunities for companies to alter the nature of their acquisition. They are more right than they realize. CFIUS is less a strict procedure and more a porous and open-ended process by which companies can enter and leave whenever they feel the transaction may be threatened. This is the reason for the low number of investigations and single prohibition.

Worse, there has been no enforcement or tracking of these companies once they withdraw. I know of one example, cited in the GAO report, where a company was allowed to withdraw from the review process. After 4 years, that company still has not refilled despite security concerns raised by some CFIUS agencies. They are, for all intents, free to continue with the acquisition without any review.

Congressional Oversight

I believe Congressional oversight is an effective tool to fix this problem. The bill I introduced requires:

Unclassified quarterly submissions of acquisitions that have occurred over a 90 period with a classified section that includes dissenting views.

The findings of the review process to be reported to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.

A layover period of 10 days after a transaction is allowed to proceed, during which time a resolution of disapproval can be introduced in Congress.

The power for a Chairman or ranking member of an oversight committee (Banking/Finance) to initiate a review.

Conclusion

The current CFIUS process is more than "opaque." It is clearly broken. And it is up to us in Congress to fix it. I look forward to what this hearing will reveal and hope we have the courage to act on what we learn.

A vital part of understanding this issue is a comprehensive analysis of transactions that have occurred. I have two questions along this line that I request be submitted to the witnesses that they can answer for the record.

Thank you for your time.

PREPARED STATEMENT OF ROBERT M. KIMMITT

DEPUTY SECRETARY, U.S. DEPARTMENT OF THE TREASURY

OCTOBER 20, 2005

Chairman Shelby, Ranking Member Sarbanes, and distinguished Members of the Senate Committee on Banking, Housing, and Urban Affairs, I appreciate the opportunity to appear before you today to discuss the Committee on Foreign Investment in the United States (CFIUS), and how CFIUS conducts national security reviews of foreign acquisitions of companies as required under the Exon-Florio Amendment. I am here speaking on behalf of the Administration, the Treasury Department, and the Committee on Foreign Investment in the United States (CFIUS).

National Security

I wholeheartedly agree with your recent comments that national security cannot take a second place to purely economic considerations. Throughout my years of Government service, starting with combat duty in Vietnam 35 years ago and including over 8 years with the National Security Council staff, I have built a career premised on the belief that protecting and advancing the national security is a Government official's highest priority. Let me assure you that my colleagues and I fully appreciate the national security concerns voiced by the Members of this Committee and Congress.

This is a demanding time for our Nation as we seek to provide for the security of our country. Indeed, no responsibility of Government is more important than protecting the national security, which is also a prerequisite for advancing economic prosperity. In our view, these missions—protecting national security and advancing economic prosperity—are inherently linked.

Safeguarding our national security depends on protecting defense-related information, maintaining our technological edge, protecting the defense industrial base, and securing our critical infrastructures, such as the U.S. telecommunications network

and related communications systems. We believe that the Exon-Florio Amendment is sufficiently flexible to provide CFIUS and the President the necessary tools to protect these national security assets. CFIUS brings together twelve agencies with diverse expertise and equities to ensure that transactions are considered from a variety of perspectives so that all national security issues are identified and considered in the review of a foreign acquisition. To provide just a few examples, CFIUS assesses whether the foreign investment under review might threaten the national security by harming the Nation's communications systems, fostering cyber-crime, or violating the privacy of users of the U.S. communications systems, and seeks to ensure the protection of sensitive U.S. information and technology relating to national defense and critical infrastructure.

Member agencies bring particular expertise essential to the assessment of the potential national security implications of specific foreign investments in the United States. This expertise includes knowledge of the level of technological sophistication of the transaction participants, the market position of alternate suppliers, the financial and product service track record, and the future outlook for transaction participants. This expertise gives CFIUS the broad perspective needed for a comprehensive assessment of the national defense, competitive performance, trade and investment policy, and commercial issues involved in each transaction. It also enables CFIUS to ensure that the national security is safeguarded in a manner consistent with longstanding U.S. policy regarding foreign investment in the United States. In addition, since certain member agencies administer U.S. export control programs for both dual use and military/defense items, CFIUS is able to evaluate the compliance record of the foreign acquirer and can offer guidance to ensure that any relevant export control issues are taken into account when the foreign acquisition is completed.

Economic Prosperity

In my view, the concept of national security includes both traditional foreign policy and defense criteria and economic considerations. Indeed, I believe there is an inherent link between our national security and a strong U.S. economy that facilitates free and fair trade, market-based exchange rates, and the free flow of capital across borders. We are mindful of the positive benefits of foreign investment to our country and therefore seek to maintain the traditional U.S. open investment policy.

Indeed, we cannot protect the national security without a strong economy, and foreign investment strengthens the U.S. economy. Foreign companies bring in new technology, managerial expertise, and capital. Foreign companies buy some U.S. companies that would otherwise go out of business or move overseas. Foreign investment enables the United States to import new ways of doing business that revive our industries and increase productivity. Foreign investment in the United States keeps jobs and technology in the United States.

A strong world economy enhances our national security by advancing prosperity and economic freedom in the rest of the world. Economic growth supported by free trade and free markets creates new jobs and higher incomes, spurs economic and legal reform, promotes democratic political systems, and helps lift large numbers of people out of poverty.

The international economy performs best when large economies embrace free trade, the free flow of capital, and flexible currencies. Obstacles in any of these areas prevent smooth adjustments to changes in international conditions. At best, such obstacles result in less than maximum growth; at worst, they create distortions and increase risks.

In the recent past, the United States has placed considerable emphasis on promoting global free trade and investment, multilaterally through its support for the resumption of negotiations in the Doha Round and regionally and bilaterally through the negotiation of Free Trade Agreements, including most recently CAFTA, and bilateral investment treaties. In addition, the United States has urged countries, including China, to adopt more flexible currency policies. However, we also need to promote policies that encourage the global free flow of capital. Too many countries maintain barriers that keep needed foreign portfolio and direct investment out while preventing domestic capital from seeking better returns in overseas financial markets.

If the United States maintains its openness to foreign direct investment, we have the credibility internationally to promote similar investment regimes in other countries. Open investment regimes based on the free flow of capital are crucial to the U.S. economy both because of the benefits provided domestically, including job creation, and because of the reciprocal opportunities such policies in other countries provide for U.S. firms seeking to invest abroad.

Investment Policy

U.S. policy toward foreign investment in the United States provides the context in which Exon-Florio is implemented. U.S. investment policy welcomes foreign direct investment and provides national treatment—treating foreign companies like we would treat U.S. companies. In return, the United States seeks to promote reciprocity in similarly open investment regimes in other nations around the world.

When capital is free to flow in response to market demand, it is channeled into its most efficient use. When the United States makes the best use of capital, as determined by the market, we achieve greater productivity and enhanced international competitiveness. This has direct benefits for our economy, and indirect but clear benefits for our national security.

To illustrate the benefits of foreign direct investment, last year foreign investors invested over $115 billion in U.S. companies in the United States. Further, according to data from the Department of Commerce's Bureau of Economic Analysis, in 2003 foreign firms operating in the United States:

- Employed 5.3 million Americans, 4.7 percent of employment in nonbank private industries;
- Had payrolls of $318 billion, an average of $60,527 per employee, 31 percent higher than the average of all companies;
- Accounted for 5.8 percent of U.S. gross domestic product originating in private industries compared to 4.3 percent a decade ago (an increase of more than 30 percent);
- Accounted for over 20 percent of all U.S. exports; and
- Spent $30 billion on research and development.

I have discussed foreign direct investment, but portfolio investment is another key engine of economic growth. The free flow of capital is one reason for the strong performance of the U.S. economy, and it is gratifying to see that countries around the world increasingly recognize the benefits to be gained from liberalized capital accounts. Openness to capital inflows creates avenues for foreign investors to contribute to economic development. At the same time, it decreases the cost of capital to local entrepreneurs, especially in the small- to medium-sized enterprise sector.

Exon-Florio

Our open investment policy has always recognized the need to protect the national security, a need that is internationally recognized as a defensible exception to an open investment regime. The United States has numerous laws and regulations that provide this critical protection.

CFIUS was established in 1975 by Executive Order of the President with the Secretary of the Treasury as its chair. Its main responsibility was "monitoring the impact of foreign investment in the United States and coordinating the implementation of United States policy on such investment." It analyzed foreign investment trends and developments in the United States and provided guidance to the President on significant transactions. However, it had no authority to take action with regard to specific foreign investments.

The Omnibus Trade and Competitiveness Act of 1988 added Section 721 to the Defense Production Act of 1950 to provide authority to the President to suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. company that the President determines threatens to impair the national security of the United States. Section 721 is widely known as the Exon-Florio Amendment, after its original Congressional cosponsors.

Specifically, the Exon-Florio Amendment authorizes the President, or his designee, to investigate foreign acquisitions of U.S. companies to determine their effects on the national security. It also authorizes the President to take such action as he deems appropriate to prohibit or suspend such an acquisition if he finds that:

(1) There is credible evidence that leads him to believe that the foreign investor might take action that threatens to impair the national security; and
(2) Existing laws, other than the International Emergency Economic Powers Act (IEEPA) and the Exon-Florio Amendment itself, do not in his judgment provide adequate and appropriate authority to protect the national security.

The President may direct the Attorney General to seek appropriate judicial relief to enforce Exon-Florio, including divestment. The President's findings are not subject to judicial review.

Following the enactment of the Exon-Florio Amendment, the President delegated to CFIUS the responsibility to receive notices from companies engaged in transactions that are subject to Exon-Florio, to conduct reviews to identify the effects of such transactions on the national security, and, if necessary, to undertake investiga-

tions. However, the President retained the authority to suspend or prohibit a transaction.

The Secretary of the Treasury is the Chair of CFIUS, and the Treasury's Office of International Investment serves as the Staff Chair of CFIUS. Treasury receives notices of transactions, serves as the contact point for the private sector, establishes a calendar for review of each transaction, and coordinates the interagency process. The other CFIUS member agencies are the Departments of State, Defense, Justice, and Commerce, OMB, CEA, USTR, OSTP, the NSC, the NEC, and the newest member, the Department of Homeland Security.

The CFIUS process is governed by Treasury regulations that were first issued in 1991 (31 CFR part 800). Under these regulations, parties to a proposed or completed acquisition, merger, or takeover of a U.S. company by a foreign entity may file a voluntary written notice with CFIUS through Treasury. Alternatively, a CFIUS member agency may on its own submit notice of a transaction. The CFIUS process starts upon receipt by Treasury of a complete, written notice. Treasury determines whether a filing is in fact complete, thereby triggering the start of the 30-day clock, and CFIUS may reject notices that do not comply with the notice requirements under the regulations. Treasury sends the notice to all CFIUS member agencies and to other agencies that might have an interest in a particular transaction, for example, the Departments of Energy and Transportation, or the Nuclear Regulatory Commission. CFIUS then begins a thorough review of the notified transaction to determine its effect on national security. In some cases, this review prompts CFIUS to undertake an "investigation," which must begin no later than 30 days after receipt of a notice. The Amendment requires CFIUS to complete any investigation and provide a recommendation to the President within 45 days of the investigation's inception. The President in turn has up to 15 days to make a decision, for a total of up to 90 days for the entire process.

CFIUS Implementation

Exon-Florio notices are voluntary. Many acquisitions by foreign investors do not implicate the national security, and parties to those transactions choose not to notify. However, companies know that failure to notify leaves their transaction subject to Presidential action indefinitely, and there is no statute of limitations. Companies also know that any CFIUS member may notify a transaction to the Committee.

During the initial 30-day review, each CFIUS member agency conducts its own internal analysis of the national security implications of the notified transaction. As part of the review, agencies with particular areas of competence, such as export controls, protection of classified information or critical infrastructure, examine whether existing laws other than International Emergency Economic Powers Act (IEEPA) are adequate and appropriate to protect the national security with respect to the transaction. The U.S. Intelligence Community provides input to CFIUS reviews. For instance, the Intelligence Community Acquisition Risk Center (CARC) now under the office of the Director of National Intelligence may be called on by CFIUS to provide intelligence support to CFIUS' review process, including threat assessments on the foreign acquirer. Further, the Department of Energy and the Department of Transportation have actively participated in the consideration of transactions that impact the industries under their respective jurisdictions. CFIUS agencies, through the Treasury Staff Chair, can seek clarifications of and supplements to the information provided in the notice by submitting additional questions to the parties to the transaction. In some cases, the parties are asked to meet with CFIUS agency staff.

If within the initial 30-day period CFIUS determines that there are no national security concerns, or any national security concerns have been mitigated, thereby obviating an investigation, Treasury, on behalf of CFIUS, writes to the parties notifying them of that determination. This concludes consideration of the acquisition for Exon-Florio purposes. However, when the Committee believes that unresolved national security issues remain at the end of the 30-day period, CFIUS conducts an investigation that ends with a report and recommendation to the President.

Depending on the facts of a particular case, CFIUS agencies that have identified specific risks that a transaction could pose to the national security may, separately or through CFIUS auspices, develop appropriate mitigation mechanisms to address those risks when existing laws and regulations alone are not adequate or appropriate to protect the national security. Agreements implementing mitigation measures vary in scope and purpose, and are negotiated on a case-by-case basis to address the particular concerns raised by an individual transaction. Publicly available examples of the general types of agreements that have been negotiated include: Special Security Agreements, which provide security protection for classified or other sensitive contracts; Board Resolutions, which, for instance, require a U.S. company to certify that the foreign investor will not have access to particular informa-

tion or influence over particular contracts; Proxy Agreements, which isolate the foreign acquirer from any control or influence over the U.S. company; and Network Security Agreements (NSA's), which are used in telecommunications cases and are imposed in the context of the Federal Communications Commission's (FCC) licensing process.

These examples in no way represent an exhaustive list of the kinds of agreements or mitigation measures that have been negotiated by CFIUS agencies. Moreover, because the facts of and issues raised by each transaction are unique, additional or varied mitigation measures will undoubtedly be required to resolve agencies' national security concerns in future transactions. In such cases, once an agreement to implement the mitigation measures is executed by the parties to the agreement and all CFIUS members are satisfied that the national security issues have been adequately addressed. CFIUS concludes its review. When mitigation measures are agreed to during an investigation, companies may request a withdrawal and refile. CFIUS then concludes its review.

As noted, publicly available NSA's provide some insights into the kinds of concerns that arise in the telecommunications sector. Also, in recent years, CFIUS has taken a close look at transactions involving technologies for either military/defense or dual use applications. For foreign acquisitions in this sector, CFIUS has analyzed the acquiring and acquired firms' records on compliance with U.S. export controls and the potential for unauthorized diversion of these technologies. In addition, in the post-September 11 environment, factors in the review have expanded to include terrorism-related issues. Finally, while CFIUS was always mindful of the potential national security impact of foreign acquisitions of U.S. companies in critical infrastructure, especially in the telecommunications sector, the addition of Homeland Security to the Committee's membership has led to an even closer focus on infrastructure vulnerabilities as they relate to foreign acquisitions under review.

When CFIUS completes a full 45-day investigation, it must provide a report to the President stating its recommendation. If CFIUS is unable to reach a unanimous recommendation after the investigation period, the Secretary of the Treasury, as Chairman, must submit a CFIUS report to the President setting forth the differing views and presenting the issues for decision. The President then has 15 days to announce his decision on the case and inform Congress of his determination.

The Exon-Florio Amendment requires that information furnished to any CFIUS agency by the parties to a transaction shall be held confidential and not made public, except in the case of an administrative or judicial action or proceeding. This confidentiality provision does not apply to Congress. Treasury, as chair of CFIUS, upon request of Congressional committees or subcommittees with jurisdiction over Exon-Florio matters, has arranged Congressional briefings on transactions for which CFIUS has completed a review. These briefings are conducted in closed sessions and, when appropriate, at a classified level. CFIUS members with equities in the transaction under discussion have also been invited to participate in these briefings.

Since the enactment of Exon-Florio in 1988, CFIUS has reviewed over 1,570 foreign acquisitions of companies for potential national security concerns. In most of these reviews, CFIUS agencies have either identified no specific risks to national security or risks have been addressed during the review period. However, 25 cases in total have gone to investigation, 12 of which reached the President's desk for decision. In 11 of those, the President took no action, leaving the parties to the proposed acquisitions free to proceed. In one case, the President ordered the foreign acquirer to divest all its interest in the U.S. company. In another case that did not go to the President, the foreign acquirer undertook a voluntary divestiture. Of the 25 investigations, 6 were undertaken since 2001 with one going to the President for decision. However, these statistics do not reflect the instances where CFIUS agencies implemented mitigation measures that obviated an investigation or where, in response to dialogue with CFIUS agencies, parties to a transaction either voluntarily restructured the transaction to address national security concerns or withdrew from the transaction altogether.

An important aspect of the Exon-Florio process is the requirement that governmental action be concluded within specified time limits. Those limits—for instance, the initial 30-day review period—necessitate that the Government act efficiently to assess all factors relating to the case. At the same time, the short timeframe does not significantly hold up transactions, which should be driven by the market and can be time-sensitive.

Improving CFIUS

Two weeks ago, this Committee heard from the GAO regarding its recent report, "Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness." I appreciate the time and resources that the

GAO dedicated to this report, and, although I do not agree with all of the assertions in the report, I do recognize a need to review current CFIUS policies and operating procedures, especially those mentioned in the GAO recommendations. The new senior CFIUS team represented at this hearing is involved in an effort to improve the CFIUS process, drawing on comments from Members of Congress, the recommendations of the GAO, and the recommendations I have received from the member agencies of CFIUS.

- First, I believe that CFIUS requires high-level attention from Treasury and the other members. You have my commitment that I will work hard to bring that high level of attention going forward. The departmental representation at today's hearing is an important indication of our common commitment in this regard.
- Second, when meeting at the deputies level, I will chair CFIUS while the Under Secretary of Treasury for International Affairs or his designee will represent the Treasury Department during consideration of a particular transaction. I think that this change will enable me to manage the process to ensure that all viewpoints are identified and given the same equal, careful consideration.
- Third, we are looking carefully at ways to allow more time to assemble the information needed to develop agency positions during the CFIUS process.
- Last, I support the idea of enhancing the transparency of the CFIUS process through more effective communication with Congress, while recognizing our shared responsibility to avoid the disclosure of proprietary information that could undermine a transaction or be used for competitive purposes. I am open to suggestions on ways to improve the transparency of the process, such as more regular reports to Congress and Congressional briefings.

Conclusion

We are in a time of both challenge and opportunity for our national security interests. Through an improved CFIUS process, we will continue to protect our national security in the context of an open investment policy that recognizes the critical link between national security and economic prosperity.

Thank you for the opportunity to appear before you today.

PREPARED STATEMENT OF DAVID A. SAMPSON

DEPUTY SECRETARY, U.S. DEPARTMENT OF COMMERCE

OCTOBER 20, 2005

On behalf of Secretary Gutierrez, I would like to thank the Committee for giving me the opportunity to appear before you today. As you know, the Department of Commerce is a member of the Committee on Foreign Investment in the United States (CFIUS), which was established in 1975 and was delegated authority by the President in 1988 to review and, as appropriate, investigate foreign acquisitions under the Exon-Florio Amendment to the Defense Production Act of 1950.[1] My testimony will describe the participation by the Commerce Department's International Trade Administration (ITA) and Bureau of Industry and Security (BIS) in CFIUS's Exon-Florio reviews of proposed mergers, takeovers, and acquisitions of U.S. firms by foreign parties.

ITA's Role

ITA was established in 1980 to carry out the international trade and investment-related functions of the Secretary of Commerce. In this capacity, ITA promotes trade and export expansion pursuant to Reorganization Plan 3 of 1979, and promotes and develops the foreign and domestic commerce of the United States pursuant to the Secretary's organic authority found in Title 15, United States Code.[2] Commerce participation in CFIUS and other international investment fora is led and coordinated by ITA. ITA has industry expertise essential to the assessment of the potential national security implications of specific foreign investments in the United States. This expertise includes knowledge of the level of technological sophistication of the trans-

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[1] *See* 50 U.S.C. app. § 2170. CFIUS's activities are pursuant to Executive Order 11858, 40 Fed. Reg. 20263 (May 7, 1975), as amended by Executive Order 12188, 45 Fed. Reg. 989 (Jan. 2, 1980), Executive Order 12661 of December 27, 1988, 54. Fed. Reg. 779 (Jan. 9, 1989), Executive Order 12869 of September 30, 1993, 58 Fed. Reg. 51751 (Oct. 4, 1993), and Executive Order 13286 of February 28, 2003, 68 Fed. Reg. 10619 (Mar. 5, 2003). The Treasury Department regulations implementing Exon-Florio are at 31 CFR Part 800 (Office of International Investment Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons).

[2] See, *for example,* 15 U.S.C. § 1512.

action participants, the market position of alternate suppliers, the financial and product service track record, and the future outlook for transaction participants. This expertise gives ITA the broad perspective needed for a comprehensive assessment of the national defense, competitive performance, trade and investment policy and commercial issues involved in each transaction, and for ensuring that the national security is fully safeguarded in a manner consistent with longstanding U.S. policy regarding foreign investment in the United States.

Within Commerce, CFIUS reviews are carried out by members of the Department of Commerce Exon-Florio Working Group. ITA chairs the group and coordinates the Department responses to the CFIUS. Members include representatives from ITA and BIS, the Technology Administration, the Economic and Statistics Administration, the National Telecommunications and Information Administration, and the Office of the General Counsel.

As provided in Treasury's regulations implementing CFIUS' delegated authority under Exon-Florio, Commerce, as a CFIUS member, may also notify CFIUS about any transactions with perceived national security implications that have not been notified by the parties to the transaction, with a request for review and subsequent action by CFIUS. ITA has a formalized process of identifying such transactions, and asks Working Group members to identify and report any potential acquisitions by foreign companies that may be of interest to CFIUS, especially those transactions that involve smaller and/or privately held U.S. firms that may not have been reported widely in the media.

BIS's Role

The Bureau of Industry and Security (BIS) supports ITA in the development of the Commerce Department position on proposed foreign acquisitions and takeovers. The overall mission of BIS is to advance U.S. national security, foreign policy, and economic security interests. While BIS is best known for developing export controls for dual use items, issuing export licenses and enforcing export controls, BIS also conducts programs designed to ensure a strong, technologically superior U.S. defense industrial base. For example, BIS administers the Defense Priorities and Allocations System program that provides for expedited shipment of critical materials and services from the U.S. industrial base to meet urgent national security needs. BIS has been very active in using this authority to support the Department of Defense in Operation Enduring Freedom and Operation Iraqi Freedom.

With respect to the CFIUS process, BIS assesses the national security, defense industrial base, and export control implications of all proposed acquisitions of U.S. companies by foreign entities that have been notified to CFIUS. In so doing, BIS seeks to ensure that the U.S. defense industrial and technology base will not be compromised by such foreign acquisitions.

In reviewing each proposed acquisition, BIS reviews internal databases to determine whether the parties to the acquisition have violated U.S. export control laws. BIS also checks its CFIUS database for previous acquisitions by the foreign company and other acquisitions in the industry. In addition, BIS assesses whether there is significant sensitive technology being acquired, and evaluates the foreign company's plans for managing its compliance with U.S. export control laws.

In order to address potential industrial base concerns, BIS works with the Department of Defense to determine the importance of the firm that is being acquired to the Nation's defense manufacturing and technology infrastructure. BIS also works with the Departments of Justice and Homeland Security, and with the intelligence community, to investigate potential problems with the acquiring firm and the possible damage to national security and homeland security that might occur as a result of foreign access to key firms in the United States. For example, if the acquiring company was in the telecommunications industry, BIS would work with Department of Homeland Security and other agencies to resolve concerns about the safety of the Nation's communications infrastructure.

In addition, BIS compares companies involved in filings with CFIUS against a series of lists of individuals, companies, and organizations that may have acted in ways that jeopardize, or have the potential to jeopardize, U.S. national security. BIS reviews classified and unclassified lists including the Bureau's Entity List, our Unverified List, our Denied Persons List, and the Treasury Department's Specially Designated Nationals and Blocked Persons List. In sum, BIS's review of CFIUS transactions focuses on the national security impact that such proposed acquisitions may have on the release of sensitive technologies and on the defense industrial base.

Mr. Chairman, the expertise that the various Commerce agencies bring to the CFIUS process is unique and important to the success of CFIUS reviews. Thank you for asking me to appear before you today, and I would be happy to answer any questions you may have at this time.

PREPARED STATEMENT OF STEWART BAKER

ASSISTANT SECRETARY FOR POLICY
U.S. DEPARTMENT OF HOMELAND SECURITY

OCTOBER 20, 2005

Mr. Chairman, Ranking Member Sarbanes, and distinguished Members of the Committee. Thank you for the opportunity to speak briefly today on the Department of Homeland Security's role as a member of the Committee on Foreign Investment in the United States.

The Department of Homeland Security is the newest member of CFIUS. We became a member in March 2003, soon after standing up as an amalgam of 22 diverse agencies whose common mission is the protection and security of our Nation and people. Since that time, we have participated in the review of more than 125 foreign acquisitions or investments involving some of the Nation's most critical infrastructure assets and components as well as technology companies vital to the defense technology base.

I mention our origins in order to stress what I believe is a key strength of the Department—we bring to CFIUS a diversity of viewpoints, expertise, and skills. The Government agencies from which we were formed give DHS a broad perspective, informed by an understanding of infrastructure threats, vulnerabilities, and consequences.

You have already heard some of my colleagues speak about achieving a balance between the desire for free and open markets and our responsibility to provide for the Nation's security in the post-September 11 environment. DHS is well-aware of the importance of free and open markets; it must maintain a close partnership with private industry in addressing critical infrastructure protection. Although our mission and expertise lead us to focus primarily on the security issues, we can never ignore the important role that foreign investment plays in our economy and, ultimately, in our national security. Indeed, we consider our CFIUS colleagues whose missions and expertise are traditionally in the economic arena to be crucial allies in the endeavor to protect and secure our Nation, and we welcome the vigorous debates that sometimes arise as opportunities to better assess and articulate the risks that these transactions may represent.

Early Warning Program and Information Sharing

To that end, we have established a program that enables us to identify transactions of potential concern well before they are formally filed with CFIUS, and we both produce and share with our colleagues on the Committee detailed summaries and assessments to inform our discussions.

Soon after joining the Committee, DHS developed a rigorous in-house process of formal reviews for individual CFIUS filings and began producing detailed assessments for each filing, bringing to bear the full scope of unclassified and classified resources available. During this process, DHS studies any consequences, vulnerabilities, and threats that may be present and makes a determination on the total risk to national security. If the risk is at an unacceptable level, DHS, together with other interested CFIUS parties, will develop tailored risk mitigation measures that are often memorialized in formal agreements.

In the past 2 years, DHS, along with DOD, DOJ, and the other CFIUS agencies, has made great efforts to share as much information as possible. We believe that bringing together each agency's unique resources spanning law enforcement, national intelligence, and open source information produces the best quality analysis. As part of this effort, DHS implemented an early warning program soon after joining the Committee. The purpose of this program is to identify those foreign investments in U.S. critical infrastructure and industrial base technology companies that may result in CFIUS filings or may pose a national security risk. We share this information with Treasury and our other partners. In many cases, prior to any CFIUS filing, we reach out to the companies involved in these transactions to ask for technical and financial briefings. We believe that this early outreach helps all parties concerned. CFIUS members get more information earlier, while the private parties have an early opportunity to explain the transaction and to allay national security concerns.

In fact, we find that sophisticated companies and experienced counsel increasingly do not wait for our outreach. Instead, they often approach DHS or other CFIUS members to offer briefings and discuss Government interests before they file. This provides more information to the Government and greater certainty to the companies involved. It sometimes allows us to agree on more effective risk management and mitigation, without the strict timelines that Exon-Florio imposes. This is par-

ticularly important for large, complex transactions, and we are pleased that counsel in such transactions also see the benefits of early consultation.

Compliance Monitoring

DHS has made another contribution to the CFIUS process—systematic, predictable enforcement. When we enter into an agreement, we expect all sides to carry it out as written. To ensure compliance, DHS takes a disciplined approach to monitoring risk mitigation agreements that it enters into. DHS analyzes each agreement to which it is a signatory and extracts the timetables, policies, and deliverables that must be tracked to determine the companies' current compliance status. DHS uses both passive and active compliance verification strategies to ensure that foreign companies continue to abide by the terms of their agreement. In sum, we believe that the Department is providing an effective, credible, and capable program to deter or promptly resolve actions that a foreign company might take to endanger the national security.

Closing Statement

In closing, I would like to observe that the occasionally differing views among the agencies within CFIUS are not signs that the process is broken. Rather, they are signs that the process is working. The best way to get to the truth is a healthy debate. CFIUS is a diverse group of executive agencies. The balance between an open investment policy and protecting national security is a delicate one, and each CFIUS case deserves to be thoroughly analyzed from all angles in order to get the best overall, comprehensive determination. Spirited discussions mean that the right people are talking to each other, and they are more likely to produce the right result.

Thank you again for the opportunity to address this important issue. I look forward to your questions.

PREPARED STATEMENT OF E. ANTHONY WAYNE

ASSISTANT SECRETARY, ECONOMIC AND BUSINESS AFFAIRS
U.S. DEPARTMENT OF STATE

OCTOBER 20, 2005

Chairman Shelby, Ranking Member Sarbanes, and distinguished Members of the Committee, thank you for the opportunity to discuss the Committee on Foreign Investment in the United States (CFIUS), the role of the Department of State in reviewing the acquisition of U.S. companies by foreign investors.

Mr. Chairman, part of the Mission Statement of the Department of State says "Create a more secure, democratic, and prosperous world for the benefit of the American people and the international community." An important part of our effort to create a secure and prosperous world is the Department's role in implementing the Exon-Florio statute, and it is an effort we take extremely seriously.

We bring to the CFIUS process expertise and experience in international economic issues as well as national and international security policy. We consider them to be mutually reinforcing elements of our work. Security and prosperity are interdependent and where one is lacking, the other will be undermined in time.

I believe our internal processes at the Department of State ensure that each and every CFIUS case receives careful scrutiny by offices responsible for both economic, foreign, and national security policy. The Bureau of Economic and Business Affairs, the Bureau of Political-Military Affairs, the Bureau of International Security and Nonproliferation, the Bureau of Diplomatic Security, the Bureau of Intelligence and Research, the Office of the Legal Adviser, and the appropriate regional bureau participate in the review of notifications received by CFIUS and forwarded to us by the Department of the Treasury as CFIUS chair. Other experts are also brought in, as needed.

The State Department brings to the CFIUS process background and insight into the political and economic context abroad in which particular foreign investors operate and the aims and motivations of governments around the world. This expertise is gained through the hard work of our Embassy personnel, from the Department of State's statutory responsibilities on defense trade and nonproliferation, and by our roles in terrorist financing and counter-terrorism policy.

This work extends far beyond CFIUS. The Arms Export Control Act (AECA) and its implementing regulations, and the International Traffic in Arms Regulations (ITAR) give the State Department independent authority to regulate the export of defense articles and services and provides for civil and criminal penalties, whether a U.S. company is foreign-owned or not, when provisions of the AECA and ITAR

are violated. Pursuant to these authorities, the State Department manages a registration system of all manufacturers, exporters, and brokers of defense articles and services, and tracks foreign ownership as part of this process.

As Deputy Secretary Kimmitt has noted in his testimony, Congress, in crafting Exon-Florio, provided that the extraordinary authority to prohibit foreign ownership or control in a particular transaction should be used only when there is credible evidence that those acquiring ownership or control might pose a threat to national security and when it is judged that other existing U.S. legal authority is inadequate to address the potential threat.

All CFIUS members share the goal of assuring that no transaction reviewed by CFIUS leads to a compromise of national security. Although the confidentiality requirements of Exon-Florio and other factors prevent me from going into cases in an open hearing, I can assure you that the process has enabled the U.S. Government to take appropriate action to address potential threats when they have arisen.

Preserving both economic security and prosperity in a post-September 11 world is a complex challenge, but it is critical to America's future. The belief that an open investment policy is essential to our economic prosperity is long-standing and dates to the founding of the Republic. It is a policy principle borne out by the facts. U.S. openness to foreign investment has helped make the United States the world's most successful economy, which in turn provides the wealth and technology needed to support the world's most powerful and best-equipped military that ensures our security.

Therefore, we have welcomed and continue to welcome foreign investment, and indeed, most State governments in the United States spend considerable time and effort to attract it. Many have been very successful in doing so, and I congratulate you, Mr. Chairman, because Alabama has been a real success story in attracting high quality foreign investment. Just like people in Alabama, we understand that foreign investment brings quality jobs that pay relatively high wages.

The free flow of capital also makes the rest of the world economically stronger, and creates overseas opportunities for U.S. investors. This is not only sound economic policy, but also our international obligation in many cases. We have enshrined the principle of providing foreign companies operating in the United States the same treatment U.S. companies receive in investment treaties and trade agreements signed with many foreign countries.

Our openness, and the benefits it has produced for us, has been very effective in encouraging others to emulate us, and open their own markets to our investors. Together with our colleagues at USTR, Treasury, and Commerce, the State Department negotiates investment agreements that seek to remove discriminatory investment barriers in other markets, and contain strong protections for American investors and their investments.

In this regard, our open investment policy is an important asset, giving us greater credibility when we seek to open other markets. At the same time, this open investment policy must be implemented in a manner that reinforces our security interests.

In conclusion, Mr. Chairman, the Department of State believes Exon-Florio and its implementation by CFIUS have strengthened our national security, while avoiding unnecessary and detrimental restrictions on our open investment policy.

Mr. Chairman, the President and Secretary Rice have entrusted all of us at the Department of State with making sure we do everything possible to protect the national security of the United States and the American people, and to promote the kind of global economic policies, including open investment climates, that will maximize U.S. prosperity. I want to assure you that we take this mission seriously and personally.

Thank you for the opportunity to appear before you today. I would be pleased to answer your questions.

PREPARED STATEMENT OF PETER C.W. FLORY

ASSISTANT SECRETARY, INTERNATIONAL SECURITY POLICY

U.S. DEPARTMENT OF DEFENSE

OCTOBER 20, 2005

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the impact of Section 721 of the Defense Production Act (50 U.S.C. App. § 2170 and also known as the Exon-Florio Amendment) on national security. We in the Department of Defense (DoD) take very seriously our role in protecting technology, the defense indus-

trial base, and the security of those critical infrastructures we depend upon to accomplish our mission. Foreign investment in the United States generally is desirable. In terms of the defense sector, foreign investment has been helpful in maintaining the viability and diversity of the defense industry.

When it comes to reviewing a foreign acquisition of a U.S. company, there are a number of factors which we in the DoD consider before taking a position. These include five major areas of interest:

First, the significance of the technologies possessed by the firm to be acquired (for example, are they "state of the art" or otherwise militarily critical? Are they classified, export controlled, or otherwise security sensitive?);

Second, the importance of the firm to the U.S. defense industrial base (for example, is it a sole-source supplier and if so, what security and financial costs would be incurred in finding and/or qualifying a new supplier, if required?);

Third, possible security risks or concerns that might be posed by the particular foreign acquiring firm (for example, is it controlled by a foreign government? Does the firm have a record of export control violations?);

Fourth, whether the company to be acquired is part of the critical infrastructures that the Defense Department depends upon to accomplish its mission; and

Fifth, can any potential national security concerns posed by the transaction be eliminated by the application of risk mitigation measures either under the Department's own regulations or through negotiation with the parties?

DoD Participants and their Roles in CFIUS

Within the Department of Defense, there are a variety of DoD offices and agencies involved in the CFIUS review of each case. The Defense Technology Security Administration (DTSA) plays an important role as our representative to the Committee on Foreign Investment in the United States (CFIUS). DTSA is responsible for the management, coordination, and formulation of the Department's position for all CFIUS cases. DTSA is also the focal point within the Department for technology security policy as regulated by the Export Administration Regulation, International Traffic in Arms Regulation and the National Disclosure Policy. The Office of the Under Secretary, Acquisition, Technology, and Logistics (USD/AT&L), determines if the U.S. company involved in a CFIUS case provides a product or service that is a critical technology. That office also evaluates the transaction's impact on the defense industrial base, including whether the firm is a sole-source provider, and what the costs would be if we were required to find a new supplier.

The Office of the Assistant Secretary of Defense for Networks Information and Integration (ASD/NII), with input from subject matter experts such as the National Security Agency and the Defense Information Systems Agency, performs vital technical reviews of filings that involve critical information and telecommunications infrastructures. In its CFIUS review of cases involving defense contractors performing classified work, the Office of the Under Secretary for Intelligence assesses whether the Defense Industrial Security Regulations are adequate to mitigate potential national security concerns of foreign control of U.S. defense contractors. The National Industrial Security Program is a separate, but parallel process to the CFIUS review that protects classified information in U.S.-located firms owned/acquired by foreign companies.

The three military services (Army, Navy, and Air Force) identify and assess the impact of the transfer of technology relevant to the particular military service, especially when cases involve current or former defense contractors. Specifically, the services review cases to determine if commodities or technologies involved in a given transaction may affect warfighters' capabilities and technological advantages. The Defense Logistics Agency assesses the effect of the transaction on defense procurement and planning. The Defense Advanced Research Projects Agency evaluates the technology to be transferred, its relationship to defense programs, and its potential impact on future defense capabilities. The Defense Intelligence Agency prepares intelligence assessments and analyzes the risk of diversion. The Office of General Counsel provides positions on legal issues, including adequacy of other laws to protect national security, and other legal assistance.

Changing Nature of DoD Suppliers

I would now like to address an issue that is gaining increasing importance for DoD, that is, the growing role of nontraditional, commercial, and dual-use suppliers to the Department. As part of defense transformation, the Department is focusing on real-time communication between those systems and personnel responsible for finding enemy targets and those systems and personnel responsible for destroying or incapacitating those targets. This goes under the name of network-centric warfare or sensor-shooter integration, and is essential to the Department's trans-

formational efforts. This transformation increasingly involves the use of technologies from commercial markets in such fields as information technology, telecommunications, and electronics, among others. Many of the suppliers are at the component and subsystem level and may not even have classified contracts.

Mitigation Measures and Security Agreements

Mitigation agreements, negotiated in conjunction with a CFIUS review, vary in scope and purpose, and are negotiated on a case-by-case basis to address the particular concerns raised by an individual transaction.

When we find potential national security concerns with a foreign acquisition, we normally use the risk mitigation measures available to us under the National Industry Security Program's Foreign Ownership, Control, and Influence Program (FOCI). The DoD imposes special mitigation/negation measures for companies that are cleared for access to classified information when they are acquired by a foreign source. These security agreements specify procedures to ensure protection of classified and export-controlled information. The Department's Defense Security Service enters into negotiations with the parties of such cases and develops specifically tailored agreements, which are designed to provide for the necessary level of security for such classified, export-controlled information and technologies.

The Department and other agencies occasionally negotiate risk mitigation measures for acquisitions where there are no classified contracts. As previously addressed, this is becoming more common as we increasingly rely on dual use and primarily commercial suppliers. As we review foreign acquisitions when FOCI does not apply, we have to enter a negotiation process with the parties to the transaction to develop appropriately tailored risk mitigation measures.

In the telecommunications sector, conditions have been imposed in the context of the Federal Communications Commission's (FCC) licensing process. Transactions involving the foreign acquisition of a U.S. telecommunications company usually are subject to regulation by the FCC, which is an independent regulatory agency. The FCC has, in some cases, agreed to place conditions on the transfer of licenses to a foreign company subject to compliance with the Network Security Agreement that CFIUS member agencies have negotiated with that company before the transaction is finalized. The Network Security Agreement includes actions the commercial parties agree to undertake (during the initial review or during the investigatory period) in order to mitigate the national security risk. CFIUS members, in turn, agree to not object to the transaction if the companies have implemented the negotiated mitigation measures.

Conclusion

Mr. Chairman that concludes my formal statement. I would be happy to answer any further questions you may have regarding this subject.

PREPARED STATEMENT OF ROBERT D. McCALLUM, JR.

ACTING DEPUTY ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE

OCTOBER 20, 2005

Introduction

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, I appreciate the opportunity to discuss the Department of Justice's role in implementing the Exon-Florio Amendment to Section 721 of the Defense Production Act of 1950 (Exon-Florio). The Department of Justice has worked vigilantly within CFIUS to implement Exon-Florio effectively to protect national security. The effective implementation of Exon-Florio is critically important to the Department's national security mission and is a responsibility we take very seriously.

Implementation of Exon-Florio Implicates Key Elements of the Department of Justice's National Security Mission

To fulfill its mission to defend the interests of the United States, ensure public safety, and prevent crime, the Department of Justice has set goals to strengthen its counterintelligence capabilities, with a focus on protecting sensitive United States information and technology relating to national defense and critical infrastructure, and to protect the Nation's communications systems by preventing and combating cybercrime and protecting the privacy of U.S. communications. Currently, the Federal Bureau of Investigation's (FBI) second and third highest priorities are to protect against foreign intelligence operations and espionage and to protect against cyber-based attacks and high-technology crimes. The Department must ensure that

it has the necessary tools and resources to accomplish its mission and meet these goals, and nothing is more important in our arsenal than the ability to conduct lawful electronic surveillance without risking interference by foreign entities and the premature, unauthorized disclosure to targets of the surveillance.

Acquisitions by foreign persons of U.S. businesses can have the potential to implicate these key areas of national security concern to the Department, particularly: counterintelligence, U.S. communications system protection, privacy protection, and the ability to conduct effective electronic surveillance. The Office of the National Counterintelligence Executive has reported in its *Annual Report to Congress on Foreign Economic Collection and Industrial Espionage* that in 2004 persons or entities from nearly 100 foreign countries made attempts to acquire sensitive U.S. information or technology, such as information systems, sensors, aeronautics, electronics, and armaments materials. One method used for this collection was foreign direct investment in U.S. businesses. There has also been a rise in foreign acquisitions of U.S. companies in the telecommunications sector, which directly implicates the Department's protection of the U.S. communications infrastructure, privacy interests, and law enforcement's electronic surveillance capabilities. The risks presented by these acquisitions vary according to the particular communications assets at issue and their interconnection with other portions of our critical infrastructure. However, certain foreign control over certain U.S. infrastructure components, absent mitigation measures, could augment the opportunities for foreign entities to disrupt U.S. communications, deny Internet or voice services to significant portions of the country, and compromise the privacy of users of the U.S. communications system.

The Department of Justice is using all of its traditional techniques and resources to combat these risks; however, Exon-Florio is an important national security tool when no other statutory authority exists, apart from the International Emergency Economic Powers Act, that is adequate to protect national security. Through its involvement in the CFIUS process, the Department has carefully examined potential threats to national security posed by specific foreign acquisitions of U.S. businesses, and where appropriate, we have developed measures to mitigate those risks. Along with other interested member agencies of CFIUS, the Department of Justice has negotiated numerous security agreements to mitigate potential threats to national security caused by those transactions.

These security agreements are typically the result of negotiations between the companies involved in the transaction and those CFIUS member agencies whose national security equities are implicated. In addition to the Department of Justice, the Departments of Homeland Security and Defense often are parties to these agreements. The agreements vary in scope and purpose, depending on the facts of a particular transaction, and are negotiated on a case-by-case basis to meet the particular national security risks at issue. For transactions that involve the communications sector, these agreements are often negotiated in conjunction with executive branch review of applications submitted to the Federal Communications Commission. Along with the Department of Homeland Security, the Department of Justice plays a key role in monitoring and enforcing the security agreements to which it is a party.

The Department of Justice has been Vigilant to Ensure Effective Implementation of Exon-Florio

Effective implementation of Exon-Florio is critical to the mission and goals of the Department of Justice. Therefore, the Department has brought together its diverse resources to address the complex issues raised by the variety of transactions coming before CFIUS. The Department's Criminal Division has primary responsibility at a policy level for CFIUS matters and closely coordinates the involvement of various departmental components in the process. These components include: The FBI, which both coordinates with the intelligence community and provides operational and analytical support in the areas of counterintelligence, critical infrastructure protection, privacy protection, and electronic surveillance; the Computer Crime and Intellectual Property Section, which provides expertise related to the U.S. communications system, cybercrime, and privacy protection; the Office of Enforcement Operations and the Narcotic and Dangerous Drug Section, both of which provide expertise related to electronic surveillance issues; and the Counterespionage Section, which provides legal guidance on counterintelligence issues. The Office of Intelligence Policy and Review assists with intelligence community coordination, and the Counterterrorism Section assists with reviewing transactions that may implicate terrorism concerns. In addition, the Antitrust Division has provided support and input in appropriate cases, and the Office of the Chief Information Officer has provided assistance on occasion. By bringing all of these diverse resources and this extensive expertise to bear, the Department of Justice has maximized its ability to participate in the effective implementation of Exon-Florio.

Conclusion

In conclusion, I again would like to thank you, Mr. Chairman, and the Committee for your interest in ensuring that Exon-Florio is used as effectively as possible and for giving me the opportunity to explain the Department of Justice's role with respect to this important national security safeguard. The Department of Justice is keenly aware of the significance of its responsibilities under Exon-Florio, and we have worked extremely hard to meet those responsibilities with the utmost vigilance, diligence, and professionalism. This Nation's security and the safety of our citizens are always the highest priority for the Department of Justice. Thank you, and I am happy to answer any questions you may have.

PREPARED STATEMENT OF PATRICK A. MULLOY

COMMISSIONER, UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

OCTOBER 20, 2005

Introduction

Mr. Chairman, Senator Sarbanes, and Members of the Committee, thank you for providing me with this opportunity to speak before you today on this crucial issue.

My name is Patrick Mulloy and I have been a member of the twelve member bipartisan, bicameral United States-China Economic and Security Review Commission since it was established by the Congress in the year 2000. The Commission's charge from the Congress is, among other things, to examine the "national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." I also teach International Trade Law and Public International Law as an Adjunct Professor at the Law Schools of Catholic University and George Mason University.

I commend the Banking Committee for holding this important oversight hearing and I am honored by the invitation to testify. I take great pride and it is a source of enormous personal satisfaction to have served in a bipartisan manner on the staff of this Committee from 1983–1998. During the period of 1987–1988, when the Exon-Florio Provision was being considered by the Congress, I served as the Committee's General Counsel and was directly involved in the negotiations which led to its enactment. Chairman Shelby, Ranking Member Sarbanes, and Senator Dodd are the only Members of this Committee today who were involved in crafting the Omnibus Trade and Competitiveness Act of 1988—in which the Exon-Florio Provision was included as Section 5021.

I was invited today to give the Committee my understanding of the background which led to the enactment of Section 5021 of Public Law—418 which was codified in Title VII of the Defense Production Act of 1950 (50 U.S.C. App 2158).

I should note that, while a member of the United States-China Economic and Security Review Commission, I am not testifying on its behalf and the views I present will be my own. I will, however, set forth the two recommendations the Commission adopted unanimously in its 2004 Report on the Exon-Florio/CFIUS matter which is the subject of today's hearing.

CFIUS Established in 1975

The Committee on Foreign Investment in the United States (CFIUS) was not established by the Exon-Florio Provision in the Omnibus Trade Bill of 1988. The CFIUS, rather, was established some years earlier in 1975 by President Ford in Executive Order 11858 issued on May 7, 1975. That order, which created CFIUS and made the Secretary of the Treasury its Chairman, charged the Committee to "have the primary 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 in such investment."

While the Treasury Secretary was given the Chairmanship of CFIUS, the Executive Order also gave the Department of Commerce a key role, charging it to, among other things, submit "appropriate reports, analyses, data, and recommendations relating to foreign investment in the United States, including recommendations as to how information on foreign investment can be kept current."

My own recollection is that in 1975, there were concerns about the fact that, because of the establishment of OPEC and the spike in oil prices in the 1972–1975 period, many oil producing countries suddenly had substantial amounts of money to buy assets in this country and CFIUS was established to help monitor such acquisitions. I had occasion, when I served as an attorney in the Antitrust Division

of the Justice Department, to attend some meetings of CFIUS in the 1981–1982 period. One matter in particular I remember is when the Kuwait Petroleum Company wanted to buy the Santa Fe International Company. This raised concerns within the executive branch because apparently Santa Fe had some technologies that U.S. authorities did not want transferred in such a merger. Since the President then lacked the authority given to him by the Exon-Florio Provision in 1988, the Antitrust Division was asked to hold up the merger on antitrust grounds. This was done and I believe an acceptable solution was negotiated by which the Santa Fe Company sold off to a third party some technologies which our Government did not want transferred to the Kuwait Petroleum Company.

Enactment of the Exon-Florio Provision

In 1987, the leadership of the Congress, troubled by our Nation's rising trade deficit, decided to craft an Omnibus Trade Bill and charged each relevant Committee in the House and Senate to craft different portions of such a bill. Senator Proxmire, then Chairman of the Banking Committee, asked the International Finance Subcommittee, led by Senators Sarbanes and Heinz, to develop the Banking Committee portions of such a bill. Chairman Proxmire asked me as his General Counsel to work closely on the process and to keep him informed of developments. I thus worked closely with Senator Sarbanes and was personally involved in the development of all facets of the Banking Committee's contributions to the Omnibus Bill.

The Banking Committee on May 19, 1987 marked up and ordered to be reported S. 1409, the United States Trade Enhancement Act of 1987, which dealt with export controls, trade promotion, exchange rates, third world debt, the Foreign Corrupt Practices Act and better access for U.S. financial institutions to foreign markets. The Committee Report stated:

> The cumulative trade deficits of over $500 billion, built up by the United States since 1982, have made this country the world's largest debtor Nation and underscore the need of our economy to compete internationally.

The bill reported by the Banking Committee did not have any provision giving the President the authority to block certain takeovers of U.S. companies by foreign purchasers. The so-called Exon-Florio Provision, which contained that authority, appeared in the bills reported by the Commerce Committee in the Senate, on which Senator Exon served, and the Energy and Commerce Committee in the House, where Congressman Florio served. After the Senate Commerce Committee reported the provision, the Banking Committee appealed to the Parliamentarian that the investment matters covered by its provisions were properly within Banking Committee jurisdiction. The Parliamentarian ruled in favor of the Banking Committee and thus the Banking Committee took the lead on the provision. It worked very closely with Senator Exon and his staff in doing so.

The various portions of the Omnibus Trade Bill, reported by each Senate Committee, were merged into one bill, each Title of which was considered sequentially on the Senate floor during the summer of 1987. The House followed a similar procedure and in fact passed its bill H.R. 3 first. This was because the trade bill was considered a revenue measure on which the House had to act first. The Senate at the conclusion of its work took up H.R. 3, substituted the text of the Senate bill and asked for a conference with the House. Senate conferees, appointed to deal with the Exon-Florio Provision were Senators Sarbanes, Dixon, and Heinz of the Banking Committee, along with Senators Exon and Danforth of the Commerce Committee.

Section 905 of the House bill provided that the Secretary of Commerce should "determine the effects on national security, essential commerce, and economic welfare of mergers, acquisitions, joint ventures, licensing, and takeovers by or with foreign companies which involve U.S. companies engaged in interstate commerce." It also charged the Secretary of Commerce (not the Treasury Secretary) to determine whether such takeovers would "threaten to impair national security and essential commerce." If such a determination were made by the Secretary of Commerce the President would block the transaction, unless the President determined there was no threat to "national security and essential Commerce." The Senate provision was quite similar and said the criteria to block a takeover was "national security or essential commerce that relates to national security."

The Department of the Treasury, then headed by Secretary Baker, led the executive branch opposition to enactment of the Exon-Florio merger review authority. Some contend it was both protection of its jurisdiction over investment policy and championing an open investment policy that led to Treasury's opposition. At any rate, the Administration put the item on its "veto list" and threatened to veto the whole Omnibus Trade bill if the provision stayed in the bill. At that point, I was directly involved in negotiations with Treasury officials as to how to make the provi-

sion acceptable to the Administration. I advised the Senators for whom I worked what I had seen regarding the Kuwait Petroleum Company/Santa Fe merger and said it was my belief that the President needed the authority given to him by the Exon-Florio Provision. Our Senators charged us in our staff negotiations to keep the provision but to try to get an agreement acceptable to the Administration.

The Treasury was adamant that the term "essential commerce" had to come out of the bill because it was not clear what that entailed. Conferees agreed to delete those words but added language to the statute and the Conference Report that they did not want the term "national security" to be narrowly interpreted. To make this absolutely clear the statute itself was revised to read:

> The President or the President's designee may, taking into account the requirements of national security, consider among other factors:
>
> (1) domestic production needed for projected national defense requirements;
> (2) the capability and capacity of domestic industries to meet national defense requirements, including the availability of human resources, products, technology, materials, and other supplies and services; and
> (3) the control of domestic industries and commercial activities by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security.

They also decided to put the provision into law under Title VII of the Defense Production Act. This was done to indicate that the Exon-Florio Provision should be interpreted as dealing with the broad industrial base issues addressed by that statute not the more narrow national security controls dealt with in export control matters. The Conference Report on the provision states:

> The standard of review in the section is "national security." The Conferees recognize that the term "national security" is not a defined term in the Defense Production Act. The term "national security" is intended to be interpreted broadly without limitation to particular industries.

On August 23, 1988, the Exon-Florio Provision, as modified in the Conference, became law as Title VII of the Defense Production Act.

Treasury Charged to Lead New Merger-Review Authority

On December 27, 1988, President Reagan issued Executive Order 12661. That order amended Executive Order 11858 which established the Committee on Foreign Investment in the United States and effectively put the President's new authority to review and block mergers for national security reasons into the hands of the Treasury-chaired CFIUS. So the Executive Department that most strongly opposed the blocking authority ended up chairing the Committee charged to implement its provisions. I think that has led to the concerns in Congress and elsewhere about the provision not being implemented as Congress intended.

Because it now had the lead for implementing the statute, the Treasury Department also took the lead in the notice and comment rulemaking that developed the regulations under which it would be administered. It took the Treasury Department almost 3 years until November 21, 1991 to promulgate the final regulations. (56 F.R. 58774–01 (1991)). Those regulations, not the Exon-Florio Provision, established the voluntary system of merger notification that has been criticized as inadequate by many.

1992 Oversight Hearing by Banking Committee

On June 4, 1992, the Senate Banking Committee's Subcommittee on International Finance and Monetary Policy, under the leadership of its Chairman, Senator Sarbanes and Ranking member Mack, held an oversight hearing on the implementation of the Exon-Florio Provision. In opening that hearing Senator Sarbanes stated:

> Of particular interest this morning are the criteria for review of Exon-Florio cases that have been developed by the Interagency Committee on Foreign Investment in the United States, which has been charged by the President with responsibility for implementing the statutory provision.

In his opening statement Senator Mack, who also served on the Armed Services Committee, stated:

> My interest this morning is to better understand how the Administration determines the U.S. national security interest through the CFIUS process.

He then referred to a matter, which was, then, of public concern, that is the acquisition of the Missile Division of the LTV Aerospace and Defense Company by Thomson-CSF, a French firm controlled by the French Government. He then stated, "We don't want any foreign government to own major U.S. defense contractors.

Senator Riegle, the Chairman of the full Banking Committee, in his opening statement said:

> The Administration examines takeovers on an isolated basis and is missing the cumulative impact such takeovers are having on our technology base. The President's science adviser, Dr. Alan Bromley, has voiced concerns about this matter. He warned policymakers that "our technology base can be nibbled from under us through a coherent plan of purchasing entrepreneurial companies."

The Assistant Secretary of the Treasury for International Affairs, Olin Wethington in his testimony told the Committee:

> After almost 4 years of experience in implementing the so-called Exon-Florio Provision we believe the statute is achieving its national security objectives, and that it has done so without compromising our open investment policy.

Mr. Peter Mills, the first Chief Administrative Officer of SEMATECH, also testified at that June 1992 hearing. SEMATECH was a joint DoD/Industry consortium which was established in the 1980's to ensure our Nation maintained the ability to make advanced semiconductor products deemed essential to our national defense needs. In that hearing, Mr. Mills voiced his concerns and frustration about the failure of CFIUS to prevent foreign interests from buying U.S. semiconductor equipment and materials suppliers. He told the Committee:

> . . . foreign interests have targeted key U.S. technologies and the present CFIUS law *or* its implementation is ineffective in preventing these transactions.

He also voiced concerns that CFIUS was not considering the cumulative effect of multiple foreign purchases of U.S. companies and urged that the Chairmanship of CFIUS be moved from the Treasury Department to the Commerce Department.

Subsequent to that hearing the Congress in 1992 enacted two key changes to Section 721 of the Defense Production Act. First, it put into the law a new provision *requiring* CFIUS to move beyond the 30-day review period and do a 45-day investigation in any instance in which an entity controlled by or acting on behalf of a foreign government is making the acquisition of a U.S. entity. It also put in a provision *requiring* the President and such agencies as the President designates to do a report in 1993 and each 4 years thereafter as to whether any foreign government has a coordinated strategy to acquire U.S. companies involved in research development or production of critical technologies. It also added additional criteria to the statute that it wanted considered during reviews of foreign takeovers.

The Treasury Department Has Failed To Implement Congressional Mandates

In 1994, the Administration submitted to the Congress its first and only report under the required quadrennial report statutory provision of the DPA. The Report stated on page 13:

> Despite examples of government involvement, the working groups did not find credible evidence demonstrating a coordinated strategy on the part of foreign governments to acquire U.S. companies with critical technologies. *The absence of credible evidence demonstrating a coordinated strategy, nevertheless, should not be viewed as conclusive proof that a coordinated strategy does not exist.*

The Report then went on to say:

> *In some cases, however, foreign governments give indirect assistance and guidance to domestic firms acquiring U.S. companies.* The main methods of government involvement include:
>
> • extending tax credits to promote foreign M&A activity;
> • exercising controlling government interest in major firms to influence foreign M&A activity, and
> • identifying technologies that are critical to national economic development, and thus prime targets for acquisition through M&A's.

After this one report the Treasury Department, which is charged by Executive Order to implement the requirements of Section 721 of the DPA in which the quadrennial report mandate is placed, has ignored this requirement of law, and no more reports on this most important matter have been prepared and given to the Congress as required by law. This means neither the CFIUS nor the Congress has the background information Congress wanted both of them to have in looking at patterns in takeovers or considering their cumulative effect.

The GAO in its most recent report on the implementation of Exon-Florio, submitted to this Committee in September 2005, notes that the statutorily required 45-day investigation of foreign government purchases of U.S. firms has been stymied

by the Treasury's insistence that any such investigations can be conducted only if, during the 30-day initial review, there is "credible evidence" that the foreign controlling interest may take action to threaten our national security (page 3). This means the Treasury has effectively read the 45-day mandated investigation of foreign government acquisitions of U.S. companies right out of the statute.

In addition, GAO on page 3 of its September 2005 Report to this Committee points out that the Treasury Department as Chair of CFIUS has "narrowly defined what constitutes a threat to national security." The GAO tells us "they have limited the definition to export controlled technologies or items, classified contracts, or specific derogatory intelligence on the foreign company." This does not carry out the statutory criteria Congress has mandated be considered. GAO on page 13 of its recent report tells us that the Treasury insists that Defense Department concerns about foreign acquisitions of integrated circuits essential to national defense is an industrial policy concern and not a "national security" concern. This flies in the face of the statute and legislative history of the Exon-Florio Provision of law. That law that was deliberately placed in the Defense Production Act to indicate Congress *did* want defense industrial base issues considered in Exon-Florio reviews.

Conclusion

I believe a review of the record demonstrates that the Treasury Department opposed the enactment of the Exon-Florio Provision and has sought to stymie its effectiveness ever since it was enacted. It is in a position to do this as it chairs and staffs the Interagency Committee that the President charged to implement the statute. The agency is so wedded to its open investment policy that it leans over backward to protect that interest over legitimate national security concerns.

The China Commission, on which I serve, in its 2004 Report to Congress unanimously recommended:

(1) that Congress explicitly provide in statute that the term "national security" in the Exon-Florio Provision includes "national economic security"

(2) that the chairmanship of CFIUS be transferred from the Treasury Department to the Commerce Department.

Under the Constitution, the Congress has the authority to regulate Interstate and Foreign Commerce. The Congress has under Exon-Florio given to the President, not the Treasury Department, the authority to block certain foreign takeovers of U.S. companies that may threaten our Nation's security. As Chairman Shelby stated at this Committee's October 6 oversight hearing on this matter, "Not everything in America is for sale." Senator Sarbanes at that hearing cited an article that appeared in the *Los Angeles Times* on October 6 that said the foreign investment "screening process was broken, leaving the country vulnerable to foreign threats." I strongly agree with the points made by both Senators.

Our Nation is facing new challenges as we find ourselves in a globalized economy where other countries have clear national strategies on how to compete and raise the standard of living of their people and their national power. We must take such matters into account when administering our open investment policy and ensure we not sacrifice technologies and industries important to our national defense by taking an ideological approach on open investment. China over the last 10 years has run massive and ever increasing trade surpluses with this country. This year alone our bilateral deficit with China will be over $200 billion. That Government has acquired a vast cache of dollars by forcing companies earning dollars to turn them in for yuan. Since China does not buy very many U.S.-made goods in comparison with what we buy from them, it can use these dollars earned through trade surpluses to buy important U.S. assets and it is now starting to do so.

Part of the reason we have run these massive trade deficits with China is because that country has for a number of years been engaged in currency manipulation to keep the yuan undervalued against the dollar. This subsidizes Chinese exports here, makes our goods more expensive there, and gives our companies incentives to move operations to China. Another of this Committee's contributions to the 1988 trade bill gave the Treasury Secretary major responsibilities in the exchange rate area. The Treasury is charged to identify currency manipulators and to persuade them, by bilateral negotiations and efforts in the IMF, to halt such practices that are deleterious to the international trading system and unfair to American companies and workers. As this Committee is well-aware the Treasury has failed to carry out its responsibilities in that area as well. Its failure there has contributed to Chinese trade surpluses and has helped China accumulate vast amounts of U.S. dollars. We will thus soon see a lot more proposed takeovers of American companies by Chinese companies. We need a serious, functioning, CFIUS process that takes account of our national security interests.

I strongly urge this Committee to look at the record and recognize the Treasury Department has not been a good steward of the Exon-Florio responsibilities given to it. The Chairmanship of CFIUS should be moved out of that Department and this Committee should remain active in its oversight of that interagency operation. I have no clients other than the public interest on this issue and have never been paid by any company or any other party to advise it on CFIUS matters.

Again, thank you very much for inviting me, and I am happy to answer any questions.

PREPARED STATEMENT OF DAVID MARCHICK

PARTNER, COVINGTON & BURLING

OCTOBER 20, 2005

Mr. Chairman, Senator Sarbanes, and Members of the Committee, thank you for the opportunity to testify before the Senate Committee on Banking, Housing, and Urban Affairs on the subject of implementation of the Exon-Florio Amendment. It is a privilege to appear before you.[1]

I applaud your leadership, Mr. Chairman, and that of the Committee for calling these hearings. Protecting U.S. national security has to be the United States' top priority. I believe we can protect our security interests and simultaneously maintain an open investment policy, including through the effective implementation of the Exon-Florio Amendment.

You have already heard testimony from the GAO, Senator Inhofe and a distinguished panel of executive branch officials. I am here to offer the perspective of a private sector adviser who works closely with the twelve members of the Committee on Foreign Investment in the United States (CFIUS). I plan to speak to four particular issues:

- First, the critical importance of foreign investment to the U.S. economy. Encouraging inward investment is essential to both our economic security and our national security.
- Second, trends in the application of the Exon-Florio Amendment. Since September 11, 2001, the Bush Administration has applied greater scrutiny to foreign investments on national security grounds, imposed tougher security requirements as a condition for approving specific transactions, and enhanced enforcement of security agreements negotiated through the Exon-Florio process.
- Third, the suitability of the Exon-Florio process to address potential security issues presented by investments from China. While certain investments by Chinese firms may present unique national security considerations, experience has shown that the President and CFIUS have adequate authority and flexibility under Exon-Florio to assess and, if necessary, mitigate any national security risks such investments may pose.
- Fourth, the myriad initiatives to amend Exon-Florio. Simply put, the Exon-Florio Amendment in its present form is more than adequate to protect our national security and still preserve our economic interests. Many of the changes being discussed in Congress would risk chilling inward investment and encouraging other governments to erect new obstacles to U.S. investment abroad. At the same time, there can and should be greater transparency with Congress while protecting proprietary business information.

The Importance of Foreign Investment to the U.S. Economy

Few would disagree that foreign investment plays a critical role in the U.S. economy. Today more than ever, the vibrancy and vitality of the U.S. economy depends on the inflow of direct foreign investment. Foreign investment supports approximately 5.3 million jobs in the United States. These typically are highly skilled, well-paying jobs; indeed, U.S. affiliates of foreign firms on average pay wages higher than the U.S. industrial mean.[2] Foreign investors also invest heavily in manufacturing operations in the United States—investment that is critically important given the present competitive pressures on the U.S. manufacturing base. It is pre-

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[1] David Marchick is a Partner in Covington & Burling, an international law firm based in Washington, DC. He has an active CFIUS practice and is co-authoring a book on Exon-Florio with Edward M. Graham, Senior Fellow at the Institute for International Economics.

[2] *See* Edward M. Graham and Paul R. Krugman, Foreign Direct Investment in the United States 71–72 (Institute for International Economics 1995).

cisely for these reasons that each of our 50 governors devotes a significant amount of time and resources to attract foreign investment to their States.

Perhaps most important, because the United States spends more than it produces and saves, and because of the deteriorating current account deficit ($197 billion in the second quarter of 2005, or some 6.3 percent of annualized GDP), our country is now literally dependent on inflows of direct and portfolio investment to cover the gap between what we consume and produce.

Of course, if foreign investors make investments in the United States, it is preferable that they do so in plant, equipment and other fixed assets that drive economic activity, rather than solely in the debt market. Subjecting our economy to the whims of foreign central banks—which today hold more than one-third of the overall public U.S. debt—creates much more risk than does foreign ownership of fixed assets in the United States.

The United States has long embraced a policy of encouraging foreign investment. Indeed, Presidents Carter, Reagan, and George H.W. Bush each issued executive statements of policy on the subject and President Clinton actively promoted inward investment. In 1983, President Reagan issued the first public statement in which a U.S. President expressly welcoming foreign investment. In this statement, President Reagan said "the United States believes that foreign investors should be able to make the same kinds of investment, under the same conditions, as nationals of the host country. Exceptions should be limited to areas of legitimate national security concern or related interests."[3]

U.S. foreign investment policy has long been consistent with President Reagan's formal statement on the issue. In fact, apart from the narrow exception of a few World War I-vintage restrictions on foreign investment in aviation, shipping, and the media, the United States has maintained an open investment policy. Hand-in-hand with that policy, laws such as the Exon-Florio Amendment, the International Emergency Economic Powers Act, and, previously, the Trading with the Enemy Act have empowered Presidents to block foreign investment or to seize foreign-owned assets (as the United States did in World Wars I and II) when U.S. national security is threatened by a particular foreign acquisition or involvement in the U.S. economy.

As a result, with the exception of 2003, when China briefly was the largest recipient of direct foreign investment, the United Stated has for many years attracted more foreign investment than any other country in the world. In addition to our open investment policy, the size of the U.S. market, the quality of our workforce and the ease with which foreign investors can operate here have all contributed to this remarkable record.

Moreover, the vast majority of foreign acquisitions do not implicate U.S. national security interests in any respect. It is hard to see a national security issue with a Daimler-Chrysler auto assembly plant, a Japanese investment in a film studio, or, my children's' favorite, Ben & Jerry's, which is owned by a Dutch company. For the narrow set of transactions that genuinely implicate U.S. national security interests, the Exon-Florio Amendment provides the President with ample authority to block a transaction or otherwise mitigate any concerns raised by a particular acquisition, and CFIUS agencies have demonstrated their willingness to use the full authority of the law.

Trends Toward Greater Scrutiny of Transactions in the Exon-Florio Review Process

The Exon-Florio Amendment created a statutory framework that is unique in a number of respects. First, there is no time bar on Exon-Florio reviews; CFIUS can review a transaction at any time, including after a transaction has closed. Second, unlike Hart-Scott-Rodino or other governmental reviews of mergers and acquisitions, Presidential decisions pursuant to Exon-Florio are not reviewable by U.S. courts because they involve national security, an inherently "Presidential" function. Third, the statute gives the CFIUS agencies broad discretion to interpret several key statutory criteria, including "foreign control," "credible evidence," and "national security." In my experience, particularly in the past few years, CFIUS has chosen to interpret these terms very broadly.

CFIUS has significantly broadened the scope of its "national security" reviews since September 11, 2001—a development that partly reflects the addition of the Department of Homeland Security to the Committee and the attendant strengthening of the security focus within CFIUS. More importantly, whereas prior to September 11 CFIUS focused primarily on (i) the protection of the U.S. defense industrial base, (ii) the integrity of Department of Justice investigations, and (iii) the ex-

[3] President Ronald Reagan, Statement on International Investment Policy, Sept. 9, 1983, *available* at *http://www.reagan.utexas.edu/archives/speeches/1983/90983b.htm.*

port of controlled technologies, CFIUS has intensified its focus on an additional goal: The protection of critical infrastructure.

Criticism against CFIUS has focused on the fact that the President has only formally blocked one transaction of more than 1,570 reviewed by CFIUS. However, this statistic obscures the manner in which CFIUS actually operates and ignores the larger number of transactions abandoned or substantially modified by parties because of the CFIUS process. There have been more investigations and withdrawals *in just the past 3 years* than there were during the previous 10 years combined. In the last 3 years, I personally have been involved in two investigations, one proposed investment that was withdrawn when it became clear that CFIUS approval would not be forthcoming, and multiple negotiations of extremely tough security agreements with CFIUS agencies.

The tougher terms now imposed by CFIUS as a condition for approving particular transactions are another indicator of the enhanced scrutiny applied to recent transactions. For many years, the security agencies within CFIUS (DOJ/FBI, DoD and now DHS) have negotiated agreements designed to mitigate the national security impact of a particular transaction. These security agreements have traditionally been negotiated by DoD for foreign acquisitions of defense companies, by the DOJ and FBI for foreign acquisitions of telecommunications companies, and by multiple agencies for acquisitions in other sectors. Since 2003, DHS has joined DOJ, DoD and the FBI in playing a central role in the negotiation and enforcement of security agreements.

By way of illustration, take the Network Security Agreements (NSA's) negotiated to mitigate the risk of foreign investment in the telecommunications sectors. (Unlike security agreements negotiated in other sectors, NSA's in the telecommunications sector are made public via the grant of FCC licenses, which often are conditioned on the agreements.)

Before September 11, NSA's for foreign acquisitions of U.S. telecommunications companies typically focused on the ability of U.S. law enforcement to conduct electronic surveillance and wiretaps and prevent foreign governments from accessing call-related data. In the last few years, NSA's have become much tougher. Some recent NSA's have become more intrusive, limiting foreign-owned telecommunications firms' freedom of action in key areas in which American-owned telecommunications firms face no similar restrictions.

For example, to varying degrees, recent NSA's have:

- permitted only U.S. citizens to serve in sensitive network and security positions (for example, positions permitting access to monitor and control the network);
- required third party screening of senior company officials and personnel having access to critical network functions;
- restricted or prohibited the outsourcing of functions covered by the NSA, unless such outsourcing is approved by the Department of Homeland Security;
- given U.S. Government agencies the right to inspect U.S.-based facilities and to interview U.S.-based personnel on very short notice (as short as 30 minutes);
- required third party audits of compliance with the terms of the NSA;
- required the implementation of strict visitation policies regulating foreign national access (including by employees of the acquiring company) to key facilities; and
- required senior executives of the U.S. entity, and certain directors of its board, to be U.S. citizens approved by the U.S. Government and responsible for supervising and implementing the NSA.

Many of these provisions reflect concepts typically utilized by the Department of Defense to mitigate security concerns associated with foreign-owned companies that have classified contracts with the Pentagon. In other words, CFIUS now imposes on foreign companies handling nonclassified telecommunications work many of the same requirements that DoD has traditionally required for foreign companies handling the Government's most sensitive defense-related classified contracts. These security commitments for companies not handling classified contracts can impose substantial costs. For global communications companies, for example, the limitations on outsourcing, routing of domestic calls, storage of data, and location of network infrastructure can create significant competitive burdens.

Finally, I should note that the CFIUS security agencies have increased the vigor with which they monitor and enforce these agreements. Unfortunately, in my view, some provisions required by CFIUS in these agreements can be overly intrusive and regulatory, unnecessarily limit companies' operations, and impose significant costs without commensurate security benefits. Notwithstanding this concern, it is important for the Committee to know that, in the past few years, CFIUS's scrutiny of

transactions has increased, security agreements have become tougher, and enforcement and monitoring has been more rigorous.

National Security Issues Associated With Investments From China

Acquisitions of U.S. companies by Chinese firms have presented CFIUS with unique issues and concerns. Of the United States' 10 largest trading partners, China is the only one not considered a strategic or political ally. China also stands out among the largest trading partners in other important respects, including the high levels of state ownership and control of its largest (and often publicly traded) companies [4] and the espionage threat assigned to China by our intelligence and law enforcement agencies.

For these reasons, Chinese investments have drawn, and will likely continue to draw, close scrutiny. Even with the concerns by some agencies, CFIUS is well equipped to make national security assessments of Chinese investment in the United States on a case-by-case basis.

While protection of U.S. national security should always be our highest priority, we can fulfill this objective while simultaneously integrating China into the global economy, including through Chinese investment in the United States. For close to 25 years, through Republican and Democratic Administrations, the United States has encouraged China to lower tariffs, eliminate nontariff barriers to trade, privatize state-owned enterprises and to participate in—and play by the rules of—the global economy. Moreover, the United States has continually pressed China to eliminate barriers to foreign direct investment by United States and other foreign companies. Successive U.S. Administrations have correctly pursued these policies not only for the economic and commercial benefit of U.S. companies and workers, but also based on the belief—correct, in my view—that market reform will facilitate democratic reform in China. A democratic China is, of course, very much in the national security interests of the United States.

Thus, as the United States Government utilizes the Exon-Florio process to assess carefully those investments from China that present a national security risk, the United States should also send a clear signal that we welcome inward investment from China. We should make clear that Chinese investments in most sectors of the United States economy present no national security issues at all. It is in the Untied States' interest to continue to support China's integration into the global economy. In addition, there should be a high threshold for rejecting proposed transactions, in part because of the myriad tools available to mitigate any perceived threats, including the use of security agreements. At the same time, if mitigation measures do not adequately protect U.S. national security, the President can and should block an investment.

Recent Proposals to Amend Exon-Florio

Recent proposals to amend Exon-Florio would, among other things:

- expand the definition of national security to include the economic and/or energy security;
- give Congress the power to force an investigation or block a transaction already approved by the President;
- extend the statutory time limits for CFIUS reviews; and,
- transfer chairmanship of the process from the U.S. Treasury to the Department of Defense or Department of Commerce.

In my view, these proposals not only are unnecessary to protect U.S. national security, but they would also have a negative impact on the U.S. economy and therefore U.S. national security. More specifically, they would chill foreign investment, slow job creation, and provide other countries with a pretext for imposing similar restrictions on U.S. investment abroad. By chilling inward foreign investment, which fuels competition and innovation, we would be harming the vitality of the U.S. economy. A strong economy is essential for U.S. national security.

Let me take each of the proposals in turn:

First, expanding Exon-Florio's criteria to include "economic security," or variations thereof, has been proposed close to a half-dozen times since 1988, including when

[4] One recent study estimated that at the end of 2001, the Chinese Government exerted ultimate ownership control over 81.6 percent of the 1,136 publicly listed Chinese companies. As of 2005, there were more than 1,300 publicly traded companies. China has made important steps to privatize and eliminate state ownership and control of some former state-owned enterprises, particularly small and medium-sized companies. At the same time, however, the Chinese Government has retained control over industries considered "strategic." *See* Exit the Dragon, Privatization and State Control in China (Stephen Green & Guy S. Liu eds., 2005).

Exon-Florio became law.[5] Indeed, the original bill offered by Senator Exon would have authorized the President to block transactions that threaten the "essential commerce" of the United States. President Reagan threatened to veto the Omnibus Trade and Competitiveness Act of 1988 because of the "essential commerce" clause in the Exon bill; proposals to expand Exon-Florio to cover "economic security" should similarly be rejected.

It would be difficult for CFIUS to implement a statutory requirement to protect "economic security." The term is extraordinarily vague. I am reminded of the late Commerce Secretary Malcolm Baldridge, who argued against a similar provision in the original Exon bill, saying "you are trying to kill a gnat with a blunderbuss."[6] Indeed, there is good reason to believe that an "economic security" test would simply become a vehicle for domestic industries seeking to block foreign competition.

Second, the proposals to allow Congress to force an investigation or to override, through a joint action by Congress, Presidential approval of a particular transaction raise serious separation of powers issues under the U.S. Constitution.[7] In addition, these proposals, if enacted, would create so much uncertainty about the prospect of Congressional involvement in the review process that a substantial number of foreign investors would simply not make investments in the United States. Congress has a legitimate and important oversight role ensuring that the Exon-Florio statute is implemented correctly. But Congress should not itself become a regulatory agency. Congress has not, and would not, override Hart-Scott-Rodino decisions made by the Department of Justice or the FTC. It should not assume that power here.

Third, I would recommend against extending the time limits for a CFIUS review. The existing time limits work well because they balance the need for the agencies to have sufficient time to conduct reviews with the concomitant need for parties to an acquisition to have the certainty that they will receive a decision—up or down—from CFIUS within a reasonable period of time. In addition, most companies that file with CFIUS—thereby starting the statutory clock—do so only after engaging in informal consultations with CFIUS. Through these informal consultations, CFIUS agencies have additional time to assess the national security risks and design mitigation strategies, if necessary. Indeed, it is common for security agreements to be hammered out before the parties file.

Another reason not to alter the current statutory timeframes is that the vast majority of transactions reviewed by CFIUS either do not pose a national security risk or the national security threat has been mitigated. Therefore, most transactions can appropriately be approved by CFIUS in 30 days. These investments typically come from companies located in countries that are our closest allies. There would be no good reason to prolong the timeframe for approving these transactions—a timeframe, by the way, that currently corresponds will with the review period under Hart-Scott-Rodino. Only a small number of transactions require additional scrutiny through an "investigation." The 45 additional days allowed in the current statutory framework—plus the informal, prefiling consultation period—are sufficient for CFIUS to do its job.

Fourth, just as there has been with respect to "economic security," there have been a number of proposals over the years to transfer the chairmanship of CFIUS away from Treasury toward the Department of Defense or the Department of Commerce. Indeed, the original Exon bill placed the responsibility in the Department of Commerce. Then-Secretary Baldridge stated bluntly that he did not want the authority.[8] While multiple agencies could competently lead the CFIUS process, placing the chairmanship at Treasury sends an important positive signal to the rest of the world. Exon-Florio was intended to give the President a tool to block those rare transactions that truly threaten national security, not to change our overall open approach toward foreign investment. Under Treasury's leadership, the presumption is—and should remain—that foreign investment is welcome unless it threatens national security. If CFIUS were chaired by an agency with a security mission, the presumption would be reversed.

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[5] *See, for example,* H.R. 2394, "The Steel and National Security Act," 107th Cong. (2001); H.R. 2624, "The Technology Preservation Act of 1991," 102nd Cong. (1991); H.R. 2386, "The Foreign Investment and Economic Security Act of 1991," 102nd Cong. (1991); H.R. 5225, 101st Cong. (1990); H.R. 3, "The Foreign Investment, National Security and Essential Commerce Act of 1987," 100th Cong. (1987).

[6] Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science, and Transp., 100th Cong. 17 (1987).

[7] *See INS* v. *Chadha,* 462 U.S. 919 (1985).

[8] Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science, and Transp., 100th Cong. 14 (1987).

Moreover, Congressional action to tighten restrictions on foreign investment in the United States could invite similar action abroad, limiting opportunities for outward investment by American companies. This is not an idle concern:

- This past summer, French politicians balked at mere rumors of PepsiCo's potential interest in acquiring Danone, the French yogurt and water company. French Prime Minister Dominique de Villepin made the extraordinary statement that "The Danone Group is one of the jewels of French industry and, of course, we are going to defend the interests of France."[9] Since then, the French Government has announced that it will establish a list of "strategic industries" that will be shielded from foreign investment. It is hard to see how yogurt is a strategic industry.
- In his State of the Union speech last April, President Putin called for a new law to protect "strategic industries" in Russia. A draft of that law is expected to be put forward next month.
- The Canadian Parliament is now considering amendments to the Investment Canada Act to permit the review of foreign investments that could compromise national security.
- China continues to restrict investment in a number of important sectors.

Other countries are closely watching what we do in the United States on Exon-Florio. The United States has worked for decades to reduce barriers to investment abroad. If we act now to restrict investment into the United States, we will be providing a green light for other countries to erect their own barriers to inward investment.

Conclusion

I would like to conclude my remarks by recalling the dire predictions expressed in the 1980's surrounding Japanese investment in the United States. These predictions of doom occurred at a time when Japan had huge trade surpluses with the United States, followed an export-led growth strategy, and needed a place to invest their significant foreign currency reserves—much like China today. Congress reacted to the concerns about growing Japanese investment by adopting the Exon-Florio Amendment.

Looking back, the fears about Japan now appear misguided. Over the last 20 years, the United States economy has been the engine of growth for the world and has been strengthened by large Japanese investments in the auto, information technology, and manufacturing sectors.

For decades, Republican and Democratic Administrations have pursued a policy of open investment, which has spurred the dynamism that drives our economy. For those few investments that implicate U.S. security interests, the Exon-Florio Amendment has given the President and CFIUS ample authority to block investments or mitigate the national security impact of such investment. Exon-Florio is a flexible statute in part because it does not define "national security." And the President should not hesitate to act to block a transaction if it truly threatens U.S. national security and the threat cannot be mitigated.

Improvements in implementation can be made, including more frequent, high-level briefings of Congress by CFIUS agencies (without compromising proprietary business information supplied by the parties to a transaction). Yet, for the reasons outlined above, I encourage the Committee to keep the existing statutory framework in place.

Thank you for the opportunity to appear before you today.

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[9] LCI News, July 20, 2005, available at *http://np.www.lci.fr/news/economie/0,,3232812-VU5WX0lEIDUy,00.html.*

RESPONSE TO A WRITTEN QUESTION OF SENATOR SCHUMER FROM ROBERT M. KIMMITT

Q.1. In his statement at the beginning of the hearing, Senator Schumer raised three issues for written comment by the witnesses: (1) the narrow definition of national security employed by the Committee on Foreign Investment in the United States (CFIUS); (2) adding economic security to Exon-Florio; and (3) expanding the criteria for blocking a foreign acquisition to include reciprocity.

A.1. Definition of National Security

"National security" is not defined in the statute or in the implementing regulations. CFIUS deliberately does not define national security because a definition would improperly curtail the President's broad authority to protect national security and, at the same time, not necessarily result in guidance sufficiently detailed to be helpful to the parties to a foreign acquisition. The statute lays out a broad set of factors that may be considered, but this is not an exhaustive list. Each transaction has unique characteristics and agencies are not constrained in examining all facets of a transaction that could impact national security. This is consistent with the fact that ultimately the judgment as to whether a transaction threatens national security rests within the President's discretion. Treasury's view of national security has evolved over the years, just as the views of all other members of CFIUS have evolved. This is to be expected, as the concept of national security is continuously evolving.

Adding Economic Security to Exon-Florio

Adding "economic security" to the Exon-Florio Amendment would not be advisable. Curtailing foreign investment on this ground would significantly alter how the United States treats foreign investment. U.S. investment policy welcomes foreign direct investment and promotes national treatment—that is, treating foreign companies and U.S. companies alike, except for limited circumstances such as national security.

The concept of national security, even as broadly applied as it is under the Exon-Florio Amendment, affects a relatively narrow segment of the U.S. economy. However, if Exon-Florio were expanded to include economic security matters that do not affect national security, foreign investment in nearly every sector of the U.S. economy would be subject to CFIUS review. Such a system would undermine the legal certainty that investors expect when they invest in the United States. Investors would either overwhelm the Government with notifications or would avoid investing in the United States. This would constitute an extraordinary reversal in the treatment of foreign investment in the United States. It would also undermine the U.S. leadership role in international fora, where we advocate more liberal investment regimes and the reduction of barriers to the free flow of capital. Finally, it could be perceived as inconsistent with the United States' obligations under various international trade and investment agreements, which generally prohibit discriminatory treatment of foreign investors except on national security grounds.

Reciprocity

Although I do not believe that reciprocity alone should be a reason for blocking a foreign acquisition, I do believe that a country's decision to close a sector to U.S. investment is a factor that CFIUS could consider when evaluating a particular transaction. For example, if another country treats a sector as sensitive because of national security concerns, then CFIUS could factor that treatment into its analysis of foreign investment in the same U.S. sector by investors of that country. The ultimate decision as to our national security interests in a particular instance, however, must be made by the United States, consistent with our nondiscrimination commitments, particularly with respect to our Bilateral Investment Treaties, Free Trade Agreements, and certain Treaties of Friendship, Commerce, and Navigation.

It is important that we continue to advocate an open investment policy through our bilateral and multilateral discussions with foreign governments. The greatest lever our negotiators have is to stress how open the American market is to investment in virtually every sector, provided that the national security is not adversely affected by such investment.

RESPONSE TO A WRITTEN QUESTION OF SENATOR ALLARD FROM ROBERT M. KIMMITT

Q.1. Of the 12 withdrawals of notices of foreign acquisitions provided to CFIUS since 2001, how many were refiled and could you provide some additional information on those that were not refiled?

A.1. Of the 12 withdrawals granted by the Committee on Foreign Investment in the United States (CFIUS) since 2001, 10 were refiled and 2 were not. In both of these cases, the issues raised by two CFIUS member agencies were addressed to the satisfaction of CFIUS. No agency has requested that CFIUS reopen a review of either transaction.

In one of the cases not refiled, the issues raised in the initial review involved the foreign company's export compliance program and a sales office located in a country of concern to the U.S. Government. Neither of these issues could be resolved in the initial 30-day review.

Despite the fact that the U.S. Government had some concerns, the foreign company was in fact in compliance with the laws and regulations of its host country. In the first withdrawal period, the foreign company and its host country made certain commitments to improve their diligence on export control and the company closed the sales office in the country of concern to the U.S. Government. The transaction was refiled, but one agency wanted a track record of compliance with the agreed commitments before relinquishing its right to object in the CFIUS process. The transaction was therefore withdrawn a second time. After some time for further review, the agency indicated to CFIUS that it had no national security concerns and saw no need for a refiling.

In the second case that was withdrawn and not refiled, one agency wanted additional time to address its issues with the foreign company concerning the transaction. The company requested a withdrawal, and CFIUS granted it. The agency continued to work

with the company and toured its facilities. The agency ultimately indicated that there were no further national security concerns and no need for a refiling.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR INHOFE FROM ROBERT M. KIMMITT

Q.1. Can you tell me whether there have been patterns of foreign acquisition by industry or specialty? Are any countries concentrating their purchases, and thus targeting our aerospace, software, materials, energy, electronics, and other sectors? Is there any sort of cumulative, broad-picture analysis that would show if a certain country or alliance of countries was intentionally or unintentionally undermining any possible aspect of national security?

A.1. The Committee on Foreign Investment in the United States (CFIUS) has performed a preliminary examination of a limited set of data on foreign acquisitions. CFIUS examined the notices of foreign acquisitions of U.S. companies filed between the years 2001–2004. CFIUS conducted a national security review of 193 foreign mergers and acquisitions of U.S. companies during this period.

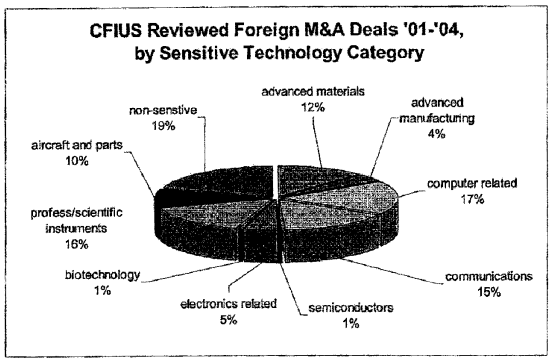
Although we are pleased to provide the results of this preliminary examination, we caution that this limited set of data from 4 years of CFIUS reviews is too small a sample of data to establish any statistically definitive patterns or conclusions regarding foreign acquisitions by industry or specialty. A more extensive analysis is tentatively planned for 2006.

Notices to CFIUS of foreign merger and acquisition (M&A) activity remained fairly constant during the 4 years at between 42 and 55 transactions per year. Of these transactions, 149, or 77 percent, involved either Western European or Canadian-based companies. United Kingdom companies alone accounted for more than 39 percent of reviewed merger and acquisition activity in this period.

Transactions involving the acquisition of critical technologies were fairly evenly distributed among the various categories within this study. The categories for computer-related, professional/scientific instruments, and communications experienced the most activity. In the computer-related category, 4 of the 7 reviews by CFIUS involved proposed acquisitions by companies from Israel.

These data are consistent with the results ofthe 1994 Quadrennial Report on U.S. Critical Technology Companies, which showed that companies from our major trading partners were also predominant investors in the U.S. market, with companies from the United Kingdom leading the way. This pattern holds in the current analysis, with one notable exception. As a share of total foreign M&A activity examined by CFIUS, Japanese activity has declined dramatically from 20 percent to 4 percent.

The following chart shows the percentage of the total M&As in the 2001–2004 period for each sensitive technology.



Q.2. I also want to know how many United States companies were purchased by Japan, United Kingdom, Germany, China, and every other foreign nation in your database. Can you give me a breakdown by nationality of the top 15 acquiring nations in regards to the industry areas they are investing in?

A.2. CFIUS does not collect comprehensive data on foreign direct investment in the United States. It does, however, have aggregate data based on notices under Exon-Florio. The two tables that follow illustrate this data.

The following table shows the number of notices of foreign acquisitions filed with CFIUS in the 2001—2004 period by the host country of the foreign acquirer.

Total CFIUS Notices of Foreign Acquisition of U.S. Companies by Host Country, 2001-2004

Country	Notices of Foreign Acquisition of U.S. Companies
United Kingdom	77
Canada	14
France	14
Germany	12
Singapore	8
Israel	7
Japan	7
Switzerland	6
Australia	5
Belgium	5
Netherlands	5
Hong Kong	4
Italy	3
Norway	3
Spain	3
Bermuda	2
Denmark	2
Finland	2
Saudi Arabia	2
Austria	1
Channel Islands	1
China	1
Croatia	1
India	1
Luxembourg	1
Malaysia	1
Mauritius	1
Peru	1
Philippines	1
Russia	1
Sweden	1

The following table shows the number of notices of foreign acquisitions filed with CFIUS in the 2001—2004 period by the host country of the foreign acquirer by industry area:

Total CFIUS Notices of Foreign Acquisitions of U.S. Companies in Sensitive Technology Categories, Top 15 Host Countries, 2001-2004

	advanced materials	advanced manufacturing	computer related	communications	semiconductors	electronics related	biotechnology	profess/scientific instruments	aircraft and parts	non-sensitive	Total
United Kingdom	14	2	17	9	0	1	0	14	6	14	77
Canada	2	1	3	1	0	1	0	2	3	1	14
France	1	0	2	0	0	1	0	4	4	2	14
Germany	2	0	1	1	0	0	0	1	1	6	12
Singapore	1	0	1	2	0	0	0	0	1	3	8
Israel	0	0	4	1	0	1	0	0	1	0	7
Japan	1	0	1	1	1	2	0	1	0	0	7
Switzerland	0	1	1	0	0	0	0	2	0	2	6
Australia	0	1	0	1	0	0	0	1	1	1	5
Belgium	1	1	0	0	0	2	0	1	0	0	5
Netherlands	2	0	1	0	0	1	0	1	0	0	5
Hong Kong	0	0	0	4	0	0	0	0	0	0	4
Italy	0	1	1	0	0	0	0	0	1	0	3
Norway	0	0	0	2	0	0	0	1	0	0	3
Spain	0	0	0	1	0	0	0	0	0	2	3

New Foreign Investment in the United States: In 2004

In addition to this data derived from notices to CFIUS under Exon-Florio, the Bureau of Economic Analysis (BEA) in the Department of Commerce publishes aggregate data on foreign direct investment.

The attached table is from BEA's *Survey of Current Business,* June 2005. It shows that total outlays by foreign direct investors to acquire or to establish U.S. businesses were $79.8 billion in 2004. This was up 26 percent from 2003. In 2004, outlays in finance and insurance accounted for almost half of the total outlays. Outlays by Canadian investors accounted for more than 40 percent of the total outlays. The largest European outlays were from the United Kingdom, followed by Germany and France. Outlays from Japan declined for the fourth year in a row.

The following are key terms for the table:

Foreign direct investment in the United States is ownership or control, directly or indirectly, by one foreign person of 10 percent

or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest in an unincorporated U.S. business enterprise.

A *U.S. affiliate* is a U.S. business in which there is foreign direct investment.

The *ultimate beneficial owner* is a person, proceeding up a U.S. affiliate's ownership chain, beginning with and including the foreign parent, that is not owned more than 50 percent by another person.

June 2005 SURVEY OF CURRENT BUSINESS

Table 7.2. Investment Outlays, Country of Ultimate Beneficial Owner by Industry of U.S. Business Enterprise, 2004

[Millions of dollars]

	All industries	Manufacturing	Wholesale trade	Retail trade	Information	Depository institutions	Finance (except depository institutions) and insurance	Real estate and rental and leasing	Professional, scientific, and technical services	Other industries
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
All countries	79,820	17,178	951	3,055	3,102	14,095	24,904	4,823	4,048	7,664
Canada	32,378	1,395	478	(D)	570	(D)	17,525	806	1,857	6,720
Europe	39,424	13,664	457	486	1,198	13,458	5,709	2,811	1,237	402
Of which:										
France	4,661	1,033	(D)	0	(D)	(D)	1,838	(D)	(D)	0
Germany	5,020	4,158	(D)	0	0	0	0	634	0	(D)
Netherlands	253	167	0	0	(D)	0	(D)	78	0	0
Switzerland	3,523	770	0	(D)	(D)	0	(D)	(D)	8	227
United Kingdom	34,166	6,273	234	0	1,154	(D)	2,619	592	(D)	(D)
Latin America and Other Western Hemisphere	1,418	(D)	0	0	0	0	(D)	0	0	0
South and Central America	(D)	(D)	0	0	0	0	(D)	0	0	0
Other Western Hemisphere	(D)	0	0	0	0	0	(D)	0	0	0
Africa	(D)	0	(D)	0	0	0	0	0	0	0
Middle East	(D)	0	0	0	100	0	(D)	835	0	(D)
Of which:										
United Arab Emirates	(D)	0	0	0	0	0	0	(D)	0	(D)
Asia and Pacific	4,800	(D)	(D)	(D)	(D)	(D)	1,178	372	914	(D)
Of which:										
Australia	2,885	297	0	0	(D)	0	988	(D)	(D)	(D)
China	(D)	0	(D)	0	0	0	0	0	(D)	0
Hong Kong	115	(D)	0	0	(D)	0	(D)	0	0	0
Japan	966	524	(D)	(D)	52	(D)	(D)	14	0	(D)
Singapore	(D)	0	0	0	0	0	0	0	(D)	0
United States [1]	(D)	(D)	0	0	(D)	0	(D)	0	0	385
Addenda:										
European Union (25) [2]	35,264	12,549	457	208	1,198	13,458	4,661	1,362	1,204	175
OPEC [3]	852	0	0	0	(D)	0	(D)	825	0	(D)

D Suppressed to avoid disclosure of data of individual companies.

1. The United States is the country of ultimate beneficial owner for businesses newly acquired or established by foreign investors that are ultimately owned by persons located in the United States (see the box "Key Terms").

2. The European Union (25) comprises the European Union (15) whose member countries are listed in footnote 2 of table 7.1 and the 10 countries—Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia—that joined the Union in May 2004. Outlays include all investments made in 2004, even if the transactions occurred before the entry of the country into the European Union.

3. OPEC is the Organization of Petroleum Exporting Countries. Its members are Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela.

Notes: Data for 2004 are preliminary. For investments in which more than one investor participated, each investor and each investor's outlays are classified by the country of each individual ultimate beneficial owner.

This table presents the major regions, the European Union, OPEC, and the following countries: Australia, Canada, China, France, Germany, Hong Kong, Japan, the Netherlands, Switzerland, the United Kingdom, and the United States. In addition, it presents any country whose total outlays for 2004 were greater than $500 million.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM ROBERT M. KIMMITT

Q.1. How do you explain the failure of CFIUS to produce, after 1993, the quadrennial report required by Exon-Florio?

A.1. Exon-Florio requires the President, and such agencies as the President shall designate, to complete and furnish to the Congress a quadrennial report which:

> (A) evaluates whether there is credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. companies involved in research, development, or production of critical technologies for which the United States is a leading producer; and
>
> (B) evaluates whether there are industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies.

In 1993, the President asked Treasury to coordinate the preparation of the first report, which was submitted in 1994. However, a

quadrennial report with regard to paragraph (A) above (regarding acquisitions) has not been produced since 1994, and I can assure you that the Administration plans to provide a comprehensive report on that subject in 2006.

Although the information required under paragraph (A) has not been provided to Congress since 1994, the information required under paragraph (B) has been provided through reports prepared by the Office of the National Counterintelligence Executive (NCIX). The Intelligence Authorization Act for fiscal year 1995 requires the President to submit annually to Congress updated information on the threat to U.S. industry from foreign economic collection and industrial espionage. This report, coordinated by the NCIX, draws on input from all the intelligence agencies. The Foreign Economic Collection and Industrial Espionage reports from 1995–2004 can be found at: *http://www.nacic.gov/publications/reports*__speeches/reports/fecie__all/Index__fecie.html.

The NCIX report covers the question of foreign government-sponsored industrial espionage activities to obtain U.S. critical technology secrets, and therefore effectively satisfies one requirement of the quadrennial report pertaining to economic espionage. The NCIX report is actually more comprehensive in scope than what the quadrennial report requires in that it seeks to characterize and assess efforts by foreign entities—government and private—to unlawfully target or acquire critical U.S. technologies, trade secrets, and sensitive financial or proprietary economic information.

Although the NCIX report provides information relating to the espionage portion of the mandate, we are working toward producing a report related to foreign acquisitions in 2006. While we work to complete this report, I think that regular Congressional briefings will provide you with more information on CFlUS' s operations and enable you to monitor CFIUS more effectively.

Q.2. GAO states that "the office within Treasury that provides staff support to the Committee—the Office for International Investment—is also the office responsible for promoting the open investment policy" supported by the Department. Would it be advisable for Treasury to place a greater organizational separation between these two responsibilities, given the fact that the work of CFIUS necessarily involves balancing national security and open investment policy considerations?

A.2. I do not think there is a conflict of interest in housing the CFIUS staff within the Office of International Investment (OII). Rather, I believe that the current organizational structure complements the CFIUS process and enables the staff to perform a thorough review.

No responsibility is more important than protecting the national security. It is also a prerequisite for supporting an open investment policy and advancing economic prosperity. These missions—protecting national security and advancing economic prosperity—are inherently linked.

The current organizational structure benefits the national security analysis because OII has the expertise to help inform the CFIUS process as to the investment regimes of U.S. trade and investment partners, including information pertaining to their na-

tional security protections. This can be an important consideration when a foreign investor acquires a U.S. company with sensitive technology, for example to help assess the likelihood that the technology will not be diverted. OII also draws on the resources of other offices, such as the Office of Terrorism and Financial Intelligence (TFI) and the Office of the General Counsel.

The OII staff, which is involved in international investment issues, is in a position to draw on the in-house CFIUS expertise. This assures that U.S. negotiators working on international trade and investment agreements are able to provide an informed perspective on the implementation of Exon-Florio to our trading and investment partners.

Q.3. Treasury is devoting increased resources to building a modern Office of Terrorism and Financial Intelligence (TFI), headed by Under Secretary Levey. To what extent is TFI involved, or should it be involved, in the work of CFIUS, especially given TFI's increasing involvement in national security issues on behalf of Treasury?

A.3. The Office of Terrorism and Financial Intelligence (TFI) is closely involved in many national security issues that are relevant in the CFIUS review of foreign acquisitions of U.S. companies. TFI's mission is to marshal the department's intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use, and combating rogue nations, terrorist facilitators, money launderers, drug kingpins, and other national security threats.

CFIUS relied heavily on TFI expertise earlier this year when a transaction under review raised the potential for some of the above issues to be a factor. We expect that TFI will continue to participate in future reviews of CFIUS cases that implicate TFI's specific expertise as well as broader competence in national security matters.

Q.4. The organizational components of the Treasury Department have changed considerably since the passage of the Exon-Florio Amendment, due in part to the transfer of substantial components of Treasury to the Department of Homeland Security. What expertise does the Department now bring to the consideration of "the effects on national security" of acquisitions of U.S. companies by nonU.S. companies?

A.4. While it is true that Treasury has undergone change in recent years, including the transfer of some of its law enforcement components, Treasury maintains a strong involvement in national security issues. Treasury sits on the National Security Council and the Homeland Security Council, and is a member of the U.S. Intelligence Community.

Indeed, the establishment and development of Treasury's Office of Terrorism and Financial Intelligence (TFI), with its intelligence and national security policy portfolios, has in many respects enhanced Treasury's involvement in the national security arena. TFI brings intelligence, enforcement, policy development, and regulatory capabilities to bear on a full range of national security issues. Recent priority areas include terrorism, proliferation of weapons of mass destruction, rogue regimes such as Iran, Syria, and North Korea, narcotraffickers, and money launderers, among

other national security threats. We draw on expertise in TFI in the CFIUS process, as appropriate.

Moreover, the concept of national security includes both traditional foreign policy and defense criteria as well as economic considerations. Indeed, there is an inherent link between our national security and a strong U.S. economy that facilitates free and fair trade, market-based exchange rates, and the free flow of capital across borders. We are mindful of the positive benefits of foreign investment to our country and therefore seek to maintain the traditional U.S. open investment policy.

In all of these ways, Treasury is a key participant in developing and implementing national security policy and brings that perspective to the CFIUS process.

Q.5. Would CFIUS function more effectively if it were a smaller body?

A.5. The current membership provides a diverse perspective, assuring a more thorough analysis of the issues than a less diverse body would provide. Member agencies bring particular expertise essential to the assessment of the potential national security implications of specific foreign investments in the United States. This expertise includes knowledge of the level of technological sophistication of the transaction participants, the market position of alternate suppliers, the financial and product service track record, and the future outlook for transaction participants. This expertise gives CFIUS the broad perspective needed for a comprehensive assessment of the national defense, competitive performance, trade and investment policy and commercial issues involved in each transaction. Any narrowing of the Committee's expertise could cause the reviews to be less effective. It would therefore be important to consider this possibility in any effort to streamline the Committee's membership.

Q.6. What explains the fact that CFIUS is now composed of six executive departments and six different components of the Executive Office of the President, especially in light of the fact that CFIUS' executive department members must staff out filings to numerous components within each of those departments?

A.6. The Committee on Foreign Investment in the United States (CFIUS) was established by Executive Order 11858 in 1975 mainly to monitor and evaluate the impact of foreign investment in the United States. There were originally 6 members: (1) the Secretary of Treasury, the chair; (2) the Secretary of State; (3) the Secretary of Defense; (4) the Secretary of Commerce; (5) the United States Trade Representative; and (6) the Chairman of the Council of Economic Advisers. In 1988, the President, pursuant to Executive Order 12661, delegated to CFIUS some of his responsibilities under Section 721. Specifically, E.O. 12661 designated CFIUS to receive notices of foreign acquisitions of U.S. companies, to determine whether a particular acquisition has national security issues sufficient to warrant an investigation and to undertake an investigation, if necessary, under the Exon-Florio provision, and to submit a report and recommendation to the President at the conclusion of an investigation. In recognition of CFIUS' expanded responsibilities, this order also expanded CFIUS' membership to include the

Attorney General and the Director of the Office of Management and Budget.

In 1993, in response to a sense of Congress resolution, CFIUS membership was expanded by Executive Order 12860 to include the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs and the Assistant to the President for Economic Policy. In February 2003, the Department of Homeland Security was added to CFIUS.

Each member agency brings a particular expertise essential to the assessment of the potential national security implications of specific foreign investments in the United States. This expertise includes knowledge of the level of technological sophistication of the transaction participants, the market position of alternate suppliers, the financial and product service track record, and the future outlook for transaction participants. This expertise gives CFIUS the broad perspective needed for a comprehensive assessment of the national defense, competitive performance, trade and investment policy and commercial issues involved in each transaction. It also enables CFIUS to ensure that the national security is safeguarded in a manner consistent with longstanding U.S. policy regarding foreign investment in the United States. In addition, since certain member agencies administer U.S. export control programs for both dual use and military/defense items, CFIUS is able to evaluate the compliance record of the foreign acquirer and can offer guidance to ensure that any relevant export control issues are taken into account when the foreign acquisition is completed.

Q.7. How many fillings has CFIUS received in which the acquirer was either a foreign government or an entity controlled by or acting on behalf of a foreign government? How many investigations has it conducted with respect to such filings?

A.7. Since 2001, there have been 42 notices of foreign acquisitions of U.S. companies where the acquirer was either a foreign government or an entity controlled or acting on behalf of a foreign government. Of this total, CFIUS has undertaken a formal investigation of 3.

CFIUS regularly gives extra scrutiny to transactions involving foreign governments. However, the statistics regarding the number of investigations do not tell the whole story. In the telecommunications sector, many foreign companies are foreign government-owned or controlled and have entered into Network Security Agreements (NSAs) when acquiring U.S. companies, thereby obviating the need for an investigation under Exon-Florio. (The NSAs are available on the FCC website.) In addition, we have had some transactions involving foreign governments that were abandoned because the foreign acquirer became aware that there were significant national security concerns and the transaction would give rise to serious objections by CFIUS.

Q.8. Please describe the factors the Department of the Treasury takes into account in reviewing an acquisition in the first stage of the CFIUS process? What factors does the Department take into account in deciding whether to recommend that a matter be taken to formal investigation? Please be as specific as possible.

A.8. At the outset, it is important to stress that each transaction is unique and CFIUS takes a case-by-case approach. The Department of the Treasury, while the chair of CFIUS, is not in a position to dictate the results of the CFIUS process, since decisions are made by consensus and reflect the views of its members. However, in general, CFIUS agencies are guided by the criteria in the Exon-Florio Amendment and, therefore, initially consider whether the foreign acquirer acting through the U.S. target company might take action to threaten the national security and, if a threat is identified, whether existing laws are adequate and appropriate to deal with it.

The same criteria guide Treasury's own internal review process. Most importantly, Treasury relies on the views of the other CFIUS members who may have expertise regarding a particular sector. In establishing whether the foreign acquirer may be a threat to national security, Treasury examines the intelligence reporting and any reports of the foreign acquirer violating U.S. laws and regulations, such as not complying with the export control laws. In addition, it is important to examine the host government of the foreign company for a number of issues, including whether it maintains an acceptable export control regime that protects against unlawful U.S. technology diversion. Treasury also refers to the factors listed in the statute that the President may consider in a review. Since these involve the defense industrial base, nonproliferation, and other issues within the primary responsibility of other member agencies, these agencies provide CFIUS an analysis of these issues.

Finally, any agency that requests an investigation is expected to provide CFIUS a paper stating its national security concerns and the rationale for an investigation. Treasury and other CFIUS members review this information to arrive at a position on whether to support an investigation. In the end, however, a single agency's request can result in an investigation.

Q.9. Why are there so few formal Exon-Florio investigations?

A.9. Relatively few acquisitions by foreign entities have the potential to affect national security. The most active foreign investors are from close ally countries such as Canada and from Western Europe, which together account for more than 70 percent of the foreign direct investment position in the United States. The vast majority of notified transactions do not require an investigation either because these transactions do not potentially threaten national security, or CFIUS is able to mitigate the national security issues that arise in connection with these transactions. Exon-Florio requires that CFIUS look first to the ability of existing laws and regulations to address national security concerns. To the extent that existing laws and regulations can accomplish this objective, there is no need to rely on Exon-Florio.

The existence of Exon-Florio raises the awareness of foreign investors contemplating acquisitions of U.S. companies to the importance of national security considerations, and it helps to ensure that foreign investments are structured in ways to avoid national security problems. In addition, companies understand that sometimes their transaction may not be approved without some type of mitigation. The use of mitigation agreements enables CFIUS to ad-

dress concerns without going into an investigation. In some cases where CFIUS agencies have identified mitigation measures during the 30-day review period that would adequately address national security concerns, companies have withdrawn their CFIUS notices in order to negotiate mitigation agreements. Once mitigation agreements are executed, the companies refile with CFIUS, and CFIUS then concludes the review.

Q.10. When would it be appropriate for CFIUS to recommend barring or limiting a transaction because the transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of domestic industries to meet national defense requirements," or "the capability and capacity of the United States to meet the requirements of national security." Please be as specific as possible.

A.10. If these factors were relevant in a particular review under Exon-Florio, CFIUS would weigh them in any decision about whether to undertake an investigation, and they would be thoroughly examined along with any other relevant national security issues before CFIUS fonnulated its recommendation to the President. Factors in the statute are not an exhaustive list, but serve as guidance to CFIUS on areas of national security concern that Congress highlighted in drafting the legislation. These factors have, in fact, figured into CFlUS recommendations in past cases, including cases where CFIUS agencies entered into an agreement to mitigate a perceived threat. However, it is important to understand that these factors by themselves do not drive a decision. For the President to take action under Exon-Florio, he must determine that there is credible evidence that the foreign person exercising control might take action that threatens to impair the national security. While this is a relatively low standard, it is clearly more than conjecture. The President must have some reason to believe, based, for example, on the foreign person's past actions or likely motives, that it will take action through the acquisition that threatens to impair U.S. national security. The injury to the national security can relate to the factors in the statute (for example, by reducing or eliminating domestic production of a good needed for national defense) or to other factors the President considers important (for example, harming critical infrastructure, terrorism financing, etc.) Likewise, the President must also find that provisions of law other than Exon-Florio and IEEPA do not provide adequate and appropriate authority to protect the national security.

Q.11. At present, filings with CFIUS are voluntary. Would Exon-Florio work more effectively if fillings were mandatory?

A.11. CFlUS has implemented the Exon-Florio Amendment in a manner that has achieved the national security objectives as prescribed in the statute without compromising our open investment policy. CFlUS's implementation of Exon-Florio has increased the awareness of investors to national security issues, brought transactions into conformity with existing laws where needed, and resulted in investors abandoning transactions that raised insurmountable national security problems. There is no evidence to suggest that transactions that are not notified to CFIUS under the current voluntary system present national security issues.

Although Exon-Florio notices are voluntary, failure to notify leaves the transaction subject to Presidential action indefinitely. In addition, any CFIUS member may notify a transaction to the staff chair. This ensures that CFlUS may review any transaction that it believes should be reviewed.

Mandatory notification would hinder U.S. efforts to promote more liberal investment regimes worldwide. The United States has consistently opposed mandatory screening mechanisms for foreign investment, and has sought the removal of such mechanisms when we have negotiated international trade and investment agreements.

Moreover, introduction of a mandatory screening process could conflict with nondiscrimination commitments, particularly with respect to our Bilateral Investment Treaties and certain Treaties of Friendship, Commerce, and Navigation and Free Trade Agreements, potentially exposing the U.S. Government to claims brought by foreign investors or their governments.

Q.12. What specific steps is Treasury prepared to take in order to increase the scope of the information that this Committee receives about the Administration of the Exon-FIorio Amendment and the work of CFlUS?

A.12. I support enhancing the transparency of the CFIUS process through more effective communication with Congress, while recognizing our shared responsibility to avoid the disclosure of proprietary information that could undermine a transaction or be used for competitive purposes. I am open to suggestions on ways to improve the transparency of the process.

In this regard, CFIUS Policy officials recommend that I meet with you and Senator Shelby, and with Representatives Oxley and Frank, to inform you and them of the recent improvements to the CFIUS process. In order to keep Congress informed adequately and regularly about the CFIUS process, I would like to offer that Treasury, on behalf of CFIUS, orally brief the Senate Banking and House Financial Services Committees generally every quarter on completed reviews. On a case-by-case basis, CFIUS may suggest that its oversight committees invite other potentially interested members and committees with jurisdiction over areas affected by decisions under Exon- Florio to attend these briefings.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR INHOFE FROM DAVID A. SAMPSON

Q.1. Can you tell me whether there have been patterns of foreign acquisition by industry or specialty? Are any countries concentrating their purchases, and thus targeting our aerospace, software, materials, energy, electronics, and other sectors? Is there any cumulative, broad-picture analysis that would show if a certain country or alliance of countries was intentionally or unintentionally undermining any possible aspect of national security?

A.1. Commerce defers to Treasury on this question. Treasury has advised that they will provide you with a response to this question in the near future.

Q.2. How many U.S. companies were purchased by Japan, United Kingdom, Germany, China, and every other foreign nation in your

database? Can you give me a breakdown by nationality of the top 15 acquiring nations in regards to the industry areas they are investing in?

A.2. As chair of the Committee on Foreign Investments in the United States (CFIUS), the Department of the Treasury maintains records for all CFIUS cases since the statute's enactment in 1988. Therefore, we defer to the Treasury Department on this question. Treasury has advised that they will provide you with a response to this question in the near future.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM DAVID A. SAMPSON

Q.1. Please describe the factors the Department of Commerce takes into account in reviewing an acquisition in the first stage of the CFIUS process?

A.1. Commerce considers a large number of factors in determining the national security implications of a proposed foreign acquisition of a U.S. company or other assets. Major aspects include the likely effects of a transaction on domestic production needed for projected national defense requirements, the compliance record of all involved parties with U.S. and multilateral export control laws (including the parties' plans for managing their compliance with export control laws), the sensitivity of any technology being acquired, the potential impact on the Nation's telecommunications, energy, and other critical infrastructure, and other factors that impact the national security. Commerce agencies work closely with the Departments of Defense, Justice, State, and Homeland Security, as well as with the intelligence community, in assessing whether the national security could be compromised by the proposed transaction.

Q.2. What factors does the Department take into account in deciding whether to recommend that a matter be taken to formal investigation? Please be as specific as possible.

A.2. The Department will recommend that an Exon-Florio filing proceed to the formal investigation stage only when all identified national security concerns have not been resolved during the review stage. Major factors that could lead to such a recommendation by Commerce include:

- Additional information is needed from the companies engaged in the transaction in order for CFIUS to fully analyze potential national security risks associated with a transaction;
- There is a need to work out mitigation measures to address national security concerns;
- Highly adverse intelligence identifies serious national security risks; and
- Control of commercial activity by the acquiring party could adversely affect U.S. capability to meet national security requirements.

Q.3. Why are there so few formal Exon-Florio investigations?

A.3. There are relatively few instances where foreign acquisitions of U.S. firms have the potential to affect national security and those effects cannot be mitigated through security agreements dur-

ing the 30-day CFIUS review period. Additionally, in most CFIUS filings, the foreign purchaser is headquartered in a country that is a close ally of the United States.

Q.4. When would it be appropriate for the Department of Commerce to recommend, in the CFIUS process, barring or limiting a transaction because: The transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of domestic industries to meet national defense requirements," or "the capability and capacity of the United States to meet the requirements of national security." Please be as specific as possible.

A.4. Commerce might recommend intervening in a transaction when CFIUS has credible evidence that the foreign person might take action that adversely affects U.S. Government agencies, defense contractors, or domestic businesses in ways that threaten to impair the national security and no other laws are adequate or appropriate to address that threat. Such action may be warranted when, among other things:

- Access to critical materials, technologies, vendors, markets, or manufacturing capability might be denied, or lost.
- There are serious national security risks associated with the transfer of vital or highly sensitive manufacturing know-how or technology.

Q.5.a. How does the Department of Commerce monitor mitigation agreements entered into as a condition for approval of acquisitions?

A.5.a. To date, Commerce has played no formal role in monitoring mitigation agreements; nor has the Department had any responsibility in enforcing these agreements. Commerce has consulted with other CFIUS members on the design and implementation of mitigation measures employed in some transactions.

Q.5.b. What part or parts of the Department of Commerce are involved in such monitoring? Please be as specific as possible.

A.5.b. Commerce has played no formal role in monitoring mitigation agreements, but other CFIUS agencies on occasion share information with Commerce relating to compliance with mitigation agreements.

Q.6. At present, filings with CFIUS are voluntary. Would Exon-Florio work more effectively if filings were mandatory?

A.6. CFIUS has implemented the Exon-Florio Amendment in a manner that has achieved the national security objectives as prescribed in the statute without compromising our open investment policy.

On balance, CFIUS implementation of Exon-Florio has increased the awareness of investors to national security issues, brought transactions into conformity with existing laws where needed, and resulted in investors abandoning transactions that raised insurmountable problems.

Although Exon-Florio notices are voluntary, failure to notify leaves the transaction subject to Presidential action indefinitely.

Mandatory notice would create a significant added burden for foreign investors.

In giving the President broad discretion under the Exon-Florio Amendment, Congress recognized the flexibility that is needed to protect the national security effectively. This flexible system would not work with a mandatory system of filing, which would require clear definitions of such threshold concepts as national security and foreign control. This would also make it easier for parties to structure transactions to avoid the statute's reach.

The consequences of adopting the amendment could be quite damaging to U.S. interests because it could chill the climate for legitimate foreign investment in the United States.

Mandatory notification would be seen as screening foreign investment, would have an adverse impact on U.S. investment policy, and hinder U.S. efforts to promote more liberal investment regimes worldwide.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR INHOFE FROM STEWART BAKER

Q.1. Can you tell me whether there have been patterns of foreign acquisition by industry or specialty? Are any countries concentrating their purchases, and thus targeting our aerospace, software, materials, energy, electronics, and other sectors? Is there any cumulative, broad-picture analysis that would show if a certain country or alliance of countries was intentionally or unintentionally undermining any possible aspect of national security?

A.1. The Department of the Treasury previously submitted a response to this request. DHS defers to Treasury on this question.

Q.2. I also want to know how many United States companies were purchased by Japan, United Kingdom, Germany, China, and every other foreign nation in your database. Can you give me a breakdown by nationality of the top 15 acquiring nations in regards to the industry area they are investing in?

A.2. The Department of the Treasury previously submitted a response to this request. DHS defers to Treasury on this question.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM STEWART BAKER

Q.1. In your view, what specific steps should be taken to improve the CFIUS process, the Exon-Florio Amendment, or both, from the perspective of the responsibilities of the Department of Homeland Security?

A.1. The Administration is carefully considering whether changes to the CFIUS process are warranted and, if so, what changes should be made. While the Administration has not made any decisions at this time, we believe that any changes to CFIUS should be guided by the following principles:

- Further integration of national and homeland security interests for a post-September 11 environment;
- Continuation of a welcoming stance toward investments in the United States because it creates good jobs for American workers;
- Preservation of that which works about CFIUS with improvements and updates where needed, while maintaining the integrity of the decisionmaking process.

Q.2. Please describe the factors the Department of Homeland Security takes into account in reviewing an acquisition in the first stage of the CFIUS process? What factors does the Department taken into account in deciding whether to recommend that a matter be taken to formal investigation? Please be as specific as possible.

A.2. The Department of Homeland Security (DHS) considers whether the acquisition may affect national security broadly construed, focusing in particular on the acquisition's potential impact on critical infrastructure and other homeland security factors, as well as traditional measures of national security. In the CFIUS process DHS examines questions such as: (1) whether DHS already has sufficient legal or regulatory authority to address any threat to homeland security that might be raised by the transaction; (2) whether DHS has homeland security concerns about the parties to the transaction; and (3) whether the homeland security concerns can be resolved with binding assurances from the parties to the transaction.

Q.3. Why are there so few formal Exon-Florio investigations?

A.3. The vast majority of notified transactions do not require an investigation either because these transactions do not potentially threaten national security, or CFIUS is able to mitigate the national security issues that arise in connection with these transactions.

Many companies understand that sometimes their transaction may not be approved without some type of mitigation. The use of mitigation agreements enables CFIUS to address concerns without going into an investigation. In some cases where CFIUS agencies have identified mitigation measures during the 30-day review period that would adequately address national security concerns, companies have withdrawn their CFIUS notices in order to negotiate mitigation agreements. Once mitigation agreements are executed, the companies refile with CFIUS, and CFIUS then concludes the review.

Q.4. When would it be appropriate for the Department of Homeland Security to recommend, in the CFIUS process, barring or limiting a transaction because the transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of domestic industries to meet national defense requirements," or "the capability and capacity of the United States to meet the requirements of national security." Please be as specific as possible.

A.4. Questions regarding defense requirements should be answered by the Department of Defense. In general, DHS would closely scrutinize a proposed purchase that could threaten the availability of a good or service that is essential to national security.

Q.5. How does the Department of Homeland Security monitor mitigation agreements entered into as a condition for approval of acquisitions? What part or parts of the Department of Homeland Security are involved in such monitoring? Please be as specific as possible.

A.5. DHS policy with the assistance of the Office of General Counsel and other assets, as necessary, tracks compliance with mitiga-

tion agreements to which DHS is a party. This monitoring includes determining whether the parties have provided information they are required to produce under the agreements, and, as necessary, making on-site compliance visits, obtaining certifications and/or audits, and following up with the companies and other agencies if an issue arises.

Q.6. At present, filings with CFIUS are voluntary. Would Exon-Florio work more effectively if filing were mandatory?

A.6. DHS does not believe that mandatory filings would improve the CFIUS process. CFIUS already possesses authority to initiate a review if a filing is not volunteered, but most often a filing is made when CFIUS requests one informally.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR INHOFE FROM E. ANTHONY WAYNE

Q.1. Can you tell me whether there have been patterns of foreign acquisition by industry or specialty? Are any countries concentrating their purchases, and thus targeting our aerospace, software, material, energy, electronics, and other sectors? Is there any cumulative, broad-picture analysis that would show if a certain country or alliance of countries was intentionally or unintentionally undermining any possible aspect of national security?

A.1. The Department of State does not maintain statistical data on cases that have come before the Committee on Foreign Investment in the United States (CFIUS). We note that an extensive analysis of the merger and acquisition activity by foreign investors in the United States is planned for 2006; we refer you to the Department of the Treasury for more information on that analysis.

Q.2. I also want to know how many United States companies were purchased by Japan, United Kingdom, Germany, China, and every other foreign nation in your database. Can you give me a breakdown by nationality of the top 15 acquiring nations in regards to the industry areas they are investing in?

A.2. As Chair of CFIUS, the Department of the Treasury maintains the database on acquisitions that have come before CFIUS, and we would refer you to Treasury for the answer to your question.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM E. ANTHONY WAYNE

Q.1. Please describe the factors the Department of State takes into account in reviewing an acquisition in the first stage of the CFIUS process. What factors does the Department take into account in deciding to recommend that a matter be taken to formal investigation? Please be as specific as possible.

A.1. The Department of State brings to the CFIUS process expertise and experience in international economic issues, export control policy, intelligence, national security, and foreign policy. Our internal processes at the Department of State ensure that each and every CFIUS case receives careful scrutiny by offices with expertise in these areas. The Bureau of Economic and Business Affairs, the Bureau of Political-Military Affairs, the Bureau of International Security and Nonproliferation, the Bureau of Diplomatic Security, the

Bureau of Intelligence and Research, the Office of the Legal Adviser, and the appropriate regional bureau participate in the review of notifications received by CFIUS and forwarded to us by the Department of the Treasury as CFIUS chair.

The Department of State is primarily guided by the criteria in the Exon-Florio Aamendment. As a result, we consider international economic implications, factor in the relevant statutes on export controls (for example, the Arms Export Control Act), and nonproliferation, etc.

The Department of State is also able to draw upon the local diplomatic and economic expertise of our embassies to provide relevant information relating to the specific transaction under review.

Q.2. Why are there so few formal Exon-Florio investigations?

A.2. The vast majority of acquisitions by foreign entities generally do not raise the possibility of harm to national security. Seventy percent of the foreign direct investment in the United States comes from Canada and Western Europe. CFIUS has not generally required an investigation in the majority of these transactions either because these transactions do not potentially threaten national security, or issues that arise can be address within current statutes. The statutory language of Exon-Florio requires that CFIUS look first to the ability of existing laws and regulations (other than the International Emergency Economic Powers Act) to address national security concerns. To the extent that existing laws and regulations can accomplish this objective, the Department believes there is no need to rely on Exon-Florio.

Exon-Florio raises the awareness of foreign investors considering investment in the United States to the importance of national security, and it helps to ensure that foreign investments are structured in a way to avoid national security problems.

Q.3. When would it be appropriate for the Department of State to recommend, in the CFIUS process, barring or limiting a transaction because the transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of domestic industries to meet national defense requirements," or "the capability and capacity of the United State to meeting the requirements of national security." Please be as specific as possible.

A.3. The Department of State thoroughly examines all relevant factors in assessing the possible impact on U.S. national security of any transaction. The Department also relies on input from other CFIUS agencies as to whether they believe a national security threat exists. Exon-Florio provides wide latitude to the President, and by extension to CFIUS, on what to consider in the areas of national security concerns that Congress highlighted in drafting the legislation. CFIUS agencies have never viewed the list of factors as a closed list, and believe the present approach ensures the flexibility to take into account new issues and concerns.

While domestic production concerns have been a part of past CFIUS recommendations, including cases where CFIUS agencies have used agency specific mitigation agreements to address a perceived threat, it is important to recognize that these factors by themselves do not drive a decision. For the President to take action

under Exon-Florio, he must determine that there is credible evidence that the foreign person exercising control might take action that threatens to impair the national security. The President must have reason to believe, based, for example, on the foreign parties' prior actions, that it will take action through the acquisition that threatens to impair U.S. national security.

The risk to national security can relate to the factors in the statute (for example, by reducing or eliminating domestic production of a good needed for national defense) or to other factors the President considers important (for example, threat to critical infrastructure, potential terrorism finance). In addition, the President also must find that provisions of law other than Exon-Florio and IEEPA do not provide adequate and appropriate authority to protect national security.

Q.4. How does the Department of State monitor mitigation agreements entered into as a condition for approval of acquisitions? What part or parts of the Department of State are involved in such monitoring? Please be a specific as possible.

A.4. The monitoring of the mitigation agreements is primarily the responsibility of the agencies that are party to the agreements. Most often it is the Department of Justice, the Department of Homeland Security, and the Department of Defense that are signatories to these agreements, with Treasury having overall responsibility as the chair of the CFIUS process. When issues come before CFIUS where the interests of the Department of State are involved, the Department does take an active role in the discussion of the mitigation agreements.

Q.5. At present, filings with CFIUS are voluntary. Would Exon-Florio work more effectively if the filings were mandatory?

A.5. No. The Department of State believes the existing Exon-Florio Amendment, as carefully crafted by Congress, successfully protects national security while maintaining the U.S. Government's longstanding open investment policy. CFIUS's implementation of Exon-Florio has made foreign investors more aware of national security issues, brought transactions into conformity with existing laws where needed, and resulted in the abandonment of transactions that raised national security concerns that could not be mitigated. There is no evidence to suggest that transactions that have not be reviewed or notified to CFIUS under the current voluntary system present national security issues.

Although Exon-Florio notices are "voluntary," failure to notify leaves the transaction subject to Presidential review and possible action indefinitely. In addition, the Department of State or any other CFIUS member may notify a transaction to the staff chair, Treasury, to ensure that CFIUS may review any transaction that it believes should be reviewed.

In the Department of State's opinion, mandatory notification would undercut U.S. Government efforts to promote more liberal investment regimes around the world. The U.S. Government and American business have consistently opposed mandatory screening mechanisms for foreign investment when such policies have been implemented by foreign governments, and have sought the removal

of such mechanisms when the United States has negotiated international trade and investment agreements.

Moreover, introduction of a mandatory screening process could conflict with nondiscrimination commitments, particularly with respect to our Bilateral Investment Treaties and certain Treaties of Friendship, Commerce, and Navigation, and Free Trade Agreements, potentially exposing the U.S. Government to claims brought by foreign investors or their governments.

RESPOSNE TO WRITTEN QUESTIONS OF SENATOR INHOFE FROM PETER C.W. FLORY

Q.1. Can you tell me whether there have been patterns of foreign acquisition by industry or specialty? Are any countries concentrating their purchases, and thus targeting our aerospace, software, materials, energy, electronics, and other sectors? Is there any cumulative, broad-picture analysis that would show if a certain country or alliance of countries was intentionally or unintentionally undermining any possible aspect of national security?

A.1. The Department of the Treasury previously submitted a response to this request. Defense defers to Treasury on this question.

Q.2. How many United States companies were purchased by Japan, United Kingdom, Germany, China, and every other foreign nation in your database? Can you give me a breakdown by nationality of the top 15 acquiring nations in regards to the industry areas they are investing in?

A.2. The Department of the Treasury previously submitted a response to this request. Defense defers to the Treasury Department on this question.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM PETER C.W. FLORY

Q.1. In your view, what specific steps should be taken to improve the CFIUS process, the Exon-Florio Amendment, or both from the standpoint of the responsibilities of the Department of Defense?

A.1. The Administration is carefully considering whether changes to the CFIUS process are warranted and, if so, what changes should be made. While the Administration has not made any decisions at this time, we believe that any changes to CFIUS should be guided by the following principles:

- Further integration of national and homeland security interests for a post-September 11 environment;
- Continuation of a welcoming stance toward investments in the United States because it creates good jobs for American workers;
- Preservation of that which works about CFIUS with improvements and updates where needed, while maintaining the integrity of the decisionmaking process.

Q.2. Please describe the factors the Department of Defense takes into account in reviewing an acquisition in the first stage of the CFIUS process? What factors does the Department take into account in deciding whether to recommend that a matter be taken to formal investigation? Please be specific as possible.

A.2. There are a number of factors that we in the Department of Defense (DoD) consider before taking a position when it comes to reviewing a foreign acquisition of a U.S. company. These include five major substantive areas of interest and one procedural area of interest. The substantive areas are:

First, the significance of the technologies possessed by the firm to be acquired (for example, are they "state of the art" or otherwise militarily critical? Are they classified, export controlled, or otherwise security sensitive?);

Second, the importance of the firm to the U.S. defense industrial base (for example, is it a sole-source supplier and if so, what security and financial costs would be incurred in finding and/or qualifying a new supplier, if required?);

Third, possible security risks or concerns that might be posed by the particular foreign acquiring firm;

Fourth, whether the company to be acquired is part of the critical infrastructures that the DoD depends upon to accomplish its mission; and

Fifth, can any potential national security concerns posed by the transaction be resolved by the application of risk mitigation measures either under DoD's own regulations or through negotiation with the parties?

The procedural issue we consider is whether there has been a willingness on the part of the parties to the transaction to voluntarily negotiate risk mitigation measures when DoD believes they are necessary and whether there is sufficient time to do so before the end of the 30-day initial review period.

Q.3. Why are there so few formal Exon-Florio investigations?

A.3. There are relatively few formal investigations because most proposed foreign acquisitions of U.S. firms do not have national security implications. For those transactions that do raise potential concerns, often the issues can be adequately mitigated in the course of the CFIUS review process.

For transactions that have required mitigation measures to protect national security, the parties typically have either negotiated mitigation measures during the 30-day review period or the companies have withdrawn their notices (with CFIUS approval) until mitigation measures were negotiated. The companies then refiled with CFIUS, with the necessary mitigation measures in place, thus enabling CFIUS to conclude its review without a formal investigation. In some cases, the companies have abandoned the proposed transaction.

Q.4. When would it be appropriate for the Department of Defense to recommend, in the CFIUS process, barring or limiting a transaction because the transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of the United States to meet the requirements of national security?" Please be specific as possible.

A.4. Because each transaction is unique and is addressed on a case-by-case basis, it is not possible to provide a generalized standard for when the Defense Department would vote to bar or limit a transaction. The Defense Department would closely scrutinize

any transaction where U.S. companies: (a) have classified contracts with the DoD, and (b) when there are potential national security concerns with a foreign acquisition which cannot be mitigated through the National Industrial Security Program's Foreign Ownership, Control, and Influence Program (FOCI). Recommendations in other transactions (for example, where no classified contracts are involved) would depend on the potential impact on national defense and the ability to mitigate any risks through DoD actions or by memoranda of agreements with the companies.

Q.5. How does the Department of Defense monitor mitigation agreements entered into as a condition for approval of acquisitions? What part or parts of the Department of Defense are involved in such monitoring? Please be specific as possible.

A.5. Every signatory agency has the authority and responsibility to monitor an agreement to which it is a party.

The Department's Defense Security Service (DSS) enters into negotiations with the parties of cases involving Foreign Ownership, Control or Influence (FOCI) when classified contracts are involved. DSS develops specifically tailored risk mitigation agreements, which it designs to provide for the necessary level of security for classified data and any export-controlled information and technologies that may accompany it. The process for mitigating FOCI for firms with facility clearances is separate and apart from the CFIUS process. DSS monitors compliance in such instances involving facility security clearances and can take actions to protect information and technology determined to be at risk.

In cases where the agreements are interagency agreements signed by several CFIUS agencies, other agencies often notify DoD of issues that arise regarding potential noncompliance.

Q.6. At present, filing with CFIUS are voluntary. Would Exon-Florio work more effectively if filings were mandatory?

A.6. No. Although Exon-Florio notices are voluntary, there is a powerful incentive for transactions with national security implications to be notified to CFIUS. The CFIUS review process potentially provides these companies with a safe harbor, and according to Exon-Florio, if a foreign firm concludes a transaction that may be covered by the statute and does not file a notification with CFIUS, the acquisition will remain open to executive branch scrutiny permanently and could be subject to divestment by order of the President. For cases in which Defense has concerns about the acquisition of a particular U.S. firm, Defense would recommend to the companies that they submit a CFIUS filing. We believe this strategy has worked effectively to protect national security to date.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM ROBERT D. McCALLUM, JR.

Q.1. In a letter to GAO, dated July 25, 2005, Deputy Assistant Attorney General Laura Parsky stated that:

> The Department shares the concern expressed in the draft report with respect to the constraints imposed by the time limits of the current process. In particular, gathering timely and fully vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment.

> Any potential extension of the time available to the participants for the collection and analysis of that information would be helpful. (Emphasis added.)

GAO Report at 48.

What would an appropriate extension of time be? How should it be implemented?

A.1. CFIUS completes the vast majority of its reviews within the initial 30-day period. For a small number of cases, which present complex and sensitive issues, more time would, of course, be helpful. It is these cases in particular to which the Department of Justice was referring in its letter of July 25,2005. The Administration is carefully considering whether changes to the CFIUS process are warranted and, if so, what changes should be made, including with respect to the time for analyzing transactions.

Q.2. Please describe the factors the Department of Justice takes into account in reviewing an acquisition in the first stage of the CFIUS process? What factors does the Department take into account in deciding whether to recommend that a matter be taken to formal investigation? Please be as specific as possible.

A.2. At both the reviewing and the investigation stages, the Department's principal concerns in the CFIUS context relate to counterintelligence, cybercrime, U.S. communications system protection, privacy protection, the ability to conduct effective electronic surveillance, and in some instances counterterrorism, although there are other areas of interest within the Department's purview that may be implicated by a particular CFIUS transaction. The Department of Justice reviews each transaction that comes before CFIUS on a case-by-case basis. Because each transaction is unique, the Department does not use a one-size-fits-all approach to analyzing transactions.

While the factors mentioned above are of particular concern to the Department of Justice, as a member of CFIUS, the Department considers many additional factors when deciding whether a transaction could affect national security and consults closely with many different components of the Department, including the Federal Bureau of Investigation (FBI), as well as the intelligence community and other CFIUS agencies to determine the full breadth of factors that may be relevant in a particular transaction. These additional national security factors include access to critical infrastructure; domestic production needed for projected national defense requirements; the capability and capacity of domestic industries to meet national defense requirements; the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security; potential effects on sales of export controlled goods, equipment, or technology to certain countries; and potential effects on U.S. international technological leadership in areas affecting U.S. national security. However, this list is not exclusive, and in accordance with Exon-Florio, the Department considers a broad array of interests that may affect national security.

Q.3. Why are there so few formal Exon-Florio investigations?

A.3. There are relatively few acquisitions within the parameters of Exon-Florio that have the potential to affect national security. If that potential exists, CFIUS agencies strive to put in place adequate security measures. If it is not possible to reach agreement on security measures during the 30-day review period or if, despite best efforts, there are still unanswered questions regarding the effects on national security created by the transaction, CFIUS undertakes investigations or, in particularly complex transactions, companies withdraw their CFIUS notices in order to negotiate security agreements. Once security agreements are executed, the companies refile with CFIUS, thereby starting a new 30-day review period. CFIUS then has no reason to investigate the transaction given the security measures that have been put in place.

Statistics about the number of CFIUS investigations do not reflect those instances where security agreements were put in place, thereby obviating the need for an investigation. In a few cases, as a result of discussions with CFIUS, the companies realize their transaction will result in a negative recommendation by CFIUS and therefore decide against proceeding with the transaction.

Q.4. When would it be appropriate for the Department of Justice to recommend, in the CFIUS process, barring or limiting a transaction because the transaction affected "domestic production needed for projected national defense requirements," "the capability and capacity of domestic industries to meet national defense requirements," or "the capability and capacity of the United States to meet the requirement of national security." Please be as specific as possible.

A.4. As stated above, the Department of Justice considers many factors when deciding whether a transaction could affect national security and consults closely with its own internal components, including the FBI, as well as the intelligence community and other CFIUS agencies to determine the full breadth of factors that may be relevant in a particular transaction. Exon-Florio provides CFIUS with the flexibility to consider any number of national security factors, including those listed above.

Because the Department of Justice reviews each CFIUS transaction on a case-by-case basis and must assess the unique combination of potential threats and vulnerabilities associated with a given transaction, it is not possible to categorize those instances when it would be appropriate for the Department to recommend that a transaction be blocked or limited. The facts relating to each transaction are unique, and the national security considerations for each transaction must be based on these unique facts.

Q.5. How does the Department of Justice monitor mitigation agreements entered into as a condition for approval of acquisitions? What part or parts of the Department of Justice are involved in such monitoring? Please be as specific as possible.

A.5. The Department of Justice has responsibility for monitoring mitigation agreements to which it is a party. The Department's monitoring efforts are tailored to meet the unique circumstances of each mitigation agreement and may include, but are not limited to, such activities as conducting on-site audits, reviewing the reports of third-party auditors, and meeting with companies to discuss

their compliance with mitigation measures. In instances where other CFIUS agencies are also parties to an agreement, the Department and these other agencies coordinate monitoring efforts and allocate monitoring responsibilities based on their respective expertise and resources. Since it joined CFIUS in March 2003, the Department of Homeland Security has made significant contributions in terms of expertise and resources in monitoring many of the agreements to which it is a party.

Within the Department, the Criminal Division has primary responsibility for coordinating the Department's efforts in the CFIUS context, including coordination of monitoring responsibilities. The FBI has played a key role in monitoring mitigation agreements.

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October 21, 2005

Richard C. Shelby, Chairman
Senate Banking Committee

Paul S. Sarbanes, Ranking Minority Member
Senate Banking Committee
SD 534
Washington, DC 20510

Dear Chairman Shelby and Senator Sarbanes:

On behalf of the U.S.-China Economic and Security Review Commission, we would like to convey to you our observations and recommendations on needed improvements to the Committee on Foreign Investments in the United States (CFIUS). [1]

The current CFIUS process does not allow for adequate Congressional oversight. The Commission believes that the opaque nature of the process prevents Congress from being able to ensure that the Exon-Florio provision is appropriately used to protect U.S. national security interests. Therefore, this Commission recommends that the Exon-Florio provision be amended to require CFIUS to provide Congress notice each proposed transaction CFIUS is requested to approve. In addition, CFIUS should be required to report to Congress on the disposition of each case it considered. Clearly, the proprietary nature of many of these transactions merits limiting access to this information and, we believe, that notice and reports be limited to the Senate Banking Committee, the House Energy, and the Armed Services Committee.

This Commission believes that economic security is an integral part of "national security" and has heard testimony to this effect. William Schneider, Chairman of the Defense Science Board, testified before the Commission stating, "it's the national economy that's ultimately the source of our military power. There are very few precedents for a country being able to do much in the way of maintaining a comprehensive military capability without a strong national economy." The Exon-Florio provision should be amended to specifically require CFIUS to consider economic security as well as national security in making decisions.

The Commission understands the responsibility of the Department of the Treasury to encourage foreign direct investment in this country. However, when that responsibility conflicts with security concerns, the Commission believes security must be the overriding

[1] Commissioners Stephen D. Bryen and William A. Reinsch dissent from the recommendations in this letter.

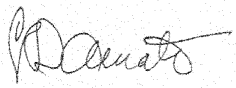
value. The recent report on CFIUS by the Government Accountability Office (GAO-05-686, September 2005) suggests that Treasury places the highest value on unrestricted access to American markets at the expense of some aspects of security by narrowly defining "national security." This Commission recommends that the chairmanship of the CFIUS be transferred to another of its member agencies.

As more Chinese companies are expected to acquire or attempt to acquire U.S. companies in the near future and as the majority of these Chinese companies will be state-owned or government affiliated, it is critical to strengthen the CFIUS process' adequacy of investigating such companies. Therefore, with particular applicability to China, this Commission believes that it is necessary to require a full investigation in every case where a company controlled by a foreign government and/or state seeks to acquire a U.S. company or activity. State-owned enterprises obviously advance government strategy, and such transactions merit special scrutiny.

The Commission applauds the moves by CFIUS to seek post-transaction reviews as indicated in the recent GAO report. We believe that these reviews should be mandated by Exon-Florio where CFIUS pursued a full investigations or where CFIUS identified a security concern that was addressed by the parties to the transaction. The results of these reviews should be provided to the above-named Congressional Committees.

We commend the Committee on its important hearings on this issue of great importance to U.S. national security, and hope it will proceed to propose the indicated amendments to the Exon-Florio provision.

Sincerely,



C. Richard D'Amato
Chairman

Roger W. Robinson, Jr.
Vice Chairman