Testimony of

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Before the House Financial Services Committee

On Foreign Investment, Jobs and National Security: The CFIUS Process

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Chairman Pryce, Ranking Member Maloney and Members of the Committee:

Thank you for the opportunity to testify before the House Committee on Financial Services on the subject of the Exon-Florio Amendment. It is a privilege to appear before you.[1]

I applaud your leadership, Madame Chairman, and that of the Committee for calling these hearings. Protecting U.S. national security has to be the United States' top priority. Notwithstanding the current debate over the acquisition of P&O by Dubai Ports World, 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 the testimony by the distinguished panel of Executive Branch officials. I am here to offer the perspective of a private sector advisor who works closely with the twelve members of the Committee on Foreign Investment in the United States (CFIUS). Since issues related to the Dubai ports controversy have been discussed extensively by others, I will not comment on this case but would be pleased to answer questions on the subject. My written testimony focuses on 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, CFIUS has applied greater scrutiny to foreign investments on national security grounds, imposed even tougher security requirements as a condition for approving specific transactions, and has enhanced enforcement of security agreements negotiated through the Exon-Florio process.

- Third, 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.

- Fourth, the global implications of Exon-Florio. Many countries around the world are considering changes to their own investment review processes. Politicization

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of the CFIUS process will encourage other countries to impose restrictions on U.S. investors abroad.

Before getting into each specific issues, allow me to try to clarify some facts about CFIUS. I have been struck by the assertions in the press that transactions breeze through the CFIUS process with alacrity. Nothing could be further from the truth.

Just because a transaction is approved in the first 30 days doesn't mean it received a cursory review. Just because the vast majority of cases are approved by CFIUS doesn't mean that the process isn't tough. And just because the President doesn't personally get involved in a review doesn't mean that the review lacks credibility.
Finally, I have seen the dozens of references to the "secret" panel. The process is supposed to be confidential. It deals with national security and intelligence issues.

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 precisely 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% 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 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.

[2] See Edward M. Graham and Paul R. Krugman, Foreign Direct Investment in the United States 71-72 (Institute for International Economics 1995).

President expressly welcomed 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 statement of policy more than two decades ago. 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 U.S. has maintained an open investment policy. For the rare instances when U.S. national security is threatened by a particular foreign acquisition or involvement in the U.S. economy, 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 U.S. did in World Wars I and II).

As a result, with the exception of 2003, when China was the largest recipient of direct foreign investment, the U.S. 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.

The vast majority of foreign acquisitions do not implicate U.S. national security interests in any respect. For the rare transaction that genuinely implicates U.S. national security interests, the Exon-Florio Amendment provides the President with ample authority to block the acquisition or otherwise mitigate the national security concerns it raises. 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, 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

[3] President Ronald Reagan, Statement on International Investment Policy, Sept. 9, 1983. *Available at* http://www.reagan.utexas.edu/archives/speeches/1983/90983b.htm.

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 export of controlled technologies, CFIUS has intensified its focus on an additional goal: the protection of critical infrastructure.

Some of the criticism of CFIUS has focused on the fact that the President has formally blocked only one transaction out of more than 1600 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 three years* than there were during the previous 10 years combined. In the last three years, I personally have been involved in three 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 ("NSAs") negotiated to mitigate the risk of foreign investment in the telecommunications sectors. (Unlike security agreements negotiated in other sectors, NSAs in the telecommunications sector are made public via the grant of FCC licenses, which often are conditioned on the agreements.)

Before September 11, NSAs for foreign acquisitions of U.S. telecommunications companies typically focused on the ability of US law enforcement to conduct electronic surveillance and wiretaps and prevent foreign governments from accessing call-related data. In the last few years, NSAs have become much tougher. Some recent NSAs 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 NSAs have:

- permitted only US citizens to serve in sensitive network and security positions (e.g., 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 US government agencies the right to inspect US-based facilities and to interview US-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 US entity, and certain directors of its board, to be US citizens approved by the US government and responsible for supervising and implementing the NSA.

Many of these provisions reflect concepts typically utilized by the US 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 non-classified 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, 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.

Recent Proposals to Amend Exon-Florio

Recent proposals to amend Exon-Florio would, among other things:

- expand the definition of national security to include 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, they would 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 Exon-Florio became law.[4] 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."[5] 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

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[4] See, for example, H.R. 3, "The Foreign Investment, National Security and Essential Commerce Act of 1987," 100th Congress, (introduced by Senator James Exon); H.R. 2386 ("The Foreign Investment and Economic Security Act of 1991," 102nd Congress (introduced by Rep. Mel Levine); H.R. 2394, "The Steel and National Security Act," 107th Congress (introduced by Rep. Dennis Kusinich); H.R. 5225, 101st Cong. (1990), H.R. 5225 (1990, 101st Congress) (introduced by Rep. Greg Waldron); and H.R. 2624, "The Technology Preservation Act of 1991", 102nd Congress, (introduced by Rep. Cardiss Collins).

[5] *Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science and Transp.*, 100th Cong. 3 (1987), at 17.

separation of powers issues under the U.S. Constitution.[6] 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.

In the vast majority of transactions reviewed by CFIUS there is either no national security risk or the national security threat can readily be mitigated. These transactions can appropriately be approved by CFIUS in the 30 day initial review period provided by statute. These investments typically come from companies located in countries that are our closest allies. There is no good reason to prolong the timeframe for approving these transactions -- a timeframe, by the way, that currently corresponds with the initial 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 for such investigations -- plus the informal, pre-filing consultation period -- are sufficient for CFIUS to do its job in the rare cases raising significant national security concerns.

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 to 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.[7] 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

[6] See *INS v. Chadha*, 462 U.S. 919 (1985).

[7] Foreign Acquisitions of Domestic Companies: Hearing on H.R. 3 Before the Senate Committee on Commerce, Science and Transp., 100th Cong. 14 (1987).

investment is welcome unless it threatens national security. If CFIUS were chaired by an agency with a security mission, the presumption would be reversed.

Fifth, I believe that significant improvements can be made within the current legislative framework in the area of transparency. The concerns voiced by Members of Congress over the Dubai Ports transaction makes it clear that Congress has serious questions about the CFIUS process. I believe if Congress had more visibility into the process, you would have greater comfort in, and knowledge that, the process is already rigorous. A few ideas for improved transparency:

- The CFIUS agencies could spend more time on the Hill briefing members of this Committee and other relevant oversight committees on their activities, processes and trends in filings.

- The CFIUS agencies could issue regular reports to Congress regarding the number of cases filed, the sectors affected, the countries of origin for investments and the number of proposed investments by foreign companies owned or controlled by foreign governments.

- The CFIUS agencies could collect and publish more aggregate and trend data. For example, CFIUS could keep better data on the number of withdrawals, including withdrawals in the first 30 days. Currently, CFIUS only collects data on the number of withdrawals after an investigation has started. In my view, this undercounts the number of transactions that are abandoned because companies realize that CFIUS approval will not be forthcoming.

- The CFIUS agencies and this committee could explore ways for this committee to receive classified briefings on substantive decisions made by CFIUS. Such classified briefings could be modeled on the process currently utilized in the Intelligence Committees: some briefings for the Big 4, others that include select staff, still others that include all Members. However, given the national security and commercial sensitivity of the information that would be provided in these briefings, there needs to be strict parameters on who would be briefed. In addition, I would assume that criminal penalties, including SEC and insider trading sanctions, would apply for leaks of classified or confidential information. CFIUS should keep sacrosanct proprietary, business confidential information.

Each of these important steps to create more transparency could be accomplished under the current statute without legislative changes.

Let me also offer some thoughts on what Congress should avoid:

- Congress should not create a public notice requirement for Exon-Florio reviews. A national security review process, because it affects U.S. national security, should by its very nature remain confidential. As part of virtually every CFIUS review, the executive branch conducts background checks on companies and individuals, undertakes an intelligence assessment and discusses highly classified

national security issues. Our national security would be negatively affected if these issues were discussed or even notified to the public. Further, CFIUS filings also include highly sensitive, proprietary company information. This often includes market sensitive information that competitors would love to have. A mandatory public notice component does not exist for Hart-Scott-Rodino. The same rules should apply to Exon-Florio. com

- Congress should avoid transparency measures which facilitate the politicization of individual CFIUS reviews. It is fairly easy for domestic competitors to dream up national security arguments against a foreign acquisition of a U.S. company. The CFIUS process is and should remain a serious, sober inquiry into the national security implications of a particular acquisition, insulated from politicization in the same way as filings under Hart-Scott-Rodino.

The Global Implications of Exon-Florio

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 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."[8] 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, including the oil sector. A draft of that law is expected to be put forward shortly.

- 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.

Let me give you a more recent, and more troubling, example in which a foreign government's proposed restrictions on U.S. investors seems to be directly linked to security commitments imposed by CFIUS on a company from that country. Specifically, the Indian government, spurred on in part by a domestic company that *itself* had a difficult time clearing CFIUS, announced its intention to impose extremely broad security

[8] LCI News, July 20, 2005, located at http://np.www.lci.fr/news/economie/0,,3232812-VU5WX0lEIDUy,00.html.

restrictions on foreign investments in the telecommunications sectors. These security restrictions were announced in the context of a proposal to raise the ceiling on permitted foreign investment in the telecommunications sector, from 49% foreign ownership to 74% foreign ownership. In this specific case, it appears that the Indian government responded to a request by the Indian company VSNL, which itself has signed an NSA related to one of their investments in the United States, to impose similar security restrictions on U.S. and other foreign investors. Specifically, in a letter publicly filed with Indian regulatory officials, VSNL wrote, "[we] propose that TRAI [the Indian regulatory authority] consider whether, in the interests of a level competitive playing field as well as regulatory symmetry, a similar security agreement process should exist in India for U.S. and other foreign carriers who desire a license to provide domestic or international services."[9] VSNL further wrote, "While we certainly do not recommend that the Indian Government force foreign carriers to wait as long as VSNL has been made to wait for its license to enter the U.S. telecommunications market, we believe that the existence of these agreements in India and other countries will have a beneficial result by moderating the willingness of the U.S. government to impose burdensome conditions and requirements in their own security agreements, which of course hinder the ability of VSNL and other foreign carriers to compete fairly against U.S. carriers who are not subject to such requirements."

Madam Chairman, this letter proves the old maxim, "what comes around, goes around." While we should never compromise national security, the Executive Branch and Congress need to realize that restrictions imposed on foreign companies in the United States will invite similar restrictions in foreign countries against U.S. companies. We need to be careful not to encourage other countries to impose restrictions that hurt American investors, nor should we chill the foreign investment that is so vital to the American economy.

Conclusion

The Dubai ports transaction has ignited a passionate debate about CFIUS. But as we all learn in law school, bad facts lead to bad law. I would hope that this committee would take a deliberate, measured approach in response to the controversy and refrain from amending Exon-Florio. Instead, the Committee could work with the CFIUS agencies to improve any shortcomings in the implementation of the Amendment.

Thank you for the opportunity to appear before you today.

[9] See http://www.trai.gov.in/VSNL.pdf (at Appendix D).