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U.S. Department of the Treasury
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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 eight 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 United States communications systems, and seeks to ensure the protection of sensitive United States 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 United States 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 towards 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% of employment in non-bank private industries;
- Had payrolls of \$318 billion, an average of \$60,527 per employee, 31% higher than the average of all companies;
- Accounted for 5.8% of U.S. gross domestic product originating in private industries compared to 4.3% a decade ago (an increase of more than 30%);
- Accounted for over 20% 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 co-sponsors.

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 investigations. However, the President retained the authority to suspend or prohibit a transaction. responsibilities.

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 information 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 (NSAs), 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 re-file. CFIUS then concludes its review.

As noted, publicly available NSAs 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-9/11 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, twelve of which reached the President's desk for decision. In eleven 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, six 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 time frame 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.
- Lastly, 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.