

Testimony of Patrick A. Mulloy
before the
Committee on Banking, Housing, & Urban Affairs
Hearing on the Implementation of the Exon-Florio Amendment and the
Committee on Foreign Investment in the United States
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 USC App 2158).

I should note that, while a member of the U.S. 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 U.S. 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 provision 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 rule-making that developed the regulations under which it would be administered. It took the Treasury Department almost three 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 advisor, 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 four 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 9/05 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 backwards 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 6th 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 6th 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 ten years has run massive and ever increasing trade surpluses with this country. This year alone our bi-lateral 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.