Testimony of Patrick A. Mulloy
before the
Subcommittee on Commerce, Trade, and Consumer Protection
House Energy and Commerce Committee
Hearing on H.R. 5337 The National Security Foreign Investment Reform and Strengthened Transparency Act of 2006
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Introduction

Mr. Chairman, Ranking Member Schakowsky, 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 and serve as the Washington representative of the Alfred P. Sloan Foundation.

During the period of 1987-1988, when the Exon-Florio Provision was being considered by the Congress, I served as the Senate Banking Committee's General Counsel and was directly involved in the negotiations which led to its enactment.

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, and the four recommendations it adopted in its 2005 report by a vote of eleven to one.

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 on May, 1975 by President Ford in Executive Order 11858. 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, among other things, to 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."

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 criterion 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 that both protection of its jurisdiction over investment policy and championing an open investment policy led to Treasury's opposition. Regardless of the reason, 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 with the objective of making 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 stating that the term "national security" was not 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"

A decision also was made 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 rather than the narrower national security controls associated with 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 and acquisition 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 that was then of public concern: the acquisition of the Missile Division of the LTV Aerospace and Defense Company by Thomson-CSF, a French firm controlled by the French Government. Senator Mack said, "We don't want any foreign government to own major U.S. defense contractors."

In his opening statement, 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'."

Mr. Peter Mills, the first Chief Administrative Officer of SEMATECH, also testified at that June 1992 hearing. SEMATECH was a joint DOD/Industry consortium that 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". [Emphasis added]

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.

1992 Amendments to Exon-Florio

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 basic 30-day review period and conduct a 45-day investigation in any instance in which an entity controlled by or acting on behalf of a foreign government is seeking to acquire of a U.S. entity. It also inserted a provision **requiring** the President and such agencies as the President designates to report to Congress in 1993 and each four years thereafter whether any foreign government has a coordinated strategy to acquire U.S. companies involved in research development or production of critical technologies. Congress also to the statute added additional criteria that it for consideration during reviews of foreign takeovers.

The Treasury Department Has Failed To Implement Congressional Mandates

In 1994 the Administration submitted to the Congress its first report under the required quadrennial report statutory provision of the DPA. It has never submitted another. The 1994 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 submitting 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 submitted 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 concerning patterns in takeovers and their cumulative effect.

The Government Accountability Office (GAO) in its September 2005 report on the implementation of Exon-Florio, 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. This is exactly the point on which the Treasury's ineffective implementation of Exon-Florio was made so absolutely clear earlier this year in the Dubai Ports transaction.

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 Treasury has "limited the definition to export controlled technologies or items, classified contracts, or specific derogatory intelligence on the foreign company." This does not reflect the statutory criteria Congress mandated. On page 13 of its report, GAO told 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 was deliberately placed in the Defense Production Act to indicate Congress *did* want defense industrial base issues considered in Exon-Florio reviews.

The CFIUS Process Needs to be Reformed

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. Awareness of this fact is one reason many Members of Congress had no confidence that the Executive Branch would adequately review the 2005 proposed purchase of Unocal the Chinese National Overseas

Oil Company (CNOOC). The Dubai Ports fiasco made the need for reform of the CFIUS process even clearer to all informed observers.

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.

In its 2005 Report the Commission by an eleven to one vote recommended:

(1) the Exon-Florio provision be amended to require CFIUS to provide Congress notice of 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.
(2) the Exon-Florio provision should be amended to specifically require CFIUS to consider economic security as well as national security in making decisions.
(3) Congress urge the President to transfer the chairmanship of CFIUS from the Treasury department to another of its member agencies.
(4) Congress should amend the Exon-Florio provision to require post-transaction reviews of CFIUS filings that have received full investigations, and that the results of these reviews be provided to Congress.

Under the Constitution, the Congress has the authority to regulate Interstate and Foreign Commerce. 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 well over $200 billion. Its Government has acquired almost one trillion 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 China, 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. 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.

My Views on H.R. 5337

Let me now offer some specific comments on H.R. 5337, the bill to reform the CFIUS/Exon-Florio process that was unanimously reported out of the Financial Services Committee on June 22, 2006. The bill, while it does not remove the Treasury from chairing the CFIUS process as I and the China Commission had previously recommended, does make major improvements in the present law and process. I will not focus my testimony on all the good things this bill does to ensure greater transparency and Congressional oversight to the process, but rather will focus on some matters where I believe improvements to the bill can be made.

First – While H.R. 5337 in its definition of "covered transactions" does apply its provisions to all foreign purchases of U.S. companies, it does not require that the Government receive notice of all such purchases. I believe the Government should have some means of gathering information on every purchase by a foreign person of a U.S. company even if that transaction is not filed for review by CFIUS. I make this point to ensure that our intelligence agencies get information on all purchases of U.S. companies so they can analyze the cumulative impact of various acquisitions of key technologies and examine patterns of foreign acquisitions. Having such analyses from the intelligence agencies can help ensure that our technology base will not, as Dr. Alan Bromley, the first President Bush's science advisor, warned, "be nibbled from under us through a coherent plan of purchasing entrepreneurial companies." Section 4(b) of H.R. 5337, which is entitled "Analysis by Director of National Intelligence," assumes that information on every transaction is available to the intelligence communities. That provision charges the Director to "expeditiously carry out a thorough analysis of any covered transaction" – not just transactions that are filed for review. The Director of National Intelligence cannot carry out this mandate unless information on all foreign purchases of U.S. companies is made available to the intelligence agencies.

Second – I believe the test for moving from a 30-day investigation to 45-day national security investigation is too strict. The bill provides that CFIUS should move from a 30-day review to a 45-day investigation if the review "results in a determination that the transaction threatens to impair the national security and that threat has not been mitigated during or prior to the review of a covered transaction." I believe the provision should be modified by substituting "could threaten" for "threatens." Otherwise the test

for commencing an investigation the same test for blocking a transaction after the conclusion of an investigation.

Third – I am concerned that many times CFIUS reviews are effectively completed before the parties to a transaction even start the CFIUS process by filing a written notice of the transaction to the Chairperson of the CFIUS Committee. This is because a practice has developed whereby, in the words of one knowledgeable private sector lawyer, "in the vast majority of cases the parties reach an agreement with the interested agencies before notice is filed with the CFIUS Committee."[1] This has the effect of making the statutory time frame almost meaningless. It also makes the CFIUS process totally non-transparent and makes it very difficult for Congress to conduct effective oversight of the process. Substantive discussions between the CFIUS agencies and the parties to a proposed transaction should not take place until after the written notice is filed that formally initiates the review process.

Fourth – I support the idea of putting the membership of CFIUS into law. I would not however, as H.R. 5337, section 3, does, include the "Chairman of the Council of Economic Advisors," the "Director of the Office of Management and Budget," or "any other designee of the President" in the CFIUS membership. I do not believe the Council or OMB bring much national security expertise to the process. They do bring, in my experience, an ideological commitment to not interfering with market transactions. I also think you do not need the open-ended "any other designee" as that could pave the way for political operatives rather than professional appointees to gain a role in making judgments on important national security matters.

Conclusion

Thank you very much for inviting me to this hearing. 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. I am happy to answer any questions.

[1] **Committee on Foreign Investment: The Critical Infrastructure Protection Program. Published by the George Mason University Law School on February 2006. See page 26.**