Testimony

of

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Good morning Mr. Chairman, Ranking Member Bachus and members of the Committee, my name is Todd Malan and I am President & CEO of the Organization for International Investment or OFII. Thank you for the opportunity to testify today.

OFII is an association representing the interests of U.S. subsidiaries of companies based abroad or "insourcing" companies. OFII has 150 member companies, which range from mid-sized businesses to some of the largest employers in the United States, such as Honda, HSBC, Sony, AEGON Insurance, Nestlé, Unilever and L'Oreal.

Collectively, insourcing companies employ 5.1 million Americans, pay 32% higher compensation than at all U.S. firms, support 19% of all U.S exports and in 2005 reinvested $59 billion in profits back into the U.S. economy.

In many respects, my members have the most at stake in regard to potential changes to the Exon-Florio Amendment because they are the companies that most frequently are subject to CFIUS reviews. Several dozen of my members have made acquisitions subject to CFIUS review in recent years and many of my member companies go through CFIUS reviews multiple times each year. In particular, a number of recent cases that have caused consternation in the business community are OFII members.

National Security is the Priority

In a post-September 11th era, protecting U.S. national security is the priority. CFIUS officials typically analyze three factors when determining whether a transaction raises national security concerns:

- *Threat:* In CFIUS's threat analysis, the agencies try to identify whether there is anything that would raise questions of trust with the buyer. Threat analysis typically relies heavily on information from intelligence agencies.
- *Vulnerability:* In CFIUS's vulnerability analysis, the agencies identify how sensitive the target company's assets are from a national security perspective.

- *Consequence:* CFIUS then determines the risk to U.S. national security by combining the threat and vulnerability analysis into a "consequence" analysis. In other words, if a buyer had "bad intent" and the target company's assets created vulnerability, what is the marginal increased risk to U.S. national security?

When functioning properly, CFIUS should use these factors as a triage doctor would in an emergency room. It should quickly analyze and approve non-sensitive transactions in which the buyer does not pose a threat and/or the target does not involve a national vulnerability. This leaves the process able to focus on transactions where the national security risk is significant. Where there are real risks, CFIUS can and should pursue mitigation agreements to address the increase in risk as a result of a transaction. For those few cases where mitigation is not an option, the President has the authority to block a transaction.

The Benefits of Foreign Investment in the U.S.

In carefully crafting the Exon-Florio Amendment, and the narrow changes to it since then, Congress recognized that foreign investment in the United States makes a positive contribution to the economy. This law is a scalpel, not a meat cleaver. Congress could have chosen to create a broader and more restrictive system that would have resulted in steeper barriers to all foreign direct investment whether or not a transaction implicated national security. It did not. This flexibility is testament to the fact that the United States has long welcomed and benefited from foreign investment. According to the most recent government figures, the facts about insourcing's contribution to the economy are clear:

- U.S. subsidiaries employ 5.1 million Americans and operate in all 50 states.
- U.S. subsidiaries support an annual payroll of $325 billion.
- Average compensation per employee is $64,428 – 32% more than compensation at all U.S. firms.

- U.S. subsidiaries are heavily concentrated in the manufacturing sector, with thirty-one percent of all American jobs at U.S. subsidiaries in manufacturing industries.

- Contrary to many people's assumptions, these companies don't just invest here to access our market. U.S. subsidiaries account for nearly 19% of all U.S. exports.

- New foreign direct investment (FDI) totaled almost $87 billion in 2005.

- U.S. subsidiaries reinvested $59 billion in their U.S. operations. In other words, profits earned here, stay here.

- U.S. subsidiaries spent $29.9 billion on U.S. research and development activities.

- Ninety-four percent of total assets owned by foreign companies are from OECD countries.

- Ninety-eight percent of U.S. FDI is from private sector firms -- only two percent of total direct investment (*assets*) is owned by companies that are controlled by foreign governments.

In today's global economy, labels such as "foreign" or "domestic" are less and less relevant. American's own over $3 trillion worth of foreign companies stock either directly through mutual funds or pension funds. On average 20% of the shares of the foreign companies with the largest investment in the U.S. are actually owned in the U.S. To me, this ownership change blurs the line between "us" and "them."

Global companies invest in the United States because of the size of our market, the quality of our workforce and the certainty and predictability of our legal regime. A few examples:

> *Novartis*, the Swiss Pharmaceutical Company, recently decided to invest $2 billion in high-wage, high-skill jobs when it moved its global research headquarters from Basel, Switzerland to Cambridge, Massachusetts.

T-Mobile USA, a U.S. subsidiary of the German-based Deutsche Telekom opened a new customer service center in Missouri last year. The new center creates 700 jobs for the area and will help T-Mobile maintain its *J.D. Power* ranking as #1 for customer service.

Samsung, the Korean electronics company, is investing $3.5 billion in its semiconductor fabrication facility in Austin, Texas. By November 2008 the expansion is expected to have created 700 new jobs with an annual payroll of $45 million.

*Tate & Lyle***,** the British food and industrial ingredient producer, recently announced that it will invest $260 million to construct the first phase of a new corn wet mill in Fort Dodge, Iowa that will produce ethanol and biodegradable starches for the paper industry.

Concerns about Current CFIUS Process

Mr. Chairman, global companies are not investing in the United States because our wages are low. If that were the case, Bangladesh would lead the world in inward investment. Rather, they are investing in the United States because our worker productivity is high, our market is large and our regulatory system is transparent and predictable. In fact, in OFII's annual CEO survey, the highest-rated factor in terms of the attractiveness of the U.S. as a location for investment was our workforce.

In a global economy, companies invest where they can maximize the value of their investment. And the United States has historically been the largest and most important market for global investment.

But that can change.

Trends within the CFIUS process since the Dubai Ports World controversy are creating more uncertainty for foreign investors. In turn, that uncertainty could lead foreign investors to invest their money elsewhere. If that occurs, both the U.S. economy and national security would suffer.

A recent study published by the National Foundation for American Policy showed that, in the last year, the number of CFIUS filings increased by 73%, the number of investigations jumped by 350% and the number of companies withdrawing their filings with CFIUS grew by 250%. There were more second-stage investigations last year than during the previous five years of the Bush Administration and more than during 1991 - 2000. The number of mitigation agreements - or conditions imposed on companies - more than tripled last year. More specifically, the Department of Homeland Security required an average of 4.5 mitigation agreements per year between 2003 and 2005. Last year, DHS required mitigation agreements in *fifteen* transactions.

While unofficial data suggests that there was growth in foreign investment in 2006, these dramatic changes within CFIUS occurred for another reason - the bureaucracy reacting to the political firestorm over the Dubai Ports World transaction. That controversy was somewhat understandable given that most people became aware of the transaction *after* CFIUS had approved it. Despite some reasonable arguments for the transaction, as well as legitimate concerns, the damage was done because the public and elected officials felt blindsided by CFIUS approval before being able to digest all of the facts. At the very least the DPW controversy is a lesson to companies and their advisors to do a better job in explaining a transaction and its benefits early in the process.

While I don't have insight into CFIUS's review of individual transactions, it is hard to imagine that in 2006 there were suddenly a much larger number of transactions that truly implicated U.S. national security. Rather, I suspect that the CFIUS bureaucracy went into a post-DPW hyper-cautious mode. Caution is warranted, but only when a transaction creates an increase in risk and no other laws are adequate to address the increased risk.

Why should Members of this Committee care of this balance is unsettled? Two reasons: First, if CFIUS agency's employees and resources are distracted with transactions that do not involve a material increase in security risk, it detracts from their ability to review transactions that *do* implicate national security. Second, if global companies begin to view CFIUS as something more than a national security screening process then it could have a negative impact on the United States' ability to attract beneficial foreign investment in areas that have no impact on national security.

Let me elaborate on that latter issue, OFII is concerned that some agencies are taking undue advantage of the leverage inherent in CFIUS. CFIUS should *not* be a fishing expedition for a single agency to address comprehensive industry objectives on a "catch-as-catch-can" basis merely because they have leverage over one industry participant. CFIUS should not be a way for the government to avoid the open and deliberative process of creating rules under normal rule-making procedures, in which public comment and Congressional accountability are present. For example, if the Department of Homeland Security perceives a vulnerability in our telecommunications infrastructure, it should address that vulnerability across the sector, without regard to the ownership of firms. Both elected officials and the public have correctly identified major chemical plants as potentially vulnerable to terrorist attack. Government agencies and the industry have worked to address this. Would it makes sense for security standards or government protections to only apply to a DuPont facility and not one owned by BASF? Of course not. CFIUS agencies should not approach national security vulnerabilities in a piecemeal fashion.

The business community was also troubled by the inclusion of the so-called "evergreen" CFIUS provision in the recent Lucent-Alcatel transaction. The evergreen provision would allow CFIUS to reopen a review and potentially order divestment for non-compliance with an agreement. In December 2006, OFII and three other business groups, the Business Roundtable, Chamber of Commerce and Financial Services Forum, wrote to Secretary of the Treasury Paulson to express our concern with this provision. The letter, of which I would ask that a copy be inserted in the record, states:

> The bedrock principle of openness [to investment], however, is challenged when the Executive imposes conditions on investments that effectively allow it to re-investigate transactions, impose new conditions, and even potentially unwind the transaction at any time....Such conditions can chill investment, make those who do invest more cautious about the types of commitments they are willing to give the government in the context of the CFIUS review, and, ultimately, harm the economy.

Mr. Chairman, if a company illegally exports products to a sanctioned country, that company should be penalized under existing criminal or civil laws. If an individual spies on the United States, they should be prosecuted under the Espionage Act and go to jail. And if a company that does business with the U.S. government does not live up to its commitments under a contract or other agreement with the government, it can be barred from doing business or employees can be prosecuted. Ample measures are available to enforce commitments made by companies in the CFIUS process. But the "evergreen" provision – the ability to rip apart companies that have merged their operations on a global basis – is a Sword of Damocles that will impact the market's valuation of the merged company. If it were ever used, the "evergreen" provision's punitive power will primarily impact the individual investors who either directly, or through their mutual funds, own the newly combined company. Who would be hurt if the government forced Alcatel and Lucent to separate? The shareholders of the company, over 40% of whom are Americans. "Evergreen" provisions are unnecessary and ultimately would cause undo harm to a broad group of people who have no role in controlling the company.

In my view, the lesson of the Dubai Ports World controversy is that CFIUS and the parties to a transaction need to do a better job communicating with Congress and ensure that Congress has greater visibility into the CFIUS process. In the aftermath of DPW, I don't think that Congress intended to signal to CFIUS that it should lower its threshold for reviewing transactions or use the process to address vulnerabilities across an industry sector. At the end of the day, I think Congress and the American people expect CFIUS to zealously focus on transactions that represent a material increase in the three factors I outlined previously (threat, vulnerability and consequence) while dispensing with

transactions that provide beneficial international investment and have little connection to national security.

Does CFIUS Need To Be Changed?

OFII supports H.R. 556 with a few changes as outlined below. Mr. Chairman, we appreciate your work, as well as that of Ms. Pryce, Ms. Maloney, and Messrs. Blunt and Crowley, to again put together a balanced bill that protects U.S. national security while welcoming beneficial foreign investment. I also applaud the way that you and others have worked during the 109th and 110th Congresses to ensure that the effort is bipartisan. We have some suggested changes to the bill as outlined below. It's important to note however, that if the bill were to become broader and more restrictive during the remaining legislative process, we would prefer no legislation to bad legislation.

As I previously stated, CFIUS has changed itself in the wake of the Dubai Ports World controversy. Some of those changes are positive. Transactions are regularly being reviewed at a much more senior level. New staff and resources have been added at Treasury and other agencies. Coordination with the DNI and other intelligence agencies has improved. Enforcement of agreements has improved. And most importantly, CFIUS has improved communication with Congress through notifications after reviews have been completed, quarterly briefings and the submission of the long-overdue Quadrennial Report.

These improvements to the CFIUS process can and should be memorialized and codified either through an Executive Order, legislation or both. Action by Congress and the Executive branch to provide certainty to both companies and CFIUS agencies is needed. Without action of some sort, the current uncertainty in the market will lead to a chill in beneficial investment. That is why your work is so important.

Allow me to share a few thoughts on some of the principles that OFII believes should be taken into account:

Maintain Time Periods for Reviews and Investigations: As mentioned above, investors need certainty, and a predictable regulatory process is an important component in an investor's calculation. The longer a transaction takes to close, the more uncertainty there will be. In OFII's view, your bill takes the right approach by preserving the initial 30-day review period, which provides CFIUS with ample time to analyze the national security risks - if any - associated with 95% of the transactions it reviews. These represent transactions coming from our closest allies - the UK, the Netherlands, Japan, Australia and the rest of Europe. We believe that the existing time periods under the law are adequate, and CFIUS has ample flexibility to extend their reviews for difficult transactions. It is also important to keep in mind that most parties conduct informal "pre-notification" meetings with CFIUS agencies to begin to flesh out issues prior to formally filing. As such, our preference would be to maintain the existing statutory time frames. However, if Congress wants to give CFIUS additional time, it is much preferable that Congress do so by giving CFIUS additional time after a second-stage investigation rather than changing the initial 30-day review period.

I am concerned, however, that the provision in the bill which gives the DNI a minimum of 30 days to complete its review will inadvertently force transactions into a second-stage investigation. My understanding, based in part on Secretary Paulson's letter to the Committee last year, is that the DNI does not believe it normally needs 30 days to conduct its intelligence analysis. The addition of this provision could result in the DNI's not providing its analysis until the end of CFIUS's own 30-day review period, thereby forcing CFIUS either to unnecessarily pursue an investigation or to complete its review without the full benefit of the DNI's analysis. CFIUS has the flexibility to extend its reviews on a case-by-case basis if the DNI states that more time is needed. I hope this provision can be adjusted when you mark-up the bill in Committee.

Communications with Congress: OFII applauds the approach taken in H.R. 556 with respect to communication with Congress. OFII agrees that Congress should be notified after and not during a review or investigation. OFII also agrees that reporting on trend information - the number of filings, the sectors which are receiving investments, the source of investment - is much more important for oversight purposes than detailed

information on individual transactions. OFII also supports the approach you have taken to protect business sensitive and proprietary information.

Mandatory investigations for government-owned companies: Some acquisitions by government-owned entities create unique and potentially problematic national security issues. But not all such acquisitions do. By mandating longer review periods for *all* acquisitions by government-owned entities -- even where there are no national security issues -- CFIUS's attention and resources will inevitably be diverted from cases that actually raise national security issues. OFII believes that you should allow companies that may be, in whole or in part, government-owned to be dealt with more expeditiously if a particular acquisition does not raise national security issues. That way, firms with government ownership that don't implicate national security or whose government ownership is benign (i.e. a foreign pension scheme owning a significant portion of a company which is analogous to the Retirement Systems of Alabama owning a significant portion of U.S. Airways) would take up fewer CFIUS resources and move through the process more quickly.

Conclusion

Let me close by complimenting the Chairman and Ranking Member for holding this hearing and for working to create smart and sound legislation on a bipartisan basis. We welcome the focus on the CFIUS review process and the role that foreign investment plays in the U.S. economy. We believe that if both are better understood, they will be more appreciated.

Mr. Chairman, thank you again for calling this hearing. We look forward to working with you, your colleagues and the Administration to enhance America's national security because a more secure nation is one that will attract investment, encourage capital accumulation, and realize long-term economic growth.