

**TESTIMONY OF
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**BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY
POLICY, TRADE AND TECHNOLOGY**

**ON H.R. 5337, THE REFORM OF NATIONAL SECURITY REVIEWS
AND FOREIGN DIRECT INVESTMENT ACT**

May 17, 2006

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

Thank you for the opportunity to testify today. It is a privilege to appear before you.

I would like to applaud your leadership, Madame Chairman, and that of Ranking Member Maloney, Chairman Oxley, Ranking Member Frank, Representative Crowley, and many other members of this Committee for the careful, deliberate, considered process you undertook to develop this bipartisan legislation. You held multiple hearings. You took testimony from a variety of witnesses and distinct perspectives. Your staff held multiple briefing sessions and studied the issues. And all of this took place in a very heated political environment in an election year. Because of your leadership, I believe that the Committee is now considering a tough, effective bill that will restore Congress's confidence in CFIUS, enhance protection of national security and maintain the United States' longstanding open investment policy.

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Comments on the Blunt/Pryce/Maloney/Crowley Bill

In my view, the most important principle that should guide Exon-Florio reform is to ensure that CFIUS has all of the tools and all of the time needed to scrutinize, dissect and act on the cases that present real national security issues, while allowing the cases that do not raise real national security issues to proceed through CFIUS in the initial 30-day period. Ensuring that transactions that don't raise national security issues can obtain Exon-Florio approval in 30 days is essential to avoid discriminatory treatment of foreign investors that would chill the investment our economy needs. As I mentioned during the Committee's March hearing, American companies that make acquisitions need to secure antitrust approval under the Hart-Scott-Rodino Act, which also has an initial 30-day review period. Preserving two 30-day, parallel regulatory processes for both domestic and foreign acquisitions of U.S. companies ensures that foreign bids for U.S. companies are not discounted or ignored because of longer regulatory timeframes.

With a few tweaks, I believe the bill currently before the Committee will enhance U.S. national security while maintaining an open investment environment. Specifically, the bill requires CFIUS to consider additional factors during the review and investigation process, including whether a transaction has a security-related impact on critical infrastructure. While I would prefer to maintain the existing time periods, it is much preferable to add additional time to the end of the investigation period, as the bill does, rather than extending the process after the initial 30-day period. It ensures that CFIUS will have the information it needs by giving the Committee greater investigatory authority. It defines the appropriate role of the intelligence agencies as an information resource, as opposed to a policy role. It enhances accountability for both CFIUS and the transacting parties by requiring certification of notices, reports, and decisions, and by establishing procedures for control and continued monitoring of withdrawn transactions. It maintains Treasury's leadership of the Committee and clarifies the security agencies' role in negotiating and enforcing security agreements. The bill maintains voluntary, as opposed to mandatory, notices. And the bill enhances transparency of the process by requiring CFIUS to collect and share more data, on an aggregate basis, through semi-

annual reports to Congress, without creating burdensome notice and reporting requirements that will politicize the process or risk leakage of business proprietary data. These provisions represent important substantive and procedural improvements to the CFIUS process.

I do, however, have several concerns with specific provisions of the bill in its current form.

First, I completely understand the dynamics that led the Committee to tighten the so-called “Byrd Amendment” for government-owned companies, particularly in the wake of the Dubai Ports Controversy. In my view, acquisitions by some government-owned companies raise unique national security issues and should receive scrutiny. U.S. companies are put at a competitive disadvantage against those government-owned companies that receive subsidized or concessional government financing. But not all government acquisitions create the same national security risk, and CFIUS should have discretion to distinguish between transactions that raise issues and those that don’t. The British government currently owns Westinghouse, the nuclear company, and the Venezuelan government currently owns CITGO. If each of those acquisitions were to be made today, they obviously would and should be treated differently given the unparalleled relationship we have with the UK and the difficult relationship we have with Venezuela. I think it would be useful for the Committee to clarify the intent of the legislation, perhaps in its report, that CFIUS can allow acquisitions by government-owned companies to go straight to the investigation stage and that CFIUS has discretion to close the investigation if no real issues exist or if any national security concerns have been mitigated.

Second, I also understand the Committee’s desire for additional accountability. But the requirement that the Secretaries or Deputy Secretaries of both the Treasury and Homeland Security personally approve and sign each and every review and investigation may create bureaucratic delays and impede CFIUS’s ability to efficiently implement Exon-Florio. Perhaps the Committee could explore ways to require the high-level sign-

off for transactions that raise real national security issues, while allowing an Undersecretary or Assistant Secretary to approve other transactions.

Third, CFIUS should never act if the Director of National Intelligence does not have adequate time to collect and analyze intelligence relating to a particular transaction. But again, the policy underpinning CFIUS reform should be to create a process that is tough enough for the complex cases and flexible enough for the easy cases. Some intelligence reviews might take 30, 45 or even 60 days. Reviews of companies that frequently go through the CFIUS process could simply be updated in a matter of days. But by creating a 30-day minimum for intelligence reviews, and requiring that the reviews be completed no less than 7 days before the end of the initial review period, the bill establishes a *de facto* 37 day process, even for transactions that raise no national security issues. I am confident that a provision can be fashioned to allow the DNI to do its job well without slowing down the entire process with a requirement for extended analysis of cases that present no national security concerns.

The Impact of Congressional Scrutiny on CFIUS

Allow me to offer a few thoughts about the impact of post-DPW Congressional scrutiny on the CFIUS process. Without question, there needs to be additional Congressional oversight of and transparency into the CFIUS process. But overly-invasive scrutiny may result in regulatory hyper-caution, or even paralysis in the process. There are already some indications of this phenomenon in both the agencies and the way the private sector has responded. In this environment, no agency official, whether a career professional or political appointee, wants to be the person to sign off on the next transaction that creates a Dubai Ports World-like controversy. With additional scrutiny from Congress, including requests for documents from the DPW case, career officials in the CFIUS agencies will be even more cautious. Careful scrutiny is important because the stakes are so high. But with a hyper-conservative bureaucracy there is real danger that deals that should be approved are rejected, or unnecessary and burdensome conditions are imposed on companies simply to provide “cover” to the bureaucracy. For example, this year alone

there have already been three investigations. In each of the last three years, CFIUS conducted two investigations each year. The easiest decision for a bureaucracy is to not make a decision, creating delays and uncertainty for foreign investors.

The private sector has already begun responding to this more cautious regulatory environment by filing many, many more cases. CFIUS has already received 32 filings this year and at this pace could receive 85 filings this year, a 31% increase. With the attractiveness of the U.S. economy and a falling dollar, CFIUS could see a dramatic increase in filings this year.

On top of this, the Senate bill contains a provision that creates a *de facto* presumption that all foreign investments in critical infrastructure present a national security risk. A few numbers will illustrate the danger of regulatory rigor mortis: since President Bush went into office, there have been 285 filings. Ten of these proceeded to an investigation. But 52 of these transactions involved a foreign-controlled corporation. Under either the House or Senate bills, there would have been a minimum of 52 investigations. In my own practice, every single transaction I have handled in the past three years falls in DHS's definition of critical infrastructure. Even if my practice over represents foreign investments in critical infrastructure, one could imagine a scenario in which up to 60% of all future filings would require a full investigation.

I am all for tough scrutiny of foreign investments in order to protect national security, but I am very concerned that the combined impact of a growth in filings, an overly cautious bureaucracy and a requirement that all government-controlled transactions proceed to investigation will completely overwhelm CFIUS's ability to conduct an efficient process. CFIUS needs the flexibility to focus on the cases that raise real concerns and dispose of those that don't. Requiring CFIUS to spend scarce time and resources on insignificant cases compromises the agencies' ability to protect national security by focusing on the cases that matter.

One final thought: the irony of the entire DPW controversy is that the perception exists that the initial 30-day review period is cursory and that transactions that don't proceed to an investigation aren't heavily scrutinized. Nothing could be further from the truth. Most of the substantive national security work gets done either during or before the initial 30-day review period by highly professional, tough national security experts. One good idea that has been raised would be to call the initial 30-day period the "investigation" and the subsequent period an "extended" or "supplemental" investigation. It is critical that Congress does not view reviews that last only the initial 30 days as anything less than rigorous.

Protection of Critical Infrastructure

The final subject I would like to address is protection of "critical infrastructure." This has become a significant issue in the debate over CFIUS reform and will continue to be an important subject as you prepare for conference committee work with the Senate Banking Committee. Protection of critical infrastructure is a new and evolving concept, and therefore CFIUS should be given the flexibility to spend its scarce time and resources to focus on those acquisitions that create real national security risks. Forcing CFIUS to scrutinize every foreign investment in critical infrastructure will compromise CFIUS's ability to focus on the transactions that matter from a national security perspective. Three different approaches have been proposed with respect to the protection of "critical infrastructure."

- H.R. 4881, offered by Chairman Hunter and other Members, would essentially prohibit foreign investment in critical infrastructure unless the particular investment is put in a "US Trust" run by American citizens and walled off from the foreign parent. If the Department of Homeland Security's (DHS) current list of "critical infrastructure" activities were used, close to 25 percent of the U.S. economy would be off limits to foreign investment under this proposal.
- The Senate bill, offered by Chairman Shelby and Senator Sarbanes, requires that foreign investments in critical infrastructure go to the "investigation" stage unless CFIUS determines that "any possible impairment to national security has been mitigated by additional assurances during" the review period. This approach creates a de facto presumption that all foreign investment in critical infrastructure creates a

security risk because it must go to an “investigation” unless the risk is mitigated. In my view, some investments in critical infrastructure do create real national security risks; other investments should not even be filed with CFIUS because they create no risk whatsoever.

- Your bill, Madame Chairman, requires CFIUS to consider whether a “covered transaction has a national security-related impact on critical infrastructure in the United States” as a factor in its deliberations. I think you have it right. It should be a factor CFIUS should consider. How significant a factor it should be will vary on a case-by-case basis.

One of the reasons that your approach makes sense is because the concept of protection of critical infrastructure is a relatively new and evolving security objective. Unlike in the area of foreign investments in the defense sector, an area in which DOD has well established regulations and security protocols, established policies and doctrines have not been developed for protection of critical infrastructure. Additional work needs to be done, in my view, to define what exactly is meant by critical infrastructure. For example, the Patriot Act defines “critical infrastructure” to be

“ “[S]ystems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.”²

This definition creates a high threshold and a relatively narrow list of assets that would “have a debilitating effect” on security. By contrast, the Department of Homeland Security has identified 12 extremely broad sectors that it considers to be critical infrastructure, including agriculture and food, water, public health, emergency services, the defense industry, telecommunications, energy, transportation, banking and finance, chemicals, postal services and shipping, and information technology.³ This definition may work for *physical* protection of critical infrastructure; it does not work for foreign investment considerations.

² Section 1016(e) of the Patriot Act, codified at 42 U.S.C. 5195c.

³ See National Strategy for the Physical Protection of Critical Infrastructure and Key Assets, (February 2003), available at www.whitehouse.gov (accessed March 13, 2006); and HSPD-7 (December 2003), available at www.whitehouse.gov (accessed March 14, 2006).

But beyond specifying these sectors, the Department of Homeland Security has not identified the types of companies, or even subsectors, for which acquisition by a foreign firm would be deemed a high risk to national security. Nor has anyone explained why foreign ownership of these sectors would de facto create a national security risk. Thirty percent of value added in the U.S. chemical sector is already produced by U.S. affiliates of foreign owned firms. In the energy sector, it would seem fairly clear that foreign acquisitions of US nuclear energy companies should be reviewed by CFIUS. What about foreign acquisitions of US firms operating in other segments of the energy sector? Many foreign companies own electric distribution companies. Do these raise national security issues? What about foreign ownership of a wind farm? Similar questions certainly apply in the other sectors, including the food, transportation (including ports), and financial sectors, where foreign ownership of US firms is common.

In my view, the Administration and Congress should work together to determine how best to protect critical infrastructure, regardless of who owns a particular company. Security policies and guidance could be developed on a sector-by-sector basis. A baseline level of security requirements should be established. If there are particular national security issues associated with foreign ownership in a particular asset, CFIUS is well equipped to mitigate that risk - or block the investment.

In sum, until policies and doctrines with respect to critical infrastructure have been further developed, it is both dangerous and unnecessary to do anything beyond adding “critical infrastructure” as a factor that CFIUS should consider. Creating an outright ban on foreign investment in “critical infrastructure” would both harm job creation and undermine national security, because foreign investment in these sectors has both increased research and development and spurred additional competition and innovation. Further, it would be unwise to create a presumption that foreign investment in critical infrastructure creates a national security risk. Rather, CFIUS should be given the discretion to deal with these issues on a case-by-case basis, examining both the trustworthiness of the acquirer and the sensitivity of the asset being acquired.

Conclusion

Let me close by applauding the work of the Committee, as well as the way you conducted that work. This has been as deliberate and bipartisan a process as I have seen in my 15 years in Washington. I am grateful for the opportunity to testify and look forward to working with you as you deliberate on this important subject.