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FOREIGN INVESTMENT AND NATIONAL SECURITY ACT OF 2006

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Mr. SHELBY, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

[To accompany S. 3549]

The Committee on Banking, Housing, and Urban Affairs, having had under consideration an original bill to amend the Defense Production Act of 1950, to strengthen Government review and oversight of foreign investment in the United States, to provide for enhanced Congressional oversight with respect thereto, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

I. PURPOSE

Section 721 of the Defense Production Act, also known as the Exon-Florio Amendment ("Exon-Florio"), established a statutory framework for the United States Government to analyze foreign acquisitions, mergers, and takeovers (hereafter "transactions") of privately-owned entities within the United States to determine whether such transactions affect the national security of the United States. The Foreign Investment and National Security Act of 2006 (hereafter "the Act") amends Section 721 for the purpose of strengthening the process by which such transactions are reviewed and, when warranted, investigated for national security concerns. In addition, the Act provides for a system of Congressional notification to address the absence of such notifications that characterized the previous history of the implementation of Section 721.

II. BACKGROUND

In 1988, Section 721 of the Defense Production Act of 1950, Exon-Florio, was passed in response to congressional concerns

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about the impact on national security of certain foreign acquisitions of United States corporate entities. Exon-Florio established a process by which proposed foreign transactions would be analyzed by the Executive Branch of the United States Government (specifically, "the President or the President's designee") to determine whether such transactions could pose a threat to U.S. national security. Historically, U.S. Presidents have assigned the responsibility for implementing Exon-Florio to the Committee on Foreign Investment in the United States (hereafter, CFIUS), a multi-agency organization established by Executive Order in 1975. Exon-Florio was amended in 1992 by the so-called "Byrd Amendment" to require that all foreign transactions involving a foreign government-owned or controlled entity would be subject to a more stringent analytical process.

Since Exon-Florio went into effect, transactions have been reviewed in a highly secretive manner in part to prevent the public release of sensitive proprietary information. The practical effect of conducting transactional reviews in this manner, however, has made congressional oversight and public understanding of Exon-Florio extremely difficult.

After a series of specific transactions brought to the forefront the difficulty in conducting thorough oversight by Congress of the security review process,[1] on February 20, 2004, the chairman of the Committee on Banking, Housing, and Urban Affairs, Senator Shelby, and the Ranking Member of the Committee, Senator Sarbanes, requested a study by the Government Accountability Office of the implementation of Exon-Florio. That study was completed in September 2005.

In its review of the Exon-Florio process, the GAO examined nine cases reviewed by CFIUS over a ten-year period, beginning in 1995. Generally, GAO found that systemic weaknesses in implementation of Exon-Florio limited its effectiveness in protecting national security. Specifically, GAO concluded that weaknesses in implementation of Exon-Florio include application of excessively narrow definitions of "national security" by the Department of the Treasury and other CFIUS member-agencies; insufficient time during the pre-investigation review period for agencies with a national security mission to collect and analyze information on transactions, and consequent excessive reliance by CFIUS on the withdrawal of corporate filings from the review process in order to gain relief from statutory time constraints; and inappropriate standards for initiation of formal investigations due to concerns among some CFIUS member-agencies of the ramifications of a formal investigation for the preservation of the U.S. open investment policy. In addition, the GAO found that responsibility for implementation of Exon-Florio within the Office of International Investment in the Department of the Treasury has created a conflict between that office's responsibility for facilitating international investment and its responsibility for reviewing foreign investment for national security concerns.

[1] Cases previously reviewed by CFIUS that were the focus of increased congressional concern included the proposed acquisition of fiber optic network provider Global Crossing Ltd. by Singapore Technology and Hutchison Whampoa of Hong Kong; the purchase by a Chinese consortium of high-precision magnet manufacturer Magnequench, Inc.; and the proposed acquisition by a Netherlands company of Silicon Valley Group, a manufacturer of computer semiconductor lithography with military applications.

In its report, GAO offered a number of recommendations for congressional action. Those recommendations include more clearly delineating the factors to be considered in CFIUS reviews and investigations; addressing the time constraint problem by replacing the existing review and investigation phases with a single 75-day review period; and providing for greater transparency by reviewing the existing Exon-Florio provision pertaining to notifications to Congress. Finally, to address congressional concerns regarding the status of cases withdrawn from CFIUS review for the purpose of "stopping the clock," GAO recommended that Congress require the Secretary of the Treasury to establish more formal and stringent criteria to govern such withdrawals, including a process for tracking withdrawn cases and mandating time frames for refiling.

While GAO was conducting its examination, but prior to the release of its findings, the China National Offshore Oil Corporation (CNOOC) announced on June 23, 2005, its intention to acquire U.S. energy company Unocal. This announcement resulted in increased congressional concerns regarding foreign acquisitions of U.S. energy companies. While the CNOOC bid was withdrawn prior to that proposed transaction's review by CFIUS, the Chinese company's bid led many members of Congress to raise questions about the transfer of ownership or control of certain sectors of the U.S. economy to foreign companies, especially to foreign companies located within or controlled by countries the governments of which might not be sympathetic to U.S. regional security interests.

On October 6, 2005, the Committee on Banking, Housing, and Urban Affairs conducted a hearing into the findings of the GAO report. Testifying on behalf of GAO was Ms. Katherine Schinasi, Managing Director for Acquisition and Management, and Ann Calvaresi, director of Industrial Base Issues. Discussion between the GAO witnesses and Banking Committee members further highlighted deficiencies in implementation of Exon-Florio and the level of dissatisfaction with the lack of communication between CFIUS and the appropriate committees of Congress. That hearing was followed on October 20 by another hearing that allowed the Banking Committee to hear directly from many of the agencies that comprise CFIUS, including the Department of the Treasury, which has the lead role in implementing Exon-Florio.

In late January 2006, congressional offices began to become aware of the proposed acquisition of terminal operations at a number of U.S. maritime ports by Dubai Ports World, an established port operator owned by the government of the Emirate of Dubai. Concern within Congress about a transaction that would transfer terminal operations to a Persian Gulf emirate through whose financial system funds had been transferred to the terrorists who carried out the September 11, 2001 attacks upon the United States, and that had been a central conduit for nuclear weapons components being smuggled to hostile regimes, provided further impetus for review of the manner in which foreign transactions are analyzed by CFIUS. In addition to concerns regarding the potential national security ramifications of the Dubai Ports World transaction, the Committee on Banking, Housing, and Urban Affairs viewed CFIUS's handling of this case as indicative of the systemic problems discussed by the GAO. That the Secretaries and Deputy Secretaries of the Departments of the Treasury and Homeland Secu-

rity were ignorant of the Dubai Ports World transaction, combined with the fact that this transaction was not subjected to a formal investigation in violation of the Byrd Amendment, compounded congressional concerns about the nature of the underlying transaction.

In response to continued concerns regarding implementation of Exon-Florio, on April 30, 2006, the Committee on Banking, Housing, and Urban Affairs met to consider legislation to reform the process by which foreign transactions are analyzed for potential national security ramifications.

III. DESCRIPTION OF THE BILL

(a) Review of transactions involving foreign persons and governments

Reviews of foreign transactions are currently conducted on a voluntary basis involving interested party submission to CFIUS of documentation pertaining to the transaction in question. CFIUS then has discretion with regard to whether to conduct a review of that transaction. This section would require CFIUS to review all transactions submitted by the persons or governments involved. The review would determine whether the transaction affected national security, and whether the transaction was required to be subjected to a formal investigation.

The timing of reviews remains consistent with current law, meaning it must be concluded within 30 days of receipt of notification of the proposed or pending transaction. Should the review determine that the proposed or pending transaction could effect national security, then an investigation, discussed below, would be required.

The issue of advancing from a review to a more formal investigation has historically carried negative commercial and political connotations. Specifically, industry and the Department of Treasury are concerned that subjecting a proposed or pending transaction to a formal investigation could adversely affect the public standing of the companies involved because the investigative phase of Exon-Florio is viewed as a sign of serious government reservations about the impact on national security of the transaction. That is one reason why, of the 470 cases notified to CFIUS during the period covered by the GAO study discussed above, only 8 were subjected to an investigation, which, under Exon-Florio, results in a presidential determination, although only two such determinations had actually been made through 2004, the period studied by GAO.[2]

Because of the convergence of the 30-day maximum time period that can be spent conducting a pre-investigation review and the reluctance of CFIUS to advance to the investigative stage, those federal agencies that are members of CFIUS and that have national security as their primary mission have occasionally found themselves with insufficient time to collect and analyze information on a proposed or pending transaction while simultaneously being sub-

[2] There has been four such determinations during 2006, possibly at least in part due to increased public and congressional attention focused on the foreign acquisition review process in the wake of the CNOOC and Dubai Ports World cases.

jected to pressures to make a determination without the need for a formal investigation.[3]

During its review of the implementation of Exon-Florio, the Committee on Banking, Housing, and Urban Affairs heard identical sentiments from other agencies with the protection of national security as their mandate. In fact, the only specific request made of the Committee during its review of Exon-Florio was for an option to extend the 30-day review period for those cases where additional time is needed to collect and analyze intelligence.[4]

With no option to extend the 30-day review period for complex cases, CFIUS has historically encouraged companies to withdraw their filings for the purpose of "stopping the clock" and allowing for additional review time without the burden of a statutorily-imposed time constraint. Withdrawn cases, however, may not be resubmitted in a timely manner, if at all, and such means of buying time are clearly inconsistent with the intent of the law. It is for this reason that the Committee included in its legislation a provision allowing for relief from the 30-day constraint in existing law by allowing for an additional period of up to 30 days for further review. In response to concerns expressed by some members of the Committee, by the Department of the Treasury, and by industry that an extension of time would be exploited by certain federal agencies to unnecessarily delay the conclusion of transactions, the Committee bill included a requirement that any extension for time beyond the initial 30-day period must be made by one of the top three officials of the agency making the request. To further address the concern about unwarranted requests for an extension of time, the Committee accepted a provision by Senator Hagel requiring the request to certify that credible evidence exists that a completed transaction would threaten to impair the national security.

There has been concern expressed by some members of Congress that the avoidance of investigations for the purpose of insulating transactions from the negative connotations of an investigation has seriously undermined the law's effectiveness. The Committee emphasizes, however, that requests for extensions beyond the initial 30-day period should not be used to compensate for delinquent or otherwise unnecessarily delayed staff work. It is the Committee's understanding that the number of cases for which such an extension would have been used in the past had it previously existed is very few. The Committee intends to monitor the use of the extension closely to ensure that is used solely for its intended purpose.

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[3] This situation was discussed, for example, by the Department of Justice in its comments to GAO: "The Department [of Justice] shares the concern expressed in the draft [GAO] report with respect to the constraints imposed by the time limits of the current process. In particular, gathering timely and fully-vetted input from the intelligence community is critical to a thorough and comprehensive national security assessment. Any potential extension of the time available to the participants for the collection and analysis of that information would be helpful." United States Government Accountability Office, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, GAO–05–686, September 2005, p.48.

[4] In addition to the written comments of the Department of Justice included in Appendix II of the GAO report, the report notes that Department of Defense officials responsible for conducting security reviews under the authority of Exon-Florio have expressed concerns with the 30-day restriction for pre-investigative reviews. According to these officials, the "30-day review" is, in practice, 23 days, as CFIUS guidelines "require member agencies to inform the Committee [CFIUS] of concerns by the 23rd day of the 30-day review * * *" See the GAO report cited above, p. 15.

(b) Investigations of certain transactions

As discussed above, relatively few of the total number of cases submitted to CFIUS for review are subjected to an investigation, which under Exon-Florio must be completed within 45 days of initiation. One reason for this result is the desire of CFIUS to resolve cases without subjecting the corporate entities involved to the potentially negative connotations of a formal investigation. However, another reason that so few transactions have been investigated has been the failure of the Department of the Treasury to accurately interpret Section 2170(b), the so-called Byrd Amendment, named for the amendment's author, Senator Robert Byrd.[5]

In introducing his amendment to Exon-Florio, Senator Robert Byrd stated on the Senate floor that it "requires that any acquisition that involves a company controlled by a foreign government * * * must automatically receive the more detailed 45-day investigation." It was because the intent of Section 2170(b) of Exon-Florio was unambiguous that the Committee on Banking, Housing, and Urban Affairs was extremely disappointed to learn that the law was being interpreted by the Department of the Treasury at variance with that intent. This disparity became clear when Deputy Secretary of the Treasury Robert Kimmitt responded to questions by Senator Byrd, the author of the language, during a briefing of the Senate Armed Services Committee with the following comment: "We have a difference on opinion on the interpretation of your amendment."

As stated, the implication of the Department of the Treasury interpretation of Section 2170(b) was that numerous transactions that should have been investigated were not. Deputy Secretary Kimmitt testified before the Committee on Banking, Housing, and Urban Affairs that 92 cases involving foreign government-owned and controlled companies were reviewed by CFIUS during the Clinton and Bush Administrations. In total, from passage of the law in 1988 to the end of 2005, only 25 cases had been subjected to an investigation. Of the 46 cases during the Clinton Administration that involved foreign government-owned and controlled companies, only one went to investigation. During the current Administration, as of March 2, 2006, only four out of 46 went to investigation. In short, noncompliance with Section 2170(b) has been a recurring problem since its passage.

Because of concerns regarding noncompliance with the Byrd Amendment, concerns that reached their zenith during congressional debate surrounding the aborted Dubai Ports World transaction, the Committee-passed legislation includes language intended to eliminate any possible ambiguity regarding the requirement for an investigation in cases involving foreign government-owned and/or controlled companies.

Another result of the aborted Dubai Ports World transaction was increased congressional concerns regarding foreign ownership or control of critical infrastructure in the United States. To address these concerns, the Committee-passed legislation establishes a new

[5] This language states an investigation is required "in any instance in which an entity controlled by or acting on behalf of a foreign government seeks to engage in any merger, acquisition, or takeover which could result in control of a person engaged in interstate commerce in the United States that could affect the national security of the United States." See 50 U.S.C. 2170(b).

requirement for a mandatory investigation: transactions that would result in foreign control of "critical infrastructure."

Because of Department of the Treasury concerns that the term "critical infrastructure" would be interpreted too broadly, and would consequently have a "chilling" effect on foreign investment in the United States, the Committee emphasized, by restating the definition of "critical infrastructure" already existing in the Defense Production Act of 1950, that the term is to be defined as follows:

> "any systems or assets, whether physical or cyber-based, so vital to the United States that the degradation or destruction of such systems or assets would have a debilitating impact on national security, including national economic security and national public health or safety."

The Committee adopted this definition, adapted from the Homeland Security Act of 2002 (Public Law 107–296) to create a realistic standard by which CFIUS should measure the potential impact on national security of individual assets that are the subject of proposed or pending transactions. The Department of the Treasury should coordinate with the Department of Homeland Security on establishing parameters designed to exclude from mandatory investigation commercial assets that clearly do not by themselves constitute critical infrastructure.

The Committee accepted an amendment by Senator Hagel to exempt from mandatory investigation critical infrastructure cases that were resolved through mitigation agreements between parties to the transaction and the federal government.

Finally, the Committee-passed legislation requires an investigation in any case in which a review by CFIUS produces sufficient information to indicate the possibility of an impairment to national security after taking into account the factors listed in subsection (g) of the bill.

The Committee-passed legislation retains the requirement that investigations conducted pursuant to this Act be concluded within 45 days.

As discussed above, some members of the Committee are concerned about the use of withdrawals by CFIUS to manipulate the statutory time lines in Exon-Florio. While withdrawals can be appropriate when the parties to a proposed or pending transaction decide to undertake a fundamental modification to the nature of the transaction, such as divestment from the U.S. company of a division or sector involved in sensitive work, there are scenarios where the use of withdrawals cause concern. Additionally, in its report on implementation of Exon-Florio, GAO noted that companies involved in acquisitions that have been completed prior to conclusion of a CFIUS review have little incentive to resolve outstanding issues and refile their paperwork with CFIUS.[6]

To address concerns about the resolution of cases withdrawn from an investigation within the initial 45-day time line, the underlying bill presented to the Committee included a proposal to require the completion of investigations even when cases are withdrawn from consideration, and that CFIUS continue to monitor the status of withdrawn cases. The Committee accepted an amendment

[6] U.S. Government Accountability Office, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness,* p.16.

by Senator Dodd that mandates that resubmitted cases be investigated for another period of up to 45 days. Review of the justification for the withdrawal must be included in the new investigation.

The purpose of this provision is to ensure that CFIUS remains engaged in monitoring unresolved transactions that are withdrawn either to avoid bumping up against Exon-Florio time lines or so that the parties involved can negotiate divestiture agreements or other mitigating measures. It is not the Committee's intent that the number of cases forwarded to the President for his or her decision be unnecessarily increased. As the law will, upon passage of this Act, continue to require a presidential determination upon the formal conclusion of an investigation, the Committee recognizes that it may be necessary to require that withdrawn cases be resubmitted for an investigation, but that, should the investigation of a resubmitted case be terminated on account of the successful negotiation of an assurances or mitigation agreement, than it will not be required to be submitted to the President for final determination.

To address concerns that mandatory refiling of documentation from withdrawn cases would extend to transactions that were terminated by mutual consent of the parties involved, a manager's amendment sponsored by the chairman and ranking member of the Committee, adopted by unanimous consent, included a provision that excludes such cases from the requirement.

One of the more difficult issues for the Committee to resolve involved the question of whether companies should be required to file with CFIUS for consideration of proposed or pending transactions. Currently and historically, Exon-Florio has operated as a voluntary regime with the parties to a transaction responsible for filing with CFIUS or risking more draconian actions by the President of the United States under the International Emergency Economic Powers Act (Public Law 95–223; 50 U.S.C. 1701). The Committee was reluctant to change the existing system to require mandatory filings. However, the manager's amendment did include a provision submitted by Senator Dodd that cases involving persons controlled by or acting on behalf of foreign governments should in part be excluded from the voluntary filing regime. For this reason, the Committee-passed legislation requires that such persons involved in acquiring, merging with, or otherwise seeking to take control of U.S. critical infrastructure relating to national security give written notice of such transaction to CFIUS.

(c) Committee on foreign investment in the United States

The Committee on Foreign Investment in the United States was established in 1975 by President Gerald Ford under Executive Order 11858. Exon-Florio, passed in 1988, did not designate a specific entity responsible for its implementation, stating instead that "the President or the President's designee" shall be responsible. President Ronald Reagan designated CFIUS, under Executive Order 12661, as the designee responsible for the new statute's implementation.

Due to its origins within the Executive Branch, the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives lacked appropriate oversight of its activities, although individual

components have testified before the Committees when requested to do so. As part of its effort to strengthen the national security review process and establish a system of congressional oversight, the Committee-passed legislation formally codifies CFIUS in statute, and designates the Secretary of Defense as Vice Chair alongside the Secretary of the Treasury's continued responsibility as Chairman. In establishing CFIUS in statute, the Committee also designates the Director of National Intelligence as a formal member. Concerns have been expressed by members of the Committee that the role of the intelligence community in supporting CFIUS's activities has been inadequate. GAO analysts briefed Committee staff on January 13, 2005, that such support has been problematic to secure and that CIA involvement in the review process was not always timely. By designating the Director of National Intelligence (DNI) as a formal member of CFIUS, the role of the intelligence community, especially the Central Intelligence Agency, in supporting CFIUS reviews and investigations will be strengthened.

In addition to designating the DNI as a formal member of CFIUS, a proposal by Senator Dodd included in the manager's amendment establishes a requirement for a formal intelligence review for each transaction brought before CFIUS, to be distributed within CFIUS no later than 15 days after the start of the review period. This requirement will ensure that each component member of CFIUS receives at least preliminary intelligence support. The provisions further require that the intelligence community continue to provide intelligence support to the review and investigation processes.

Among concerns that arose in the aftermath of the aborted Dubai Ports World transaction and the role of CFIUS in reviewing that transaction was the lack of adequate accountability. The Committee-passed legislation includes a requirement that will have the effect of codifying current practice: formally designating a lead agency for each transaction submitted for review. By formally designating a lead agency for each review and investigation, accountable agencies will be more easily identified.

The Committee-passed legislation includes a requirement for the Chairman and Vice Chairman of CFIUS, in consultation with the Secretaries of State and Energy, the Chairman of the Nuclear Regulatory Commission, and the DNI to develop a system for assessing and classifying countries according to specified criteria: individual country's adherence to nonproliferation control regimes and relationship to the United States, as well as the risk a certain country poses that militarily-sensitive technologies could be diverted from the country in question or that it constitutes a risk for transhipment of such technologies. CFIUS would then be required to consider a country's assessment and classification in determining the risk to national security of a proposed or pending transaction.

A country classification system is not new. Since 1996, such a system has been used in determining licensing requirements for the export of high performance computers. It was implemented through 15 C.F.R. 740.7. This system categorized countries into, originally, four tiers. President Clinton later combined tiers one and two. Tier 1 included NATO and Major non-NATO allies. Tier 4 includes terrorist-supporting countries, including Iran, North Korea, Sudan, and Syria. Tier 3 constitutes the key category for

purposes of determining national security considerations. Such countries as Russia, China and Pakistan are included in Tier 3.

Because implementation of Exon-Florio involves regulating the transfer to foreign companies and countries of potentially sensitive technologies and assets, the export control review process applied to high performance computers could be appropriately applied to CFIUS-conducted reviews and investigations. A country classification system would ensure that each country in which a foreign company is based is considered in a broad context involving geopolitical realities that may otherwise not be considered.

Because of concerns expressed by the Departments of State and the Treasury that a country classification system can prove harmful to diplomatic and economic relationships, the Committee-passed language provides for that system's protection from public disclosure, including exempting it from Freedom of Information Act filings. The Committee emphasizes that agency concerns that a system for classifying foreign countries according to national security criteria could undermine U.S. foreign relations continue to be fully considered. It is the Committee's intent that bilateral relationships, adherence to nonproliferation regimes, and the risk of diversion of militarily-sensitive technologies to third parties be addressed in all CFIUS reviews and investigations. The Committee remains sensitive to agency concerns about the ramifications of a classifications system for maintaining certain relationships.

In addressing the reluctance of Treasury and other members of CFIUS concerned with protecting the U.S. open investment policy to subject transactions to an investigation, the GAO report notes the possible conflict involved in having the same departmental personnel responsible for protecting that policy also being responsible for implementing Exon-Florio national security reviews.[7] GAO reported that employees of the Department of Treasury responsible for implementation of Exon-Florio are also responsible for facilitating foreign direct investment in the United States and ensuring that U.S. companies enjoy reciprocal access in foreign markets.

The United States open investment policy is vital to U.S. economic growth. Concerns exist, however, that the dual responsibilities imposed upon these employees has resulted in a tilt among such employees in the direction of protection of that policy at the expense of the national security mandate. For this reason, the Committee-passed legislation includes a provision requiring that Department of the Treasury employees responsible for implementation of Exon-Florio have no other function within the department.

(d) Action by the President

Existing Presidential authorities under Exon-Florio, and the President's responsibilities therein, remain adequate to ensure the protection of the United States from threats to national security resulting from foreign transactions of U.S. entities. For this reason, the Committee recommends minimal modifications to existing law in this area.

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[7] U.S. Government Accountability Office, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, p. 14.

(e) Findings of the President

This section restates the President's authority to block a proposed or pending transaction if he/she believes that credible evidence exists that the completed transaction could result in a threat to the national security. It further restates existing language specifying that the authorities provided under this Act are to be applied when other provisions of law, particularly the International Emergency Economic Powers Act, are inadequate to protect the national security.

(f) Actions and findings nonreviewable

Restates existing Exon-Florio provision protecting Presidential decisions resulting from exercise of the authorities of this Act from judicial review.

(g) Factors to be considered

Exon-Florio incorporates a number of factors that CFIUS may consider when assessing the potential national security implications of a proposed or pending transaction. These factors include the domestic production needed for projected national defense requirements and related defense industrial base issues and the potential effects of the proposed or pending transaction on a foreign country that supports terrorism or that poses a risk of proliferating militarily-sensitive technologies, particularly those used in the manufacture of weapons of mass destruction.

The existing list of factors that "may" be considered in a national security review is both inadequate to ensure a thorough review in the post-Cold War environment of national security affairs and presents an unacceptable risk that key issues will not be addressed. For this reason, the Committee-passed legislation expands the list of factors to be considered and makes consideration of the factors mandatory for all reviews. The additions to the list of factors to be considered reflects the Committee's belief that critical infrastructure assets need to be carefully scrutinized when they become the object of a foreign acquisition.

In addition, while nonproliferation of weapons of mass destruction remains one of the country's most pressing priorities, greater attention must be provided to foreign transactions that could result in a foreign military's ability to improve its conventional capabilities through acquisition of U.S. technologies. United States regional interests can be threatened by improvements in the technological capability of foreign militaries with which the United States may be at odds. Consequently, the Committee included in the list of factors that "shall" be considered the potential effect of the proposed transaction on U.S. regional security concerns and on "the long term projection of United States requirements for sources of energy and other critical resources and materials."

Finally, as discussed earlier, in reviewing the acquisition of the Peninsular and Oriental Steam Navigation Company by Dubai Ports World, CFIUS failed to adequately consider such risks as the region in which the United Arab Emirates exists, including its proximity to Iran, the recent history of Pakistani scientist Abdul Qadeer Khan exploiting Dubai's lax regulatory environment to smuggle nuclear components to Iran, Libya and North Korea, and

Dubai's role as a central conduit for funding of the terrorist attacks of September 11, 2001.

In order to address these concerns, the list of factors to be considered will henceforth require individual countries to be analyzed in a more comprehensive manner, including the risk each country poses that militarily-sensitive technologies can or are diverted from or through it, as well as the relationship of the country in which the foreign company is based with the United States. The Department of State has expressed concerns about the political sensitivity of a classification system, as would be required to be established under the bill initially brought before the Committee. Consequently, language was added during the Committee's consideration of the bill stipulating that the classification system would be for internal use of the U.S. Government only and would not be made available to the public. The classification metric would be exempt from Freedom of Information Act requests.

(h) Confidentiality of information

The Committee-passed legislation includes Exon-Florio's already-existing provision for protection of proprietary or business-sensitive information submitted to CFIUS as part of a review.

Some foreign transactions could have a substantial effect on the communities in which the U.S. entity is located. With the increased emphasis on critical infrastructure assets mandated by the Committee-passed legislation, state-level officials may need to be made aware, on certain occasions, of a pending transaction that could adversely affect their state. During public debate over the Dubai Ports World transaction, for instance, numerous state-level officials expressed concern about the lack of information they had been provided regarding a transaction that affected large facilities in their states. For this reason, the manager's amendment passed by the Committee during its consideration of the legislation includes a provision by Senator Menendez that requires CFIUS to notify governors of states containing critical infrastructure assets that are the subject of a foreign transaction for the purpose of discussing potential security concerns that may arise from the transaction. The legislation includes further language designed to ensure that confidentiality provisions in the Act that apply to the federal government apply equally to governors who are so notified.

(i) Additional assurances

The Committee-passed bill seeks to address the ability of the agencies that comprise CFIUS to adequately enforce agreements negotiated between those agencies and the parties to a transaction subject to CFIUS oversight. Mitigation agreements are the basis for the resolution of many of the transactions reviewed by CFIUS. They involve commitments made by the parties to the government, usually with the agency or agencies within CFIUS with the most direct interest in the nature of the transaction, and adherence to the terms of the agreement is very important to the national security of the United States. The legal status of mitigation agreements is not addressed in Exon-Florio, although, as stated, many cases involving national security concerns reviewed by CFIUS are resolved through such agreements.

The government's ability to monitor and enforce mitigation agreements lies at the heart of the process by which transactions are examined for national security concerns. Consequently, the legal status of mitigation agreements needs to be more clearly established in statute. For this reason, the Committee-passed legislation includes provisions intended to ensure that mitigation agreements constitute legally-binding contracts enforceable in the United States District Court for the District of Columbia, and that agreements are monitored and enforced in the appropriate manner. Assurances are to be treated by the courts as a continuing covenant of the persons on whose behalf a CFIUS assessment was sought, and continuing observance of the assurances is to be a condition of any CFIUS or Presidential determination. The assurances are to be embodied in a written agreement executed by the foreign person or government on whose behalf the CFIUS assessment was sought, and executed by either the Chairman or Vice Chairman of CFIUS on behalf of the United States. Compliance with the assurances is to be monitored, and may be investigated, in the same manner as violation of a civil statute. Enforcement remedies include injunctive relief, damages, and divestiture.

(j) Notice and reports to Congress

The Committee has been very concerned about the absence of communications between it and CFIUS over the span of many years. The requirement in Exon-Florio for a Quadrennial Report on foreign acquisition strategies that could harm national security and industrial espionage activities directed against U.S. companies has been ignored, with only one report having been produced since the requirement was mandated in 1992.

Throughout its history, and especially since the passage of Exon-Florio, CFIUS has operated largely without oversight by Congress. It is important to recognize and acknowledge the highly sensitive nature of the commercial transactions that come before CFIUS for review. However, Congress, through the appropriate committees of jurisdiction, must have greater insight into CFIUS's activities than heretofore has been the case. Congressional committees with jurisdiction for vital matters of national security routinely enjoy far greater access to sensitive information as a part of their legitimate oversight roles, including issues pertaining to nuclear weapons and covert operations. The issues before CFIUS, while sensitive, do not rise to the level of government conduct that warrants the level of opaqueness that has been characteristic of CFIUS activities to date.

A routine process of notifications from CFIUS to the key committees with oversight of its activities—in effect, the Senate Banking, Housing, and Urban Affairs and House Financial Services Committees—is warranted given both the Congress's legitimate oversight role and the questionable resolution of several cases that have come before CFIUS. It is for these reasons that the Committee recommends a requirement that CFIUS report to the appropriate committees of Congress on the status of transactions that come before it. These notifications should include measures taken to resolve cases where mitigation agreements are employed. In addition, the Committee recommends that chairmen and ranking members of committees with direct oversight of CFIUS-member agencies that

are designated by the chairman and vice chairman of CFIUS as the lead agencies for individual reviews and investigations should be notified on the same basis as the principal committees of jurisdiction.

One of the more troubling aspects to the outcome of the Dubai Ports World transaction was the absence of accountable officials at high levels of lead agencies, particularly troubling given both the scale and magnitude of the transaction and the fact that it involved a Persian Gulf country with a long history as a hub for smuggling activities. Key officials in the Departments of the Treasury and Homeland Security were not aware of the transaction until after the wide-spread expression of concern by many members of Congress and the public threw the transaction's survival into jeopardy. To address that situation, the Committee recommends a provision requiring that notifications to Congress upon completion of reviews and investigations be certified by the chairman and vice chairman of CFIUS as well as the head of the agency designated by the chairman and vice chairman as lead for each individual transaction.

Finally, the Committee recommends that the existing requirement for a quadrennial report be replaced with a requirement for an annual report that will serve as the basis for annual oversight hearings to be carried out by the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives. The annual report will include a discussion of the potential impact on the U.S. defense industrial base and critical infrastructure of foreign acquisitions during the preceding year; an aggregative analysis of such acquisitions for the preceding four years; a prospective discussion of risks to national security and U.S. critical infrastructure that CFIUS anticipates adopting for the following year; an evaluation of whether there is credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. critical infrastructure or companies involved in research, development or production of critical technologies; and an evaluation of whether there are industrial espionage activities directed by foreign governments against private U.S. companies. Such a report is essential to ensure that Congress is fully informed on the level and nature of foreign direct investment in the United States, not for the purpose of impeding such investment, which is essential for U.S. economic growth, but for the purpose of both exercising its constitutionally-directed role of regulating commerce with foreign nations and to ensure that legitimate national security considerations are not sacrificed in deference to purely commercial considerations.

The requirement for an annual report is based on the same logic as the biannual Humphrey-Hawkins Act and Foreign Exchange Rate Reports submitted to the Committee by the Federal Reserve Board and the Department of the Treasury respectively. The discipline of producing an annual report should enable CFIUS to focus on the strategies that should underlie its day-to-day operations and provide as well a basis for public information about CFIUS.

The Committee recognizes, as emphasized above, the legitimate requirement for the protection of sensitive proprietary information. Foreign direct investment in the United States is a vital component of U.S. economic well-being, and protection of business-sensitive in-

formation used in the course of CFIUS deliberations, as well as the intelligence provided in support of a CFIUS review, should be protected from unwarranted or unauthorized disclosure. For this reason, the intelligence assessments that comprise part of the annual report can be provided in classified form, with an unclassified version made publicly available. Similarly, the Committee-passed legislation includes a provision authorizing the chairman of CFIUS, in consultation with the vice chairman, to withhold from public release proprietary information as the chairperson deems appropriate.

IV. HEARINGS

The Committee on Banking, Housing, and Urban Affairs held the following public hearings on implementation of the Exon-Florio Amendment to the Defense Production Act of 1950:

October 6, 2005 A Review of the CFIUS Process for Implementing the Exon-Florio Amendment

Witnesses: Ms. Katherine Schinasi, Managing Director, Acquisition and Sourcing Management, U.S. Government Accountability Office; Ms. Ann Calvarese Barr, Director, Industrial Base Issues, U.S. Government Accountability Office.

October 20, 2005 Implementation of the Exon-Florio Amendment and the Committee on Foreign Investment in the United States

Witnesses: The Honorable James Inhofe, United States Senator; The Honorable Robert Kimmitt, Deputy Secretary, Department of the Treasury; The Honorable David A. Sampson, Deputy Secretary, Department of Commerce; The Honorable Stewart Baker, Assistant Secretary for Policy, Department of Homeland Security; The Honorable E. Anthony Wayne, Assistant Secretary for Economic and Business Affairs, Department of State; The Honorable Robert McCallum, Acting Deputy General, Department of Justice; The Honorable Peter Flory, Assistant Secretary for International Security Policy, Department of Defense; The Honorable Patrick A. Mulloy, U.S.-China Economic and Security Review Commission; Mr. David Marchick, Partner, Covington and Burling.

March 2, 2006, Continued Examination of Implementation of the Exon-Florio Amendment: Focus on Dubai Ports World's Acquisition of P&O

Witnesses: The Honorable Robert Kimmitt, Deputy Secretary, Department of the Treasury; The Honorable Eric Edelman, Under Secretary for Policy, Department of Defense; The Honorable Robert Joseph, Under Secretary for Arms Control and International Security, Department of State; The Honorable Stewart Baker, Assistant Secretary for Policy, Department of Homeland Security.

V. COMMITTEE CONSIDERATION

The Committee on Banking, Housing, and Urban Affairs met in open session on March 30, 2006, and ordered the bill reported, as amended.

VI. CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

Section 11(b) of the Standing Rules of the Senate, and Section 403 of the Congressional Budget Impoundment and Control Act, require that each committee report on a bill contain a statement estimating the cost of the proposed legislation. The Congressional Budget Office has provided the following cost estimate and estimate of costs of private-sector mandates.

MAY 3, 2006.

Hon. RICHARD C. SHELBY,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for the Foreign Investment and National Security Act of 2006.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Matthew Pickford.

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

Foreign Investment and National Security Act of 2006

This legislation would amend the Defense Production Act of 1950 to establish in law the Committee on Foreign Investment in the United States (CFIUS). Under the bill, the commission would consist of at least eight permanent members (including the Secretaries of the Departments of Treasury, State, Defense, Commerce, and Homeland Security; as well as the Attorney General, Director of the Office of Management and Budget; and the Director of National Intelligence) to coordinate a review of foreign investment in the United States that involves national security or critical infrastructure in the United States. The legislation would formalize and expand the review and investigation process and increase the role of the Office of the Director of National Intelligence.

CBO expects that complying with the bill's provisions would increase the administrative expenses of federal agencies, but because of the confidential nature of the CFIUS review process, the number of agencies involved, and the confidential information needed to prepare an estimate for some provisions of the legislation, CBO cannot determine a precise estimate of the likely total costs of this bill. Additional costs over the 2007–2011 period, however, would generally come from agencies' salary and expense budgets which are subject to annual appropriation. Such costs would probably total at least a few million dollars per year.

Enacting the legislation would likely increase collections of fines and penalties for violations of the notification provisions. Such collections are recorded in the budget as revenues and deposited in the Treasury. CBO estimates that the additional collections of penalties and fines would not be significant because of the relatively small number of cases likely to be involved.

The legislation contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no direct costs on state, local, or tribal governments.

The CBO staff contact for this estimate is Matthew Pickford. The estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VII. REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

The bill seeks to ensure that transactions involving companies owned or controlled by foreign governments undergo a thorough investigation to determine whether the national security would be impacted by the transactions. Such a requirement was believed to have been imposed with passage in 1992 of amendments to the Defense Production Act of 1950, particularly the so-called Byrd Amendment. Given the fact that the Department of the Treasury has interpreted that amendment at variance with congressional intent, many more cases will henceforth be subjected to an investigation than heretofore has been the case. This could entail the production of more documentation by involved corporate entities than would otherwise have been required.

The requirement established in the bill under (b)(A)(ii) that foreign transactions involving U.S. critical infrastructure be subjected to an investigation unless national security concerns have been previously addressed through conclusion of a mitigation agreement could entail costs to both the government, charged with implementing the provisions of the bill, and the corporate entities charged with complying.

The Congressional Budget Office Cost Estimate prepared for this bill notes that enactment of the legislation "would likely increase collections of fines and penalties for violations of the notification provisions . . . CBO estimates that the additional collections of penalties and fines would not be signficant because of the relatively small number of cases likely to be involved."

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