

September 2005

DEFENSE TRADE

Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness





Highlights of [GAO-05-686](#), a report to Congressional Requesters

Why GAO Did This Study

The 1988 Exon-Florio amendment to the Defense Production Act authorizes the President to suspend or prohibit foreign acquisitions of U.S. companies that may harm national security, an action the President has taken only once. Implementing Exon-Florio can pose a significant challenge because of the need to weigh security concerns against U.S. open investment policy—which requires equal treatment of foreign and domestic investors.

Exon-Florio's investigative authority was delegated to the Committee on Foreign Investment in the United States—an interagency committee established in 1975 to monitor U.S. policy on foreign investments. In September 2002, GAO reported on the implementation of Exon-Florio. This report further examines that implementation.

What GAO Recommends

This report contains matters for congressional consideration regarding Exon-Florio's coverage and improvements to the law's implementation. In commenting on a draft of this report, the Secretary of the Treasury, as Committee Chair, disagreed with GAO's characterization of the Committee's process and the adequacy of insight into that process. Based on GAO's review of the process, GAO continues to believe that increased insight and oversight could strengthen the law's effectiveness.

www.gao.gov/cgi-bin/getrpt?GAO-05-686.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Ann Calvaresi-Barr at (202) 512-4841 or calvaresibarra@gao.gov.

DEFENSE TRADE

Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness

What GAO Found

Foreign acquisitions of U.S. companies can pose a significant challenge for the U. S. government in implementing the Exon-Florio amendment because while foreign investment can provide substantial economic benefits, these benefits must be weighed against the potential for harm to national security. Exon-Florio's effectiveness in protecting U.S. national security may be limited because the Department of the Treasury—as Chair of the Committee on Foreign Investment in the United States—and others narrowly defines what constitutes a threat to national security and, along with some other member agencies, is reluctant to initiate investigations to determine whether national security concerns require a recommendation for possible presidential action. Some Committee members have argued that this narrow definition is not sufficiently flexible to protect critical infrastructure, secure defense supply, and preserve technological superiority in the defense arena. The Committee's reluctance to initiate an investigation—due in part to concerns about potential negative effects on the U.S. open investment policy—limits the time available for member agencies to analyze national security concerns. To provide additional time, while avoiding an investigation, the Committee has encouraged companies to withdraw their notification of a pending or completed acquisition and to refile at a later date. However, for companies that have completed the acquisition, there is a substantially longer time before they refile to complete the Committee's process; in some cases they never do, leaving unresolved any outstanding concerns.

In our 2002 report, GAO recommended improvements in provisions to assist agencies in monitoring actions companies have agreed to take to address national security concerns. The Committee has improved provisions on monitoring compliance, and the Department of Homeland Security is actively involved in monitoring company actions.

Agencies Represented on the Committee on Foreign Investment in the United States

Executive Departments	Executive Office of the President
Department of the Treasury (chair)	Council of Economic Advisers
Department of Commerce	National Economic Council
Department of Defense	National Security Council
Department of Homeland Security	Office of Management and Budget
Department of Justice	Office of Science and Technology Policy
Department of State	Office of the U. S. Trade Representative

Source: Executive Order 11858, as amended.

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Abbreviations

DOD Department of Defense
GAO Government Accountability Office

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United States Government Accountability Office
Washington, DC 20548

September 28, 2005

The Honorable Richard Shelby
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate

The Honorable Evan Bayh
United States Senate

Foreign acquisitions of U.S. companies can pose a significant challenge for the U.S. government because of the need to balance the U.S. open investment policy against the potential that an acquisition may harm national security. Under the U.S. open investment policy, foreign investors are to be treated no differently than domestic investors. In 1988, Congress passed the Exon-Florio amendment¹ to the Defense Production Act, which authorizes the President to suspend or prohibit foreign acquisitions, mergers, or takeovers² of U.S. companies if a foreign controlling interest might take action that threatens national security. Exon-Florio is meant to serve as a safety net to be used when laws other than Exon-Florio and the International Emergency Economic Powers Act³ may not be effective in protecting national security.

The President delegated the investigative authority of Exon-Florio to the Committee on Foreign Investment in the United States (Committee)—an interagency committee established in 1975 to monitor and coordinate U.S. policy on foreign investment in the United States. The Committee is chaired by the Secretary of the Treasury. To provide the broadest latitude

¹ 50 U.S.C. app. § 2170.

² In the remainder of this report, acquisitions, mergers, and takeovers are referred to as acquisitions.

³ The International Emergency Economic Powers Act gives the President broad powers to deal with any “unusual and extraordinary threat” to the national security, foreign policy, or economy of the United States (50 U.S.C. §§ 1701-1706). To exercise this authority, however, the President must declare a national emergency to deal with any such threat. Under this legislation, the President has the authority to investigate, regulate, and, if necessary, block any foreign interest’s acquisition of U.S. companies (50 U.S.C. § 1702(a) (1) (B)).

for determining whether an acquisition presents a national security threat, neither the statute nor the implementing regulation defines “national security.”

Exon-Florio establishes a four-step process for examining a foreign acquisition of a U.S. company: (1) voluntary notice by the companies, (2) a 30-day review to identify whether there are any national security concerns, (3) a 45-day investigation to determine whether those concerns require a recommendation to the President for possible action, and (4) a presidential decision to permit, suspend, or prohibit the acquisition. The law requires that the Committee report to Congress on the circumstances surrounding any acquisition that results in a presidential decision. This requirement was added in 1992 to provide Congress insight into the process.

In September 2002,⁴ we reported on several weaknesses in the process used by the Committee as well as in the agreements negotiated with companies under Exon-Florio to mitigate identified national security concerns. You asked us to further examine the Committee’s implementation of Exon-Florio. We also determined whether the Committee had implemented the recommendations from our 2002 report.

To understand the Committee’s process for reviewing foreign acquisitions of U.S. companies, we met with officials from the Department of Commerce, the Department of Defense, the Department of Homeland Security, the Department of Justice, and the Department of the Treasury—the agencies that are most active in the review of acquisitions—and discussed their involvement in the process. Further, we conducted case studies of nine acquisitions that were filed with the Committee between June 28, 1995, and December 31, 2004. We selected acquisitions based on recommendations by Committee member agencies and the following criteria: (1) the Committee permitted the companies to withdraw the notification; (2) the Committee or member agencies concluded agreements to mitigate national security concerns; (3) the foreign company had been involved in a prior acquisition notified to the Committee; or (4) GAO had reviewed the acquisition for its 2002 report. We did not attempt to validate the conclusions reached by the Committee on any of the cases we reviewed. To determine whether the weaknesses in

⁴ GAO, *Defense Trade: Mitigating National Security Concerns under Exon-Florio Could be Improved*. [GAO-02-736](#) (Washington, D.C.: Sept. 12, 2002).

provisions to assist agencies in monitoring agreements that GAO had identified in its 2002 report had been addressed, we analyzed agreements concluded under the Committee's authority between 2003 and 2005. We conducted our review from April 2004 through July 2005 in accordance with generally accepted government auditing standards.

Results in Brief

The manner in which the Committee on Foreign Investment in the United States implements Exon-Florio may limit its effectiveness. For example, Treasury, in its role as Chair, and some others narrowly define what constitutes a threat to national security—that is, they have limited the definition to export-controlled technologies or items and classified contracts, or specific derogatory intelligence on the foreign company. Other members have argued that this definition is not sufficiently flexible to provide for safeguards in areas such as protection of critical infrastructure, security of defense supply, and preservation of technological superiority in the defense arena. In one case, some member agencies would not agree with the Departments of Defense's and Homeland Security's using the authority of Exon-Florio and the Committee as a basis for an agreement that Defense officials believed necessary to mitigate national security concerns because the concerns did not, in the opinions of these Committee members, fit this narrow definition.

In addition, the Committee is reluctant to initiate investigations because of a perception that they would discourage foreign investment—a potential conflict with U.S. open investment policy. Treasury, in its capacity as Chair, applies a strict standard in determining whether an acquisition should be investigated. The Chair has established as the criteria for initiating an investigation essentially the same criteria that the law provides as the basis for the President to suspend or prohibit the transaction or order divestiture. Those criteria are: the likelihood that (1) there is credible evidence that the foreign controlling interest may take action to threaten national security and (2) no other laws are appropriate or adequate to protect national security. Defense and other agencies have argued that since the statute applies these criteria to presidential decisions, these criteria should not be the standard for initiating an investigation. Defense officials and others have stated that the 45 days of the investigation should be used to analyze the acquisition to determine whether those criteria are met. In addition, the Committee's guidance requires member agencies to determine the likelihood of meeting the standard by the 23rd day of the 30-day review. Several officials commented that, in complex cases, it is difficult to complete analyses to meet that

standard within 23 days. To avoid the negative connotation associated with initiating an investigation, the Committee encourages companies to withdraw their notification to provide additional time, rather than proceed to the investigation phase. When companies withdraw their notifications and refile at a later date, the 30-day review period is restarted. If there are concerns, allowing a withdrawal can heighten risks, particularly when a company has completed the acquisition before notifying the Committee. For example, one company had completed an acquisition over one year before filing with the Committee, but was allowed to withdraw its notification. Four years later the company has yet to refile, despite concerns raised by some agencies about the acquisition. Further, the use of withdrawals contributes to the opaque nature of the process because very few cases reach a presidential decision, only two between 1997 and 2004, and thus very few transactions are subject to the required reporting to Congress.

In our 2002 report, we recommended improvements in provisions to assist agencies in monitoring actions companies had agreed to take to mitigate or address concerns. The Committee has improved provisions on monitoring company compliance with mitigation agreements, and the Department of Homeland Security is actively involved in monitoring agreements to which it is a party. In analyzing two recent agreements, we identified provisions that addressed our prior concerns. For example, both agreements clearly identified the offices within the Departments of Homeland Security and Justice to which the companies should report.

This report contains matters for congressional consideration to help resolve the disagreements as to the extent of coverage of Exon-Florio and to require interim protections where specific concerns have been raised, specific time frames for refile, and a process for tracking any actions being taken during a withdrawal period in cases where the transaction has been completed.

The Department of the Treasury, as Committee Chair, provided comments on a draft of this report on behalf of all Committee members. However, the Department of Justice provided comments in a separate letter. Overall, Treasury disagreed with our characterization of the Committee's process in that the Chair believes issues are fully vetted and consensus has always been reached. During the course of our review, certain member agencies raised concerns about the Committee's process that indicated differing views among Committee members when reviewing certain cases. These differing views concerned what constitutes a threat to national security,

the sufficiency of the time allowed for reviews, and the appropriate criteria for initiating an investigation.

- In one case we reviewed where member agencies disagreed over what should be deemed a national security concern, the narrower definition—one that excludes national security concerns raised by certain member agencies—prevailed, in that the notice was withdrawn instead of the case proceeding to investigation.
- In complex cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute, case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days.
- Policy-level officials from two member agencies have indicated that the debate over the criteria for initiating an investigation remains unresolved.

The Department of Justice’s comments were generally technical and we have incorporated them as appropriate. However, Justice did share the concern expressed in our report with respect to the time constraints imposed by the current process, particularly its effect on gathering and using input from the intelligence community. Justice commented that any “extension of the time available...would be helpful.”

Background

In 1988, the Congress enacted the Exon-Florio amendment to the Defense Production Act, which authorized the President to investigate the impact of foreign acquisitions of U.S. companies on national security and to suspend or prohibit acquisitions that might threaten national security. The President delegated this investigative authority to the Committee on Foreign Investment in the United States. The Committee is an interagency group that was established by executive order in 1975 to monitor the impact of and coordinate U.S. policy on foreign investment in the United States.⁵ The Committee is chaired by the Secretary of the Treasury, and its membership includes representatives from executive branch departments and the Executive Office of the President (see table 1). The President added the Department of Homeland Security to the Committee in 2003,

⁵ Executive Order 11858 (May 7, 1975), as amended by Executive Order 12188 (Jan. 2, 1980), Executive Order 12661 (Dec. 27, 1988), Executive Order 12860 (Sept. 3, 1993), and Executive Order 13286 (Feb. 28, 2003).

reflecting an increased focus on domestic security in the aftermath of the September 11, 2001, terror attacks and subsequent global war on terror.

Table 1: Agencies Represented on the Committee on Foreign Investment in the United States

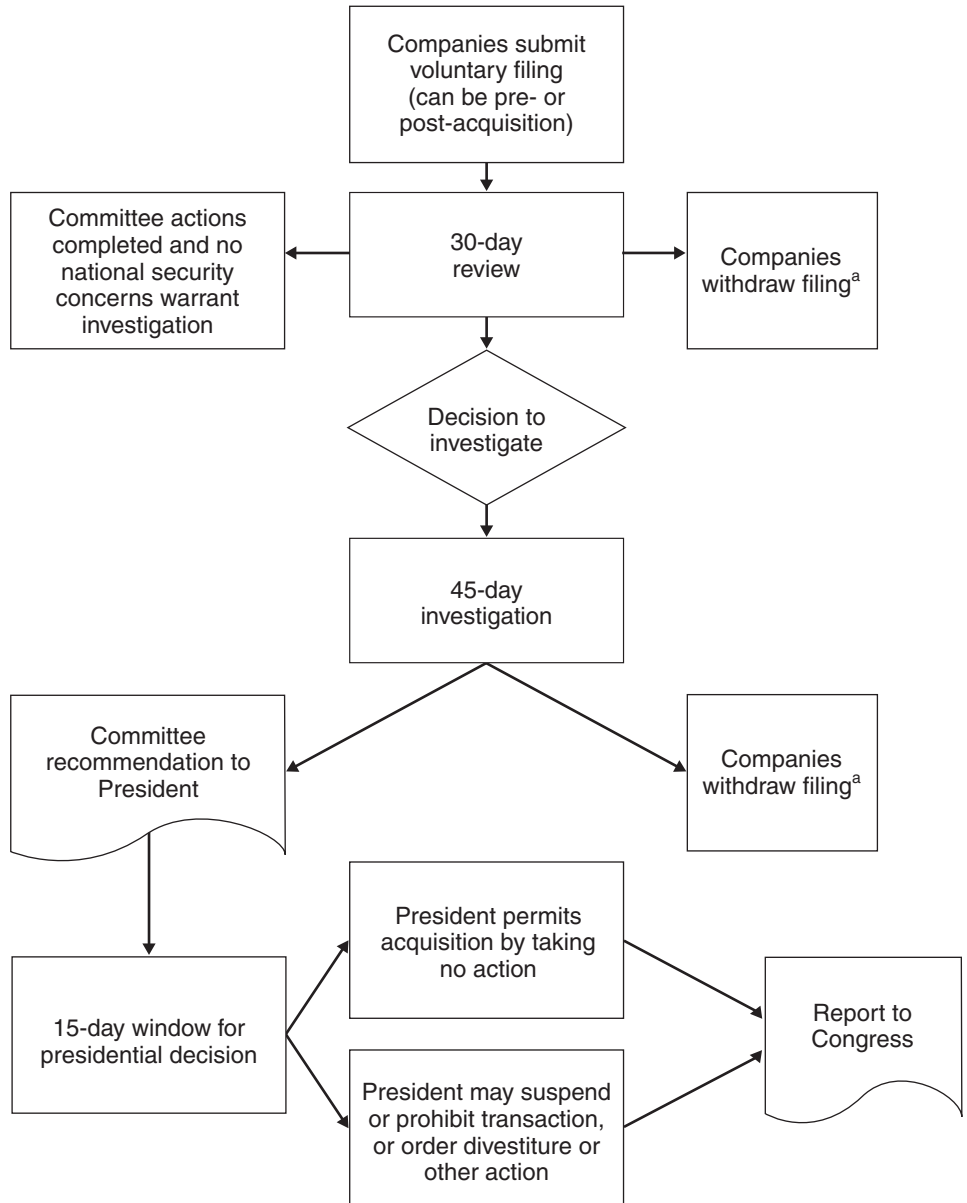
Agencies represented	Year added	Lead office mission
Executive Departments		
Department of the Treasury (Chair)	1975	Office of International Investment: Coordinates policies toward foreign investments in the United States and U.S. investments abroad.
Department of Commerce	1975	International Trade Administration: Coordinates issues concerning trade promotion, international commercial policy, market access, and trade law enforcement.
Department of Defense	1975	Defense Technology Security Administration: Administers the development and implementation of Defense technology security policies on international transfers of defense-related goods, services, and technologies.
Department of State	1975	Bureau of Economic and Business Affairs: Formulates and implements policy regarding foreign economic matters, including trade and international finance and development.
Department of Justice	1988	Criminal Division: Develops, enforces, and supervises the application of all federal criminal laws, except for those assigned to other Justice Department divisions.
Department of Homeland Security	2003	Information Analysis and Infrastructure Protection: Identifies and assesses current and future threats to the homeland, maps those threats against vulnerabilities, issues warnings, and takes preventative and protective action.
Executive Office of the President		
Council of Economic Advisers	1980	Performs analyses and appraisals of the national economy for the purpose of providing policy recommendations to the President.
Office of the United States Trade Representative	1980	Directs all trade negotiations of and formulates trade policy for the United States.
Office of Management and Budget	1988	Evaluates, formulates, and coordinates management procedures and program objectives within and among federal departments and agencies, and controls administration of the federal budget.
National Economic Council	1993	Coordinates the economic policymaking process and provides economic policy advice to the President.
National Security Council	1993	Advises and assists the President in integrating all aspects of national security policy as it affects the United States.
Office of Science and Technology Policy	1993	Provides scientific, engineering, and technological analyses for the President with respect to federal policies, plans, and programs.

Source: GAO analysis.

In 1991, the Treasury Department issued regulations to implement Exon-Florio. As shown in figure 1, Exon-Florio and the regulations establish a four-step process for reviewing a foreign acquisition of a U.S. company:

voluntary notice, 30-day review, 45-day investigation, and presidential decision.

Figure 1: The Committee on Foreign Investment in the United States' Process for Implementing the Exon-Florio Amendment



Source: GAO analysis based on 50 U.S.C. App. § 2170 and 31 C.F.R. Part 800 and case file review.

^aAt any point prior to a presidential decision, companies can request to withdraw a notification.

Notifying the Committee of an acquisition is not mandatory. However, any member agency is authorized to submit a notification of an acquisition if

the companies have not done so. To date, no agency has submitted a notification of an acquisition. Instead, when a member agency becomes aware of an acquisition that may be subject to Exon-Florio, the agency informs Treasury, as Chair, and Committee staff contact the companies to encourage them to officially notify the Committee of the acquisition to begin a review. Committee officials noted that companies have an incentive to notify the Committee prior to completing the acquisition because Exon-Florio provides the President with the authority to order companies to divest completed acquisitions found to pose a threat to national security.

Under Exon-Florio, after receiving notification of a proposed or completed acquisition, the Committee begins a 30-day review to determine whether the acquisition could pose a threat to national security.⁶ The Treasury Department, as Committee Chair, forwards the notification documentation to the lead office in each of the member agencies. Lead offices forward the information to other offices within their agency. For example, the Defense Technology Security Administration, the lead office for the Department of Defense, forwards notification to 12 other offices within the department. These other offices may also forward the notification, as appropriate. In one case, the point-of-contact in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, one of the initial 12 offices, forwarded the notification to four other offices within that organization.

In most instances, the Committee completes its review within the 30 days. However, if the Committee is unable to complete its review within 30 days, the Committee may either allow the companies to withdraw the notification or initiate a 45-day investigation. If the Committee concludes a 45-day investigation, it is required to submit a report to the President containing its recommendations. If Committee members cannot agree on a recommendation, the regulations require that the report to the President include the differing views of all Committee members.⁷

Under Exon-Florio, the President has 15 days to decide whether to prohibit or suspend the proposed acquisition, order divestiture of a completed acquisition or take no action. The President may take action upon a determination that (1) there is credible evidence that leads the

⁶ 50 U.S.C. App. § 2170(a).

⁷ 31 C.F.R. § 800.504(b).

President to believe that a foreign controlling interest might take action that threatens to impair national security and (2) laws other than Exon-Florio and the International Emergency Economic Powers Act are inadequate or inappropriate to protect national security. Under the regulations, the President's divestiture authority, however, cannot be exercised if (1) the Committee has informed the companies in writing that their acquisition was not subject to Exon-Florio or had previously decided to forego investigation or (2) the President has previously decided not to act on that specific acquisition under Exon-Florio.⁸ The Committee may reopen its review or investigation and revise its recommendation to the President if it determines that the companies omitted or provided false or misleading information.⁹ In some cases, the companies will decide not to proceed with the transaction because of concerns that a presidential decision would be unfavorable. However, the President has ordered divestiture in only one case. In 1990, the President ordered a Chinese aerospace company to divest its ownership of a U.S. aircraft parts manufacturer.

Under the original Exon-Florio law, the President was obligated to report to the Congress on the circumstances surrounding a presidential decision only after prohibiting an acquisition. In response to concerns about the lack of transparency in the Committee's process, in 1992 Congress passed the Byrd Amendment to Exon-Florio, requiring a report to the Congress if the President makes any decision regarding a proposed foreign acquisition.

Companies can request to withdraw their notification at any time prior to the President announcing a decision. A Treasury official told us that the Committee generally grants withdrawal requests. After the Committee approves a withdrawal, any prior voluntary notices submitted no longer remain in effect. Any subsequent refile by the parties is considered as a new, voluntary notice to the Committee.

⁸ 31 C.F.R. § 800.601(d).

⁹ 31 C.F.R. § 800.601(e).

The Committee's Implementation of Exon-Florio May Limit Its Effectiveness

The manner in which the Committee implements Exon-Florio may limit its effectiveness because (1) Treasury, in its role as Chair, has narrowly defined what constitutes a threat to national security and (2) the Committee is reluctant to initiate a 45-day investigation because of a perceived negative impact on foreign investment and a conflict with the U.S. open investment policy. As a result of the narrow definition, some issues that Defense, Homeland Security, and Justice officials believe have important national security implications, such as security of supply, may not be addressed. In addition, the reluctance to initiate the 45-day investigation compresses the time available to consider issues. This compressed time frame limits agencies' ability to complete their analysis of some cases. The Committee encourages companies to request withdrawal of their notification to provide additional time to resolve issues and to avoid the need for investigation. However, when companies that have already completed the acquisition are allowed to withdraw, there is a substantially longer time before they refile, and in some cases they never do, leaving unresolved any outstanding concerns.

Threats to National Security Are Narrowly Defined

Under the statute, the President or the President's designee may make an investigation to determine whether a foreign acquisition might threaten the national security of the United States. Neither the statute nor its implementing regulations define national security. This permits a broad interpretation of the term. The statute does provide factors to be considered in determining a threat to national security; however, consideration of these factors is not mandatory. These factors include the following:

- Domestic production needed for projected national defense requirements.
- 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.
- The control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security.
- The potential effects of the proposed or pending transaction on sales of military goods, equipment, or technology to any country identified under applicable law as (a) supporting terrorism or (b) a country of

concern for missile proliferation or the proliferation of chemical and biological weapons.

- The potential effects of the proposed or pending transaction on U.S. international technological leadership in areas affecting national security.

Despite the broad coverage of the factors under the statute, Treasury and some other Committee member agencies have continued to view threats to national security in the traditional and more narrowly defined sense. That is, they based their definition on a U.S. company's possession of export-controlled technologies or items, classified contracts, and critical technology; or specific derogatory intelligence on the foreign company. The Departments of Justice and Defense have applied a broader view of what might constitute a threat to national security. And since being added to the Committee, the Department of Homeland Security has begun to analyze acquisitions both in traditional terms and more broadly in terms of the potential vulnerabilities posed by the acquisition. According to Justice, Homeland Security, and Defense officials, vulnerabilities can result from foreign control of critical infrastructure, such as control of or access to information traveling on networks. Vulnerabilities can also result from foreign control of critical inputs to defense systems or a decrease in the number of innovative small businesses conducting research on developing defense-related technologies. While these vulnerabilities may not pose an immediate threat to national security, they may create the potential for longer-term harm to U.S. national security interests by reducing U.S. technological leadership in defense systems.

The agencies that favor applying the narrower, more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate the concerns being raised by the Department of Defense and others. For example, in reviewing a 2001 acquisition involving a U.S. company that produced precision optics and semiconductor manufacturing equipment, Defense and Commerce raised concerns about (a) foreign ownership of sensitive but unclassified technology used in reconnaissance satellites, (b) the possibility of this sensitive technology being transferred to countries of concern, and (c) maintaining U.S. government access to the technology. Treasury officials said that the concerns raised by Defense and Commerce were not national security concerns because they did not involve classified contracts, the foreign company's country of origin was a U.S. ally, and there was no specific negative intelligence about the company's actions in the United States.

During a more recent review, disagreement over the scope of Exon-Florio resulted in a weakening of the enforcement provisions in an agreement. The Defense Department had raised concerns about the security of its supply of specialized integrated circuits as a result of a proposed acquisition. These unique integrated circuits are used in a variety of defense technologies, such as unmanned aerial vehicles, the Joint Tactical Radio System, and communications protection devices including devices used for cryptography. A Defense Science Board task force recently noted that the functions performed by Defense-unique integrated circuits are essential to the national defense of the United States. However, in Treasury's view, the Department of Defense's concerns about its supply of integrated circuits were industrial policy concerns, not national security concerns, despite the importance of these circuits to a variety of defense technologies. Treasury, as Chair of the Committee, and several other members deemed the concerns outside the scope of Exon-Florio authority and would not allow the agreement between the Departments of Defense and Homeland Security and the companies to include any mention of the Committee. As a result, a provision that included strong enforcement language was deleted from an agreement with the acquiring company. In the absence of such language, presidential or Committee action can only result if the companies materially misrepresented information during the Committee's review. In our view, without that provision, the consequences of failure to comply with the agreement are less certain.

The Standard for Investigation Limits the Number of Investigations

The Committee has been reluctant to initiate investigations, to avoid both the negative connotations of an investigation and the need for a presidential decision. As a result, the Committee has initiated few investigations. From 1997 through 2004, the Committee received 470 notices, including 19 refilings, for 451 proposed or completed acquisitions. The Committee initiated only eight investigations during the period (see table 2).

Table 2: Notifications to the Committee on Foreign Investment in the United States and Actions Taken, 1997 through 2004

Year	Notifications	Acquisitions^a	Investigations^b
1997	62	60	0
1998	65	62	2
1999	79	76	0
2000	72	71	1
2001	55	51	1
2002	43	42	0
2003	41	39	2
2004	53	50	2
Total	470	451	8

Source: Department of the Treasury.

^aAcquisitions that were withdrawn and refiled are shown in the year of initial notification.

^bInvestigations are shown in the year of their notification.

According to Treasury Department officials, the Committee reviews foreign acquisitions with a view to protecting national security while maintaining U.S. open investment policy, which provides for equal treatment of foreign and domestic investors. The office within Treasury that provides staff support to the Committee—the Office for International Investment—is also the office responsible for promoting the open investment policy. The Committee’s goal is to implement Exon-Florio without chilling foreign investment in the United States. According to Treasury officials, being the subject of an investigation may have negative connotations for a company. If it becomes public knowledge that the acquiring company is the subject of an investigation, it may be perceived that the government views the acquisition as problematic and the stock price of the company may fall. Thus, avoiding an investigation helps maintain the confidence of investors.

Consistent with its desire to avoid investigations, the Treasury Department, as Committee Chair, applies strict criteria in determining whether an acquisition should be investigated. The criteria for initiating an investigation are the likelihood that (1) there is credible evidence that the foreign controlling interest may take action to threaten national security and (2) no other laws are appropriate or adequate to protect national security. This is essentially the same criteria provided by the statute as the

basis for the President to take action to suspend or prohibit an acquisition under Exon-Florio.¹⁰ The Defense Department and others have stated that these criteria are inappropriate for determining whether to initiate an investigation because the 45 days of the investigation should be used to determine whether the criteria are met to inform the Committee's recommendation to the President. Exon-Florio does not provide specific guidance for the appropriate criteria for initiating a 45-day investigation. The statute merely provides that "the President or the President's designee may make an investigation to determine the effects on national security" of acquisitions that could result in foreign control of a U.S. company.¹¹

Withdrawals Bypass Regulatory Time Frames

Committee guidelines require member agencies to inform the Committee of concerns by the 23rd day of the 30-day review allowed by Exon-Florio. According to one Treasury official, this time frame is necessary to meet the legislated 30-day requirement for completing a review. For some cases, particularly complex ones, the 23-day rule does not allow enough time to complete reviews and address concerns. For example, one Defense official said that, without advance notice of the acquisition, the time frames are too short to complete analysis and provide input for the Defense Department's position. Another Defense official said that to meet Treasury's deadline, analysts have between 3 and 10 days to analyze the acquisition. In one instance, Homeland Security was unable to provide input within the time frame.

When agencies have needed more time to gather information or negotiate an agreement to mitigate national security concerns, the Committee generally suggests that companies request to withdraw their notification. If the company does not want to withdraw, the Committee can initiate an investigation. Exon-Florio's implementing regulations permit the Committee to allow companies to withdraw their notifications at any time before a presidential decision.

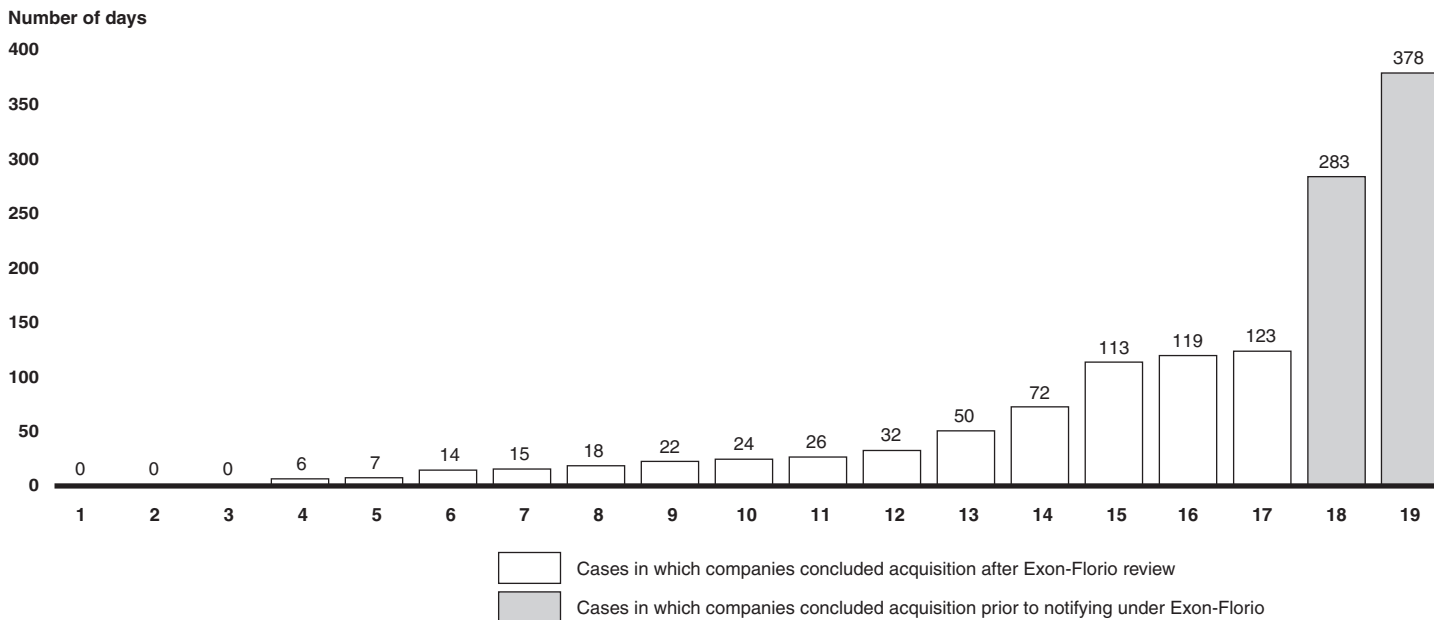
When companies have withdrawn their notification prior to concluding an acquisition, the companies have an incentive to resolve any outstanding

¹⁰ 50 U.S.C. app. § 2170(e).

¹¹ 50 U.S.C. App. § 2170(a). Under the statute, investigations are mandatory in those cases in which the acquiring company is "controlled by or acting on behalf of a foreign government" and the acquisition could result in control of the U.S. company and could affect the national security of the United States (50 U.S.C. App. § 2170(b)).

issues and refile as soon as possible. However, if an acquisition has been concluded, there is less incentive to resolve issues and refile. Since 1997, companies involved in 18 acquisitions have withdrawn their notification and refiled 19 times. In one case, the company withdrew and refiled twice. In 16 cases, the acquisitions had not yet been concluded, and the time between withdrawal and refile ranged between 0 days and 4 months (see fig. 2). In two cases, the companies had already concluded the acquisition, and 9 months and 1 year, respectively, passed before the companies refiled. In both cases, Defense or Commerce had raised concerns about potential export control issues. These concerns remained unresolved throughout the period.

Figure 2: Number of Days between Withdrawal and Refiling in 19 Withdrawn Notifications



Source: GAO analysis.

In addition to cases where a company that completed an acquisition withdrew and subsequently refiled, we identified two instances in which companies that had concluded an acquisition before filing with the Committee withdrew and have not refiled. In one case, the company filed with the Committee more than a year after completing the acquisition. The Committee allowed it to withdraw the notification to provide more time to answer the Committee’s questions and provide assurances concerning export control matters. The company refiled and was permitted to

withdraw a second time because there were still unresolved issues. Four years have passed since the second withdrawal.

In another case, a company filed with the Committee over 6 months after completing its acquisition of an internet backbone company. The Committee allowed the company to withdraw the notification more than 2 years ago because the Committee was busy with another, high-profile acquisition. The Committee has not requested that the company refile even though analysts within one agency had concerns about the acquisition. As a result, the review process has never been completed. A Treasury Department official said that the member agency that has national security concerns about a particular transaction is responsible for ensuring that the company refiles. However, the Committee's guidance to member agencies specifically states that Treasury will manage activities during withdrawal by specifying time frames and goals to be achieved.

In six of the eight investigations that have been undertaken since 1997, withdrawal was allowed after the investigation had begun. Withdrawal and refiling to restart the clock limits the potential negative connotation of an investigation. However, this practice also limits instances that require a presidential decision, contributing to the opaque nature of the Exon-Florio process because reporting to Congress on the results of Committee actions only occurs as a result of a presidential decision. Only two of the eight cases resulted in a presidential decision and a subsequent report to the Congress (see table 3).

Table 3: Investigations and Outcomes, 1997 through 2004

Year	Investigations^a	Notices withdrawn after investigation begun	Presidential decisions
1997	0	0	0
1998	2	2	0
1999	0	0	0
2000	1	0	1
2001	1	1	0
2002	0	0	0
2003	2	1	1
2004	2	2	0
Total	8	6	2^b

Source: U.S. Department of the Treasury.

^aInvestigations are shown in the year of their notification.

^bIn both cases the President took no action, thereby allowing the transaction.

Provisions for Monitoring Compliance Have Improved

In our 2002 report, we identified several weaknesses in the agreements that agencies negotiated with companies under the Exon-Florio Amendment. Specifically, the two agreements that we reviewed either did not specify (1) the time frame for implementing provisions of the agreement or (2) the action that would be taken if the company failed to comply within the stated time frame, thus providing no incentive for the companies to act or no penalty for noncompliance. And in one case, the company failed to meet the agreed upon time frame. In addition, the agreements did not specify which offices in Committee member agencies would be responsible for monitoring compliance with the agreements. We recommended in our 2002 report that, to ensure compliance with agreements, the Secretary of the Treasury, as Chair of the Committee, increase the specificity of actions required by mitigation measures in agreements negotiated under Exon-Florio and designate in the agreements the agency responsible for overseeing implementation and monitoring compliance with mitigation measures.

Three agreements negotiated between 2003 and 2005 contain specific time frames for actions to be taken:

- In a telecommunications agreement, the company was required to adopt and implement a visitation policy within 90 days after the agreement became effective.

-
- In a software agreement, the company had to adopt mandatory policies and procedures to implement the agreement within 90 days and provide copies to the government points of contact.
 - In an electronics agreement, the company had to appoint a security officer and two security directors within 90 days of a vacancy to ensure compliance with the agreement, subject to approval by the Departments of Defense and Homeland Security.

Two of the three agreements also contained strong language concerning the consequences of noncompliance with the terms of the agreement. For example, these agreements stated that if the company (1) fails to comply with the terms of the agreement, (2) makes a materially false or incomplete statement, (3) increases foreign entity control, or (4) makes other material changes in circumstances, the Attorney General, the Secretary of Defense, or the Secretary of Homeland Security may raise concerns to the Committee or the President.

All three agreements also provided specific offices within the signatory agencies to which the companies are to report. For example, the telecommunications agreement designates as points of contact the Assistant Attorney General of the Justice Department's Criminal Division, the General Counsel at the Federal Bureau of Investigation, the Deputy General Counsel for Acquisition, Technology, and Logistics at the Department of Defense, and the General Counsel at the Department of Homeland Security.

The Department of Homeland Security has taken the lead on monitoring compliance for those agreements that it has signed under Exon-Florio. According to Homeland Security officials, the agency maintains compliance tables to track companies' compliance with time frames provided for in the agreements. To keep all interested parties informed, the Department sends out periodic e-mails to other agencies informing them of the status of companies' compliance efforts.

The Departments of Defense, Commerce, and Justice significantly rely on Homeland Security to monitor companies' compliance with the agreements. Homeland Security officials stated that Homeland Security Presidential Directive 7 gives the Department the authority to protect critical infrastructure assets such as telecommunications and information technology. According to a Defense official, the Department of Defense has no authority to enforce companies' compliance with agreements signed pursuant to Exon-Florio. A Commerce Department official similarly

stated that Commerce's authority is limited to enforcing compliance with export control laws. As a result, the Department of Homeland Security is the only one of the three with broad enforcement authority. Further, according to Justice officials, while Justice has authority to seek enforcement of agreements signed pursuant to Exon-Florio and to which it is a signatory, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

Conclusions

In the aftermath of the September 11, 2001, terror attacks on the United States and the subsequent war on terrorism, the nature of threats facing this country has changed. In addition to traditional threats to national security, vulnerabilities in areas such as the nation's critical infrastructure have emerged as potential threats. Exon-Florio provides the latitude for the Committee on Foreign Investment in the United States to address these threats. But the effectiveness of Exon-Florio as a safety net depends on the manner in which the broad scope of its authority is implemented. The narrow, more traditional interpretation of what constitutes a threat to national security fails to fully consider the factors currently embodied in the law. Further, the time constraints imposed on agencies to develop a position before the statutory deadline limits member agencies' ability to complete in-depth analyses. Those time constraints, together with the Committee's reluctance to initiate investigations, can result in the Committee permitting companies to withdraw their notifications. When companies withdraw after completing an acquisition, the Committee may lose visibility over the transaction, and the companies may choose not to refile.

The initial legislation provided for congressional oversight through a requirement that the circumstances surrounding any negative decision by the President be reported to the Congress. To improve congressional oversight, the Byrd amendment expanded required reporting to include the circumstances surrounding all presidential decisions. However, the Committee's reluctance to proceed to investigation, coupled with the use of withdrawal to resolve cases without the need for presidential decisions, has resulted in the circumstances surrounding only two cases being reported to the Congress since 1997. This criterion for reporting contributes to the opaque nature of the Committee's process and is limiting the information that is provided to the Congress. In addition, where companies have concluded the acquisition prior to filing with the Committee and concerns have been identified, permitting withdrawal expands the opportunity for harm to national security before the Committee takes action.

Matters for Congressional Consideration

In light of the differing views within the Committee on Foreign Investment in the United States regarding the extent of authority provided by Exon-Florio, the Congress should consider amending Exon-Florio by more clearly emphasizing the factors that should be considered in determining potential harm to national security. In addition, to address Treasury's concern with the impact of investigations on U.S. open investment policy and the member agencies' concerns with having sufficient time to address relevant issues concerning the acquisitions, the Congress should consider eliminating the distinction between a review and an investigation and make the entire 75-day period available for review. The Committee could then be required to submit recommendations to the President only if presidential action was necessary. Also, to provide more transparency and facilitate congressional oversight, the Congress should revisit the criterion for reporting circumstances surrounding cases to the Congress. For example, the Congress could require an annual report on all transactions that occurred during the preceding year. Such a report could provide the Congress with information on the nature of each acquisition; the national security concerns raised by Committee member agencies, if any; how the concerns were mitigated; and whether each acquisition was concluded or abandoned, in addition to any presidential decisions required under the statute.

In addition, in view of the need to ensure that national security is protected during the period that withdrawal is allowed for companies that have completed or plan to complete an acquisition prior to the Committee completing its work, the Congress should require that the Secretary of the Treasury, as Committee Chair, establish (1) interim protections where specific concerns have been raised, (2) specific time frames for refileing, and (3) a process for tracking any actions being taken during the withdrawal period.

Agency Comments and Our Evaluation

We provided a draft of our report to the Departments of Commerce, Defense, Homeland Security, Justice, and Treasury for comment. In responding, the Department of Treasury noted that it was providing comments on behalf of all the members of the Committee on Foreign Investment in the United States. However, the Department of Justice provided comments in a separate letter.

Overall, Treasury disagreed with our findings. At issue is our characterization of the Committee's process and the adequacy of insight into the Committee's deliberations—concerns that Treasury states have caused the Committee to question our understanding of how it operates.

Our understanding of the Committee’s process is based on an extensive examination of Committee guidelines, case files, and memorandums; discussions with member agencies, including Treasury, on the process and the time frames the Committee uses to come to a decision; and a review of the laws and regulations that provide the Committee with criteria against which to assess threats to national security.

Treasury asserts that all Committee decisions are reached only by consensus among member agencies. However, during the course of our review, certain member agencies raised concerns about the Committee’s process that indicated fundamentally differing views among Committee members when reviewing certain cases. These disagreements involved different views on what constitutes a threat to national security, the sufficiency of the time allowed for reviews, and the appropriate criteria for initiating an investigation. While we agree that opposing views can, and should, be vigorously debated, such a debate does not demonstrate that issues have been fully vetted or that consensus has been reached, as Treasury implies. In fact, in a number of cases, we found evidence that indicates otherwise, for example:

- In one case we reviewed where member agencies disagreed over what should be deemed a national security concern, the narrower definition—one that excludes national security concerns raised by certain member agencies—has prevailed, in that the notice has been withdrawn instead of the case proceeding to investigation.
- In complex cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute, case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days. In its comments on our draft report, the Department of Justice shared our concern with respect to the time constraints imposed by the current process. Specifically, Justice stated that “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.”
- Policy-level officials from two member agencies have indicated that the debate over the criteria for initiating an investigation remains unresolved.

Given these fundamental differences, we concluded that the extent to which issues are vetted and consensus is reached on certain cases is, at best, uncertain.

Treasury also cites Committee guidelines on withdrawals—which state that parties, not member agencies, have the authority to request a withdrawal—to dispute our position that the Committee has encouraged companies to withdraw notifications to provide additional time to examine acquisitions. Guidelines stating that certain actions should be taken do not necessarily provide evidence that such actions were indeed taken. In five cases that we reviewed, letters from the companies requesting withdrawal and/or letters from Treasury, as Committee Chair, approving the requests to withdraw cited the need for more review time on the part of the government as the reason for the withdrawal. Regardless, Treasury’s detailed discussion of the withdrawal process ignores the key issue. Allowing companies to withdraw notices to provide more time for a review without initiating an investigation significantly increases the risk that companies will not refile in a timely manner—particularly in cases where the foreign acquisition has been completed—and that national security concerns will remain unaddressed. Avoiding investigations by using withdrawals also contributes to the opaque nature of the process because without an investigation there is no presidential decision and required reporting to the Congress.

Understandably, Treasury is cautious about providing details into the Committee’s deliberations, given the sensitivity of the information discussed and the need to protect it. And we appreciate the challenges each case presents. However, despite Treasury’s assertion that the oral briefings provided by agency members to duly authorized committees of the Congress when requested are appropriate, the fact that our review was prompted by congressional concerns about the Committee’s review and investigation process suggests otherwise.

Finally, Treasury criticized our review methodology—specifically, it questioned whether we spoke to all appropriate parties. We focused on the agencies that were most active in Exon-Florio reviews, as we noted to Treasury at the beginning of our review. During our preliminary discussions and throughout the review, none of the Committee member agencies, including Treasury, raised concerns with our methodology or suggested that we contact the Department of State, the United States Trade Representative, or the Council of Economic Advisers. Our reviews of the official Committee files, located at the Treasury Department, supported our view that the Departments of Commerce, Defense,

Homeland Security, Justice, and Treasury were the most active agencies. Regardless, when it became clear to us that information from other Committee members could be germane, as was the case with the National Security Council, we attempted to contact them. In the case of the National Security Council, officials declined to meet with us. At the time we sent the draft report for comment, we were contacted by the Department of State and the U. S. Trade Representative who wanted to discuss the draft report. We met with representatives of both agencies to discuss their concern that our report did not adequately recognize the importance of open investment and was too focused on national security.

We recognize that in implementing Exon-Florio, the Committee must consider national security in the context of open investment—a challenge we point out in the opening statement of our report. However, the purpose of the Exon-Florio amendment is to protect national security in the context of U.S. open investment policy. It is how national security is protected through the Committee process that needs to be better understood. We believe that understanding can be enhanced by improved insight and oversight of the process.

The Department of Justice in its letter also provided technical comments, which we incorporated as appropriate. Treasury's letter, along with our responses to specific comments, is reprinted in appendix I. Justice's letter is reprinted in appendix II.

Scope and Methodology

To examine the process used by the Committee and its member agencies to review and investigate foreign acquisitions, we analyzed case files and discussed with Committee staff members the factors considered when cases are reviewed, the process and time frame the Committee uses to come to a decision, and the laws and regulations that provide the Committee with criteria against which to assess threats to national security.

We examined in depth nine acquisitions notified to the Committee on Foreign Investment in the United States between June 28, 1995, and December 31, 2004. We selected acquisitions based on recommendations by Committee member agency officials and the following criteria: (1) the Committee permitted the companies to withdraw the notification; (2) the Committee or member agencies concluded agreements to mitigate national security concerns; (3) the foreign company had previously notified the Committee of a prior acquisition; or (4) GAO had conducted a prior review. The objective of the case reviews was to understand and

document the Committee's and its members' approaches to and processes for reviewing foreign acquisitions of U.S. companies. We did not attempt to validate the conclusions reached by the Committee on any of the cases we reviewed.

We also obtained information about other foreign acquisitions that we did not conduct case reviews on, and we also used information on other acquisitions obtained during prior GAO reviews. We obtained and analyzed data from relevant Committee member agencies, including the Departments of Commerce, Defense, Homeland Security, and Treasury. While we were not granted access to files held by the Department of Justice, we discussed individual cases with Justice officials and obtained adequate information to meet our objectives. We also discussed the Committee's approach and process with Committee staff officials from member agencies most actively involved—namely, the Departments of Commerce, Defense, Homeland Security, Justice, and Treasury.

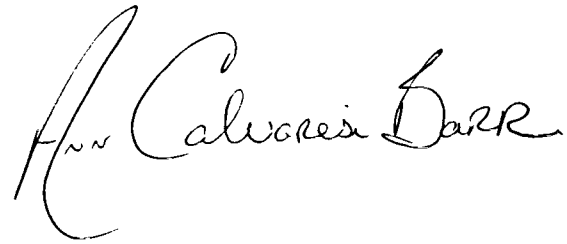
To determine whether the weaknesses in provisions to assist agencies in monitoring agreements that GAO had identified in its 2002 report had been addressed, we analyzed agreements concluded under the Committee's authority between 2003 and 2005 and compared these agreements with those GAO had previously analyzed. We discussed with Committee staff members the steps that they are taking to monitor agreements and enforce compliance.

We conducted our review from April 2004 through July 2005 in accordance with generally accepted government auditing standards.

As we agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this letter. At that time, we will send copies of this report to the Chairman and Ranking Minority Member of the House Committee on Financial Services and to other interested House and Senate committees and subcommittees. We will also send copies to the Secretaries of Commerce, Defense, Homeland Security, and Treasury and the Attorney General. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

Please contact me at (202) 512-4841 or calvaresibarra@gao.gov if you have any questions regarding this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page

of this report. A list of major contributors to this report is listed in appendix III.

A handwritten signature in black ink that reads "Ann Calvaresi Barr". The signature is written in a cursive style with a large initial "A" and "B".

Ann M. Calvaresi-Barr
Director
Acquisition and Sourcing Management

Appendix I: Comments from the Department of Treasury

GAO's comments supplementing those in the report text appear at the end of this appendix.



UNDER SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 12, 2005

Ms. Ann Calvaresi-Barr
Director
Acquisition and Sourcing Management
U.S. Government Accountability Office
Washington, DC 20548

Dear Ms. Calvaresi-Barr:

I am responding to your letter of June 30, 2005, to Secretary Snow requesting comments on the GAO draft Report, "Defense Trade: Exon-Florio May Have Limited Effectiveness in Protecting U.S. National Security." These comments are made on behalf of all the members of the Committee on Foreign Investment in the United States (CFIUS).

See comment 1.

We believe that CFIUS has implemented the Exon-Florio provision (Exon-Florio) effectively to protect the national security. In light of this, CFIUS has a number of serious concerns with the draft Report, which, unlike prior GAO reports on CFIUS, reveals a fundamental misunderstanding of how the Committee operates. Our major concerns are summarized below.

See comment 2.

First, to the extent that the draft Report implies that Treasury or any other CFIUS agency dictates certain decisions or courses of action, it is simply incorrect. CFIUS is an interagency committee chaired by the Secretary of the Treasury. All CFIUS decisions are reached only by consensus among the CFIUS member agencies. The decisions described in the draft Report illustrate this point in that they all were agreed to by senior officials from all CFIUS agencies. The draft report seems to have focused on the vigorous debate that often occurs as CFIUS considers a proposed acquisition, not the outcome of such debates.

See comment 3.

Second, the draft Report inaccurately describes CFIUS and the Department of the Treasury as Chair in other ways. Notably, the draft Report claims that Treasury has narrowly defined "national security." To the contrary, no agency or agencies "define" national security for CFIUS. Any agency may bring forward national security concerns to have them fully considered to enable CFIUS members to reach the necessary consensus on how those concerns should be addressed. The erroneous proposition that individual agencies "define" national security for CFIUS forms the basis for the GAO's lead conclusion, "Exon-Florio's effectiveness in protecting U.S. national security may be limited."¹

¹ Paragraph 1 of the Highlights: What GAO Found.

Third, the draft Report states that in response to congressional concerns, GAO met with officials from the Departments of Commerce, Defense, Homeland Security, Justice and Treasury, which in GAO's view are "the agencies that are the most active in the review of acquisitions."² GAO apparently did not solicit any input from other members of CFIUS, such as the Department of State, the Office of the United States Trade Representative, nor the Council of Economic Advisers.³ Despite GAO's unsubstantiated assertion, these organizations – like the ones GAO did choose to meet with – are very much engaged in CFIUS reviews. If GAO had interviewed senior policy officials from these organizations, which reflect the broad spectrum of CFIUS membership, the Committee is confident that GAO would have gained a more informed perspective on the CFIUS process.

Finally, it is worth noting that, while Exon-Florio requires CFIUS to analyze transactions for their effects on national security, other factors are also relevant. When Exon-Florio was enacted, Congress understood that there were already a number of effective legislative provisions to protect the national security. These ranged from laws that restrict the foreign ownership of U.S. air carriers to laws that regulate the export of sensitive technology or that restrict access to sensitive information. In recognition of these existing laws, Congress limited Exon-Florio to situations where other tools were not adequate or appropriate to deal with a national security threat. The provision is designed to be used judiciously. Using Exon-Florio in ways that were not intended would send a confusing message to our trading and investing partners around the world, could be inconsistent with our commitments under various international agreements to provide national treatment to foreign companies, and implicitly would call into question the U.S. Government's commitment to an open investment policy, all of which would damage U.S. interests – including national security interests – in the context of these agreements and commitments. Unnecessary restrictions by the U.S. on foreign investment may also encourage other governments to restrict foreign investment by U.S. firms. Indeed, all CFIUS members recognize that often there is an inherent link between national security interests and U.S. economic prosperity and that U.S. prosperity is furthered through foreign investment in the United States. Through robust debate among CFIUS members, we seek to protect national security in the context of an open investment policy that respects this critical link. We believe we have been successful. Continued congressional sensitivity to these critical national interests is especially important in today's global economy.

In addition, I have attached an appendix with additional comments on the following specific issues:

- Definition of National Security
- Standard for Initiating an Investigation
- The Day 23 Rule
- Mitigation Measures

² Paragraph 2 on page 2 of June 2005 GAO Report #05-686.

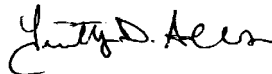
³ State and USTR have written to GAO specifically to express their objections that GAO did not contact them in connection with preparing the draft report.

See comment 4.

- Monitoring Compliance, Enforcing Agreements, and Remedies
- Withdrawals
- Industrial Policy
- Vulnerabilities from Foreign Control Alone
- GAO Conclusion Re Amending Exon-Florio to Specify Additional Factors
- GAO Conclusion Re Eliminating the Distinction between a Review and an Investigation
- GAO Conclusion Re Revisiting the Criterion for Reporting to Congress
- GAO Conclusion Re Amending the Regulations to Provide Interim Protections
- Interagency Process

Thank you for the opportunity to comment on GAO's draft Report.

Sincerely,



Timothy D. Adams
Under Secretary for International Affairs

Additional Comments on Specific Issues

Definition of U.S. National Security

See comment 5.

There are statements⁴ in the draft Report that Treasury, as Chair, or Treasury along with other Committee members, has narrowly defined what constitutes a threat to national security and that this narrow definition limits the effectiveness of Exon-Florio to protect U.S. national security. The recommendations of the Committee are informed by an extremely broad range of factors and not by the narrow definition described in the draft Report or any similarly narrow standard. Any such definition would inappropriately limit the President's necessary discretion to protect national security.

See comment 6.

This open-ended approach allows the President maximum flexibility to respond on a case-by-case basis to the unique facts and circumstances of each case. As stated in the portion of the regulations that discusses their scope, "The principal purpose of section 721 is to authorize the President to suspend or prohibit any merger, acquisition, or takeover by or with a foreign person engaged in interstate commerce in the United States when, in the President's view, the foreign interest exercising control over that person might take action that threatens to impair the national security."⁵ Only the President decides what constitutes a threat to the national security and what actions are in the interest of U.S. national security in any particular case that is sent for a determination under Exon-Florio.

See comment 7.

The draft Report states that in regard to one transaction CFIUS reviewed, "[t]he Treasury Department said that the concerns raised by Defense and Commerce were not national security concerns because they did not involve classified contracts, the foreign company's country of origin was a U.S. ally, and there was no specific negative intelligence about the company's actions in the United States."⁶ This statement suggests that one agency's view was somehow determinative of CFIUS's actions in this case. The comment ignores that the transaction at issue was fully investigated and extensive mitigation measures were put in place before CFIUS completed its review. Again, this illustrates that the draft Report ignores that all member agencies participate in the Committee's decision-making process and that CFIUS, as a Committee, decides whether there are threats to the national security and works closely with member agencies to develop appropriate mitigation measures.

See comment 8.

Standard for Initiating an Investigation

See comment 9.

The draft Report repeatedly asserts that Treasury, along with some other member agencies, is reluctant to initiate investigations⁷ and applies an overly strict standard in

⁴ Paragraph 1 of the Highlights: What GAO Found, paragraph 3 on page 2, and paragraph 3 on page 8.

⁵ 31 CFR 800.101

⁶ Paragraph 2 on page 9.

⁷ Paragraph 1 of the Highlights: What GAO Found. Related references are made in paragraph 1 on page 3; paragraph 3 on page 8; paragraph 2 on page 10, and paragraph 1 on page 16.

See comment 10.

determining whether an acquisition should be investigated.⁸ The question of whether to undertake an investigation demands careful deliberation on the part of all CFIUS members, including Treasury. The reason is obvious: a 45-day investigation potentially involves the President in the ultimate decision about a foreign acquisition. If CFIUS concludes after a 30-day review that there are unresolved national security issues, then an investigation is entirely appropriate. The GAO has cited no case since the enactment of Exon-Florio in 1988 where a Committee decision not to investigate was the result of imposition of a “strict standard” for deciding whether to investigate.

Treasury made available to GAO the CFIUS Guidelines which state that “Policy or Deputies CFIUS meetings are called to consider an action that may ultimately involve a Presidential decision. All agencies must be represented at the policy or deputy level and should be prepared to present their views.” The Guidelines go on to state that “[i]f any agency has national security concerns regarding the transaction and policy level officials concur, a 45-day investigation is undertaken.” As this indicates, Committee decisions are made on a consensus basis and the Committee’s members are expected to, and do, participate in this process.

See comment 11.

The Day 23 Rule⁹

The draft Report states that “the time constraints imposed on agencies to develop a position prior to the statutory deadline limits [sic] agencies’ ability to complete in-depth analyses.”¹⁰ The CFIUS Guidelines include time frames for completing the various phases of the reviews. The Guidelines state “Any CFIUS agency informs the Staff Chair as soon as possible, but in any case no later than Day 23 of a particular CFIUS review, unless extenuating circumstances prevent notice by this date, that it will request a policy level meeting to discuss the agency’s request for CFIUS to undertake a 45-day investigation under the Exon-Florio provision.” The purpose of the Day 23 deadline is to enable CFIUS to meet its obligations under the tight 30-day time frames of Exon-Florio. In most cases, CFIUS agencies are able to complete their reviews within the 23-day time frame; where they are not, CFIUS has been flexible enough to allow agencies as much time as possible under the 30-day time frame to complete their reviews and CFIUS has been able to identify and resolve national security concerns.

GAO’s criticism also overlooks the impact Exon-Florio has on the awareness of foreign investors contemplating acquisitions of U.S. companies of the importance of national security considerations and the ways it has resulted in foreign investments being structured to avoid national security problems. Many companies filing with CFIUS undergo extensive preparation, including ensuring compliance with existing laws and regulations pertaining to national security, before they even file their notices with the Committee.

⁸ Paragraph 1 on page 3, and paragraph 2 on page 11

⁹ Paragraph 3 on page 11. Related reference is made in paragraph 1 on page 3.

¹⁰ Paragraph 1 on page 16. Related references are made in paragraph 1 of the Highlights: What GAO Found; paragraph 1 on page 3; paragraph 3 on page 8, and paragraph 3 on page 11.

See comment 12.

Mitigation Measures

The draft Report states that “[t]he agencies that favor applying the narrower, more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate the concerns being raised by Defense and others.”¹¹ This assertion is undermined by the fact that CFIUS agencies have sought extensive mitigation measures in many more cases than they did just a few years ago. Since 1997, CFIUS agencies have negotiated at least 21 mitigation agreements in conjunction with a CFIUS review.

The mitigation agreements negotiated in conjunction with a CFIUS review vary in scope and purpose, and are negotiated on a case by case basis to address the particular concerns raised by an individual transaction. Some examples of the types of agreements are available through public sources; however, these examples in no way represent an exhaustive list of the kinds of agreements or mitigation measures that have been negotiated by CFIUS agencies. Moreover, because the facts of and issues raised by each transaction are unique, additional or varied mitigation measures will undoubtedly be required to resolve agencies’ national security concerns in future transactions. A few examples of the general types of agreements that have been negotiated include:

Special Security Agreement (SSA): These agreements provide security protection to the particular aspect of the company’s operation that deals with classified or other sensitive contracts.

Board Resolution: The U.S. company may be required to adopt a board resolution that certifies the foreign investor will not have access to particular information or influence over particular contracts.

Proxy Agreement: These agreements are used to totally isolate the foreign acquirer from any control or influence over the U.S. company.

Network Security Agreements (NSA): In cases in the telecommunications sector, conditions have been imposed in the context of the Federal Communications Commission’s (FCC) licensing process. Transactions involving the foreign acquisition of a U.S. telecommunications company usually are subject to regulation by the FCC, which is an independent regulatory agency. The FCC has in some cases agreed to condition the transfer of licenses to a foreign company on its compliance with the NSA that CFIUS member agencies have negotiated with that company. The NSAs are public documents available on the FCC’s website. Among other things, the NSAs have included numerous and varied protection measures for the security of the U.S. communications infrastructure, such as provisions relating to information storage and access and the company’s ability to comply with rules, regulations and orders related to law enforcement and national security. Some of the other strong security measures that have been used in NSAs include but are not at all limited to:

¹¹ Paragraph 2 on page 9.

- Personnel Screening: the acquired company may be required to implement a screening process for all personnel in positions that have access to the communications network or data associated with it.
- Outsourcing: there may be requirements that either limit the ability of the acquired company to outsource to non-U.S. companies, or impose some type of screening of personnel performing the outsourced services.
- Visitation: the acquired company may be required to implement a visitation policy that requires the appointment of a security officer in the company to review requests to visit the U.S. communications infrastructure by non-U.S. citizens.
- Routing: the company may be prohibited from routing domestic communications outside the United States except for special situations such as to avoid network disruptions.
- Security Audits: the acquired company may be required to undergo and report to Executive Branch agencies audits, potentially by third parties, of its network security practices.

Monitoring Compliance, Enforcing Agreements, and Remedies

The draft report states that “The Departments of Defense, Commerce, and Justice rely on DHS to monitor companies’ compliance with the agreements.”¹² Justice participates in several aspects of monitoring compliance with respect to the agreements to which they are a party. Therefore, to be more accurate, this statement should read: “The Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies’ compliance with the agreements.”

See comment 13.

In addition, with regard to enforcement authority, the draft report states, “[T]he Department of Homeland Security is the only one of the three [agencies that often sign security agreements] with broad enforcement authority. Further, according to Justice officials, while Justice has enforcement authority in some instances, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.”¹³

See comment 14.

We wish to clarify that the question of which agencies monitor agreements is distinct from which agencies enforce them. The Committee believes that any signatory agency has the authority to monitor the agreement, although there are differences in resources among them for this purpose. As for the separate question of which agencies have authority to enforce agreements, we would note that the Justice Department clearly has the authority to undertake enforcement actions, both on its own behalf as well as for other signatories. Justice’s position is that it has the unqualified authority to enforce such agreements to which it is a signatory.

See comment 15.

Further, to avoid any possible misunderstanding, it is worth noting that it is not just Justice’s Criminal Division that participates in the CFIUS process. The Federal Bureau

¹² Paragraph 5 on page 15.

¹³ Paragraph 5 on page 15.

See comment 16.

of Investigation (FBI) has been, and continues to be, a very active and critical participant, and other components of Justice have played a role on a case-by-case basis.

The draft Report also states that Treasury and several other members deleted “strong enforcement language” from an agreement with a foreign acquiring company.¹⁴ This discussion in the draft Report actually refers to a proposed remedies provision, not an enforcement provision. As noted previously, each transaction reviewed under Exon-Florio is unique. Therefore, for each mitigation agreement, member agencies utilize the most effective mitigation measures and strongest enforcement mechanisms and remedies appropriate to the particular facts and circumstances to ensure compliance. Although we cannot provide specific comment on the individual case at issue in the draft Report, CFIUS agencies have been vigilant to ensure that there are no transactions for which compliance with mitigation measures is uncertain.

Withdrawals

See comment 17.

The draft Report states, “To provide additional time, while avoiding an investigation, the Committee has encouraged companies to withdraw their notification . . .”¹⁵ As noted earlier, Treasury made available to the GAO the CFIUS Guidelines. The Guidelines state:

Parties, not CFIUS agencies, have the authority to request a withdrawal. The withdrawal option is not a means to extend the time frames set by the statute. Legitimate reasons to grant a withdrawal include providing parties an opportunity to get in compliance with existing national security laws and regulations, and to provide additional information to clarify national security issues that may not necessarily warrant a Presidential determination. The CFIUS Chair, not any single member agency, communicates with the parties regarding the appropriateness of this option.

See comment 18.

CFIUS as a whole decides whether a party to a transaction may withdraw its filing, but Treasury as the Chair communicates this decision to the parties. While “the Committee generally grants withdrawal requests,”¹⁶ CFIUS frequently specifies in its letter granting the request the conditions for the withdrawal. In cases where a withdrawal is granted because the parties are abandoning the transaction, that fact would be specified in the letter granting the request for withdrawal. Where a withdrawal is granted and a re-filing is expected, that expectation would also be stated in the letter granting withdrawal.

The GAO raises concerns about two transactions that were notified after the transactions had closed, were allowed to withdraw, and were never renotified.¹⁷ In these cases, CFIUS granted the companies’ request for a withdrawal to provide additional time to

¹⁴ Paragraph 1 on page 10.

¹⁵ Paragraph 1 of the Highlights: What GAO Found; paragraphs 2 and 3 on page 8; paragraph 1 on page 12, and paragraph 1 on page 16.

¹⁶ Paragraph 2 on page 8.

¹⁷ Paragraph 1 on page 13.

See comment 19.

resolve specific issues. Treasury, as Chair, tracked developments on the cases and coordinated closely with the interested agencies regarding whether the companies should be urged to refile in order to resolve national security concerns. Although refiling was not deemed necessary, it should be noted that CFIUS agencies also understood that so long as action is not concluded under Exon-Florio, the President retains his authority to suspend or prohibit these transactions if he makes the findings required under the statute.

Industrial Policy

See comment 20.

The draft Report states that some members of CFIUS “argued that [CFIUS’s] narrow definition of national security is not sufficiently flexible to provide for safeguards in areas such as protection of critical infrastructure, security of defense supply, and preservation of technological superiority in the defense arena.”¹⁸ As noted earlier, CFIUS considers a range of factors in assessing threats to national security, precisely because it does not want to limit the President’s flexibility. CFIUS considered all of these areas in transactions it recently reviewed.

Vulnerabilities from Foreign Control Alone

See comment 21.

The draft Report states that certain CFIUS officials told the GAO that “[v]ulnerabilities can result from foreign control of critical infrastructure.”¹⁹ Although this may be the case, it is equally true that vulnerabilities can result from foreign influence in commerce in a myriad of ways other than through control, such as through contractual relationships. Yet these concerns are not addressed by Exon-Florio, which calls for a case-by-case determination concerning a particular foreign investor and a particular U.S. company. In particular, Exon-Florio requires the President to examine the credible evidence that such a foreign investor might take action that threatens to impair U.S. national security, whether or not the foreign investor intends to or actually takes such action. CFIUS recognizes that foreign control alone does not automatically constitute a threat to national security and that there can be vulnerabilities in critical infrastructure even without foreign control.

GAO Conclusion Re Amending Exon-Florio to Specify Additional Factors

The draft Report states that “[i]n light of the disagreement within the Committee on Foreign Investment in the United States with regard to the extent of authority provided by Exon-Florio, the Congress may want to consider amending Exon-Florio by more clearly emphasizing the factors that should be considered in determining potential harm to national security.”²⁰

The current framework provided by Exon-Florio for national security reviews allows the broadest possible latitude for CFIUS to consider foreign acquisitions of U.S. companies

¹⁸ Paragraph 3 on page 2.

¹⁹ Paragraph 1 on page 9.

²⁰ Paragraph 3 on page 16. Related references in paragraph 1 of the Highlights: What GAO Recommends, and paragraph 3 on page 3.

See comment 22.

that may pose national security concerns and for the President to take action as needed. The list of factors in the statute that the President “may consider” in making a determination is an open list. The President and CFIUS may and do consider other factors. Well before the creation of the Department of Homeland Security, CFIUS reviewed transactions involving critical infrastructure, including the “control of or access to information traveling on networks.”²¹ Since the creation of the Department of Homeland Security, CFIUS has reviewed many transactions involving critical infrastructure, which can often be important to the national security.

We believe that the statute is already flexible enough to encompass domestic production necessary for homeland security as a factor that the President may consider, and CFIUS already considers it. We would be prepared, however, to consider including this factor in a list of factors the Committee may consider in the implementing regulations in order to make this more explicit.

See comment 23.

GAO Conclusion Re Eliminating the Distinction between a Review and an Investigation

The draft Report states that Congress may want to eliminate the distinction between a 30-day review period and 45-day investigation period in favor of considering the entire 75-day period as available for review.²²

Although there are some complex transactions for which the 30-day time period poses a significant challenge to the Committee’s ability to conduct a thorough and comprehensive review, CFIUS completes the vast majority of its reviews within the initial 30-day review. In fact, GAO found in 2002 that: “For the most part, the Committee on Foreign Investment in the United States is able to fulfill its responsibility to ensure that foreign acquisitions of U.S. companies do not threaten national security without resorting to investigations.”²³ Of 1,560 reviews, 1,535 have been completed in the 30-day review period. Companies usually make closure of the transaction contingent on conclusion of the CFIUS review. Moreover, as mentioned earlier, companies, particularly for transactions with implications for national security, often will have already completed extensive preliminary work to comply with existing laws and regulations pertaining to national security before filing a notice with CFIUS. Although for certain transactions an extension of time available for the collection and analysis of information would ease the burden on the government, for most transactions, extending the time for review by 45 days would be unnecessary and could have a negative effect on foreign investment in the United States by extending the regulatory review process and delaying the closing of acquisitions. Such an extension also could have the unintended effect of deterring CFIUS filings in the first place, which would be contrary to Exon-Florio’s national security objective.

²¹ Paragraph 1 on page 9.

²² Paragraph 3 on page 16.

²³ Paragraph 3 on page 11 of September 2002 GAO Report #02-736.

See comment 24.

GAO Conclusion Re Revisiting the Criterion for Reporting to Congress

The draft Report states that Congress may want to revisit the criterion for reporting to Congress.²⁴ As provided in the Exon-Florio provision, the President sends a report to Congress with a decision. Treasury, along with other agencies with equities in any particular transaction, provide briefings to duly authorized committees of Congress whenever requested, following completion of action under the statute. Detailed unclassified reports to Congress could provide a road map for foreign acquiring companies to circumvent national security reviews under Exon-Florio. Exon-Florio has a confidentiality provision in order to protect proprietary information that companies voluntarily provide to CFIUS. Companies may not invest in the United States if they fear that proprietary information may be made public. We therefore believe that oral closed session briefings, consistent with the confidentiality provision of Exon-Florio, are appropriate. We are happy to work with the Congress on developing a reasonable periodic reporting schedule for completed reviews to give interested Members information about transactions that may be of interest and for which CFIUS could provide follow-up briefings.

We would stress the importance that any attempts to make the process more transparent to Congress, and thus more susceptible to Congressional scrutiny, should not result in any compromise to the current confidentiality afforded to companies that file under the statute. The CFIUS process is a voluntary one, and any potential procedure that might be perceived as lessening the confidentiality currently afforded to filers could result in a diminution in the number of applications the Committee receives and an erosion of the confidence companies have that their sensitive and proprietary information will be closely held. Without such confidence and the resulting full disclosure to the Committee, it will be impossible for the Committee to undertake a meaningful review of any transaction.

GAO Conclusion Re Amending the Regulations to Provide Interim Protections

The draft Report recommends that “Treasury, as chair of the Committee, amend current regulations to require interim protections where specific concerns have been raised, and to establish specific timeframes for refile along with a process for tracking any actions being taken during the withdrawal period.”²⁵ This would apply to transactions that have closed or will close prior to CFIUS completing its review during any period when a transaction has withdrawn. CFIUS has the authority to require interim protections and has done so when it felt such protections were needed.

We stand by Treasury’s comments on the 2002 GAO Report in which the same recommendation was made. Interim measures would be difficult to negotiate and would detract from efforts to complete the CFIUS review, where we believe the emphasis

²⁴ Top of page 17.

²⁵ Paragraph 1 on page 17. Related reference in paragraph 1 of the Highlights: What GAO Found, and paragraph 1 on page 3.

See comment 25.

should stay. Overly rigorous schedules could prevent agencies from performing a complete review.

Interagency Process

The Committee notes that the Congress deliberately created Exon-Florio to be a broad and flexible statute that would give the President the authority needed to deal with threats to our national security. Given the statute's time constraints and the natural competition of differing perspectives on the part of the CFIUS members, no one should be surprised that there are moments of friction in implementing the statute. Indeed, the Committee's discussions are frequently spirited. Nonetheless, all member agencies agree that the Committee's deliberations have been consistently collegial and professional and that in the end we achieve the results intended under the statute. The Committee, despite -- and perhaps because of -- its many perspectives, is ultimately united in seeking the best possible outcome for the United States and our national security. We fully expect that the Committee will continue to be effective in the future.

The following are GAO's comments on the Department of the Treasury's letter dated August 12, 2005.

GAO's Comments

1. Our understanding of the Committee's process is based on an extensive review of Committee guidance and case files and structured interviews and discussions with member agencies, including Treasury. Further, except where changes in Committee make-up and proceedings have occurred since 2002, our discussion of the laws and the Committee's process is consistent with our 2002 report.
2. As we point out in our evaluation of agency comments in the report, certain member agencies raised concerns that indicated fundamental disagreement among members when reviewing certain cases. Given these fundamental disagreements, we concluded that the extent to which issues are vetted and consensus is reached on certain cases is, at best, uncertain.
3. To analyze cases notified to the Committee and determine whether threats to national security exist, each agency effectively operationalizes its own definition of national security. The implication that individual agencies do not apply a definition is unrealistic.
4. We agree that Exon-Florio should be used judiciously as a safety net when laws other than Exon-Florio and the International Emergency Powers Act may not be effective in protecting national security—a point we make in the opening paragraph of our report. However, in cases where Committee members disagree on whether Exon-Florio applies, we have found that a more narrow definition of national security often takes precedence or the companies are allowed to withdraw their notification to avoid investigations. Treasury's rather lengthy discussion in its comment letter on the need to protect U.S. open investment policy underscores our concern.
5. In numerous case documents GAO reviewed, the definitional bounds agencies used in considering national security concerns are apparent. Some agencies followed routine analytical processes, searching specific databases related to export controls, acquisition history, and critical technology information—sources that would reveal whether the foreign acquisition involved any export-controlled technology or item or classified contracts, or whether there was specific derogatory intelligence on the foreign company. Other agencies prepared specific vulnerability or threat assessments that have their own methodological parameters. The debate among Committee members on each notification is fueled by these differing definitions.

6. We agree that, taken in total, member agencies consider a broad range of national security factors when cases are analyzed. We also agree that anything other than the broad consideration of a range of national security factors by the Committee would inappropriately limit the President's necessary discretion to protect national security.
7. While only the President decides what constitutes a threat to national security and what actions are in the interest of U.S. national security in cases that are sent for a determination, only two cases have reached this stage since 1997. Further, only 8 of 451 cases have undergone investigations. By allowing withdrawals of notifications rather than initiating investigations, the Committee effectively pre-empts the President from using his discretion to make a determination. To this end, the Committee has defined what constitutes a threat to national security, not the President. Further, since only those few cases that go to the President for a determination require reporting to the Congress, there is little insight into the Committee's deliberations. Our review found that for specific cases, there has been significant disagreement among member agencies on what constitutes a threat to national security and what actions are in the interest of national security. In two such cases, companies were allowed to withdraw their notices, and to date, they have yet to refile, leaving the concerns unresolved.
8. Again, Treasury's response skews our finding. In two cases we reviewed, when an agency raised what it deemed a national security concern and other Committee members did not agree, the narrower definition of national security—which excludes the concern raised—prevailed, in that the notice was withdrawn instead of the case proceeding to investigation. Regardless, the case Treasury refers to was cited in our 2002 report as an example of an agreement in which nonspecific language made the agreement difficult to implement. For example, to mitigate a concern about access to technology, the agreement required a "good faith effort" to divest a subsidiary. When the company divested part, but not all, of the subsidiary—citing lack of interested buyers as the rationale—government officials could not determine whether the company's efforts were made in good faith because the agreement did not include criteria defining what actions would constitute a good faith effort. In addition, the agreement contained no consequences for failure to comply with the monitoring terms of the agreement within the stated time frames, and as we noted, the company failed to meet the terms of one provision. Given this outcome, it is unclear how Treasury can assert that "extensive mitigation measures were put in place" or how this case exemplifies

that all member agencies participate in the Committee's decision-making process.

9. We agree that the decision to undertake an investigation demands careful deliberation on the part of all Committee members. However, in two cases we reviewed, documentation shows that in determining whether to initiate an investigation, Treasury, as Committee Chair, applies essentially the same criteria that the Exon-Florio amendment directs the President to use to decide whether to take action to suspend or prohibit a transaction. While Treasury states that an investigation is entirely appropriate if national security issues remain unresolved at the end of the 30-day review period, we found that rather than initiating an investigation, the Committee commonly allows companies to withdraw their notifications and refile at a later date to provide more time for review. Our report has not cited cases where a Committee decision not to investigate was the result of the application of an overly strict standard for deciding whether to investigate because where we noted the application of this standard, the companies withdrew their notice.

Further, by applying the Presidential decision-making criteria at the conclusion of the 30-day review, the Committee effectively preempts the President's opportunity to make a determination. In a 2004 case, documentation from a policy-level meeting shows that the appropriateness of applying these criteria in Committee deliberations was debated; the debate was not resolved at the time, and officials from two separate agencies told us that the debate continues. The implementing regulations for Exon-Florio make no distinction between the activities the Committee undertakes during the review and investigation periods—other than preparing a report to the President at the end of an investigation—and provide no criteria for determining when to initiate investigation. It is, in part, for this reason that we are proposing that the entire 75-day period be available for analyzing cases, if needed. Eliminating the distinction between the review and investigation periods would help ensure that sufficient time is available for thorough analyses of cases and that the presidential decision-making criteria are only applied by the President.

10. Guidelines requiring that certain actions be taken do not provide evidence that such actions were indeed taken. For example, in one 2004 case we reviewed, after a policy-level decision to initiate an investigation was made, some Committee member agencies, including the Chair, placed calls to corporate counsel informing them of the pending investigation and advising that their clients withdraw their

notices. Because the companies withdrew, an investigation was never initiated.

11. As stated in our report, we understand that the purpose of the 23-day rule is to enable the Committee to meet its obligations under Exon-Florio's statutory time limits for 30-day reviews. For the majority of cases where national security concerns either do not exist or agency members agree that concerns are addressed by other laws, the 23-day rule may help facilitate the closure of cases before the expiration of the 30-day review period. However, in complex cases—cases in which national security concerns have been raised and for which Exon-Florio is the relevant statute—case documentation we reviewed revealed the significant pressures some agencies face to complete analysis within 23 days. In five cases that we reviewed, letters from the companies requesting withdrawal and/or letters from Treasury, as Committee Chair, approving the requests to withdraw cited the need for more review time on the part of the government as the reason for the withdrawal. In one such case, an electronic message we reviewed cited the Committee's workload on another high profile case as the reason that the Committee sought to have a notice withdrawn. In that case, the transaction had already been completed and the company had requested withdrawal on day 23, before agencies completed their analysis to determine whether to request an investigation. Because the company never refiled a notice, the national security concerns identified by two member agencies have not been further examined. Further, it should be noted that in its comments, the Department of Justice said that any additional time that could be made available to collect and analyze information needed to conduct a thorough and comprehensive national security assessment would be helpful.
12. We have acknowledged the use of mitigation agreements¹ in our current report as a major tool used by the Committee. In fact, we point out that the more recent mitigation agreements have addressed several of the problems with such agreements that we noted in our 2002 report. However, strengthening or increasing the number of mitigation

¹ GAO recently issued two reports that have identified vulnerabilities when the government uses some of the remedies noted by Treasury: one, overseeing contractors under foreign influence and two, ensuring classified information is protected. (GAO, *Industrial Security: DOD Cannot Ensure Its Oversight of Contractors under Foreign Influence Is Sufficient*, [GAO-05-681](#) (Washington, D.C.: July 15, 2005); GAO, *Industrial Security: DOD Cannot Provide Adequate Assurance That Its Oversight Ensures the Protection of Classified Information*, [GAO-04-332](#) (Washington, D.C.: Mar. 3, 2004).

agreements does not ensure that all national security concerns raised by member agencies are sufficiently examined. Further, the particular passage cited by the Under Secretary is not disputing that mitigation agreements are often negotiated but rather is pointing out that there is not agreement on when these mitigation agreements are needed. As we reported, agencies that apply the more traditional definition of what constitutes a threat to national security have resisted using Exon-Florio to mitigate or address the concerns raised by other Committee members.

13. We have revised our report to reflect that the Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies' compliance with the agreements.
14. We did not mean to imply that Justice does not have the authority to undertake enforcement actions and have clarified that in the report.
15. We agree that the Federal Bureau of Investigation and other Justice Department components have been and continue to be a very active and critical participant in the Committee's process. We also acknowledge there are other Committee agency components that are also critical to the process such as the Bureau of Industry and Security in the Department of Commerce; the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics–Industrial Policy, and the Central Intelligence Agency. Committee member agencies use many internal resources as part of their process.
16. A remedy is defined as a legal means of preventing or redressing a wrong or enforcing a right. A Defense official confirmed that the provision in question that was deleted from the agreement stated that if the company (1) fails to comply with the terms of the agreement, (2) makes a materially false statement, (3) increases foreign entity control, or (4) makes other material changes in circumstances, the Attorney General, the Secretary of Defense or the Secretary of Homeland Security may raise concerns to the Committee or the President. Without having this provision, it is unclear what remedy will be available to the Committee and its member agencies to enforce this mitigation agreement.
17. Despite what is stated in the guidelines, in practice the Committee has allowed companies or parties to withdraw their notices to provide member agencies additional time to complete their analyses or to negotiate mitigation measures. Documentation from Committee files shows that 12 of the 20 withdrawals we identified that have been granted since 1997 to companies that intended to continue the

acquisition were granted to allow member agencies to either negotiate mitigation agreements, continue obtaining information from the companies, or otherwise continue analyses.

18. Of the 26 letters granting withdrawal that we reviewed, only three explicitly stated conditions for the withdrawal: in two cases, the companies were abandoning the transaction; in the third, the company agreed to divest its U.S. acquisition.
19. We recognize that the President retains the authority to take action if the Committee's review is not completed. However, our review of case files does not support the Under Secretary's assertion that Treasury, as Chair, tracked developments on the withdrawn cases that were notified after the transactions were closed. Further, it is unclear how Treasury could conclude that refiling is unnecessary in these cases, given that the withdrawals were granted to provide additional time to resolve specific concerns raised by other agencies. For example, in one case, a Treasury official told us that she was unaware that the Department of Defense had concerns. By not having the companies refile, Defense's concerns were not fully vetted. In another case, a Defense official provided documentation indicating that the Defense Department's position remained that conditions should be imposed on the transaction. In our view, refiling serves two purposes: (1) it provides assurances to the companies that action will not be taken at a future date and (2) it permits Committee member agencies to ensure that no national security concern was overlooked.
20. The documentation we reviewed clearly showed that Treasury and Defense have different views of what constitutes a threat to national security. For example, in one case, Treasury officials wrote three separate memos stating that in Treasury's view, Defense and Commerce Department concerns about (a) foreign ownership of sensitive but unclassified technology used in reconnaissance satellites, (b) the possibility of this sensitive technology being transferred to countries of concern, and (c) maintaining U.S. government access to the technology were not national security concerns.
21. We agree that vulnerabilities can result from a variety of things not addressed by Exon-Florio. We merely provided examples of the kinds of vulnerabilities that may result from foreign control. We were not addressing the universe of vulnerabilities, only some of those addressed by Exon-Florio, the subject of our report.
22. We agree that Exon-Florio provides broad latitude for the Committee to consider whether foreign acquisitions constitute a threat to national

security. Our concern is how Exon-Florio is being implemented. Given the internal disagreement among Committee members and the lack of transparency as to how disagreements are resolved, we believe that additional guidance from the Congress would be beneficial.

23. We recognize that, in most instances, 30 days is sufficient to conclude reviews. If Exon-Florio were amended, then we expect that the Committee could manage the process so that the vast majority of cases would continue to be completed within 30 days. However, Exon-Florio is to be used when other laws are inadequate—in short, to act as a safety net. The ability to complete “a vast majority” of reviews in 30 days is not relevant to Exon-Florio’s importance as a safety net. Moreover, as we point out in our report, some agency officials have stated that 30 days is insufficient in complex reviews. The Justice Department, in its official comments, stated that any potential extension of the time available to the participants for the collection and analysis of information from the intelligence community would be helpful (see page 2 of Justice Department comments in app. II).

Treasury officials have pointed out that being the subject of an investigation may have negative connotations for a company, and that the Committee tries to avoid initiating investigations. By eliminating the distinction between investigations and reviews, this negative connotation and the potential impact on investment would no longer exist.

The Under Secretary expressed concern that extending the time frames would deter filings but did not explain the basis for his concern. However, the Committee need not rely solely on voluntary filings. The implementing regulations state that “any member of the Committee may submit an agency notice of a proposed or completed acquisition to the Committee through its staff chairman if that member has reason to believe, based on facts then available, that the acquisition is subject to section 721 and may have adverse impacts on the national security. In the event of agency notice, the Committee will promptly furnish the parties to the acquisition with written advice of such notice.”²

24. The Congress has made numerous efforts to conduct oversight of the Committee’s activities—first in the original Exon-Florio legislation by requiring a report when the President prohibited an acquisition, and

² 31 C.F.R. § 800.401(b).

again in 1992 by passing the Byrd Amendment to require a report when the President makes any decision regarding a foreign acquisition. In addition, in requesting our review, the Senate Banking Committee cited the “opaque nature” of the Exon-Florio process as a reason for its request, which suggests that the Committee on Foreign Investment in the United States has not been successful in keeping the Congress adequately informed. We agree that the confidentiality afforded to the companies under Exon-Florio should not be compromised. However, subsection (c) of the statute provides that the confidentiality provisions “shall not be construed to prevent disclosure to either house of Congress or to any duly authorized committee or subcommittee of the Congress.” Therefore, we stand by our suggestion that the Congress may wish to revisit the congressional reporting requirement.

25. As we stated in our 2002 report, the regulations should not call for negotiating interim measures, but rather for the Committee to use its authority to impose them as a condition of withdrawal where the transaction has been completed or will be completed during the withdrawal period. Further, as we state in our report, “the Committee’s guidance to member agencies specifically states that Treasury will manage activities during withdrawal by specifying time frames and goals to be achieved.” Because Treasury has declined to implement our recommendation, we are including our recommendation as a matter that Congress may wish to consider.

Appendix II: Comments from the Department of Justice



U.S. Department of Justice

Criminal Division

Office of the Assistant Attorney General

Washington, D.C. 20530

July 25, 2005

Mr. Norman J. Rabin, Managing Director
Homeland Security and Justice
Government Accountability Office
Washington, DC 20548

Dear Mr. Rabin:

This is to provide the Department's comments on your draft report, entitled "Exon-Florio May Have Limited Effectiveness in Protecting U.S. National Security." We would like to thank the Government Accountability Office (GAO) for examining the issues covered by the draft report and for providing the Department the opportunity to comment on its contents.

We have several points of clarification. First, at page 15, in the final paragraph, the draft report states that "The Departments of Defense, Commerce, and Justice rely on DHS to monitor companies' compliance with the agreements." The Department of Justice does participate in several aspects of monitoring compliance with respect to the agreements to which we are a party; therefore, to be more accurate, this statement should read: "The Departments of Defense, Commerce, and Justice significantly rely on DHS to monitor companies' compliance with the agreements."

In addition, in the final paragraph beginning on page 15, after noting the positions of the Departments of Defense and Commerce that they lack authority to enforce security agreements signed pursuant to Exon-Florio, the draft report states:

As a result, the Department of Homeland Security is the only one of the three with broad enforcement authority. Further, according to Justice officials, while Justice has enforcement authority in some instances, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

The Department of Justice's position is that any signatory party to an agreement entered into pursuant to Exon-Florio has the authority to enforce that agreement – and certainly the Department of Justice has the unqualified authority to enforce such agreements to which it is a signatory. For that reason, the last sentence should read:

Further, according to Justice officials, while Justice has authority to seek enforcement of agreements signed pursuant to Exon-Florio and to which it is a

**Appendix II: Comments from the Department
of Justice**

signatory, the Department of Homeland Security has more resources for monitoring compliance as well as the legal mandate to act.

The draft report includes a formal recommendation that the Department of the Treasury amend the regulations of the Committee on Foreign Investment in the United States (CFIUS) to ensure that companies that withdraw an initial filing are tracked and required to refile according to a specific time frame. The Department of Justice suggests that, if this recommendation is adopted, any implementing language be crafted in such a manner that it does not inhibit or in any way discourage initial filings.

The draft report also makes other, informal suggestions for revising the CFIUS process through both regulatory and legislative changes to Exon-Florio. The Department of Justice requests that any attempts to make the process more transparent to Congress, and more susceptible to Congressional scrutiny, not in any way impede the current confidentiality afforded to companies that file under the statute. The CFIUS process is a voluntary one, and any potential procedure that might be perceived as lessening the confidentiality currently afforded to filers could result in a diminution in the number of applications the Committee receives and an erosion of the confidence companies have that their sensitive and proprietary information will be closely held. Without such confidence and the resulting full disclosure to the Committee, it will be impossible for the Committee to undertake a meaningful review of any transaction.

The Department shares the concern expressed in the draft 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.

The Department also wishes to clarify that, as far as we know, the Committee as a body has not been a party to any of the national security agreements that have been negotiated to date. Rather, the national security agreements are comprised of commitments from individual agencies with specific equities at stake, and only those individual agencies are parties to the agreements. The consideration for the agreements is that the party agencies will not object to the transaction in the CFIUS process. The agreements do not bind the Committee as a whole or the agencies who are not parties.

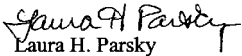
Finally, to avoid any possible misunderstanding, we want to point out that it is not just the Department's Criminal Division that participates in the CFIUS process. The Federal Bureau of Investigation (FBI) has been, and continues to be, a very active and critical participant, and other components of the Department have played a role on a case-by-case basis. The draft report notes, at page 9 in the first full paragraph, that since the Department of Homeland Security joined the Committee, both the Departments of Defense and Homeland Security "have begun to analyze acquisitions both in traditional terms and more broadly in terms of the potential vulnerabilities posed by the acquisition." For the sake of clarity, it should be noted that, for some time before

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of Justice**

the Department of Homeland Security joined the Committee, the Department of Justice and the FBI had been analyzing proposed transactions in the "broad terms" referred to in the report and expanding the Committee's analytical approach.

Thank you for your consideration of these comments. Please do not hesitate to contact us if you would like additional assistance regarding this matter.

Sincerely,


Laura H. Parsky
Deputy Assistant Attorney General

cc: Mr. Thomas Denomme, Assistant Director
Mr. Gregory Harmon, Senior Analyst

Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contact

Ann M. Calvaresi-Barr, (202) 512-4841

Acknowledgments

In addition to the contact named above, Thomas J. Denomme, Assistant Director, Allison Bawden, Gregory K. Harmon, Paula J. Haurilesko, Karen Sloan, John Van Schaik and Michael Zola made key contributions to this report.

Related GAO Products

Defense Trade: Mitigating National Security Concerns under Exon-Florio Could Be Improved. [GAO-02-736](#). Washington, D.C.: September 12, 2002.

Defense Trade: Identifying Foreign Acquisitions Affecting National Security Can Be Improved. [GAO/NSIAD-00-144](#). Washington, D.C.: June 29, 2000.

Foreign Investment: Implementation of Exon-Florio and Related Amendments. [GAO/NSIAD-96-12](#). Washington, D.C.: December 21, 1995.

Foreign Investment: Foreign Laws and Policies Addressing National Security Concerns. [GAO/NSIAD-96-61](#). Washington, D.C.: April 2, 1996.

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