Testimony of
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Chairman Barr, Representative Moore and Members of the Committee:

Thank you very much for the opportunity to testify, and thank you for your leadership on this important issue. My name is David Marchick and I am a Managing Director at the Carlyle Group, a global investment firm. I also formerly practiced CFIUS law, testified before this committee during the last CFIUS reform process and wrote a book on the subject of national security and foreign direct investment. The book was not a best seller.

Senator Cornyn, Congressman Pittenger and other co-sponsors of FIRRMA deserve enormous credit for highlighting some of the challenges in the CFIUS process in light of the evolving investment and transaction environment. They and their staffs have worked hard on a bill that would strengthen CFIUS and clarify the Committee's authorities.

This Committee is grappling with a complex tradeoff between two important but occasionally competing policy objectives: protecting and preserving US national security and attracting foreign investment to the United States. Nothing is more important than protecting our national security interests. At the same time, Congress and every administration since World War II have also recognized that foreign investment in the United States creates jobs, enhances productivity, fosters innovation and strengthens the US economy. The United States is a huge investor overseas and we would not want our actions restricting foreign direct investment to spur other countries to block US investment abroad. President Reagan was the first US president to establish the principle that foreign investors and domestic investors should be treated equally; Presidents Bush through Obama each issued their own similar statements, and hopefully President Trump will as well.

The stakes are high and the risk of error is significant. The Executive Branch and Congress have not always balanced these policy objectives well.

In the decade after World War I, certain personnel in the Department of Navy were convinced that our next war would be against the United Kingdom. At that time, the UK had superiority in air, at sea and in mass communications, primarily radio. At the encouragement of the Navy, and under threat of action from Congress, President Wilson seized all foreign-owned radio stations, including British owned radio stations, then the largest in the country. Over the next decade, Congress took steps to restrict foreign investment in aviation, shipping and telecommunications, limits that still exist today under US law. Obviously, we never went to war with the UK and actions against the UK at that time, in hindsight, proved to be an overreach.

The United States has also erred in not acting when it should have acted. Prior to and during World War I, the United States seized a range of German assets, particularly in the chemical sector, known as the "high tech" sector in the economy at the time. However, the US developed too lax an attitude toward certain FDI between the two world wars, allowing certain German investments in the United States that were likely utilized for espionage in the U.S.[1]

More recently, in the 1980s and 1990s, many in Congress feared that Japan was taking over assets in the United States and eclipsing the United States as the most competitive and largest economy in the world. Many of those investments from Japan turned out to be money-losing investments and none, to my knowledge, compromised US national security. It is hard to imagine today, but some commentators and Members of Congress were up in arms about Japanese acquisitions of golf courses and the Rockefeller center. At one point, seven Members of the House of Representatives held a press conference outside the Capitol where they smashed a Japanese "boom box" with sledgehammers. In hindsight, the United States would have been much better off if Japan, our ally and the second largest economy in the world at the time, grew at a much faster pace than they did over the past

[1] "US National Security and Foreign Direct Investment," by Edward M. Graham and David M. Marchick (Peterson Institute, May 2006), p. 31

25 years. Today, Japanese companies are intertwined into the fabric of local communities throughout our country and Japanese investment represents a net positive for the United States.

At various times over the past four decades, concerns have ebbed and flowed about foreign direct investment from the Middle East, Japan, Dubai and now China. How should Congress legislate with these shifting national security imperatives in mind? Congress should equip CFIUS with all of the necessary tools to protect national security. CFIUS should also have broad discretion to adjust to new threats, as national security priorities change over time. However, the Executive Branch should use those tools judiciously and carefully, since very few foreign investments implicate US national security interests. Further, we should not let the passions of any particular moment restrict investment that the United States wants and needs.

As the Congress considers ways to strengthen Section 721 of the Defense Production Act, allow me to offer a few principles that might guide your thinking:

First, CFIUS absolutely needs the tools to block or address the risk of any foreign investment compromising US national security. To my knowledge, CFIUS has used its authority frequently. Indeed, the number of transactions that have been effectively blocked, including through withdrawal, has increased significantly in the past 18 months. The number of transactions withdrawn or blocked reached 27 in 2016 and 14 in 2015. In other words, the number of blocked or withdrawn transactions doubled in 2016 from 2015 and grew many times over since the early 2000s. The Rhodium Group, a consulting firm that monitors foreign investment in the United States, reported that CFIUS either blocked or forced the abandonment of more than $8 billion in China-related investments in 2017 alone.[2] I am not familiar with the facts of these particular cases or the rationale for blocking them, but clearly CFIUS has exercised its authority to block investments frequently and with great impact.

[2] "Chinese FDI in the US in 2017: A Double Policy Punch" (Rhodium Group, 2018), http://cim.rhg.com/notes/chinese-fdi-in-the-us-in-2017-a-double-policy-punch

Second, CFIUS should be designed to scrutinize carefully those transactions that raise concerns, but quickly approve those transactions that do not implicate US national security interests. I have frequently analogized the CFIUS process to triage in an emergency room. An effective emergency room – one overwhelmed with patients – will quickly and thoroughly attend to the patient having a heart attack or a serious wound, but will speedily move out the kid with a minor cut. Similarly, CFIUS should carefully scrutinize those cases that raise national security concerns but quickly approve those cases that do not present such issues.

In the M&A world, time is money. More specifically, time creates uncertainty in closing a transaction. Take the following simple example: imagine you are selling your house and you have three bidders. The first bidder is American, bids $200,000 and can close in thirty days. The second bidder is British, bids $210,000 but cannot close for 90 days. The third bid is for $550,000 but raises national security concerns. They will not be able to close for 6 months, if at all. Who will you go with?

Picking between bidder A and B is a tough call. However, for the context of today's hearing, you want to ensure that bidder A and B operate on a level playing field so that both can close quickly, and the United States does not impede or slow down foreign investment that does not raise national security concerns. Carlyle has sold a number of companies to highly regarded investors from the UK, Germany, Canada, Japan and other allied countries, and on occasion has sold non-sensitive assets to investors from other countries. For any non-sensitive transaction, it is in the United States' interest for those transactions to flow quickly, without delay or cost, through CFIUS.

Current law contemplates a first phase review of 30 days. I would encourage the Committee to maintain a 30-day period for first phase reviews – the same time period for first phase antitrust reviews under the Hart-Scott-Rodino Act. Section 721, as amended by the Foreign Investment and National Security Act of 2007 (FINSA), grants CFIUS broad discretion to extend any transaction to a second-phase review – any agency can force an investigation. However, as mentioned above, transactions that do not raise national security concerns should be approved quickly, efficiently and without great expense or delay.

Third, any changes in CFIUS's authority should be narrowly tailored to capture precisely those transactions that need national security review. Casting too wide a net will actually undermine national security because the volume of transactions will overwhelm the system and reduce the focus on those transactions that matter from a national security perspective. When I testified before this committee in 2006, I noted that CFIUS was overwhelmed with cases and the system was slowing down non-sensitive transactions. That year, CFIUS received a then modern-era record 113 filings but only 7, or just over 6%, went to investigation.

Last year, CFIUS reviewed nearly *240* cases of which *70%* went to a second-phase review, or investigation.[3]

Returning to the concept of emergency room triage, CFIUS should use the strongest microscope to scrutinize transactions that raise legitimate national security concerns while at the same time promptly approving those that do not. In 2015, as published in the latest CFIUS annual report, CFIUS reviewed 143 cases; 66, or slightly less than half, went to investigations. China accounted for 29 of the total cases, meaning than non-Chinese transactions accounted for almost 80% of the cases. Canada represented 22, the UK - 19, and Japan - 12. In total, investments emanating from investors based in countries that are our closest allies accounted for 93 filings,[4] yet still more than half of the overall cases went to second-phase investigation. In my view, too many cases are going to investigation and CFIUS should clear the easier cases much more quickly. Certain investments from our closest allies could raise national security concerns while many transactions from China raise no concerns. The key is for CFIUS to focus on those cases that really matter and dispose of the others quickly and favorably.

I hope the committee will explore with Treasury whether the high number of second phase reviews was really due to national security concerns with those transactions, or whether some of the transactions were moved to a second phase review because CFIUS did not have sufficient resources to review the high number of cases. I am aware of certain cases that

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[3] https://home.treasury.gov/news/press-releases/sm0262

[4] This total includes cases originating in the EU, Canada, Japan, South Korea, Singapore, Australia or Switzerland, all of which are close US allies. https://www.treasury.gov/resource-center/international/foreign-investment/Documents/Unclassified%20CFIUS%20Annual%20Report%20-%20(report%20period%20CY%202015).pdf , pps. 16-17.

went to investigation simply because CFIUS authorities could not get the right signatures to approve a transaction. One other data point to flag – the Department of Justice and Federal Trade Commission reviewed more than 1,800 filings in 2016, but only 54 cases, or 3%, were subject to a second request.[5] Obviously, those processes are entirely different, but the point is the same – it is important to clear the easy cases quickly.

FIRRMA would dramatically expand the number of cases that CFIUS reviews. For example, it covers certain real estate transactions – including leases – by foreign persons near a military installation in the United States.[6] In 2016, there was over $66 billion in foreign investment US commercial real estate, and foreign buyers acquired almost 300,000 residential properties in 2017 alone.[7] Even if you exclude residential real estate, the numbers would be high. In 2015, 2016 and 2017, approximately 9.3%, 5.1% and 4.3% of commercial real estate transactions involved cross-border buyers. That equates to 3,153, 1,544 and 1,321, respectively.[8] The 3-year average is 2,006. In other words, foreign commercial real estate acquisitions alone could overwhelm the CFIUS process – and this does not include the large number of leases that foreign entities presumably execute annually. Furthermore, in many cases, private citizens do not know about the existence of military or national security-sensitive sites. They are all over the Washington DC area, I assume. Does that mean that any commercial real estate investment and/or lease in the greater Washington area that involves a foreign investor needs to be reviewed by CFIUS?

FIRRMA also covers transactions which involve the sharing of intellectual property and associated support related to "critical technology" with foreign persons, including through joint ventures.[9] It also covers non-controlling investments in "critical technology" or "critical infrastructure" companies.[10] And the legislation potentially creates duplication in government reviews for cases involving export controls. We already have a very detailed review process for licensing of technology exports – one that certainly could be strengthened. However, this Committee has always focused on improving efficiency in

[5] https://www.ftc.gov/news-events/blogs/competition-matters/2017/10/diving-data-hsr-report

[6] FIRRMA, Sec. 3(a)(5)(B)(ii)

[7] https://www.nar.realtor/sites/default/files/documents/2017-Profile-of-International-Activity-in-US-Residential-Real-Estate.pdf

[8] "US Capital Trends, The Big Picture", Real Capital Analytics, 2016 – 2017 reports.

[9] FIRRMA, Sec. 3(a)(5)(B)(v)

[10] FIRRMA, Sec. 3(a)(5)(B)(iii)

government. I would encourage the Committee to focus on that objective when drafting CFIUS legislation.

To be clear, Senator Cornyn and Congressman Pittenger are correct that CFIUS should conduct national security reviews of transactions where proximity to a sensitive military or intelligence site could compromise US national security. Similarly, CFIUS should have the authority to capture transactions that are designed to evade CFIUS review or where minority investments are undertaken to gain access to, or effectuate the transfer of, sensitive technology.

However, Congress should be careful in designing the breadth of CFIUS jurisdiction to ensure that (i) the system is not overwhelmed with hundreds or thousands of cases, and (ii) CFIUS can carefully identify, pinpoint and scrutinize those transactions that truly raise national security concerns. I would encourage the Committee to draft with precision the definition of covered transactions to pinpoint precisely the type of transactions that are of concern from a national security perspective. I understand that this Committee, your Senate counterparts and the Treasury Department are exploring ways to narrow FIRRMA's focus, an effort which I applaud.

Finally, amendments to CFIUS's authorities should not extend CFIUS jurisdiction to non-controlling investments in the United States.

The United States benefits from both direct foreign investment and passive foreign investment in the United States. Both types of investment create jobs, economic dynamism and vitality in the US economy.

Passive investment is just that – passive. Just like when someone invests in a mutual fund, they entrust their money to that firm or fund, but the firm or fund has total discretion to invest and manage that money. The same is true for investments in private equity, venture capital, real estate, energy and infrastructure funds.

In the last two years alone, private equity firms invested more than $1.1 trillion in the US economy, with significant investments in energy, infrastructure, manufacturing and consumer

products.[11] Over the next few years, private equity investments in the US should grow since US-focused private equity funds have raised a record amount of capital – from 2014-2017, aggregate capital raised reached a $1.7 trillion.[12] Approximately 21% of capital committed to these funds from 2014-2017 emanate from non-US limited partners.

As you know, Carlyle and other private equity, real estate, venture capital, energy and infrastructure firms all operate with a very similar general partner-limited partner structure. Typically, a limited partner (LP) commits capital to a particular fund managed by a general partner (GP), entrusting that GP to invest, manage, create value and exit investments at its discretion. LPs have no rights to direct, determine, supervise, review or influence a GP's investment decisions. LPs do have the right to receive non-public financial information on their investments on a quarterly basis (or more frequently, in certain cases). The entire private capital industry is highly focused on ensuring that private equity, real estate, venture capital, energy and infrastructure investments managed by US firms and persons continue to be treated as passive, regardless of the origin of our LPs.

While we are sensitive to the issues FIRRMA is trying to address with regard to non-controlling investments, we are concerned that the passive investment carve-out is too narrow and would exclude (i.e., include within CFIUS's jurisdiction) many investments that are, in fact, truly passive. Moreover, most investment review processes in the United States and other countries focus on the concept of "control," and moving away from that concept represents a significant departure from precedent. In the LP-GP context, foreign LPs, regardless of their size or percentage in a particular fund, do not have the ability to control the funds or the businesses in which the funds are invested or gain access to sensitive technology, IP or other non-financial information. Foreign LPs in such funds should always be treated as passive and therefore not subject to CFIUS jurisdiction. Again, I understand that Senators Cornyn and Pittenger, the relevant committees and the Treasury Department are exploring such changes. Thank you for your attention to this important issue.

[11] AMERICAN INVESTMENT COUNCIL 2017-Q4 Private Equity Industry Investment Report, located at http://www.investmentcouncil.org/app/uploads/2017-q4-industry-investment-report.pdf

[12] http://www.preqin.com

Conclusion

I appreciate this committee's thoughtful and thorough manner in approaching this issue – holding hearings, staff briefings, inviting comments from the public and fostering a debate. Similarly, Congressman Pittenger, Senator Cornyn and their staffs deserve credit for the enormous amount of time, effort and thought they have committed to this issue. Hopefully, this testimony and hearing today will better enable to you carefully craft new legislative authority for CFIUS that will both protect US national security and continue the United States' longstanding policy of welcoming foreign direct investment.