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Testimony

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The President's Decision To Order a
Chinese Company's Divestiture of a
Recently Acquired U.S. Aircraft Parts
Manufacturer

Statement of
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Before the
Subcommittee on Commerce, Consumer
Protection and Competitiveness
House Committee on Energy and Commerce
House of Representatives



Mr. Chairman and Members of the Subcommittee:

I am pleased to testify today before this Subcommittee. At your request, we examined certain issues regarding the President's February 1, 1990, decision to order a firm of the People's Republic of China, the China National Aero-Technology Import and Export Corp. (CATIC), to divest its recently acquired control of the U.S. firm, MAMCO Manufacturing, Inc. The issues relate to (1) the interagency process for reviewing national-security related foreign investments, (2) existing means for safeguarding information possessed by MAMCO, and (3) sources of information needed in investigating the national security implications of the investment. These issues arose because CATIC proceeded to complete its acquisition of MAMCO before the government had finished its review of the investment, as provided for under the 1988 Exon-Florio Amendment to the Defense Production Act.

CATIC is an export-import company controlled by the Chinese Ministry of Aerospace Industry. MAMCO was a small, privately-owned firm, which produces metal parts and assemblies for aircraft. Some of its machinery is subject to U.S. export controls. MAMCO had not previously exported its products, and so had not had to apply for export licenses.

As you know, the Exon-Florio Amendment gave the President new authority to investigate and, if appropriate, block or suspend

foreign mergers, acquisitions, or takeovers that may threaten to impair national security. The President delegated his authority to review foreign investment transactions to the interagency Committee on Foreign Investment in the United States, known as CFIUS and chaired by the Treasury Department. The Exon-Florio Amendment does not specifically require foreign investors to notify CFIUS of their investments in national-security related firms. However, the consequences of not notifying CFIUS may be severe, because the President may later order divestiture of specific investments, as was done in the CATIC-MAMCO case. This is the first investment since enactment of the Exon-Florio Amendment to be disallowed by the President.

Our ability to discuss publicly the details of this case is limited both by the confidential nature of much of the available information and by the law's provision of confidentiality for information filed with the President by the parties involved.

INTERAGENCY REVIEW PROCESS

The Exon-Florio Amendment provides specific maximum timeframes for reviewing foreign investments. The review process is permitted to take a maximum of 90 days, including a 30-day initial review period to determine whether to initiate an investigation, then 45 days to complete such an investigation, and a final 15 days for the President to act. According to proposed regulations, the 30-day

review period begins on the first calendar day following receipt of notification either from one of the investment parties or from a CFIUS member agency. The CFIUS staff chairman retains the right to reject voluntary notices that do not comply with the information needs specified in the proposed regulations.

The amendment allows the review process to be expedited, and would allow the President to suspend completion of a foreign investment earlier in the 90-day period, but only if the President can make the required findings, applicable to all his actions under the amendment, that

- (1) there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security, and
- (2) provisions of law, other than the Exon-Florio Amendment and the International Emergency Economic Powers Act, do not, in the President's judgment, provide adequate and appropriate authority for the President to protect the national security.

The decision by CATIC and MAMCO to complete the investment transaction was made before the initial 30-day CFIUS review process was completed, an action not prohibited by the law. According to CFIUS, the 30-day process began on Monday, November 6, 1989, when the CFIUS staff chairman accepted the notification voluntarily

provided by MAMCO on November 3, 1989. CFIUS considered the 30-day process as due to end on December 5, 1989. The transaction was completed on November 30, 1989, when CATIC purchased all the voting securities of MAMCO. CFIUS was not notified that the transaction would be completed before the end of the 30-day period.

During this initial 30-day review, CFIUS staff followed the standard practice of notifying CFIUS member agencies of the proposed CATIC investment and providing them with copies of the notification letter and documents. CFIUS member agencies then notify their appropriate internal offices to assist in reviewing the investments. For example, in the Commerce Department, the initial CFIUS contact was the Office of Trade and Investment Analysis within the International Trade Administration. This office asked certain other parts of Commerce to review aspects of the transaction. One of these was the Bureau of Export Administration, which checked its files for evidence or allegations of export control violations.

Commerce staff were notified of the proposed CATIC-MAMCO investment on November 6, 1989, and by November 17, 1989, the Bureau of Export Administration had developed information indicating potential issues warranting further investigation. Questions were developed to clarify whether MAMCO's products, or its factory machinery, would fall under existing export controls, because MAMCO had not previously exported its products. These types of questions were

faxed to MAMCO on November, 27, 1989, requesting the company's response by November 29, 1989, in anticipation of a CFIUS meeting on this case on November 30, 1989. MAMCO provided its response to these questions by fax on November 29, 1989, but did not mention to CFIUS that the takeover would be completed the next day. CFIUS members met on that day, November 30, 1989, but did not yet know that the takeover had already been completed.

We did not find evidence that CFIUS had informed MAMCO of its potential concerns about the investment. CFIUS staff told us that it is not their practice to provide such information before their initial review is completed. In this case, their potential concerns were based on confidential information concerning CATIC. CFIUS staff also noted the law's clear authority to require divestiture and that investors proceeding with their transactions are aware of the risk.

At the November 30, 1989, CFIUS meeting, a sufficient number of agencies requested that an investigation be conducted of the CATIC-MAMCO investment on the general grounds that important questions remained unanswered about the investment. On December 4, 1989, the 29th day of the review period, CFIUS made a determination to undertake a formal investigation, in order to assess MAMCO's present and potential production and technological capabilities, and CFIUS informed CATIC and MAMCO of this decision. At this point, MAMCO and CATIC had clear indications that the

Administration had potential security concerns about the investment. Yet there is no indication that the parties informed CFIUS that the transaction had been completed.

The Administration, however, had not completed the investigative efforts that would have formed the basis for the President's required findings regarding credible evidence of intent to impair the national security and inadequacy of other laws to protect the national security. These findings were made after (1) a visit to MAMCO in mid-December 1989 by officials of the Commerce and Defense Departments representing CFIUS, (2) further government development of confidential information regarding CATIC's past activities, and (3) evaluation by the Commerce Department of the adequacy of the Export Administration Act in covering the circumstances of this case.

We did not examine the CFIUS review process in detail beyond the point at which the transaction was completed, except to determine that it followed standard CFIUS processes.

SAFEGUARDING INFORMATION

We believe that the circumstances of this case raise general questions about the adequacy of existing means of safeguarding controlled technical data when a foreign investment transaction is being considered or is completed before the Exon-Florio national

security review process is completed. In this case, for example, it appears that CFIUS staff did not become aware of the transaction's completion until several days later.

Under export control regulations, an export license is required if controlled technical data is to be discussed or otherwise released during visits by a foreign national. This access or release could occur during visits to discuss or negotiate the investment transaction, as well as other activities once the transaction is completed. The administration, of course, has the authority to deny an export license for such releases.

We note that it is difficult to detect illegal technology transfers. Administering the export control laws requires reliance on good faith compliance by U.S. companies with the rules on technical data exports. If foreign nationals are to visit U.S. facilities and gain access to controlled technical data, it is incumbent on U.S. companies to be aware of and comply with U.S. export control requirements. Without good faith compliance, it would be difficult for the U.S. government to be aware of visits by foreign nationals that could result in the transfer of controlled technical data. In cases where there may be reason to doubt a prospective foreign purchaser's good faith compliance with the rules, the U.S. export control process should not be expected to serve as adequate protection against technology loss.

INFORMATION SOURCES

With regard to your questions about the sources of the Administration's information on this investment, much of the information came from confidential sources. The official government statistics on foreign investment, maintained by the Commerce Department's Bureau of Economic Analysis (BEA), do not appear to have been relevant to the investigation, and in any case are considered proprietary data generally protected from release outside of BEA. Information on CATIC's other subsidiaries in the United States was obtained through other, confidential information sources.

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Mr. Chairman, this concludes my statement. I will be happy to try to answer any questions you may have.