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DEFENSE INDUSTRIAL  
SECURITY

Issues in the Proposed  
Acquisition of LTV  
Corporation Missiles Division  
by Thomson-CSF

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Mr. Chairman, Members of the Subcommittee:

I am pleased to be here today to discuss some aspects of our work regarding foreign ownership of and control and influence over U.S. defense companies and the relationship between Thomson-CSF and the government of France. In March 1990, we provided the House Armed Services Committee a statement for the record on Special Security Agreements (SSA)--one method the Defense Department uses to deal with foreign-owned U.S. companies working on classified defense contracts.<sup>1</sup> In May 1992, Congressman Charles Wilson asked us to examine various aspects of the French government's ownership of and control and influence over Thomson-CSF, as well as Thomson's arms sales to Libya, Iraq, and the former Soviet Republics. We have requested information on these matters from executive branch agencies, but to date they have been unwilling or unable to provide us with the information we requested. Nevertheless, we have obtained some limited information from other sources that may be useful to the Subcommittee.

First, I would like to clarify some elements of our March 1990, statement regarding SSAs, partly because it may have been misinterpreted by others who testified before the Committee in May 1992. Second, I will present some initial information we obtained on the French government's relationship with Thomson-CSF. Finally,

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<sup>1</sup>Defense Industrial Security: Special Security Agreements Permit Foreign-owned U.S. Firms to Perform Classified Defense Contracts (GAO/T-NSIAD-90-17, Mar. 21, 1990). See also Foreign Investment: Analyzing National Security-Related Investments Under the Exon-Florio Provision (GAO/T-GGD-92-49, June 4, 1992).

I will discuss some questions about SSAs, voting trusts, and proxy arrangements, regarding how they work and their ability to protect highly sensitive classified material and technologies from unauthorized disclosure.

CLARIFICATION OF GAO'S MARCH 1990  
STATEMENT FOR THE RECORD ON SSAs

In our March 1990 statement, we reported that Defense Department officials were not aware of any compromises of classified data under SSAs. We noted, however, that the defense security community held widely varying views on the adequacy of SSAs to protect classified information and that the military services planned to implement more stringent policies than Defense required.

We did not conclude from our review that SSAs were working successfully. In fact, current and former security officials had told us that Defense's policy on SSAs needed to be reassessed and clarified to better define the circumstances under which SSAs would be acceptable or appropriate, particularly for protecting highly classified material. For example, they noted that the Defense Department and the services had approved waivers and exceptions to existing SSA policies to allow some SSA firms access to Top Secret, compartmented, and special access contract information--much of which was not releasable to our closest allies.

As of about November 1989, 20 foreign-owned U.S. firms were cleared under SSAs and were working on about 325 classified defense contracts or subcontracts. As of March 1990, SSA firms had classified contracts worth almost \$1.3 billion, according to Defense. The Defense Department estimated that 12 of these contracts involved access to Top Secret information and 107 involved special access information. As of April 1991, 27 foreign-owned U.S. firms were working on classified contracts under SSAs. Again, I would like to reemphasize that in our earlier work we did not determine whether SSAs successfully protected U.S. classified materials or technologies. We also have not determined whether or how SSA policy has been clarified.

REVIEW OF FRENCH GOVERNMENT AND  
THOMSON-CSF RELATIONSHIPS

In connection with our more recent efforts to examine the government of France's ownership and control of Thomson-CSF and Thomson's arms sales to other countries, we requested information on these issues from the Departments of State, Treasury, Commerce and Defense. These agencies have been unwilling or unable to provide us the information we requested. A reason one agency gave us was the ongoing interagency Committee on Foreign Investment in the United States known as (CFIUS) review of Thomson-CSF's proposed acquisition of LTV. Much of the information we requested is routinely reported by U.S. embassies to Washington, D.C., and analyzed by the State, Treasury, and Commerce Departments. Other

information we requested and have not obtained includes data the Defense Department compiles, analyzes, and maintains on worldwide arms sales and security matters. To date, these four agencies have not provided any official documents or other information we requested, nor have they provided any information verbally. We have, however, obtained some limited information from the Securities and Exchange Commission (SEC), Thomson-CSF's Washington office, and public sources and we are continuing our efforts to obtain needed information from the other agencies.

On the basis of the information available to us, we could not reach conclusions about the level or extent of the French government's influence or control over Thomson-CSF. Nevertheless, our analysis indicates that while Thomson-CSF may operate very much like a purely commercial company, the French government (1) has certain legal powers to intervene in the company's operations if necessary and (2) has potential--if not actual--direct and indirect financial and other influences over the strategic goals and direction of the company.

Thomson-CSF is majority -owned and -controlled by Thomson S.A., a company nearly wholly owned and controlled by the French state. According to Thomson-CSF's latest public filing with the Securities and Exchange Commission,<sup>2</sup> as of June 1991, Thomson S.A. owned 56

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<sup>2</sup>Thomson-CSF's next filing with the Securities and Exchange Commission is due by June 30, 1992.

percent of Thomson-CSF's ordinary stock and controlled nearly 72 percent of CSF's voting rights. Ten of CSF's 15 board members were elected by Thomson S.A., including two officials from government ministries. Twelve of Thomson S.A.'s 18 board members were nominated by the French government.

In its response to the British Monopolies and Mergers Commission on a proposed merger between British Aerospace and Thomson-CSF,<sup>3</sup> the French government stated that it exercised indirect influence over Thomson-CSF through Thomson S.A.'s majority shareholding and voting rights. It also stated that it reserved the right to pass judgment on the company's results only insofar as they might affect the results of the parent company. In addition, Thomson-CSF has an agreement--a contrat d'objectifs--with Thomson S.A. that defines the company's lines of conduct and strategic goals for the 1988-92 period. These agreements were apparently formulated on a consultative basis with the French government. The British commission concluded that while the French government is empowered to intervene in the management of Thomson-CSF as it deems necessary, it had seen no evidence of CSF's operating to a state plan. It further noted that the 50:50 joint venture under consideration would dilute the influence the French government could exercise through CSF's parent company.

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<sup>3</sup>British Aerospace plc and Thomson-CSF S.A.: A Report on the Proposed Merger, The Monopolies and Mergers Commission, the United Kingdom, January, 1991.

While there are indications that the French government has not intervened in the day-to-day management of Thomson-CSF, various sources indicate that the French government has the power to do so. Additionally, Thomson-CSF's SEC filing for 1990 states that under certain legislation applicable to all nationalized industries, significant acquisitions and divestitures by Thomson-CSF are subject to French government approval.

We also obtained some limited information regarding French government capital infusion into Thomson-CSF. Thomson-CSF reported to the Securities and Exchange Commission that its parent, Thomson S.A., received 1 billion French francs in 1988 (\$167.2 million) and 2 billion French francs in early 1990 (\$346.6 million) from the French government as capital contributions. The report states that these funds allowed Thomson S.A. to provide financial support for the activities of its subsidiaries, including Thomson-CSF. The government funds Thomson-CSF received through the parent company were principally through subscription to convertible debt and equity CSF had issued since 1983. Other sources indicate that the bulk of the funds may have gone to the consumer electronics arm of the Thomson group. It is unclear from this information how much of these funds actually went to Thomson-CSF. It is also unclear whether future capital infusions might be considered necessary or forthcoming for other purposes.

QUESTIONS CONCERNING SSAs,  
VOTING TRUSTS, AND PROXIES

While the French government has legal, financial, and corporate powers to influence and control Thomson-CSF, the Defense Department in previous cases has used SSAs, voting trusts, and proxy arrangements in an effort to mitigate the effects of foreign influence and control over U.S. companies performing classified contracts. Further questions arise as to whether these arrangements and the resources available to the U.S. government for dealing with foreign acquisitions of companies like LTV can effectively (1) eliminate or mitigate potential foreign government control and influence over the company and (2) ensure against unauthorized or unintended disclosure of sensitive, classified data and technologies.

The Defense Department testified before the Committee in May 1992, indicating that it was requiring a voting trust or proxy agreement--rather than an SSA--for Thomson-CSF to perform LTV contracts requiring access to "proscribed information" which includes Top Secret and special access information. Proxy agreements and voting trusts are similar in that they attempt to isolate the foreign owners from the business management of the U.S. company enough to ensure against unauthorized access to classified information. Under these arrangements, the foreign owner cedes the management of the company to cleared U.S. citizens.

The key controls under voting trusts and proxy agreements are (1) the board of directors comprises only cleared U.S. citizens; (2) several of these directors serve on a company Defense Security Committee, which oversees security matters at the facility, and reports annually to the Defense Department; (3) visits between the foreign parent and the U.S. facility must be approved in advance and recorded.

However, the directors usually cannot make certain major decisions without the foreign parent company's approval. The foreign stockholders still must approve major decisions, including mergers, sales or disposals of substantial assets, and reorganizations. In addition, "routine business visits" of a purely commercial nature are normally not under the purview of the Security Committee but require approval at a lower level. The parent company would also normally receive quarterly financial reports including information on actual and projected sales, expenses, investments, and financial needs and possibly other information.

We have not reviewed the operation of these arrangements at the plant level. However, the terms of the agreements raise a number of issues which this committee might wish to address to the Defense Department in connection with Thomson-CSF's proposed acquisition of LTV. For example, how rigorously are controls in SSAs and voting trust and proxy arrangements implemented and enforced? How closely does or can Defense monitor these arrangements to ensure that the

integrity of the controls remains intact? Does Defense have sufficient personnel to effectively monitor the arrangements? How strictly are visits by engineers to or from the foreign parent companies monitored and controlled by the U.S. companies' Defense Security Committees? Can these arrangements or SSAs be modified to effectively negate a foreign government's influence over future mergers and acquisitions or its ability to provide capital infusions to a U.S. defense firm?

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you have at this time.

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