92-486 SPR
June 8, 1992

CRS Report for Congress

Congressional Research Service • The Library of Congress

The LTV--Thomson-CSF Sale: Issues In National Security and Technology Transfer

Glenn J. McLoughlin
Specialist in Science and Technology
Science Policy Research Division

SUMMARY

Thomson-CSF, a French electronics firm, and the Carlyle Group, an American investment firm, together made an offer in April 1992 to purchase LTV Corporation's missile and aerospace divisions. While Thomson-CSF has provided assurances to the U.S. Government that no secret or sensitive technology will be exchanged or compromised, many are concerned that this sale represents a new development in the flow of technology outside of U.S. borders. Central issues brought to the forefront with this proposed sale include the role of the Committee on Foreign Investment in the United States (CFIUS), Congress' role in reviewing CFIUS, and U.S. national and industry interests in the Thomson-CSF and Carlyle Group acquisition of LTV's two divisions.

The Proposed LTV Sale

The LTV Corporation is an American high-technology firm which has provided weapons technologies for the U.S. Army and Air Force. However, declining civilian and defense sales during the mid-1980s resulted in LTV's filing for Chapter 11 bankruptcy in 1986. On February 3, 1992, to help fulfill financial obligations of creditors and to bring bankruptcy proceedings to closure, the LTV Corporation announced that Martin Marietta and Lockheed Corporation (both U.S. firms) had made offers to acquire the aerospace and missile divisions of LTV, respectively, for $355 million. Yet, while that agreement was being considered by a Federal bankruptcy court judge, Thomson-CSF, a French firm in which the French Government has a 58-percent stake, and the Carlyle Group, an American investment firm, made a counter bid of $400 million for the missile and defense divisions in March. While Thomson-CSF and the Carlyle Group would own each division independently, the proposed acquisition was made jointly (primarily because of the complicated financing involved). The Federal bankruptcy judge administering the LTV proceedings entertained successively higher bids from both groups. On April 10, a final offer of $450 million was accepted by the judge from Thomson-CSF and

CRS

CRS Reports are prepared for Members and committees of Congress

the Carlyle Group for the missile division ($300 million) and aerospace division ($150 million), respectively.[1]

Preliminary terms of the agreement reported in the press indicate that special security restrictions will be applied so that technology developed for U.S. military services would be shielded from Thomson-CSF.[2] While officials at Thomson-CSF contend that only 5 percent of LTV's business is highly classified (top secret), Chester Paul Beach, the Department of Defense's acting general counsel, contends that about 75 percent of the current LTV missile contracts involve components requiring special security clearances.[3] A recent article contends that a Defense Intelligence Agency (DIA) report prepared for the House Armed Services Committee stated there is a 100-percent chance that U.S. technology would be diverted to unauthorized parties if this sale goes through.[4] The 100-percent score would mark the first time--after 199 previous reports analyzing previous takeovers by foreign parties of U.S. firms--that the highest rating has been given by DIA.[5]

The role of the Carlyle Group in this proposed sale appears twofold. It is acting as a catalyst and coordinator for financing the sale of the LTV missile division to Thomson-CSF. It is also acquiring an equity stake in the aerospace division of LTV, which it will run as a separate entity from Thomson-CSF's stake in the missile division. While the Carlyle Group is taking the lead to arrange financing for the entire purchase, some believe that it is acting as a "front" for Thomson-CSF and the French Government, a charge which Frank

---

[1] Pearlstein, Steve. Undoing a Done Deal. The Washington Post, Apr. 19, 1992. p. H1; H4.

[2] One arrangement would allow LTV to have a solely American Board of Directors to manage the missile division, with Thomson-CSF's having only an equity stake. The second type of national security restriction would be for Thomson-CSF to apply to the Department of Defense for voting positions on LTV's Board of Directors and access to LTV's technology, under certain restrictions. This second arrangement is called a Special Security Agreement (SSA), which apparently Thomson-CSF has applied for.

[3] Schmitt, Eric. Administration Must Decide on LTV Unit's Sale to French. The New York Times, May 20, 1992. p. D 20.

[4] Capaccio, Tony. DIA: Thomson Poses Highest Level Diversion Risk. Defense Week, May 26, 1992. p. 1.

[5] Ibid., p. 1. This report was presented as background to the House Armed Services Committee for hearings on the sale on May 14, 1992. The DIA has not confirmed the findings of this report.

Carlucci, former Secretary of Defense and now Vice Chairman for the Carlyle Group, has vehemently denied.[6]

The role of the French Government in this transaction is also controversial. The French Government has a 58 percent equity stake in Thomson-CSF, as well as a majority stake in Credit Lyonnais, one of the banks underwriting the acquisition. Senator Jeff Bingaman, Chairman of the Subcommittee on Defense Industry and Technology of the Senate Armed Services Committee has stated: "There isn't a country in the world that would permit the U.S. through a government-owned company to purchase its defense industry."[7] But if the proposed sale is ultimately blocked, it may cause a significant rift in U.S.-French relations. Officials with the French Government have denied allegations they are trying to overtake a critical U.S. technology base. They contend that their financial stake in Thomson is no different from U.S. Government contracts for the U.S. aerospace industry. However, many analysts question linking contract awards to direct equity positions, pointing out that the Federal Government does not have the latter in the U.S. aerospace industry.

Committee on Foreign Investment in the United States (CFIUS)

The Committee on Foreign Investment in the United States (CFIUS) was established by Executive order in 1975 to address concerns in the Federal Government that growing foreign investments in the United States--at that time primarily by OPEC--had possible political as well as economic repercussions.[8] CFIUS is an inter-agency Federal committee, comprised of the Secretaries from four Federal agencies (State, Treasury, Defense, and Commerce), as well as the United States Trade Representative, the Chairman of the President's Council of Economic Advisers, the U.S. Attorney General, and the Director of the Office of Management and Budget. Prior to 1988, CFIUS met infrequently and had done little to fulfill its mandate.[9] By 1988, in an attempt to provide CFIUS with a more specific mandate and a more active (rather than advisory) role, a provision addressing CFIUS was included in the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418).

---

[6] Statements of Senator Ernest Hollings and Mr. Frank Carlucci during hearings on the Pending Transactions Under the Exon-Florio Amendment. Transcript of hearings, Committee on Commerce, Science and Transportation. United States Senate, May 14, 1992. p. 40-43. [unpublished]

[7] Van Voorst, Bruce. Giving Away the Weapons Store. Time, June 1, 1992. p. 37.

[8] U.S. Library of Congress. Congressional Research Service. Foreign Investment: The Exon-Florio National Security Test, by James K. Jackson. CRS Report 90-4463 E, Sept. 26, 1990. p. 4.

[9] Ibid., p. 5.

The post-1988 CFIUS has the authority not only to review cases of foreign acquisition of U.S. companies and technology, but also to recommend directly to the President whether such a sale should be allowed, and to recommend against the sale if the national security interests of the United States are threatened. CFIUS has 30 days to decide whether to investigate a case after a proposal is offered to a U.S. firm--called a preliminary investigation--and then 45 days to conduct a full investigation of a proposed sale. At the end of the 45 day period it makes a recommendation to the President as to whether the sale should be permitted or not.

By early 1992, there had been over 700 cases of proposals for foreign acquisition of U.S. firms or divisions of firms; CFIUS had investigated 13 cases, and had advised against the sale of one of these cases.[10] One of the most publicized and controversial of these 13 cases involved Semi-Gas Systems, Inc., an equipment supplier for the U.S. Government-supported consortium SEMATECH, which was purchased by Nippon Sanso KK, a Japanese firm. CFIUS did not advise against the sale of Semi-Gas Systems to Nippon Sanso KK, despite objections by some that such a sale undercut the very reason SEMATECH was created.[11]

CFIUS initiated a preliminary investigation after the April 10 Thomson-CSF and Carlyle Group offer. After deciding that this preliminary investigation warranted a more detailed analysis, CFIUS began a full investigation, which will be completed in late June. At that time it will make a recommendation to President Bush as to whether the sale should be completed or blocked.

ISSUES

Many are concerned that the LTV sale will compromise the national security of U.S. weapons systems, despite the assurances of Thomson-CSF officials.[12] While the specific language of the LTV--Thomson-CSF agreement has not been made public, an official from Thomson-CSF has made public assurances that they will work with DOD to ensure that classified and export-control information will be protected. Furthermore, since DOD does not prohibit a company from an allied nation from working on classified defense

---

[10] China National Aero-Technology Import and Export Corporation's (CATIC) proposed acquisition of Mamco Manufacturing, a U.S. aerospace parts manufacturer, in 1990. Auerbach, Stuart. President Tells China to Sell Seattle Firm. The Washington Post, Feb. 3, 1990. p. A1.

[11] U.S. Library of Congress. Congressional Research Service. The Semi-Gas Systems Sale: Technology and National Security Issues, by Glenn J. McLoughlin. CRS Report 91-263 SPR, Mar. 12, 1991. 14 p.

[12] Statement of Jim D. Bell, Chairman and President of Thomson-CSF of America, before the Committee on Commerce, Science and Transportation of the U.S. Senate, May 14, 1992. p. 1-9.

work, the Thomson-CSF official contends that his company has an "impeccable" record of compliance with American security regulations and export controls.[13]

However, the prospect of relying on France to support U.S. R&D has concerned many policymakers. Opponents to the sale cite specific weapons technologies in which there are no alternative suppliers or in which LTV has been the dominant supplier worldwide such as the MLRS medium range mobile rocket launcher, ATACM launch system, and the ERINT close-in anti-tactical-missile interceptor.[14] How employees in the missile division of LTV will isolate or quarantine national security information from officials at Thomson-CSF is unclear and has not been made public at this time.[15]

A second broader issue is that the LTV missile division sale to Thomson-CSF is part of a larger pattern of sales of important U.S. firms and their technology to foreign parties. In particular is the concern that such sales are eroding the defense industrial base of the United States. Dr. Susan Tolchin of George Washington University notes that sales of important U.S. companies and technologies to foreign buyers include the semiconductor, advanced materials, telecommunications, and computer industries, and the LTV sale may be yet another in a long line of critical industries and assets lost to foreign parties.[16] In contrast, Thomson-CSF and Carlyle Group officials have stressed that their acquisition of the LTV divisions will preserve American jobs at LTV's main facility in Houston, Texas as well as future R&D programs and weapons technology for the U.S. military.

Finally, the LTV sale brings attention once again to CFIUS and the role of the Federal Government in reviewing such sales to foreign nationals. Last year Congress reauthorized the Defense Production Act for FY 1992, which included reauthorization for CFIUS. While previous decisions by CFIUS allowing foreign purchases raised congressional interest in changing CFIUS' charter and more explicitly defining U.S. national and economic security interests, nonetheless CFIUS retained its original authority. This may change after the CFIUS decision on the Thomson-CSF and Carlyle Group offer is announced in late

---

[13] Ibid.

[14] Statement of Theodore H. Moran, Karl F. Landegger Professor, Georgetown University, before the Subcommittee on Defense Industry and Technology of the Senate Armed Services Committee, Apr. 30, 1992. p. 5-6.

[15] A similar issue arose during CFIUS' consideration of the Semi-Gas Systems sale to Nippon Sanso KK. U.S. Library of Congress. Congressional Research Service. The Semi-Gas Systems Sale: Technology and National Security Issues, op. cit., p. 4-5.

[16] Statement of Dr. Susan J. Tolchin, Professor of Public Administration, The George Washington University, before the Subcommittee on Defense Industry and Technology of the Committee on Armed Services of the U.S. Senate, Apr. 30, 1992. p. 2-4.

June. By May 1992, over 40 Senators and 20 Representatives have petitioned President Bush to stop the sale, and legislation has been introduced to prevent the sale (S. 2704, below). In addition, several hearings have been held regarding the role of CFIUS in the LTV--Thomson-CSF and Carlyle Group offering. Congress may revisit the role of CFIUS in the LTV sale (by redefining CFIUS or creating a new review mechanism) and the definition of U.S. national economic security in a global economy again.

LEGISLATION

S. 2704 (Senator Byrd)

A bill to prevent any foreign person from purchasing or otherwise acquiring the LTV Aerospace and Defense Company. Introduced and referred to the Committee on Banking, May 13, 1992.

HEARINGS

U.S. Congress. Subcommittee on Economic Stabilization. Committee on Banking of the House of Representatives. Hearings on the Exon-Florio Legislation and Foreign Direct Investment, March 31 and April 2, 1992.

-----. Subcommittee on Defense Industry and Technology. Committee on Armed Services of the U.S. Senate. Hearings on the National Security Implications of Proposed Sale of LTV Corporation's Aircraft and Missile Divisions, April 30, 1992.

-----. Committee on Commerce, Science and Transportation. Hearings on the Pending Transactions Under the Exon-Florio Amendment, May 14, 1992.

-----. Defense Policy Panel and Investigations Subcommittee. Committee on Armed Services of the U.S. House of Representatives. Sale of LTV's Missile and Aircraft Divisions, May 14, 1992.