ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

INTERNATIONAL
SECURITY AFFAIRS

10 JUL 1981

MEMORANDUM FOR THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES

SUBJECT: DoD Position on a Proposed Kuwaiti Petroleum Company Investment in a Joint Venture with Pacific Resources, Inc.

ISSUE: Are there national defense and security concerns which suggest that the Pacific Resources, Inc./Kuwait Petroleum Company proposed joint oil refinery venture be denied?

DISCUSSION: Since all CFIUS members are familiar with the terms of the joint venture, they will not be reviewed here. DoD has evaluated the proposed deal based on two criteria: (1) broad national security implications of petroleum producer investment in downstream operations in the US and (2) the implications of the PRI/KPC deal for security of supply of military products to DoD components in the Western Pacific region.

With regard to the first criterion, DoD is not comfortable with the lack of a well-defined general policy on producer investment in downstream operations in the US. Continuing investment by certain energy producers in US downstream operations could have serious implications for flexibility in refinery operations to supply fuel to military forces and defense contractors. In addition, this type of investment could have consequences for the long-term structure of energy industry in the US. All questions relating to such a policy would have to be studied much further in order to make a sound policy recommendation. Given the lack of such a policy, we cannot make a judgment on the basis of this criterion and therefore, suggest that, quite aside from the case at hand, a general policy formulation be undertaken either in CFIUS or another appropriate forum.

Regarding the second criterion, we have investigated the supply security problem in terms of the following:

(a) Peacetime Operation of Military Forces - Attached are figures on the historical supply of PRI products to DoD regions for FY 76, 78, 80, and projections for FY81. Also indicated are the percentages of peacetime product consumption by particular DoD regions met by PRI. The only type of fuel supplied to a significant extent by PRI to the Western Pacific region is marine diesel fuel (DFM). Dependence on PRI has varied between 25 and 33 percent of consumption with no clear trend up or down. Other dependencies are all in the less than 15 percent range. However, if an energy crisis short of military conflict were to occur involving a cutoff of traditional crude supplies to

PRI's refinery, DoD would have the following courses of action: (1) invocation of the Defense Production Act to require priority allocation of alternate crude supplies to PRI to meet their DoD obligations or (2) acquisition of products from alternate sources on the West Coast which we understand to have excess capacity.

(b) Wartime Supplies for Military Forces - In the event of a military conflict, DoD would utilize its war reserve stocks with resupply to be obtained from priority allocation under DPA authority. In fact, it is DoD's view that, if the conflict did not involve the Persian Gulf region with no effect on Kuwaiti supplies to the US, the guarantee of supply by the Kuwaitis actually enhances the security of supply to DoD as well as other customers because of their broad resource base and what would be an incentive to keep the refinery economically viable.

(c) Defense Contractor Supplies - Again, DPA would allow priority allocation of product or crude for supply of essential defense contractor services in a crisis. Otherwise, would be no problems involving contractor supply during normal market conditions.

DOD POSITION: DoD does not object to this proposed Kuwaiti investment because of its marginal direct impact on defense-related activities.

However, we wish to go on record with the following:

(a) DoD is concerned that significant foreign control of US energy downstream activities could possibly affect national security interests.

(b) DoD recommends that CFIUS or another appropriate interagency body begin a review of the criteria which should be used to determine acceptable levels of foreign investment in US energy downstream operations.

David B H Denoon

David B. H. Denoon
Deputy Assistant Secretary
International Economic
& Energy Affairs

Attachment

Drafted by: Dave Tarbell
695-9282

FY 76

Type of Fuel	Millions Gallons Per Year		Percent DoD Contracts by Area			
	Western Pacific	West Coast	Western Pacific	West Coast	Total Pacific	Total World
JP-4	0	78.2	0	3.8	3.2	1.7
JP-5	0	57.7	0	14.2	10	5.8
DFM	0	67.1	0	27.7	10.9	5.3

FY 78

Type of Fuel	Millions Gallons Per Year		Percent DoD Contract by Area			
	Western Pacific	West Coast	Western Pacific	West Coast	Total Pacific	Total World
JP-4	0	94.2	0	4.8	4.0	2.1
JP-5	24.9	44.4	13.9	9.9	11.0	6.4
DFM	15	79.8	3.8	31.7	14.8	7.1

FY 80

Type of Fuel	Million Gallons Per Year		Percent DoD Contracts by Area			
	Western Pacific	West Coast	Western Pacific	West Coast	Total Pacific	Total World
JP-4	14.5	54.3	3.6	2.7	2.8	1.5
JP-5	3.9	50	2.3	11.7	9	5.2
DFM	28.3	69.3	6.8	25.8	14.2	6.9

FY 81

Type of Fuel	Million Gallons Per Year: Western Pacific	Million Gallons Per Year: West Coast	Percent DoD Contracts by Area: Western Pacific	Percent DoD Contracts by Area: West Coast	Percent DoD Contracts by Area: Total Pacific	Percent DoD Contracts by Area: Total World
JP-4	41.8	54.6	10	3	4	2
JP-5	0	57.6	0	13.2	9.5	5.5
DFM	0	85.3	0	33	13	6.3
TOTAL	41.8	197.5				

UNITED STATES GOVERNMENT

memorandum

DATE: July 10, 1981

REPLY TO ATTN OF: Bob Murphy

SUBJECT: Full CFIUS Meeting, July 13, 1981

TO: Jerry Jordan

There will be a meeting of the Committee on Foreign Investment in the U.S. on Monday, July 13, at 9:30 a.m. in Room 4426 at the Treasury Building. The purpose of the meeting will be to discuss the Elf Aquitaine deal and the general issue of Canadian investment practices. A draft paper prepared by Treasury concerning the Elf Aquitaine deal will be available late today. I will pass along a copy when it arrives.

It seems likely that the question of appropriate U.S. response to Canadian investment practices under NEP and FIRA will arise. If this is the case, the options outlined in the USTR paper discussed at last Tuesday's TPC meeting are relevant (attachment). As Marshall Casse pointed out at this morning's CEA staff meeting, CEA went along with Commerce, Treasury and USTR at the TPC meeting in supporting possible use of reciprocity under the Mineral Lands Leasing Act of 1920. Interior desires more time to fully evaluate this aspect of the Act. In addition, they are concerned that the USG maybe embracing this option too quickly and without appreciating how the law would be implemented. Interior claims that the administrative apparatus required to determine ownership of leases would be monstrous -- on the scale of the former Council on Wage and Price Stability -- requiring 200 staffers and an analytical unit. Another problem is the apparent requirement that the reciprocity clause be applied retroactively. USTR also is investigating the possibility of using the Section 301 provisions of the Trade Act of 1974 to deal with discriminatory Canadian investment practices and is "quietly" informing the Canadian government about this.

Two final points:

- o Congress is moving ahead on this issue (Attachment - Kassebaum bill) so some positive response by USG is needed.
- o Avoid any legislative options as could set dangerous precedent.

cc: WN, JB, AW, MC, ES

CABINET TRADE POLICY COMMITTEE

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506

July 6, 1981

MEMORANDUM TO Members of the Trade Policy Committee

FROM William E. Brock

SUBJECT Attached Paper on Canadian Investment Policy

The attached options paper will be discussed at tomorrow's meeting of the Trade Policy Committee. The paper reflects the outcome of a meeting of the Trade Policy Review Group held on Thursday, July 2, 1981, where the various policy options for dealing with the problem of discriminatory Canadian investment policies (the Foreign Investment Review Agency and the National Energy Program) were discussed.

The outcome of the Trade Policy Committee's consideration of this paper will have an important effect on our future efforts with the Canadians and the following upcoming events:

- Wednesday's meeting of the Advisory Committee for Trade Negotiations;
- Thursday's testimony by State, Treasury and USTR before the House Subcommittee on Oversight and Investigations (Committee on Energy and Commerce); and,
- Friday's meeting between the President and Canadian Prime Minister Trudeau.

7/9

7/10

Attachment

CANADIAN INVESTMENT POLICY

PROBLEM

FIRA and the NEP 1/

Virtually all new foreign direct investment proposals in Canada are subject to review by FIRA and approval by the Canadian Cabinet. Only those investment proposals judged to be of "significant benefit to Canada" are approved. As a prerequisite for approval, investors enter into legally binding commitments in one or more of five performance areas (e.g., reduced imports, increased exports, etc.). Also subject to FIRA review are expansions of foreign-owned firms into unrelated areas (e.g., an oil company purchase of a department store) and mergers between parent companies outside of Canada that involve the transfer of ownership of a Canadian subsidiary (whether or not the merger results in an increased degree of foreign ownership in Canada). The current Canadian Government announced in April 1980 that it intended to expand FIRA's legislated mandate to include performance reviews of existing foreign firms operating in Canada. (1)

Under the NEP (announced on October 28, 1980), the Canadian Government announced its policy of "Canadianizing" the oil and gas sector through discriminatory investment policy instruments designed to disadvantage foreign-owned firms while financially assisting Canadian-owned firms. (2) One of these policy instruments (due to be legislatively implemented through the draft Canada Oil and Gas Act) provides that only those firms (or consortia) which are at least 50 percent Canadian-owned will be permitted to participate in the production of oil and gas from the so-called "Canada Lands" (the Yukon, Northwest Territories and offshore areas). (2a)

Of greater concern than the "Canada Lands" provision is the Petroleum Incentives Program (due to be legislatively implemented through the draft Energy Security Act). Here, earned depletion allowances will be phased out and replaced by substantial direct subsidies paid to firms under the new Petroleum Incentives Program. Only firms which are at least 50 percent Canadian-owned can qualify for the subsidies. The amount of subsidy paid is to increase in proportion to the level of Canadian ownership in an oil and gas firm. (2b)

1/ The Canadian Government's Foreign Investment Review Agency (FIRA) and Canada's National Energy Program (NEP).

POLICY ISSUES

The numerous issues and problems associated with discriminatory Canadian investment policies can be divided into long-term policy issues and immediate problems.

Long-Term Policy Issues

- Discriminatory Canadian investment policies, to the extent they foster disinvestment in Canada by U.S. firms, have great potential for adversely impacting U.S. exports to Canada. Seventy-five percent of the imports from the United States of the 300 largest firms in Canada represent intracompany transactions between a U.S. parent and a Canadian branch or subsidiary.

- Canadian policy, particularly as reflected in the NEP, is having, and will continue to have, major adverse financial consequences for particular U.S. companies in depressing the earnings and asset values of these firms.

- U.S. investors' commitments to FIRA with regard to the purchase of Canadian goods arguably violate GATT Article III.

- FIRA and the NEP are serious derogations from the national treatment principle formulated in the OECD. Left unchanged, Canada's policies can be expected to serve as a precedent for other countries' treatment of foreign investors (particularly LDCs) and for further investment restrictions in Canada. According to the American Embassy in Ottawa, a provision of the draft Energy Security Act authorizes the future extension of discriminatory NEP investment policies to the coal and uranium sectors.

- Over the longer term, restrictive Canadian investment policies can be expected to have a detrimental impact on the structure and growth of the Canadian economy.

Immediate Problems

- A number of U.S. firms 2/ have recently been, or are now, the targets of "unfriendly" takeover attempts by large Canadian firms. In some cases, Canadian investment policies (particularly the NEP) have provided the

Conoco - DuPont merger may eliminate one large case

2/ Hobart, Conoco, St. Joe, Cities Service, Texasgulf.

economic basis for these takeover attempts. In all cases, Canadian policies (particularly FIRA policy) have had the effect of severely hampering managements' 3/ efforts to defend U.S. firms from the takeover attempts.

- Largely as a result of representations made by U.S. firms adversely affected by Canadian investment policies, the interest of the Congress 4/ in these issues has grown dramatically in recent months and weeks. USTR, State and Treasury have been requested to testify before Congressman Dingell's Subcommittee on July 9 5/ and draft legislation 6/ has been introduced which, among other things, would temporarily restrict Canadian energy investments in the United States.

- Canadian Prime Minister Trudeau will be in Washington for meetings with the President on July 10.

- The President has been urged by members of Congress to raise the issue of discriminatory Canadian investment policies at the Ottawa Economic Summit (July 20-21). 7/ Other Summit participants have expressed concern over the NEP in the past.

U.S. OBJECTIVES

The primary objective of the United States Government should be to bring about an end to discriminatory Canadian investment policies through diplomatic/legislative initiatives which do not unduly compromise global U.S. investment policy or engender unacceptable costs to U.S. economic interests.

The protection, through appropriate actions, of American firms and citizens from economic harm arising out of Canada's discriminatory investment policies should be a secondary short-term objective of the United States Government. In this connection, measures providing for reciprocal treatment of Canadian firms and citizens should not be regarded as "reciprocity for reciprocity's sake" but as actions designed to provide relief to U.S. interests affected by an inequitable situation.

3/ It is fair to say that stockholders may not always see their interests as coinciding with those of management in these takeover attempts.

4/ House Subcommittee on Mines & Mining, House Subcommittee on Telecommunications, Consumer Protection and Finance, and Oversight and Investigations Subcommittee (House Energy and Commerce Committee).

5/ See Attachment 1.

6/ H.R. 4033 and S.1429 (Title II).

7/ See Attachment 2.

U.S. POLICY OPTIONS

The policy options agreed to at the July 2, 1981 meeting of the Trade Policy Review Group are listed below. The options are not intended to be seen as mutually exclusive.

(1) Presidential Demarche. In the course of his discussions with Canadian Prime Minister Trudeau on July 10, the President should raise the issue of discriminatory Canadian investment policies and note that these policies are having an increasingly detrimental impact on the U.S. - Canada relationship.

Pros: Would highlight the seriousness of the issue and advance our primary objective by demonstrating continuing concern over Canadian policies at the highest level of the U.S. Government.

Would demonstrate the Administration's responsiveness to representations made by the private sector and the Congress.

Cons: May be viewed by Canadian officials as detracting from the stated purpose of the Prime Minister's visit (i.e., preparations for the Summit).

(2) Margin Requirements. U.S. companies complain that Canadian firms' tactics in recent "unfriendly" takeover attempts have been furthered by the absence of margin requirements on borrowed funds used for tender offers. The Administration should express its support for legislation akin to Title I of H.R. 4033 and S. 1429 which would amend the Securities Exchange Act of 1934 to make the margin requirements for domestic purchasers of securities applicable to foreign purchasers of securities in certain significant transactions involving the United States securities markets. Legislation such as that found in Title II of these bills--providing for a moratorium on Canadian investments in U.S. energy companies--should not be supported by the Administration.

Pros: Would advance our secondary objective by removing a problem which, although not directly related to Canadian investment policies, serves to compound U.S. firms' difficulties with those policies.

Would demonstrate the Administration's willingness to begin to tackle these issues without discriminating against foreign borrowers.

Both the SEC and the FRB have no objections to such legislation to impose margin requirements on foreign purchasers of U.S. shares when these requirements are the same as those imposed on U.S. purchasers.

Cons: Passage of such legislation would only serve to discourage some takeover attempts.

Such legislation would have little or no effect on our primary objective, i.e., eliminating the negative aspects of FIRA and the NEP.

(3) Mineral Lands Leasing Act of 1920. Under the Act, Canadian firms could be denied access to leases on federally-controlled lands for certain minerals (including oil and gas) on the grounds that Canadian laws, customs or regulations deny similar or like privileges (unrestricted access) to citizens or corporations of this country. The Department of the Interior should expedite a determination on whether or not Canada should continue to be regarded as a "reciprocating nation" under the Act. Further, in the event that Canada is determined to be non-reciprocating, Interior should be prepared to indicate exactly how a determination would impact existing and future leasing to Canadian companies.

Pros: Changing the status of Canadian companies for the purposes of the Act would demonstrate that Canada's actions are regarded seriously in the United States and would advance our primary objective.

Action under the Act could advance our secondary objective by discouraging some takeover attempts.

There is considerable flexibility in the interpretation of the Act's reference to "similar or like privileges". Further, the status of Canadian firms could quickly be changed again if suitable changes were made to Canadian policies.

The action can be taken administratively without requiring a change in U.S. law.

Cons: Taken in isolation, invocation of the Act's "reciprocity" provision might not suffice to bring about a change in Canadian investment policy.

Action against Canadian firms under the Act could reduce energy investment in the United States.

There are no current rules and procedures governing the invocation of the Act's "reciprocity" provision and the Department of the Interior is not now equipped to effectively enforce such a determination.

(4) Increased CFIUS Role. Under this option, the Committee on Foreign Investment in the United States (CFIUS) would review all future Canadian investments in the United States that can be shown to be related to the Canadian National Energy Program.

Pros: Would send a clear signal to Canada on the U.S. Government's concern over the NEP and contribute to the eventual attainment of our primary objective.

May contribute to attainment of our secondary objective by discouraging some takeover attempts.

May alleviate current Congressional pressure.

Cons: Taken in isolation, would be unlikely to induce major changes in the Canadian NEP.

Would be a distinct departure from previous CFIUS policy.

(5) Section 301 Action. 8/ This option provides for the exercise of the President's retaliation authority under Section 301 of the 1974 Trade Act, as amended. The authority permits the President, upon his own motion or after receipt of a petition, to impose restrictions on Canadian products or services, to withdraw trade agreement concessions, or take any other appropriate action within his power. Before taking such action, the President must first determine that Canadian investment policies are: (1) inconsistent with Canada's trade agreement obligations, i.e., those contained in the GATT or MTN Codes; or (2) unreasonable or discriminatory and a burden on U.S. commerce. Generally, the President must provide an opportunity for public comment on proposed retaliatory action; however, this requirement may be waived if the President determines that expeditious action is required.

Pros: The actual or threatened exercise of retaliatory authority under Section 301 could, depending on the retaliation involved, be a powerful means to use in the attainment of our primary objective.

The authority is broad in scope, flexible, and can be exercised quickly.

Cons: Where trade-related retaliation (e.g., import restrictions on Canadian products) is taken without GATT sanction, the U.S. could be subject to a challenge in the GATT for violating U.S. obligations under the GATT.

8/ See Attachment 3 for more detailed information on the use of Section 301.

In addition to the policy options outlined above, options which were considered by the Trade Policy Review Group and rejected include:

- Administration support of legislation providing for a nine-month moratorium on Canadian investments in U.S. energy companies;
- Amendment of the Mining Act of 1872 to include a reciprocity provision similar to that found in the Mineral Lands Leasing Act of 1920;
- Countervailing duty action against imported products from Canada produced from petroleum;
- Cancellation or renegotiation of the existing bilateral Defense Production Sharing Arrangement;
- Administration support for legislation which would authorize CFIUS to disallow takeovers of existing U.S. firms by foreign government-controlled enterprises or by other foreign enterprises upon a determination that the foreign home country does not afford comparable access to its own direct investment market;
- Restrictions on the flow of both U.S. equity and debt capital to Canada through discriminatory regulatory and tax policies; and,
- A U.S. Government threat to block completion of the Alaska Natural Gas Transportation System (pipeline).

Attachments

ATTACHMENT 1

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

MICHAEL F. BARRETT, JR.
CHIEF COUNSEL/STAFF DIRECTOR

June 29, 1981

VIA MESSENGER

The Honorable William E. Brock
United States Trade Representative
1800 G Street
Washington, D. C. 20506

Dear Mr. Brock:

The Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce has been investigating the impact on U.S. companies operating in Canada of the investment and the proposed energy policies of the Trudeau government. On June 19, the Subcommittee convened a public hearing on this subject. After taking testimony from representatives of St. Joe Minerals, Conoco and Cities Service -- three companies that have been or are now being adversely affected by Canadian policies -- and from former Under Secretary of State George Ball, it is clear that Canadian programs are discriminating against American companies and their stockholders. Once the proposed National Energy Program (NEP) is enacted, the discrimination will be intensified. This unfair treatment, which has been directed at a much larger group of companies than the above-mentioned examples, must be stopped before it seriously disrupts the traditionally friendly relations between our two countries.

As you are no doubt aware, the next Economic Summit Conference is scheduled to be held in Toronto from July 19th to the 21st. This meeting would appear to be an ideal forum to engage in frank and serious discussions on this issue with the Canadians, especially given the presence of senior officials of our European allies, who are also negatively affected by Canada's economic nationalism. Here I would note that the European Economic Community has already openly criticized the Canadian policies for violating the OECD code requiring equal treatment of businesses by member nations regardless of nationality.

In order to discuss our country's diplomatic efforts to date and our possible future initiatives, especially at the Economic Summit, I invite an appropriate official from the Office of the United States Trade Representative to testify before the Subcommittee on Thursday, July 9, 1981 at 10:00 a.m. As is customary, I request that the witness present an opening statement. It can be of any reasonable length and will

be placed in the record in its entirety. If lengthy, I would ask that an oral summary of not more than ten minutes be given. In accordance with Committee Rules, please submit 50 copies of your written statement to the offices of the Subcommittee 48 hours in advance of the hearing. Additionally, if you wish copies of your statement to be distributed to the public and press, we ask that you bring with you to the hearing an additional 50 copies for this purpose.

I request that your statement comment on the following questions:

(1) Does the United States Trade Representative agree that restrictions by Canada on investment by non-Canadians is unfair or discriminatory to U.S. companies?

(2) Is the proposed NEP likely to adversely affect the operations of the Canadian subsidiaries of U.S. energy companies?

(3) Do Canadian economic policies violate the Organization for Economic Cooperation and Development code or any other formal or informal international agreements? If so, please explain.

(4) What has been the response of the United States Trade Representative to these Canadian policies? Please list chronologically and explain all official United States Trade Representative actions on this subject since 1979.

(5) What has been the response of the Government of Canada to United States Trade Representative initiatives to date? What changes, if any, have been made by the Canadians as a result of your representations? Have these changes altered the basic thrust and effect of Canadian policies?

(6) If Canada, or for that matter any of our major trading partners, takes actions or threatens to take actions that are seriously and unjustly prejudicial to U.S. commercial interests in that country, should the U.S. government retaliate in kind if the application of the unjust policies cannot be mitigated through diplomatic means?

If you have any questions regarding the content or the procedure of the Subcommittee's hearing, please contact

Mr. Michael Barrett, Chief Counsel and Staff Director, at 225-4441 or Mr. Stephen Sims, Special Assistant, at 225-4617.

I look forward to hearing from you on this most important subject.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:Sm

ATTACHMENT 2

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

June 24, 1981

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

The House Energy and Commerce Committee is concerned with the increasing problems U.S. investors seem to be having as a result of discriminatory treatment by the Canadian Foreign Investment Review Agency (FIRA). The FIRA has refused to allow investment in certain fields in Canada by non-Canadians, and has even blocked the transfer between U.S. corporations of Canadian assets. This adverse treatment is certain to become even more pronounced once the National Energy Program (NEP) is passed by the Canadian Parliament. The effect of these actions has been and will increasingly be to depress the earnings prospects for American-owned companies in Canada. Taken with the actions of the FIRA, which effectively restricts the marketability of U.S. subsidiaries in Canada to Canadian buyers, these policies devalue the Canadian assets of U.S. corporations and thereby injure their millions of stockholders.

The NEP has several purported objectives, such as security of supply and development of energy resources, which may be admirable but it also contains various disincentives for U.S. investors including:

-- The establishment of an objective of at least 50 percent Canadian ownership of the petroleum industry by 1990;

-- A system of incentives for oil exploration and development which is biased in favor of companies with a high degree of Canadian ownership while reducing the competitive viability of foreign-owned Canadian companies;

-- The requirement that a company must have at least 50 percent Canadian ownership before obtaining a production license on "Canadian lands";

-- A guaranteed 25 percent back-in interest for the government-owned oil company, Petro-Canada, on all successful oil and gas exploration on "Canadian lands"; and

-- New taxes on oil and gas for financing Canada's takeover of presently foreign-owned companies.

Considering such developments, the Oversight Subcommittee convened a hearing on June 19 at which representatives from Conoco, Cities Service, St. Joe Minerals, and Lehman Brothers testified. The first three companies have been directly and adversely affected by Canada's actions. Conoco recently exchanged its 52.9 percent interest in Hudson's Bay Oil and Gas of Canada for Dome Petroleum of Calgary's recently acquired 22 million Conoco shares plus $245 million. It was economically coerced into doing so under difficult and unfair circumstances caused by Canada's economic nationalism and the lack of adequate response to these policies by our government. Cities Service is fighting an effort by Nu-West Group Limited (Nu-West), a Canadian corporation, which has purchased 6 million shares (more than 7%) of Cities Service stock, to exchange for valuable Canadian oil and gas properties at distressed prices. St. Joe Minerals was forced to sell CANDEL Oil Ltd. in which it had a 92% share, to raise cash in order to resist a takeover attempt by Seagrams Ltd., a Canadian Company.

The testimony before the Committee documents the following serious problems resulting from Canadian policies:

-- The NEP discriminates against foreign-owned companies in contravention of Canada's international commitments;

-- Canada's Foreign Investment Review Agency provides the Canadian government an effective tool to control and exclude foreign investment as it sees fit;

-- The effects of the National Energy Program and Foreign Investment Review Agency reinforce each other. The NEP depresses the value of assets held by American companies in Canada, as well as the future earnings potential of a foreign-controlled company while FIRA blocks any non-Canadian competitive bidding for the stock. This permits Canadian companies to then acquire the American assets at "fire-sale" prices;

-- American interests in energy companies were sold under duress at depressed prices to Canadian firms which paid for such by trading U.S. stock in an affiliated company purchased under financial conditions not available to any other American company;

-- The financial advantage accruing to Canadian firms comes from the existing practice in the United States of the Federal Reserve margin requirement. U.S. companies can use only 50 percent of the price of tendered shares as collateral for loans while Canadian firms can receive 100 percent loans from their banks; and

-- The Mineral Lands Leasing Act of 1920 allows foreign participation in mineral leases on federal lands only if a foreign country allows reciprocal privileges to U.S. citizens. Clearly, the NEP, as presently proposed, as well as the activities of FIRA, are direct violations of the reciprocity requirement.

A legislative solution may be required to counterbalance these unfair policies of the Trudeau Government. Since this should be avoided if possible, it would appear that the first course of action would be a clear and strong U.S. diplomatic initiative to convince Canada to voluntarily change its policies. The Ottawa Economic Summit on July 20 and 21 provides an ideal opportunity for you to express the U.S.'s serious concerns over Canada's expanding discriminatory investment, energy, and trade policies to Prime Minister Trudeau while the Secretaries of State and Treasury and the U.S. Trade Representative should reinforce this argument with their counterparts. We would point out that the OECD has already publicly disapproved of the thrust of the Canadian policies. In these discussions, it should also be pointed out to Prime Minister Trudeau that developing countries are watching closely Canada's policies which, if enacted, would undermine the efforts of other industrialized countries to encourage adoption by these countries of fair and equitable standards for international trade and investments.

Our Committee plans to have subsequent hearings prior to the Summit meeting on this subject and will be shortly extending invitations to Secretaries Haig and Regan and possibly other Administration personnel.

We again strongly urge you to make this matter a high priority at the Summit meeting because of the adverse effect the Canadian policies have on the interests of U.S. citizens.

Sincerely,

John D. Dingell
Chairman

James T. Broyhill
Ranking Minority Member

JDD:Sm

Exercise of Presidential Retaliation Authority Under Section 301

Section 301 of the Trade Act of 1974, as amended, is a domestic authority which may be exercised unilaterally or, in certain cases, with international sanction. In the case of Canadian policies or actions believed to be inconsistent with the GATT or MTN Codes, e.g., FIRA performance requirements affecting imports which are inconsistent with the national treatment provisions of GATT Article III, the United States could first raise the issue in the GATT Council or appropriate Code Committee and, after consulting with Canada, request information of a dispute settlement panel. If, after receiving the panel's findings, the GATT Council decides that Canada's actions are GATT inconsistent, it can direct Canada to cease its practice or provide compensation to the United States. Failing that, the Council can authorize the United States to retaliate. In terms of domestic retaliatory authority, the President, of course, is not bound by the decision of the GATT Council, i.e., he can still exercise his Section 301 authority in the face of an adverse GATT decision. However, the U.S. could then be subject to GATT-sanctioned counter-retaliation by Canada.

In the case of Canadian policies which are not covered by GATT (e.g., the NEP and many aspects of FIRA), the President can immediately exercise his Section 301 authority after determining that Canadian practices are "unreasonable" or "discriminatory" and a "burden or restriction" on U.S. commerce. These terms are undefined in the statute and offer the President a broad scope for action.

Presidential retaliation under Section 301 may take many forms. Specifically, he is authorized to impose duties or other import restrictions on Canadian products. This retaliation measure can be targeted to specific segments of the Canadian economy which are responsible for, or may have the most influence in, persuading the Canadian Government to repeal or modify its investment policies. Similarly, the President may impose fees or restrictions on Canadian services. Because such retaliation applies to services--not products--it is not covered by GATT. Therefore, its exercise cannot be challenged in the GATT. The President may also withdraw trade agreement concessions, i.e., tariff concessions or Code obligations. Finally, the President may take any other appropriate action within his power.

The purpose of the exercise of Presidential retaliatory authority under Section 301 is "...to obtain the elimination of such act, policy, or practice" which is determined to be inconsistent with any trade agreement or unreasonable or discriminatory and burdens or restricts United States commerce.

..... CONGRESS

____ SESSION

S. _____

(Note.—Fill in all blank lines except those provided for the date, number, and reference of bill.)

IN THE SENATE OF THE UNITED STATES

Mr.s. Kassebaum (for herself and Mr. Johnston of Louisiana)

introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Securities Exchange Act of 1934 to make the margin requirements for domestic purchasers of securities applicable to foreign purchasers of securities in certain significant transactions involving the United States securities markets, and for other purposes. (Insert title of bill here)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I -- MARGIN REQUIREMENTS

SHORT TITLE

SECTION 101. This title may be cited as the "Margin Requirements Fairness Act of 1981."

FOREIGN PERSONS

SECTION 102. (a) Section 7(f) of the Securities Exchange Act of 1934 (15 U.S.C. § 78g(f)) is amended--

(1) by redesignating paragraphs (2) and (3) as as Paragraphs (3) and (4), respectively; and

(2) by inserting after paragraph (1) the following new paragraph:

"(2) It is unlawful for any person not subject to paragraph (1) of this subsection to obtain, receive, or enjoy the beneficial use of the proceeds of a loan or other extension of credit from any lender (without regard to whether the lender's office or place of business is in a State or the transaction occurred in whole or in part within a State) for the purpose of (a) purchasing or carrying United States securities, or (b) purchasing or carrying within the United States any other securities, if (i) under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited or would be prohibited if it had been made or the transaction had otherwise occurred in a lender's office or other place of business in a State, and (ii) a statement has been or is required to be filed under section 13(d) or section 14(d) of this Act by such person in connection with the purchasing or carrying of such securities. For purposes of clause (ii) of the preceding sentence, a statement shall be deemed to have been or to be required to be filed by a person if it has been or is required to be filed by (I) such person, (II) any partnership, limited partnership, syndicate, or other group which is deemed to be a "person" pursuant to section 13(d)(3) of this Act and of which such person is a member, or (III) group described in clause (II) of this sentence."

(b) Paragraph (4) of section 7(f) of the Securities Exchange Act of 1934, as redesignated by subsection (a) of this section 15 use 78g(f) is amended by striking out "United States person" and inserting in lieu thereof "persons".

(c) Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) is amended by adding at the end thereof the following new subsection:

"(g) Any United States person injured or threatened with injury by reason of a violation of this section or the rules and regulations prescribed pursuant thereto, and any person whose securities are being purchased or carried, may bring an action in the appropriate district court of the United States, or in the appropriate United States court of any territory or other place subject to the jurisdiction of the United States, to recover damages for such injury or to enjoin such a violation".

REPORTING

SEC. 103. Section 13(d)(1)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)(B)) is amended to read as follows:

"(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price or proposed purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, (i) a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public; and (ii) information as to whether the margin requirements imposed pursuant to

section 7 of this title and the regulations promulgated thereunder are applicable and not being violated;".

EFFECTIVE DATE

SEC. 104.(a) The amendments made by this title take effect on June 24, 1981, and the provisions of paragraph (2) of section 7(f) and section 7(g) of the Securities Exchange Act of 1934, as so amended, shall apply to any loan or extension of credit in connection with any purchase or carrying of any securities on or after June 24, 1981, if (1) such loan or extension of credit originated on or after such date, (2) any of the proceeds thereof used to purchase or carry such securities were disbursed on or after such date, or (3) the person who has obtained, received or used the loan or extension of credit to purchase or carry securities acquires directly or indirectly by any means any additional securities of the same issuer on or after such date. (b) For the purpose of this section--

(1) "any loan or extension of credit" shall be deemed to include all loans or extensions of credit to the same person in connection with the purchase or carrying of any securities of the same issuer; and

(2) any "person" shall be deemed to include (A) such person, (B) any partnership, limited partnership, syndicate, or other group which is deemed to be a "person" pursuant to section 13(d)(3) of the Securities Exchange Act of 1934 and of which such person is a member, or (C) any other member of any group described in clause (B) of this sentence.

TITLE II -- FOREIGN ENERGY INVESTMENT

SHORT TITLE

SEC. 201. This title may be cited as the "Foreign Energy Investment Act of 1981".

TAKEOVER MORATORIAM

SEC. 202. (a) During the period beginning on July 1, 1981, and ending on March 31, 1982, except as provided in (b) of this section, it shall be unlawful for any Canadian person to acquire, directly or indirectly, by purchase or trade any voting securities of a United States energy resources corporation if, after such acquisition, more than 5 per centum of any class of voting securities of such corporation will be directly or indirectly owned by (1) such Canadian person, (2) any partnership, limited partnership, syndicate, or other group (within the meaning of section 13(d)(3) of the Securities and Exchange Act of 1934 (15. U.S.C 78m (d)(3) of which such Canadian person is a member, (3) the other members of any such partnership, limited partnership, syndicate, or other group, or (4) any combination of the foregoing. Any transfer of securities in violation of this subsection shall be null and void and shall be of no legal effect.

(b) The prohibition contained in paragraph (a) of this section shall not apply to any acquisition which was the subject of an agreement to merge between a United States energy resources corporation and a Canadian person prior to June 24, 1981.

INVESTMENT STUDY

SEC. 203. The Secretary of Energy, in consultation with the Secretary of State, the Secretary of Defense, the Secretary of the Interior, the Secretary of Commerce, the Securities and Exchange Commission, and other appropriate federal officials and agencies, shall undertake a comprehensive study of direct and indirect investment in United States energy resources enterprises by foreign persons and report his findings and recommendations to the Congress not later than March 1, 1982. In conducting the study, the Secretary shall consider and evaluate the following --

(1) the extent to which foreign countries, and particularly Canada, restrict, discriminate against or discourage non-national ownership or control of their energy resources and deny reciprocal privileges with respect to energy resources; and

(2) the effects on the economy, energy policy, national security, and foreign relations of the United States, and on United States securities markets and investors, of discriminatory policies or practices of foreign countries, and particularly Canada, concerning United States energy resources enterprises.

CERTAIN DEFINITIONS

SEC. 204. For the purpose of this title --

(1) the term "Canadian person" means any individual who is a citizen or resident of Canada or any corporation, partnership, association, joint stock company, trust, or other entity or group which is organized under the laws of or has its principal place of business

in Canada, or any other individual or entity or group which is owned or controlled directly or indirectly by such an individual or entity or group; and

(2) the term "foreign person" means any individual who is a citizen of a country other than the United States or who does not reside in the United States or any entity which is organized under the laws of or has its principal place of business in a country other than the United States, or any other individual or entity or group which is owned or controlled directly or indirectly by such an individual or entity or group; and

(3) the term "United States energy resources enterprise" means any business entity organized or existing under the laws of the United States or any State which --

(A) engages in (i) the exploration for, or the development, production, or transmission of, crude oil or natural gas, (ii) the refining of petroleum products, or (iii) the development of alternate fuels; and

(B) has assets valued at more than $100,000,000 as of July 1, 1981.

UNITED STATES GOVERNMENT

memorandum

DATE: July 10, 1981

REPLY TO ATTN OF: Bob Murphy

SUBJECT: Full CFIUS Meeting, July 13, 1981

TO: Jerry Jordan

There will be a meeting of the Committee on Foreign Investment in the U.S. on Monday, July 13, at 9:30 a.m. in Room 4426 at the Treasury Building. The purpose of the meeting will be to discuss the Elf Aquitaine deal and the general issue of Canadian investment practices. A draft paper prepared by Treasury concerning the Elf Aquitaine deal will be available late today. I will pass along a copy when it arrives.

It seems likely that the question of appropriate U.S. response to Canadian investment practices under NEP and FIRA will arise. If this is the case, the options outlined in the USTR paper discussed at last Tuesday's TPC meeting are relevant (attachment). As Marshall Casse pointed out at this morning's CEA staff meeting, CEA went along with Commerce, Treasury and USTR at the TPC meeting in supporting possible use of reciprocity under the Mineral Lands Leasing Act of 1920. Interior desires more time to fully evaluate this aspect of the Act. In addition, they are concerned that the USG maybe embracing this option too quickly and without appreciating how the law would be implemented. Interior claims that the administrative apparatus required to determine ownership of leases would be monstrous -- on the scale of the former Council on Wage and Price Stability -- requiring 200 staffers and an analytical unit. Another problem is the apparent requirement that the reciprocity clause be applied retroactively. USTR also is investigating the possibility of using the Section 301 provisions of the Trade Act of 1974 to deal with discriminatory Canadian investment practices and is "quietly" informing the Canadian government about this.

Two final points:

- o Congress is moving ahead on this issue (Attachment - Kassebaum bill) so some positive response by USG is needed.
- o Avoid any legislative options as could set dangerous precedent.

cc: WN, JB, AW, MC, ES

CABINET TRADE POLICY COMMITTEE

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506

July 6, 1981

MEMORANDUM TO Members of the Trade Policy Committee

FROM William E. Brock

SUBJECT Attached Paper on Canadian Investment Policy

The attached options paper will be discussed at tomorrow's meeting of the Trade Policy Committee. The paper reflects the outcome of a meeting of the Trade Policy Review Group held on Thursday, July 2, 1981, where the various policy options for dealing with the problem of discriminatory Canadian investment policies (the Foreign Investment Review Agency and the National Energy Program) were discussed.

The outcome of the Trade Policy Committee's consideration of this paper will have an important effect on our future efforts with the Canadians and the following upcoming events:

- Wednesday's meeting of the Advisory Committee for Trade Negotiations;
- Thursday's testimony by State, Treasury and USTR before the House Subcommittee on Oversight and Investigations (Committee on Energy and Commerce); and,
- Friday's meeting between the President and Canadian Prime Minister Trudeau.

7/9

7/10

Attachment

CANADIAN INVESTMENT POLICY

PROBLEM

FIRA and the NEP 1/

Virtually all new foreign direct investment proposals in Canada are subject to review by FIRA and approval by the Canadian Cabinet. Only those investment proposals judged to be of "significant benefit to Canada" are approved. As a prerequisite for approval, investors enter into legally binding commitments in one or more of five performance areas (e.g., reduced imports, increased exports, etc.). Also subject to FIRA review are expansions of foreign-owned firms into unrelated areas (e.g., an oil company purchase of a department store) and mergers between parent companies outside of Canada that involve the transfer of ownership of a Canadian subsidiary (whether or not the merger results in an increased degree of foreign ownership in Canada). The current Canadian Government announced in April 1980 that it intended to expand FIRA's legislated mandate to include performance reviews of existing foreign firms operating in Canada. (1)

Under the NEP (announced on October 28, 1980), the Canadian Government announced its policy of "Canadianizing" the oil and gas sector through discriminatory investment policy instruments designed to disadvantage foreign-owned firms while financially assisting Canadian-owned firms. (2) One of these policy instruments (due to be legislatively implemented through the draft Canada Oil and Gas Act) provides that only those firms (or consortia) which are at least 50 percent Canadian-owned will be permitted to participate in the production of oil and gas from the so-called "Canada Lands" (the Yukon, Northwest Territories and offshore areas). (2a)

Of greater concern than the "Canada Lands" provision is the Petroleum Incentives Program (due to be legislatively implemented through the draft Energy Security Act). Here, earned depletion allowances will be phased out and replaced by substantial direct subsidies paid to firms under the new Petroleum Incentives Program. Only firms which are at least 50 percent Canadian-owned can qualify for the subsidies. The amount of subsidy paid is to increase in proportion to the level of Canadian ownership in an oil and gas firm. (2b)

1/ The Canadian Government's Foreign Investment Review Agency (FIRA) and Canada's National Energy Program (NEP).

POLICY ISSUES

The numerous issues and problems associated with discriminatory Canadian investment policies can be divided into long-term policy issues and immediate problems.

Long-Term Policy Issues

- Discriminatory Canadian investment policies, to the extent they foster disinvestment in Canada by U.S. firms, have great potential for adversely impacting U.S. exports to Canada. Seventy-five percent of the imports from the United States of the 300 largest firms in Canada represent intracompany transactions between a U.S. parent and a Canadian branch or subsidiary.

- Canadian policy, particularly as reflected in the NEP, is having, and will continue to have, major adverse financial consequences for particular U.S. companies in depressing the earnings and asset values of these firms.

- U.S. investors' commitments to FIRA with regard to the purchase of Canadian goods arguably violate GATT Article III.

- FIRA and the NEP are serious derogations from the national treatment principle formulated in the OECD. Left unchanged, Canada's policies can be expected to serve as a precedent for other countries' treatment of foreign investors (particularly LDCs) and for further investment restrictions in Canada. According to the American Embassy in Ottawa, a provision of the draft Energy Security Act authorizes the future extension of discriminatory NEP investment policies to the coal and uranium sectors.

- Over the longer term, restrictive Canadian investment policies can be expected to have a detrimental impact on the structure and growth of the Canadian economy.

Immediate Problems

- A number of U.S. firms 2/ have recently been, or are now, the targets of "unfriendly" takeover attempts by large Canadian firms. In some cases, Canadian investment policies (particularly the NEP) have provided the

Conoco - DuPont merger may eliminate one large case

2/ Hobart, Conoco, St. Joe, Cities Service, Texasgulf.

economic basis for these takeover attempts. In all cases, Canadian policies (particularly FIRA policy) have had the effect of severely hampering managements' 3/ efforts to defend U.S. firms from the takeover attempts.

- Largely as a result of representations made by U.S. firms adversely affected by Canadian investment policies, the interest of the Congress 4/ in these issues has grown dramatically in recent months and weeks. USTR, State and Treasury have been requested to testify before Congressman Dingell's Subcommittee on July 9 5/ and draft legislation 6/ has been introduced which, among other things, would temporarily restrict Canadian energy investments in the United States.

- Canadian Prime Minister Trudeau will be in Washington for meetings with the President on July 10.

- The President has been urged by members of Congress to raise the issue of discriminatory Canadian investment policies at the Ottawa Economic Summit (July 20-21). 7/ Other Summit participants have expressed concern over the NEP in the past.

U.S. OBJECTIVES

The primary objective of the United States Government should be to bring about an end to discriminatory Canadian investment policies through diplomatic/legislative initiatives which do not unduly compromise global U.S. investment policy or engender unacceptable costs to U.S. economic interests.

The protection, through appropriate actions, of American firms and citizens from economic harm arising out of Canada's discriminatory investment policies should be a secondary short-term objective of the United States Government. In this connection, measures providing for reciprocal treatment of Canadian firms and citizens should not be regarded as "reciprocity for reciprocity's sake" but as actions designed to provide relief to U.S. interests affected by an inequitable situation.

3/ It is fair to say that stockholders may not always see their interests as coinciding with those of management in these takeover attempts.

4/ House Subcommittee on Mines & Mining, House Subcommittee on Telecommunications, Consumer Protection and Finance, and Oversight and Investigations Subcommittee (House Energy and Commerce Committee).

5/ See Attachment 1.

6/ H.R. 4033 and S.1429 (Title II).

7/ See Attachment 2.

U.S. POLICY OPTIONS

The policy options agreed to at the July 2, 1981 meeting of the Trade Policy Review Group are listed below. The options are not intended to be seen as mutually exclusive.

(1) Presidential Demarche. In the course of his discussions with Canadian Prime Minister Trudeau on July 10, the President should raise the issue of discriminatory Canadian investment policies and note that these policies are having an increasingly detrimental impact on the U.S. - Canada relationship.

Pros: Would highlight the seriousness of the issue and advance our primary objective by demonstrating continuing concern over Canadian policies at the highest level of the U.S. Government.

Would demonstrate the Administration's responsiveness to representations made by the private sector and the Congress.

Cons: May be viewed by Canadian officials as detracting from the stated purpose of the Prime Minister's visit (i.e., preparations for the Summit).

(2) Margin Requirements. U.S. companies complain that Canadian firms' tactics in recent "unfriendly" takeover attempts have been furthered by the absence of margin requirements on borrowed funds used for tender offers. The Administration should express its support for legislation akin to Title I of H.R. 4033 and S. 1429 which would amend the Securities Exchange Act of 1934 to make the margin requirements for domestic purchasers of securities applicable to foreign purchasers of securities in certain significant transactions involving the United States securities markets. Legislation such as that found in Title II of these bills--providing for a moratorium on Canadian investments in U.S. energy companies--should not be supported by the Administration.

Pros: Would advance our secondary objective by removing a problem which, although not directly related to Canadian investment policies, serves to compound U.S. firms' difficulties with those policies.

Would demonstrate the Administration's willingness to begin to tackle these issues without discriminating against foreign borrowers.

Both the SEC and the FRB have no objections to such legislation to impose margin requirements on foreign purchasers of U.S. shares when these requirements are the same as those imposed on U.S. purchasers.

Cons: Passage of such legislation would only serve to discourage some takeover attempts.

Such legislation would have little or no effect on our primary objective, i.e., eliminating the negative aspects of FIRA and the NEP.

cost to U.S.?
may be necessary political goal that G has acted.

(3) Mineral Lands Leasing Act of 1920. Under the Act, Canadian firms could be denied access to leases on federally-controlled lands for certain minerals (including oil and gas) on the grounds that Canadian laws, customs or regulations deny similar or like privileges (unrestricted access) to citizens or corporations of this country. The Department of the Interior should expedite a determination on whether or not Canada should continue to be regarded as a "reciprocating nation" under the Act. Further, in the event that Canada is determined to be non-reciprocating, Interior should be prepared to indicate exactly how a determination would impact existing and future leasing to Canadian companies.

Pros: Changing the status of Canadian companies for the purposes of the Act would demonstrate that Canada's actions are regarded seriously in the United States and would advance our primary objective.

Action under the Act could advance our secondary objective by discouraging some takeover attempts.

There is considerable flexibility in the interpretation of the Act's reference to "similar or like privileges". Further, the status of Canadian firms could quickly be changed again if suitable changes were made to Canadian policies.

The action can be taken administratively without requiring a change in U.S. law.

Cons: Taken in isolation, invocation of the Act's "reciprocity" provision might not suffice to bring about a change in Canadian investment policy.

Action against Canadian firms under the Act could reduce energy investment in the United States.

There are no current rules and procedures governing the invocation of the Act's "reciprocity" provision and the Department of the Interior is not now equipped to effectively enforce such a determination.

(4) Increased CFIUS Role. Under this option, the Committee on Foreign Investment in the United States (CFIUS) would review all future Canadian investments in the United States that can be shown to be related to the Canadian National Energy Program.

Pros: Would send a clear signal to Canada on the U.S. Government's concern over the NEP and contribute to the eventual attainment of our primary objective.

May contribute to attainment of our secondary objective by discouraging some takeover attempts.

May alleviate current Congressional pressure.

Cons: Taken in isolation, would be unlikely to induce major changes in the Canadian NEP.

Would be a distinct departure from previous CFIUS policy.

(5) Section 301 Action. 8/ This option provides for the exercise of the President's retaliation authority under Section 301 of the 1974 Trade Act, as amended. The authority permits the President, upon his own motion or after receipt of a petition, to impose restrictions on Canadian products or services, to withdraw trade agreement concessions, or take any other appropriate action within his power. Before taking such action, the President must first determine that Canadian investment policies are: (1) inconsistent with Canada's trade agreement obligations, i.e., those contained in the GATT or MTN Codes; or (2) unreasonable or discriminatory and a burden on U.S. commerce. Generally, the President must provide an opportunity for public comment on proposed retaliatory action; however, this requirement may be waived if the President determines that expeditious action is required.

Pros: The actual or threatened exercise of retaliatory authority under Section 301 could, depending on the retaliation involved, be a powerful means to use in the attainment of our primary objective.

The authority is broad in scope, flexible, and can be exercised quickly.

Cons: Where trade-related retaliation (e.g., import restrictions on Canadian products) is taken without GATT sanction, the U.S. could be subject to a challenge in the GATT for violating U.S. obligations under the GATT.

8/ See Attachment 3 for more detailed information on the use of Section 301

In addition to the policy options outlined above, options which were considered by the Trade Policy Review Group and rejected include:

- Administration support of legislation providing for a nine-month moratorium on Canadian investments in U.S. energy companies;

- Amendment of the Mining Act of 1872 to include a reciprocity provision similar to that found in the Mineral Lands Leasing Act of 1920;

- Countervailing duty action against imported products from Canada produced from petroleum;

- Cancellation or renegotiation of the existing bilateral Defense Production Sharing Arrangement;

- Administration support for legislation which would authorize CFIUS to disallow takeovers of existing U.S. firms by foreign government-controlled enterprises or by other foreign enterprises upon a determination that the foreign home country does not afford comparable access to its own direct investment market;

- Restrictions on the flow of both U.S. equity and debt capital to Canada through discriminatory regulatory and tax policies; and,

- A U.S. Government threat to block completion of the Alaska Natural Gas Transportation System (pipeline).

Attachments

ATTACHMENT 1

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

June 29, 1981

VIA MESSENGER

The Honorable William E. Brock
United States Trade Representative
1800 G Street
Washington, D. C. 20506

Dear Mr. Brock:

The Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce has been investigating the impact on U.S. companies operating in Canada of the investment and the proposed energy policies of the Trudeau government. On June 19, the Subcommittee convened a public hearing on this subject. After taking testimony from representatives of St. Joe Minerals, Conoco and Cities Service -- three companies that have been or are now being adversely affected by Canadian policies -- and from former Under Secretary of State George Ball, it is clear that Canadian programs are discriminating against American companies and their stockholders. Once the proposed National Energy Program (NEP) is enacted, the discrimination will be intensified. This unfair treatment, which has been directed at a much larger group of companies than the above-mentioned examples, must be stopped before it seriously disrupts the traditionally friendly relations between our two countries.

As you are no doubt aware, the next Economic Summit Conference is scheduled to be held in Toronto from July 19th to the 21st. This meeting would appear to be an ideal forum to engage in frank and serious discussions on this issue with the Canadians, especially given the presence of senior officials of our European allies, who are also negatively affected by Canada's economic nationalism. Here I would note that the European Economic Community has already openly criticized the Canadian policies for violating the OECD code requiring equal treatment of businesses by member nations regardless of nationality.

In order to discuss our country's diplomatic efforts to date and our possible future initiatives, especially at the Economic Summit, I invite an appropriate official from the Office of the United States Trade Representative to testify before the Subcommittee on Thursday, July 9, 1981 at 10:00 a.m. As is customary, I request that the witness present an opening statement. It can be of any reasonable length and will

be placed in the record in its entirety. If lengthy, I would ask that an oral summary of not more than ten minutes be given. In accordance with Committee Rules, please submit 50 copies of your written statement to the offices of the Subcommittee 48 hours in advance of the hearing. Additionally, if you wish copies of your statement to be distributed to the public and press, we ask that you bring with you to the hearing an additional 50 copies for this purpose.

I request that your statement comment on the following questions:

(1) Does the United States Trade Representative agree that restrictions by Canada on investment by non-Canadians is unfair or discriminatory to U.S. companies?

(2) Is the proposed NEP likely to adversely affect the operations of the Canadian subsidiaries of U.S. energy companies?

(3) Do Canadian economic policies violate the Organization for Economic Cooperation and Development code or any other formal or informal international agreements? If so, please explain.

(4) What has been the response of the United States Trade Representative to these Canadian policies? Please list chronologically and explain all official United States Trade Representative actions on this subject since 1979.

(5) What has been the response of the Government of Canada to United States Trade Representative initiatives to date? What changes, if any, have been made by the Canadians as a result of your representations? Have these changes altered the basic thrust and effect of Canadian policies?

(6) If Canada, or for that matter any of our major trading partners, takes actions or threatens to take actions that are seriously and unjustly prejudicial to U.S. commercial interests in that country, should the U.S. government retaliate in kind if the application of the unjust policies cannot be mitigated through diplomatic means?

If you have any questions regarding the content or the procedure of the Subcommittee's hearing, please contact

Mr. Michael Barrett, Chief Counsel and Staff Director, at 225-4441 or Mr. Stephen Sims, Special Assistant, at 225-4617.

I look forward to hearing from you on this most important subject.

Sincerely,

John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

JDD:Sm

ATTACHMENT 2

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF THE
COMMITTEE ON ENERGY AND COMMERCE
WASHINGTON, D.C. 20515

June 24, 1981

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

The House Energy and Commerce Committee is concerned with the increasing problems U.S. investors seem to be having as a result of discriminatory treatment by the Canadian Foreign Investment Review Agency (FIRA). The FIRA has refused to allow investment in certain fields in Canada by non-Canadians, and has even blocked the transfer between U.S. corporations of Canadian assets. This adverse treatment is certain to become even more pronounced once the National Energy Program (NEP) is passed by the Canadian Parliament. The effect of these actions has been and will increasingly be to depress the earnings prospects for American-owned companies in Canada. Taken with the actions of the FIRA, which effectively restricts the marketability of U.S. subsidiaries in Canada to Canadian buyers, these policies devalue the Canadian assets of U.S. corporations and thereby injure their millions of stockholders.

The NEP has several purported objectives, such as security of supply and development of energy resources, which may be admirable but it also contains various disincentives for U.S. investors including:

-- The establishment of an objective of at least 50 percent Canadian ownership of the petroleum industry by 1990;

-- A system of incentives for oil exploration and development which is biased in favor of companies with a high degree of Canadian ownership while reducing the competitive viability of foreign-owned Canadian companies;

-- The requirement that a company must have at least 50 percent Canadian ownership before obtaining a production license on "Canadian lands";

-- A guaranteed 25 percent back-in interest for the government-owned oil company, Petro-Canada, on all successful oil and gas exploration on "Canadian lands"; and

-- New taxes on oil and gas for financing Canada's takeover of presently foreign-owned companies.

Considering such developments, the Oversight Subcommittee convened a hearing on June 19 at which representatives from Conoco, Cities Service, St. Joe Minerals, and Lehman Brothers testified. The first three companies have been directly and adversely affected by Canada's actions. Conoco recently exchanged its 52.9 percent interest in Hudson's Bay Oil and Gas of Canada for Dome Petroleum of Calgary's recently acquired 22 million Conoco shares plus $245 million. It was economically coerced into doing so under difficult and unfair circumstances caused by Canada's economic nationalism and the lack of adequate response to these policies by our government. Cities Service is fighting an effort by Nu-West Group Limited (Nu-West), a Canadian corporation, which has purchased 6 million shares (more than 7%) of Cities Service stock, to exchange for valuable Canadian oil and gas properties at distressed prices. St. Joe Minerals was forced to sell CANDEL Oil Ltd. in which it had a 92% share, to raise cash in order to resist a takeover attempt by Seagrams Ltd., a Canadian Company.

The testimony before the Committee documents the following serious problems resulting from Canadian policies:

-- The NEP discriminates against foreign-owned companies in contravention of Canada's international commitments;

-- Canada's Foreign Investment Review Agency provides the Canadian government an effective tool to control and exclude foreign investment as it sees fit;

-- The effects of the National Energy Program and Foreign Investment Review Agency reinforce each other. The NEP depresses the value of assets held by American companies in Canada, as well as the future earnings potential of a foreign-controlled company while FIRA blocks any non-Canadian competitive bidding for the stock. This permits Canadian companies to then acquire the American assets at "fire-sale" prices;

-- American interests in energy companies were sold under duress at depressed prices to Canadian firms which paid for such by trading U.S. stock in an affiliated company purchased under financial conditions not available to any other American company;

-- The financial advantage accruing to Canadian firms comes from the existing practice in the United States of the Federal Reserve margin requirement. U.S. companies can use only 50 percent of the price of tendered shares as collateral for loans while Canadian firms can receive 100 percent loans from their banks; and

-- The Mineral Lands Leasing Act of 1920 allows foreign participation in mineral leases on federal lands only if a foreign country allows reciprocal privileges to U.S. citizens. Clearly, the NEP, as presently proposed, as well as the activities of FIRA, are direct violations of the reciprocity requirement.

A legislative solution may be required to counterbalance these unfair policies of the Trudeau Government. Since this should be avoided if possible, it would appear that the first course of action would be a clear and strong U.S. diplomatic initiative to convince Canada to voluntarily change its policies. The Ottawa Economic Summit on July 20 and 21 provides an ideal opportunity for you to express the U.S.'s serious concerns over Canada's expanding discriminatory investment, energy, and trade policies to Prime Minister Trudeau while the Secretaries of State and Treasury and the U.S. Trade Representative should reinforce this argument with their counterparts. We would point out that the OECD has already publicly disapproved of the thrust of the Canadian policies. In these discussions, it should also be pointed out to Prime Minister Trudeau that developing countries are watching closely Canada's policies which, if enacted, would undermine the efforts of other industrialized countries to encourage adoption by these countries of fair and equitable standards for international trade and investments.

Our Committee plans to have subsequent hearings prior to the Summit meeting on this subject and will be shortly extending invitations to Secretaries Haig and Regan and possibly other Administration personnel.

We again strongly urge you to make this matter a high priority at the Summit meeting because of the adverse effect the Canadian policies have on the interests of U.S. citizens.

Sincerely,

John D. Dingell
Chairman

James T. Broyhill
Banking Minority Member

JDD:Sm

Exercise of Presidential Retaliation Authority Under Section 301

Section 301 of the Trade Act of 1974, as amended, is a domestic authority which may be exercised unilaterally or, in certain cases, with international sanction. In the case of Canadian policies or actions believed to be inconsistent with the GATT or MTN Codes, e.g., FIRA performance requirements affecting imports which are inconsistent with the national treatment provisions of GATT Article III, the United States could first raise the issue in the GATT Council or appropriate Code Committee and, after consulting with Canada, request information of a dispute settlement panel. If, after receiving the panel's findings, the GATT Council decides that Canada's actions are GATT inconsistent, it can direct Canada to cease its practice or provide compensation to the United States. Failing that, the Council can authorize the United States to retaliate. In terms of domestic retaliatory authority, the President, of course, is not bound by the decision of the GATT Council, i.e., he can still exercise his Section 301 authority in the face of an adverse GATT decision. However, the U.S. could then be subject to GATT-sanctioned counter-retaliation by Canada.

In the case of Canadian policies which are not covered by GATT (e.g., the NEP and many aspects of FIRA), the President can immediately exercise his Section 301 authority after determining that Canadian practices are "unreasonable" or "discriminatory" and a "burden or restriction" on U.S. commerce. These terms are undefined in the statute and offer the President a broad scope for action.

Presidential retaliation under Section 301 may take many forms. Specifically, he is authorized to impose duties or other import restrictions on Canadian products. This retaliation measure can be targeted to specific segments of the Canadian economy which are responsible for, or may have the most influence in, persuading the Canadian Government to repeal or modify its investment policies. Similarly, the President may impose fees or restrictions on Canadian services. Because such retaliation applies to services--not products--it is not covered by GATT. Therefore, its exercise cannot be challenged in the GATT. The President may also withdraw trade agreement concessions, i.e., tariff concessions or Code obligations. Finally, the President may take any other appropriate action within his power.

The purpose of the exercise of Presidential retaliatory authority under Section 301 is "...to obtain the elimination of such act, policy, or practice" which is determined to be inconsistent with any trade agreement or unreasonable or discriminatory and burdens or restricts United States commerce.

_____ CONGRESS

_____ SESSION

S. _____

(Note.—Fill in all blank lines except those provided for the date, number, and reference of bill.)

IN THE SENATE OF THE UNITED STATES

Mr.s. Kassebaum (for herself and Mr. Johnston of Louisiana)

introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Securities Exchange Act of 1934 to make the margin requirements for domestic purchasers of securities applicable to foreign purchasers of securities in certain significant transactions involving the United States securities markets, and for other purposes. (Insert title of bill here)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I -- MARGIN REQUIREMENTS

SHORT TITLE

SECTION 101. This title may be cited as the "Margin Requirements Fairness Act of 1981."

FOREIGN PERSONS

SECTION 102. (a) Section 7(f) of the Securities Exchange Act of 1934 (15 U.S.C. § 78g(f)) is amended--

(1) by redesignating paragraphs (2) and (3) as as Paragraphs (3) and (4), respectively; and

(2) by inserting after paragraph (1) the following new paragraph:

"(2) It is unlawful for any person not subject to paragraph (1) of this subsection to obtain, receive, or enjoy the beneficial use of the proceeds of a loan or other extension of credit from any lender (without regard to whether the lender's office or place of business is in a State or the transaction occurred in whole or in part within a State) for the purpose of (a) purchasing or carrying United States securities, or (b) purchasing or carrying within the United States any other securities, if (i) under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited or would be prohibited if it had been made or the transaction had otherwise occurred in a lender's office or other place of business in a State, and (ii) a statement has been or is required to be filed under section 13(d) or section 14(d) of this Act by such person in connection with the purchasing or carrying of such securities. For purposes of clause (ii) of the preceding sentence, a statement shall be deemed to have been or to be required to be filed by a person if it has been or is required to be filed by (I) such person, (II) any partnership, limited partnership, syndicate, or other group which is deemed to be a "person" pursuant to section 13(d)(3) of this Act and of which such person is a member, or (III) group described in clause (II) of this sentence."

(b) Paragraph (4) of section 7(f) of the Securities Exchange Act of 1934, as redesignated by subsection (a) of this section 15 use 78g(f) is amended by striking out "United States person" and inserting in lieu thereof "persons".

(c) Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) is amended by adding at the end thereof the following new subsection:

"(g) Any United States person injured or threatened with injury by reason of a violation of this section or the rules and regulations prescribed pursuant thereto, and any person whose securities are being purchased or carried, may bring an action in the appropriate district court of the United States, or in the appropriate United States court of any territory or other place subject to the jurisdiction of the United States, to recover damages for such injury or to enjoin such a violation".

REPORTING

SEC. 103. Section 13(d)(1)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)(B)) is amended to read as follows:

"(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price or proposed purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, (i) a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public; and (ii) information as to whether the margin requirements imposed pursuant to

section 7 of this title and the regulations promulgated thereunder are applicable and not being violated;".

EFFECTIVE DATE

SEC. 104.(a) The amendments made by this title take effect on June 24, 1981, and the provisions of paragraph (2) of section 7(f) and section 7(g) of the Securities Exchange Act of 1934, as so amended, shall apply to any loan or extension of credit in connection with any purchase or carrying of any securities on or after June 24, 1981, if (1) such loan or extension of credit originated on or after such date, (2) any of the proceeds thereof used to purchase or carry such securities were disbursed on or after such date, or (3) the person who has obtained, received or used the loan or extension of credit to purchase or carry securities acquires directly or indirectly by any means any additional securities of the same issuer on or after such date. (b) For the purpose of this section--

(1) "any loan or extension of credit" shall be deemed to include all loans or extensions of credit to the same person in connection with the purchase or carrying of any securities of the same issuer; and

(2) any "person" shall be deemed to include (A) such person, (B) any partnership, limited partnership, syndicate, or other group which is deemed to be a "person" pursuant to section 13(d)(3) of the Securities Exchange Act of 1934 and of which such person is a member, or (C) any other member of any group described in clause (B) of this sentence.

TITLE II -- FOREIGN ENERGY INVESTMENT

SHORT TITLE

SEC. 201. This title may be cited as the "Foreign Energy Investment Act of 1981".

TAKEOVER MORATORIAM

SEC. 202. (a) During the period beginning on July 1, 1981, and ending on March 31, 1982, except as provided in (b) of this section, it shall be unlawful for any Canadian person to acquire, directly or indirectly, by purchase or trade any voting securities of a United States energy resources corporation if, after such acquisition, more than 5 per centum of any class of voting securities of such corporation will be directly or indirectly owned by (1) such Canadian person, (2) any partnership, limited partnership, syndicate, or other group (within the meaning of section 13(d)(3) of the Securities and Exchange Act of 1934 (15. U.S.C 78m (d)(3) of which such Canadian person is a member, (3) the other members of any such partnership, limited partnership, syndicate, or other group, or (4) any combination of the foregoing. Any transfer of securities in violation of this subsection shall be null and void and shall be of no legal effect.

(b) The prohibition contained in paragraph (a) of this section shall not apply to any acquisition which was the subject of an agreement to merge between a United States energy resources corporation and a Canadian person prior to June 24, 1981.

INVESTMENT STUDY

SEC. 203. The Secretary of Energy, in consultation with the Secretary of State, the Secretary of Defense, the Secretary of the Interior, the Secretary of Commerce, the Securities and Exchange Commission, and other appropriate federal officials and agencies, shall undertake a comprehensive study of direct and indirect investment in United States energy resources enterprises by foreign persons and report his findings and recommendations to the Congress not later than March 1, 1982. In conducting the study, the Secretary shall consider and evaluate the following --

(1) the extent to which foreign countries, and particularly Canada, restrict, discriminate against or discourage non-national ownership or control of their energy resources and deny reciprocal privileges with respect to energy resources; and

(2) the effects on the economy, energy policy, national security, and foreign relations of the United States, and on United States securities markets and investors, of discriminatory policies or practices of foreign countries, and particularly Canada, concerning United States energy resources enterprises.

CERTAIN DEFINITIONS

SEC. 204. For the purpose of this title --

(1) the term "Canadian person" means any individual who is a citizen or resident of Canada or any corporation, partnership, association, joint stock company, trust, or other entity or group which is organized under the laws of or has its principal place of business

in Canada, or any other individual or entity or group which is owned or controlled directly or indirectly by such an individual or entity or group; and

(2) the term "foreign person" means any individual who is a citizen of a country other than the United States or who does not reside in the United States or any entity which is organized under the laws of or has its principal place of business in a country other than the United States, or any other individual or entity or group which is owned or controlled directly or indirectly by such an individual or entity or group; and

(3) the term "United States energy resources enterprise" means any business entity organized or existing under the laws of the United States or any State which --

(A) engages in (i) the exploration for, or the development, production, or transmission of, crude oil or natural gas, (ii) the refining of petroleum products, or (iii) the development of alternate fuels; and

(B) has assets valued at more than $100,000,000 as of July 1, 1981.

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS

Date: 7/11

To: Jerry Jordan

From: Bob Murphy

RE: Paper for CFIUS Meeting on Monday

Treasury informed me late Friday that the draft paper on the Elf Aquitaine-Texasgulf deal will be distributed at the meeting on Monday.

I'll check first thing Monday morning to see if you'll be attending. I plan to sit in on the meeting in any event.

Attached is a brief past memo concerning the Elf Aquitaine issue.

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20506

July 7, 1981

MEMORANDUM FOR: Frank Vukmanic

FROM: Bob Murphy

SUBJECT: Elf Aquitaine bid for Texas Gulf

This note briefly summarizes what I see as the two key issues on which an economic (as opposed to national security or antitrust) assessment must focus.

First, the principal of minimizing barriers to flows of goods and services between countries is naturally extended to flows of capital. There is no good economic argument for restricting such flows. In a situation where a foreign government controls the foreign firm involved in the takeover, an argument can be made that future unfair trade practices (subsidies for intermediate goods, sourcing of supplies, dumping of final product produced in U.S.) are possible. Fears of predatory pricing by a U.S.-based subsidiary of a foreign government controlled firm are likely to be greater than in a case where the foreign firm is privately held because the foreign government may not be as concerned about short-term profits. In addition, some may argue that government involvement in private markets alone is a problem, whether it be domestic or foreign government. If, however, U.S. antitrust laws and dumping/countervailing duty laws are properly enforced, the distinction of foreign government controlled versus foreign privately controlled is of little economic consequence. What matters is the operation of U.S. domestic markets and fair international trade practices, not the operation of foreign home markets and the degree of government involvement therein.

Second, the involvement of the Canadian Government through control of the Canadian Development Corporation (CDC) links the Elf Aquitaine-Texasgulf takeover with the broad issue of discriminatory Canadian investment policies. If the 37 percent share held by CDC was instead held by a U.S. company or another foreign concern, there would be little

reason for opposing the deal on economic grounds. Because the deal includes a swap of Texasgulf's Canadian assets for the 37 percent share held by CDC, the issue arises as to whether discriminatory Canadian investment policy has made Texasgulf more susceptible to a takeover bid. Under current Canadian policy, Texasgulf's Canadian assets are more valuable to Canadian concerns than to U.S. or other foreign holders. This aspect of the takeover attempt suggests that economic issues pertaining to government involvement center around the Canadian National Energy Program (NEP), and not around the role of the French Government in Elf Aquitaine. Hence, discussion of this specific case might well be integrated with recent discussions in the Trade Policy Review Group (TPRG) concerning NEP.

cc: JJ, BN, JB, AW, ES, MC