



**STATEMENT FOR THE RECORD OF
THE RAIL SECURITY ALLIANCE**

**BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS**

**AT A HEARING ENTITLED
“CFIUS REFORM: EXAMINING THE ESSENTIAL ELEMENTS”**

JANUARY 18, 2018

Introduction

The Rail Security Alliance (RSA), a collaborative of American freight rail manufacturers, suppliers and other interests, appreciates the opportunity to submit a statement for the record to the Senate Committee on Banking, Housing, and Urban Affairs to highlight the urgent need for reforms to the Committee on Foreign Investment in the United States (CFIUS). As the Committee is aware, CFIUS has long served as an important tool for protecting U.S. national security interests from being compromised by foreign investments. However, the evolution of digital technologies, increased use of murky financing by foreign investors, and a changing international landscape since the last CFIUS update in 2007, among other things, suggest that the CFIUS is very much in need of an overhaul, as it is often ill-equipped to deal with these new risks to economic and national security.

Chinese state-owned enterprises have particularly, and troublingly, exploited these gaps in the CFIUS process to strategically entrench Chinese government-owned firms in the American freight rail manufacturing sector among other industries across the United States. Allowing China to continue to target and do harm to the stability of U.S. freight rail manufacturing not only threatens roughly 65,000 American jobs,¹ but also has the potential to severely compromise our economic and national security.

Freight rail is a core component of U.S. critical infrastructure, according to the Department of Homeland Security.² With nearly 140,000 miles of railroad covering the United States, freight rail regularly transports sensitive materials such as oil and nuclear waste that are integral to American defense and economic infrastructure. Yet freight manufacturing, which offers Chinese interests an opportunity to offload excess capacity of both freight supplies as well as steel and other raw materials, has increasingly drawn Chinese government investment activity in the United States. Today, Chinese state-owned interests are using circuitous and anti-competitive tactics to build freight rail manufacturing capabilities in the U.S. market that are undermining U.S. industry and raising dire concerns about the national and economic security of the United States. Despite the intent of Congress when it first established CFIUS over 40 years ago, the CFIUS process as we know it is not equipped to address these urgent challenges.

As Congress examines possible reforms to CFIUS to address these gaps, we ask the Committee to consider these critical facts:

- China is strategically targeting the U.S. freight rail manufacturing sector, first with aggressive and anticompetitive early moves into U.S. transit rail that have nabbed four

¹ Oxford Economics, *Will We Derail US Freight Rolling Stock Production?*, May 2017, at 5.

² Department of Homeland Security, *Transportation Systems Sector Overview*, July 6, 2017. <https://www.dhs.gov/transportation-systems-sector>

U.S. metropolitan transit contracts thus far, largely through anticompetitive underbidding practices.

- With China's government picking up U.S. transit rail contracts, Chinese state-owned enterprises are now using their rail manufacturing capabilities to take on the U.S. freight manufacturing sector.
- This activity is a pattern for China's state-owned rail sector: Over the last nine years, it has systematically wiped out the entire freight rail manufacturing capability in Australia. Without proper government oversight, the same thing could all-too-easily occur in the U.S. market.
- The upshot of such a catastrophe would be felt not only by the U.S. manufacturing sector: Forcing America's industrial, military, and other government interests to rely significantly or wholly on Chinese government-made freight rail cars raises grave security concerns.
- CFIUS has thus far failed to recognize these concerns or been able to address the implications of having the Chinese government closely involved in a core sector of our nation's infrastructure.
- According to the National Security Council, the Chinese are targeting 13 additional industries aside from freight rail across the United States where primary motivation is market share and profit-making comes second, if at all.

China's CRRC Targets U.S. Rail Manufacturing

The "Made in China 2025" initiative, a key component of China's 13th Five-Year plan,³ identifies the rail manufacturing sector as a top target for Chinese expansion and has driven strategic investment and financing activities of the China Railroad Rolling Stock Corporation (CRRC) in third-country markets and the United States. CRRC is wholly owned by the Government of China and it has 90 percent of China's domestic market for production of rail locomotives, bullet trains, passenger trains and metro vehicles.⁴ In 2015, CRRC reported revenues of more than \$37 billion⁴ — significantly outpacing the entire U.S. railcar market, which had \$22 billion of output during the same year.⁵ According to Chinese state media, CRRC

³ U.S.-China Economic and Security Review Commission, *2016 Report to Congress*, November 2016, at 100. ⁴ Langi Chiang, *China's largest train maker CRRC Corp announces 12.2 billion yuan in contracts*, South China Morning REPORT, July 23, 2015.

⁴ Macquarie Research, *CRRC Corp Ltd: Too big to roll too fast*, May 20, 2016, at 3.

⁵ Oxford Economics, *Will We Derail US Freight Rolling Stock Production?*, May 2017, at 24.

plans to increase overseas sales to \$15 billion by 2020, about double the level of export orders in 2014,⁶ and the U.S. market is a prime target.

Since 2015, we have witnessed CRRC establish rail assembly operations in three states, along with additional research and bidding operations in three others. By beginning with a business strategy to take market share in the U.S. transit rail manufacturing sector and deploying near-limitless financing from its home government to help lower the below-market bids for new U.S. metropolitan transit projects, CRRC has quickly established itself as an unbeatable force in U.S. transit rail competition.

Several recent cases involving CRRC bids for new transit rail projects serve as compelling examples:

- CRRC bid \$567 million – roughly half the next highest bid (from Bombardier, a company with a longstanding U.S. manufacturing workforce and footprint) – to win the contract with the MBTA in Boston in 2014.⁷ The initial order of fully-built, in China, CRRC railcars were delivered to Boston late last year.
- In 2016, CRRC won a contract to provide transit rail for the Chicago's CTA, bidding \$226 million less than the next-highest bidder.^{8,9}
- In early 2017, CRRC bid \$137.5 million for a contract with SEPTA in Philadelphia, underbidding the next-largest bidder by \$34 million.¹⁰
- In March 2017, CRRC finalized a contract with the Los Angeles County Metropolitan Transportation Authority for its transit rail system that could be worth up to \$647 million,¹¹ reportedly leveraging below-market financing to enable them to undercut other bidders.

Faced with the outcomes of these anticompetitive tactics, transit rail manufacturers in the U.S. market are feeling the pinch and many have already begun to downsize U.S. manufacturing

⁶ Brenda Goh, *China Trainmaker CRRC to build more plants abroad in expansion plan: China Daily*, REUTERS, Dec. 5, 2016, <http://www.reuters.com/article/us-crrc-expansion-idUSKBN13U0EJ>.

⁷ Bonnie Cao, *After Winning MBTA Contract, China Trainmaker CRRC Plans American Expansion*, Boston Globe, Sept. 11, 2015. <https://www.bostonglobe.com/business/2015/09/11/after-winning-mbta-contract-china-trainmaker-crrc-plans-american-expansion/jnS1kU7uHWFG9gjWmDEjM/story.html>

⁸ Corilyn Shropshire, *First Step to New CTA Rail Cars: Build the Factory in Chicago*, Chicago Tribune, Mar. 16, 2017. <http://www.chicagotribune.com/business/ct-cta-new-railcar-plant-0316-biz-20170315-story.html>

⁹ Jason Laughlin, *Mass.-Based Company with Chinese Backing Beats Local Group for SEPTA Car Contract*, The Philadelphia Inquirer, Mar. 21, 2017. <http://www.philly.com/philly/business/transportation/Mass-based-company-with-Chinese-backing-beats-out-local-group-for-SEPTA-car-contract.html>

¹¹ Keith Barrow, *Los Angeles Orders CRRC Metro Cars*, International Railway Journal, Mar. 24, 2017. <http://www.railjournal.com/index.php/north-america/los-angeles-orders-crrc-metro-cars.html>

facilities and workforces,¹²¹³ with the prospects of more workforce reductions to come. Anticipating the opportunity to unseat other manufacturers here and take advantage of the opportunity that these U.S. job reductions are likely to create, CRRC most recently announced that it is developing a 204,000-square foot plant in Springfield, Massachusetts, where it will assemble railcar components shipped from China to the United States.¹⁴

The dangers to allowing CRRC's anticompetitive actions are evident in Australia, whose rail manufacturing sector CRRC entered in 2008. In less than 10 years, CRRC effectively decimated the sector, undoing the other four manufacturers in that country, which left only CRRC standing.¹⁵ CRRC leveraged financing from its own government to help customers acquire its product at costs well below the market. Today, almost no meaningful Australian freight rolling stock manufacturing exists¹⁶ – CRRC's Australia footprint is almost exclusively that of an assembler of Chinese-made parts and a financier of purchases from CRRC.

CRRC: A Case Study for CFIUS Reform

In 2016, CRRC announced a joint venture with Majestic Legend Holdings Limited and Vertex Rail Technology to create a new railcar manufacturing enterprise, Vertex Rail Corporation. This initial formation appeared to be structured as a greenfield investment, avoiding a CFIUS review, though this is mostly optical, as the company is effectively a way to enable the Chinese government investment in a subsidiary of Vertex Rail Technology. Public reports from Vertex's general counsel indicated that ownership would transfer once the company produced several hundred freight cars. Due to this alarming investment by the Chinese government, 55 Members of the House and 42 Senators raised concerns about this transaction and urged CFIUS to investigate.¹⁷ Nevertheless, Vertex announced in late 2016 that CFIUS would allow the deal to move forward. Given CRRC's existing stronghold in U.S. transit rail, the Vertex deal now provides CRRC with the opportunity to rapidly expand into the freight rail sector where additional national security risks come into play.

Implications for National Security

Unlike the U.S. maritime shipping industry, whose security is protected by the 100-year-old Jones Act – a measure that requires vessels transporting goods between U.S. ports to be U.S. built and majority U.S.-owned – freight rail in America has been left comparatively unprotected.

¹² See *UPDATE: GE closing 3 former Alstom plants in Chattanooga*, WRCB, June 21,

¹³ <http://www.wrcbtv.com/story/32156061/update-ge-closing-3-former-alstom-plants-in-chattanooga>; *GE making layoffs at Salem plant*, WDBJ7, Mar. 24, 2017, <http://www.wdbj7.com/content/news/GE-making-layoffs-at-Salemplant-417044683.html>.

¹⁴ Jim Kinney, *CRRC MA Springfield plant has deal to build subway cars for Los Angeles*, MASSLIVE, Dec. 22, 2016, http://www.masslive.com/business-news/index.ssf/2016/12/crrc_plans_final_assembly_of_los_angeles.html.

¹⁵ *Id.*

¹⁶ *Id.* at 15-16.

¹⁷ Brandon Wissbaum, *Congress members call for investigation into Vertex's ties with Chinese corporations*, WECT, July 29, 2016. <http://www.wect.com/story/32574814/congress-members-call-for-investigation-into-vertexs-ties-with-chinese-corporations>

Yet the Department of Homeland Security (DHS) deems the U.S. rail sector as part of the nation's critical infrastructure,¹⁸ noting that 140,000 rail miles enable U.S. freight rail to run through every major American city and every military base in the nation. Freight rail transports not only military freight and industrial products, but also nuclear material and hazardous chemicals that can be safely and effectively transported only by rail. There are very real concerns, DHS has noted, about freight rail vulnerability, including through cyber-attack. As DHS reported in 2010:

With the merger of information system technology and transportation infrastructure, railroad operations have become increasingly reliant on information systems and communications technologies. Rail companies have made growing use of onboard-computers, local area networks, automated equipment identifiers, global positioning system (GPS) tracking, automatic reporting of work orders to headquarters, car scheduling and train order systems, and two-way wireless communications. . . . Nearly all . . . rail cars are tagged with automatic identification transponders, which automatically record and report car location as it passes a wayside detector. . . . The railroad's growing dependence on these centralized monitoring and control systems, including Centralized Traffic Control networks, prompts concerns of possible cyber-attacks upon these systems.¹⁹

That assessment, written seven years ago, did not account for substantially more complex digital capabilities that have since evolved, or are in development, for U.S. freight rail cars and freight train operations. Yet, the assessment underscores the clear danger of a foreign country, and particularly the government of China and its state-owned enterprises, having undue control of freight manufacturing in the U.S. market.

Already, there are reports of Chinese manufacturers investigating the production of their own “telematics” technology to allow the monitoring and control of their freight cars.²⁰ Needless to say, as China's CRRC becomes more dominant as a U.S. rail manufacturer, there are urgent questions we must answer regarding whether a growing presence of – and reliance on – freight cars from the major state-owned Chinese rail enterprise could compromise the security and safety of industrial, military, and other U.S. freight shipments.

¹⁸ Presidential Policy Directive 21 (PPD-21) identifies 16 critical infrastructure sectors, including “Transportation Systems.” The Department of Homeland Security defines “Freight Rail” as one of the seven key subsectors. *See generally*, PPD-21, *Critical Infrastructure Security and Resilience*, Feb. 12, 2013, <https://www.whitehouse.gov/the-press-office/2013/02/12/presidential-policy-directive-critical-infrastructure-security-and-resil> and *Transportation Systems Sector*, Dep't of Homeland Sec., Mar. 25, 2013, <http://www.dhs.gov/transportation-systems-sector>.

¹⁹ Department of Homeland Security, *Transportation Systems Sector-Specific Plan: An Annex to the National Infrastructure Protection Plan* (2010), at 285.

²⁰ *China plans 'smart trains' to take on global rail companies*, CHINA DAILY, March 10, 2016, http://english.chinamil.com.cn/news-channels/2016-03/10/content_6952271_2.htm.

Recommendations

This hearing is an important step to amending CFIUS to enable the U.S. Government to tackle this pressing challenge. As Congress debates this issue, we recommend the following updates be made to CFIUS:

- Expand the Committee’s jurisdiction to cover greenfield investments where an investor is a foreign sovereign, state owned enterprise or is financed by such a party.
- Expanded definition of “control by a foreign government” to include the access of the buyer to below-market loans and other financing directly or indirectly from government sources.
- Systematically increased scrutiny of investments from certain countries, like China, that pose a significant threat to the United States or have demonstrated a strategic goal of investing in U.S. manufacturing or critical infrastructure sectors.
- Expand existing factors of consideration in the CFIUS process to include patterns of investment and their potential long-term effects on market share in a critical infrastructure sector.
- Ensure mandatory reviews of foreign investments by a state-owned enterprise in any U.S. critical infrastructure sector.

Conclusion

We appreciate the Committee’s interest in addressing these issues. The strategic targeting of our nation’s infrastructure by the government of China and its state-owned enterprises poses a fundamental threat not only to the economic and security of the United States, but to our country’s standing as a global power. Addressing these concerns will not follow any single solution, but we believe reforms to the CFIUS process are an essential part of protecting U.S. infrastructure from being compromised by foreign influence. To that end, we support efforts being led by Senator Cornyn to pursue needed changes to the CFIUS law, as well as other similar efforts to bolster the Administration’s ability to track and protect U.S. economic interests relative to investment activity by SOEs in the rail manufacturing sector.

Thank you again for the opportunity to submit testimony and the members of RSA look forward to hearing the solutions put forward by Congress to address these threats.

Respectfully submitted,



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