# NINTH ROUNDTABLE ON FREEDOM OF INVESTMENT, NATIONAL SECURITY AND "STRATEGIC" INDUSTRIES

*Paris, France – 17 December 2008*

## Summary of the discussions by the Secretariat

1. The 'Freedom of Investment, National Security and 'Strategic Industries'" (FOI) project provides a forum for discussing how governments can reconcile their duty to safeguard essential security interests of their people with the need to protect and expand an open international investment system. This note summarises the views and information contributed by both OECD and non-OECD participants in the Ninth Roundtable held under the FOI project. In addition to OECD members and the eleven non-member adherents to the OECD investment instruments, the Roundtable benefitted from the participation of representatives from Russia, South Africa, and the China Investment Corporation (one of China's sovereign wealth funds).

2. This meeting took place during a period when governments were very much focused on managing the economic and financial crisis. Noting that investment supports both growth and structural adjustment, Roundtable participants reaffirmed the importance of maintaining and strengthening freedom of investment in the face of the crisis.

### *Tour d'horizon* of recent developments

3. The *Tour d'horizon* is a permanent feature of FOI Roundtables. It provides an opportunity for Roundtable participants to monitor, share information and express views and recommendations on recent investment policy developments. Discussions at the ninth Roundtable covered developments in 5 countries: France, Italy, Germany, United States and New Zealand:

> **France** was asked by the FOI Roundtable participants to explain how its "Strategic Investment Fund" (hereafter, the Fund) fits with the commitments to non-discrimination it makes under the OECD investment instruments. In November 2008, France established the Strategic Investment Fund as a corporate holder of publicly-owned shares in French private companies. The fund will aim to support the growth needs of strategic companies so that they are able to develop and will aim to stabilise the capital of strategic companies that have capacities, technologies, and jobs precious for the economy. The state and the Caisse des Depots et Consignations (CDC) own 49 per cent and 51 per cent, respectively, of the fund. Each will contribute liquidity worth 3 billion

euros and shares worth 7 billion euros. France noted that the fund's corporate structure ("societe anonyme" or S.A.) allows it independent decision-making, and that the fund is open to other investors, including private investors, and foreign investors (although CDC will remain majority owner). The fund's corporate purpose is to be a profit-seeking equity investor with a long term perspective. In principle, the fund will take minority positions and will be free to alter its positions. France explained that, since the fund's statutes have not yet been published, not all of its seven-member Board have been named, and its investment strategy has not been determined, it is too early to address the investment practice of the fund. Asked whether the fund's first purchases from non-resident investors could create the impression that state pressure would be used to buy-out such investors on disadvantageous terms, France stated its intention that both the form and the operation of the fund will be in line with the principle of non-discrimination.

**Germany:** FOI Roundtable participants resumed their consideration[1] of Germany's draft amendment to the Foreign Trade and Payments Act, which is expected to supplement Germany's current "essential security" reviews of foreign investments. Germany reported that the *Bundesrat* (upper house of Parliament) is now reviewing the draft (available in German at http://www.bmwi.de/BMWi/Navigation/Service/gesetze,did=223394.html). The draft law extends the existing investment review procedures to any investment of more than 25 per cent of a German company (irrespective of its sector) if it jeopardizes public order or security. In contrast, the current law and regulations provide for reviews only of greater-than-25-per-cent investments in certain military goods and cryptographic equipment. The following points were made during the discussions:

- *Review procedures*. Germany described the review procedure that would be created by the draft law as a "lean procedure". No notification or registration is required. The Ministry of Economics has three months' time in which to initiate a review (starting from the time the investor formalises its intent to acquire a company[2]). If the three months pass, the Ministry of Economics can no longer initiate a review. If the Ministry decides to initiate a review, it will contact the company, and the company is required to submit information. The Ministry may "subject the acquisition to certain conditions or order a prohibition within two months of receipt of the information." If it "does not take any action within this period of time, the acquisition may not be examined thereafter." In order to enhance transparency and predictability, the draft law allows investors to apply for a "certificate of non-objection" from the Ministry of Economics. The certificate confirms that the investment does not endanger public order or security and the Ministry may not initiate a review once it has issued a certificate. Germany indicated that the 25 per cent ownership threshold for reviews is deliberately identical to that used for the blocking minority as regulated in Germany's stock company law (*Aktiengesetz*). Under the draft law, the Ministry of Economics will consult other Ministries concerned, for advice within their competency, so as to assure that the reviews benefit from appropriate expertise; a prohibition of an investment is subject to the prior consent of the Federal Government which makes clear the exceptional nature of a prohibition.

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1 Germany's draft law has been discussed at earlier FOI Roundtables. See, for example, the Summary of the Tour d'horizon at the eighth FOI Roundtable available at: www.oecd.org/dataoecd/14/5/41675491.pdf

2 Germany described this three month limit in more detail as follows: The Federal Ministry of Economics "may decide to initiate a review of the investment within three months of the signature of the purchase contract or the publication of the decision to make the public offer or of the fact that control of the company has been attained."

- *EU-based companies controlled by non-EU owners*. Many Roundtable participants were concerned about provisions in the draft law that provide for reviews of EU-based companies that are controlled by non-EU owners (with a 25 per cent ownership threshold for non-EU control). Germany responds that "an examination is subject to indications that the EU company is used as a vehicle to circumvent a possible examination." Germany also cites ECJ jurisprudence in saying that, typically, this would apply to corporations (e.g. "shell corporations") which do not have "regular business activities in the European Union." The European Commission indicated that, in light of the EC Treaty's guarantee of freedom of establishment, any measures that do not treat all EU companies the same are conditioned and strictly limited by legal principles such as proportionality, as demonstrated by the ECJ's jurisprudence. The legislation, if passed, will be reviewed by the European Commission. Germany indicated that any concerns raised would be addressed.

- *Consistency with international obligations*. Germany explained that draft law allows, in accordance with article 3 of each of the OECD Codes of Liberalisation, for restriction or prohibition of investments only if the investment "threatens German's public order or security. A genuine and sufficiently serious threat affecting one of the fundamental interests of society must exist." The draft legislation refers explicitly to the EC Treaty and the case law of the European Court of Justice (ECJ). Germany also noted that ECJ jurisprudence makes clear that a public order or security threat excludes "economic security or industrial policy." Germany was asked by Roundtable participants if selecting a narrow definition of security concerns and providing a more precise definition of these concerns would not better serve its policy stance of welcoming investments and enhance the predictability of its review procedure.

**Italy** was asked by FOI Roundtable participants to explain reports that it plans to assess sovereign wealth fund or other foreign investments. Italy explained that it has established a "Strategic Committee for the National Economic Interest" as a consultative body to Parliament. The Committee is made up of advisers from Ministries of Foreign Affairs and Treasury, who will jointly examine and advise on specific foreign investors and investments into Italy. The Committee has no power to block any foreign investment nor is any law foreseen to create such an authority. The Committee is tasked to consider the national interest in terms of economic interest, and to favour and recommend certain principles such as transparency. For example, the Committee will recommend that foreign government-controlled investors use the new Santiago Principles (adopted by the International Working Group of Sovereign Wealth Funds) as their guide. Italy noted that currently there is no ownership threshold for the Committee's examination and that the creation of this advisory group does not alter Italy's long standing policy of welcoming foreign investment, particularly given its recent commitments in the G20 statement. In relation to the investments of sovereign wealth funds, the government may draw up its own principles – especially on transparency – that it could recommend to those who invest in Italy, to be taken up on a voluntary basis.

The **United States** was asked to explain the approach of its amended regulations and guidance for "national security" screening foreign investment, in relation to the OECD *Guidelines for Recipient Country Policies Relating to National Security*.[3] The Treasury Department, as Chair of CFIUS, recently issued the regulations and guidance. The guidance indicates types of transactions that CFIUS has reviewed and that have presented national security considerations. The guidance: 1) explains the relevance of national security considerations in the context of CFIUS reviews; 2) illustrates the types of transactions that have presented national security

3 See www.oecd.org/daf/investment/foi.

considerations; and 3) clarifies the purpose of the guidance. (The regulations and guidance can be found at http://www.treas.gov/offices/international-affairs/cfius/.) Roundtable participants expressed concerns about the lack of clear definitions (e.g. of control) and wondered if CFIUS procedures could not be made more predictable, to make it easier for investors to know if they fall under the rules or not. The United States acknowledged that the CFIUS process is trading off some predictability for what is considered a more precise identification of security risks (by avoiding fixed percent-ownership thresholds or other "bright line" tests). The United States called the CFIUS process a deliberately fact-specific process, noting that only when it is determined that 1) a clear national security risk exists, and 2) no legal authority exists to address the risk under other law, will CFIUS take action. In response to a question about the role of the Department of Labour in the CFIUS process, the United States answered, quoting legislation, that the "role is limited to 'identify[ing] for the Committee any risk mitigation provisions proposed to or by the Committee that would violate US employment laws.'" Asked whether there is an intensification of the review process, the United States stated that, under the new rules, the level of scrutiny has not increased, but there has been an increase in filings (not necessarily due to the new rules).

**New Zealand** was asked to explain more fully its approach in investment reviews for essential security, in light of its commitment to non-discrimination. It described its review procedure under the Overseas Investment Act 2005 and its implementing regulations, a recent modification to the regulations, and a decision prohibiting a proposed investment taken on the basis of the modified regulations. New Zealand screening of investments in "sensitive" assets ("significant business assets," "sensitive land" and fishing quota) does not amount to a prohibition on investment in any identified sectors. New Zealand recently made a change to the Overseas Investment Regulations 2005 that allows Ministers to consider control of "strategic infrastructure assets" as a factor in an assessment of whether an investment in sensitive New Zealand land will, or is likely to, benefit New Zealand (strategic infrastructure assets have not been defined). The recent change did not change the scope of investments that are screened; it expanded the number of factors that the relevant Ministers may consider in determining whether an investment in sensitive land will, or is likely to, benefit New Zealand. This new factor notably only applies to investments in sensitive land (not to investment in significant business assets or fisheries quota). In one case, a decision was taken to prohibit a proposed investment in sensitive land, based on the Ministers' assessment that the investment could not benefit New Zealand, on the basis of any of the applicable criteria.

**Multiple Approval Processes: Practical difficulties of co-ordinating among government agencies to achieve the least restrictive investment environment**

4. Two lawyers, who in their practice help companies deal with regulatory procedures, described the experience of a foreign investor seeking approval for an investment from an OECD Member country's investment review authority while simultaneously complying with other regulatory requirements. In this story, a friendly takeover was completed successfully, in compliance with multiple rules. It illustrated how cumulative approval processes may impose important delays and conflicting information requirements on investors.

5. The situation involved two laws. One, Germany's Foreign Trade and Payments Act (*AWG*) authorises the Ministry of Economics to review certain investment proposals that may raise security concerns, and, if necessary, to reverse an acquisition. (The Ministry has up to eight weeks after reception of complete documentation to make its decision.) The second, Germany's Securities Acquisition and Takeover law (*WpÜG)*, sets a strict timetable (8 weeks) from public offer to purchase and requires confidentiality (it does not provide an explicit exception to allow a company to simultaneously undergo the *AWG* review). The lawyers' experience suggests that the two timetables do not fit comfortably with each

other. Regardless of how unacceptable is the risk of reversing the takeover (with consequences for the share prices of the buyer and target companies), the purchaser may not obtain security clearance before its first share purchases: the confidentiality requirement prevents earlier security clearance because securities authorities cannot authorise an applicant to make purchase information available to other regulatory processes.

6. The only way to assure compliance with both laws in a timely manner was to negotiate a "mitigation contract" with the Ministry of Economics. This contract committed the company to managing its acquisition in a particular way, but did not require it to divulge information in possible contravention of German securities law. While the lawyers believe the *AWG* and *WpÜG* should be harmonized to allow an earlier review by the Ministry of Economics so that a mitigation contract is not necessary, they concluded that the option of negotiating such a contract, and their collaboration with Germany's Ministry, achieved a satisfactory outcome.

7. The possibility of earlier security clearance (in a confidential procedure) would have avoided three problems. First, an unfavourable balance of risks: if the early deal assessment had properly included some estimation for the regulatory risk due to an unfinished security screening period, would the purchaser have chosen to invest? Second, interference with share values: hedge fund inquiries at a late stage of the takeover--while the purchaser still awaited security clearance-- suggest that marketplace speculation as to its outcome may have influenced the share price of the target company. Third, legal review: in practice, legal review was unavailable, due to the short window for action.

8. The speakers concluded that "getting to know each other" and early communication were keys for a successful relationship with regulators, which allows difficulties with multiple procedures to be overcome. These views were echoed by other Roundtable participants: a representative of a sovereign wealth fund reiterated the importance of speed and predictability. This investor noted that nearly-identical regulatory risks had arisen during its purchase in another country. Asked about regulatory coordination in a federal system (presenting several levels of regulation), the United States agreed that interference among different procedures is possible. There is no one agency overseeing the others. Participants generally agreed that this issue should continue to be given adequate attention as part of the assessment and monitoring of national security investment measures under the Freedom of Investment process.

**Foreign government-controlled investment**

9. The ninth FOI Roundtable continued discussions of foreign government-controlled investors (started at the Roundtable VIII). Roundtable participants welcomed presentations from two other OECD bodies: the Competition Committee and on the Working Group on Privatisation and Corporate Governance of State-Owned Assets. Participants also discussed possible future work in this area. These discussions are summarised below:

***Competition Policy perspectives on foreign government controlled investors***

10. The Secretariat of the OECD Competition Policy Committee described a competition policy perspective on investments by foreign government-controlled investors. The presentation began with the observation that, for competition authorities, "government ownership can matter": it might strengthen a company's capacity to act anti-competitively because direct or indirect government control may weaken market pressures (e.g. through regulatory arrangements) or may shield it from the full force of competition law enforcement (for example, because domestic law provides foreign sovereign immunity).

11. On the other hand, whether a company is foreign or domestic matters little to competition authorities, except inasmuch as it raises issues of jurisdiction. Most OECD countries require, when

asserting anti-trust jurisdiction, that illegal conduct has some anti-competitive effect within the country (the "effects doctrine"). Furthermore, international cooperation among competition authorities helps them to deal with situations where transactions have competition effects in multiple jurisdictions. This is increasingly common: markets and companies are often global, but competition authorities' enforcement powers are generally limited to their respective jurisdictions. Competition authorities deal with this in two ways: 1) through parallel enforcement of competition rules; and 2) through bilateral and multilateral agreements aimed at facilitating mutual legal assistance.

12. Direct investments, by domestic or foreign actors, that take the form of mergers and acquisitions are the transactions most likely to be subject to review by competition authorities. Concerns could arise if the transactions change the nature of competition in such a way that firms will be significantly more likely to coordinate to raise prices, to lower product quality or to stifle innovation. Mergers and acquisitions by foreign government-controlled investors are, like their domestic counterparts, routinely subject to anti-trust review. Should concerns be identified, the competition authority can block transactions unless the parties can offer sufficient remedies to address the concerns.

13. Foreign government investors can assume a variety of legal forms: state-owned enterprises, pension funds or other government-controlled entities such as sovereign wealth funds. The exact nature of a foreign government-controlled investor, its public policy mission and its links with its government are characteristics of interest to competition officials, both for their impact on competition and for determining the entity's status with respect to enforcement actions. These characteristics will interact in complex ways to determine which competition enforcement actions, if any, should be taken. How competition law principles apply according to the legal status of different types of government-controlled investors is an issue that could benefit from further analysis.

14. The presentation ended by noting that the competition community, in this period of crisis, faces political pressure to soften enforcement of anti-trust rules. This mirrors protectionist pressures from domestic constituencies that may influence investment policy decisions. The OECD Competition Committee has recognised the benefits of foreign investments, including those of government-controlled entities. A favourable environment for foreign investments, regardless of their ownership, has beneficial effects on the entire economy and on consumers. Thus, the competition and investment policy communities share certain policy objectives – to resist protectionist and anti-competitive pressures and to safeguard the interests of key constituencies such as consumers and citizens. There may even be scope for cooperation between the two communities. For example, if investment policies permit restrictions that may have an impact on competition, but on grounds other than competition (e.g. national security), then it would make sense to design procedures that foresee a role for competition experts to participate in deliberations for such decisions so as to help to assess and highlight the costs of such policies for competition.

15. Roundtable participants agreed that the Investment Committee Chair should send a letter to the Chair of the Competition Committee expressing the Roundtable's interest in cooperation in exploring the treatment of foreign government-controlled investment under competition law and practices.

***Upcoming work of the OECD Working Group on Privatization and Corporate Governance of State-owned Assets***

16. The Secretariat of the OECD Working Group on Privatisation and Corporate Governance of State-Owned Assets, described its project on "state-owned enterprises and the world economy". In three parts, this project includes: 1) fact-finding to create a typology and collect data (a stand-alone review of Brazil may contribute to the data); 2) analysis of consequences (particularly focusing on the interface with regulatory agents); and 3) if it is deemed useful, possible further development of norms. The *OECD*

*Guidelines for the Corporate Governance of State-Owned Enterprises* (henceforth, SOE Guidelines), at the time they were drafted, did not consider foreign operations of state owned enterprises.

17. Recognising the potential relevance of this work for the Roundtable, the Working Group proposes to prepare an analysis of the management of the foreign investments of SOEs based on the *Guidelines for the Corporate Governance of State-Owned Enterprises*. The analysis would explore how the SOE Guidelines might be used as a governance and transparency norm in order to enhance the performance of the SOE investor and to reassure recipient countries. The Roundtable participants welcomed the proposal.

**FOI Roundtables and the Heiligendamm Dialogue Process (HDP)**

18. The Chair invited the co-chairs of the HDP Investment Working Group to report on the progress in their work, noting that HDP participants are systematically invited to the FOI Roundtable, so there is significant overlap and potential for synergy. Mexico and the United States reported that, for at least the investment theme, the HDP has proven to be a useful forum, particularly because of the informality and frankness of the exchanges among the participating countries. The HDP meetings are not negotiating sessions; rather they allow participants to discuss issues and to identify "common ground" in the investment policy field. Commitment to transparent and open investment policies is one area where such common ground has been found. Others are the value of investment agreements including protection of investor rights, and the importance of policy flexibility for governments to regulate in the public interest, including for the pursuit of development objectives. Importantly, HDP participants agreed that these three "objectives" need not be in conflict.

19. Furthermore, HDP participants agree that responsible business conduct (RBC) and corporate social responsibility (CSR) support and reinforce open investment policies, though some expressed concern that they might serve as an informal barrier to investment and trade. They agree that existing international standards for RBC and CSR should be further promoted; and see little need for setting new standards. While recognizing that different countries will have different priorities, HDP participants discussed the need for existing international standards to be used by businesses as a basis to develop sector-specific standards, and by government, for supportive public policy. Discussions also covered barriers to foreign investment, the role of foreign direct investment in economic growth, creating jobs, spurring innovation and productivity, and enhancing national competitiveness.

20. With respect to next steps, discussion of the above topics will continue, and the impact of the financial crisis will be examined. The co-chairs expect that the HDP Investment Working Group will develop shared messages in the following areas:

- international investment as a motor for global growth and development, so freedom of investment must be preserved, especially in times of crisis;
- assuring, within the framework of international investment agreements, governments' ability to regulate in the public interest and to pursue national development objectives;
- improving the coherence among existing investment agreements;
- reinforcing CSR/RBC as a necessary complement to freedom of investment, supporting business' efforts to adapt (especially to particular sectors) and use existing CSR/RBC international standards as well as guiding governments in designing public policy in this domain.