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

Paris, France – 26 March 2009

Summary of Roundtable discussions by the OECD Secretariat

1. The 'Freedom of Investment, National Security and 'Strategic Industries'" project provides an inter-governmental forum for protecting and expanding an open international investment environment while also addressing other legitimate needs and concerns that recipient countries might have. Since 2006, the main focus of these concerns has been security-related investment measures. More recently, Roundtable participants have identified the implications for investment policy of measures taken to respond to the global crisis as being an additional source of concern. Monitoring of policy measures of both OECD and non-OECD Participants contributes to observance of international investment commitments, including those taken in the context of the G20.

2. This note summarises the views and information contributed by Participants in the Tenth Roundtable held under the Freedom of Investment project. In addition to OECD members and Brazil and other ten non-member adherents to the OECD investment instruments, the Roundtable benefitted from the participation of representatives from India, Russia, South Africa, the International Monetary Fund (IMF), and the United Nations Conference on Trade and Development (UNCTAD).

Tour d'horizon of recent developments

3. The *Tour d'horizon* is a monitoring function and a permanent feature of Freedom of Investment 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 tenth Roundtable covered developments in four countries: Australia, Canada, India, and the United States:

- **Australia** was asked to explain the government's recent proposal to modify the existing foreign investment screening regime, including a proposal to bring non-equity "investments" under review, in light of commitments to keeping markets open. (The announcements by government coincided with a company's plan to exchange foreign cash for a minority equity stake plus a larger stake of convertible notes). Australia explained that the government seeks Parliament's passage of two kinds of amendments to the *Foreign Acquisitions and Takeovers Act 1975* and its regulations:

-First, Australia will liberalise opportunities for foreign investment in residential real estate,[1] with some adjustments to the screening in this area (developers will no longer have to limit sales to foreign investors to 50 % of any development; temporary residents purchasing a residence will no longer need to notify; and compliance costs are expected to decline).

-Second, Australia will clarify the operation of its screening regime through proposed amendments to the *Foreign Acquisitions and Takeovers Act 1975*, with the aim of ensuring that the Act works as intended by addressing "compliance issues" and closing "avenues for avoidance." The challenge will be to ensure that the amended Act captures foreign investment through the use of more complex investment structures that, while not strictly equity, give the investor a degree of influence over the management of the target business. The Press Release issued by the Australian Treasurer states the following:

> *In light of the growing use of more complex investment structures, the Government intends to clarify the operation of the foreign investment screening regime. The Government will amend the Act to ensure that it applies equally to all foreign investments irrespective of the way they are structured. In particular, the amendments will ensure that any investment, including through instruments such as convertible notes, will be treated as equity for the purposes of the Act."*[2]

Although the details of this proposal are still being drafted, Australia explained that the review body is likely to take into account not only equity holdings but also stock options, convertible notes, or other instruments that convey "any ability to influence management of a business, now or in the future." When passed, the amendment will be retroactively effective from the date of the Treasurer's announcement, 12 February 2009.

Australia also described the Australian Senate Economics Committee's inquiry into experience of sovereign wealth funds' and state-owned companies' investments (both in Australia and elsewhere), their role in acquisitions of significant shareholdings of companies, and the impact and outcomes of these acquisitions on business, growth, and competition. Asked if this inquiry or its results would influence the decisions taken in the screening of a planned transaction involving Rio Tinto, a major mining firm, with a partner in China, Australia indicated that no such influence was expected. The conclusions of the Senate Committee inquiry would be general in character; moreover, they are due only after the screening decision will be taken.

- **Canada** reported on recent amendments[3] to the Investment Canada Act which, among other things, will establish a national security review procedure that is to be administered independently from the existing investment review.

-As for the existing review, the amendments will make the basis for the threshold "enterprise value" (it is currently "book value of gross assets"); changes the threshold to CAN 1 billion in gross assets over a four year period (it currently stands at USD 312 million); eliminates the lower review threshold in certain sectors (transportation services, financial services, and uranium

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1 Subsequent to the meeting, this amendment to the regulations was adopted, and is available at http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/0/DCA23A691114D52FCA25758400154E0C?OpenDocument.

2 Quote from Australian Treasurer press release No. 17, February 12, 2009, http://www.treasurer.gov.au/; formatting has been changed relative to the original.

3 The bill is available at http://www2.parl.gc.ca/HousePublications/Publications.aspx?Language-E&Parl=40&Ses=2&Mode=1&Pub=Bill&Doc=C-10_3

production services); requires the Minister to justify decisions to disallow investment; allows disclosure of administrative information on the review process; and requires the publication of an annual report on the operation of the Act. Canada stated that its two assessments (one conducted before and one after the market declines) projected between a 50 and 75 percent decline in the volume of reviews due to the set of amendments. After the details of implementation are worked out, Canada will "lock in" these liberalisation measures by adjusting its reservations and exceptions under the OECD Codes of Liberalisation and the OECD National Treatment Instrument.

-The new National Security review procedure will examine whether a transaction is "injurious to national security" in a two-stage procedure that is to be administered independently from the existing investment review to ensure its focus on national security concerns. In the first stage, if national security threat associated with an investment is identified (primarily by Canada's security and intelligence agencies), and if the Minister of Industry -- after consultation with the Minister of Public Safety and Emergency Preparedness -- considers that the investment could be injurious to national security, the Minister of Industry will refer the question to the Governor in Council (GIC) which will determine whether a review should be ordered. Once ordered, a second stage begins: the Minister of Industry (after consultation with the Minister of Public Safety and Emergency Preparedness) will conduct the review and report to the GIC with recommendations. Then, GIC will have the authority to take any measures in respect of the investment that it considers advisable to protect national security. This may include disallowing the investment, attaching conditions, or ordering divestment. Asked whether "freezing" of a transaction during review was necessary given the possibility to order divestment, Canada explained that it will apply in very few cases (the majority of transactions will be notified after completed). Canada noted that under the general review "freezing" is part of existing practice, and this has not been changed in the present amendments. Asked if the last resort principle[4] could be made explicit, Canada noted that although it is not explicit in the law, it is expected to be the practice, given the operation of numerous other laws and regulations that protect national security.[5] It was noted that the principles from the OECD's *Guidelines on Recipient Country Investment Policies relating to National Security* were used to guide the development of Canada's law. As a result, the highest level authority –Governor in Council -- takes the decision, there are no automatic reviews, the procedure relies on an identification of risks, the time periods will be known to investors and will be fixed, and an investor has a right to judicial review. Asked about government's plans for communication to investors regarding the changes, Canada stated that the government would be looking for opportunities to make these changes known (the changes have retroactive effect to 6 February).

- **India** was asked if it anticipates difficulty in applying a requirement that companies provide the Foreign Investment Promotion Board with details of beneficial ownership (given that the ownership of listed companies can change rapidly). India noted that, with regard to ownership, it has recently modified its approach across the board, by replacing the equity holdings test with a test of "owns and controls." Therefore, India's foreign investment screening will take into account non-equity forms of control, such as the ability to appoint directors. To explain its new

4 The "last resort" principle is used in the *Guidelines for Recipient Country Policies relating to National Security* developed by the FOI Roundtables. It states that restrictive investment measures should only be "used, if at all, when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.

5 For example, the Controlled Goods Programme of the Defense Production Act; Export and Import Permits Act; The Security of Information Act; the Canadian and International Security Certificate Programme; and the Criminal Code.

approach, India has issued simplified guidance on measuring indirect foreign investment.[6] Downstream investment (investment by an Indian subsidiary) is not counted in indirect foreign investment if the upstream company is owned *and controlled* by resident Indian citizens and/or Indian companies that are owned and controlled by resident Indian citizens.[7] Similarly, the screening procedure's threshold exempts companies owned *and controlled* by resident Indian citizens and/or Indian companies that are owned and controlled by resident Indian citizens. In general, India offered to return to this issue at a later Roundtable (or prepare a written reply for later circulation).

- The **United States** was asked to describe experience with mitigation agreements under the Committee on Foreign Investment in the United States (CFIUS) investment review process, including follow up procedures and enforcement. CFIUS has used mitigation agreements in circumstances where "a covered transaction posed genuine national security risks but CFIUS agencies determined that risk could be effectively mitigated through contractual provisions entered into with the parties tailored to address CFIUS' concerns." The US explained that mitigation agreements have been concluded in only a small fraction of cases. Asked the investors' impression of this procedure, the US indicated that was difficult to assess (no measurement has been attempted). It was suggested that long experience, including among those lawyers and others who advise the businesses, help to make such agreements a good option when they make possible an otherwise unacceptable transaction. As evidence of the company's "willingness" in such circumstances, the US recalled one instance of a company volunteering terms that CFIUS determined were unnecessarily restrictive (it is CFIUS that decides). To explain why the agreements are rarely used, the US emphasized that they are tailored to meet national security concerns previously identified, *only where those concerns cannot be adequately addressed by other means*. Prior to initiating a mitigation agreement, the agency requesting the agreement must, in writing, both identify the national security concern and state that it cannot be prevented by operation of existing laws; CFIUS must agree to both contentions. Asked what powers and procedures help CFIUS agencies to monitor compliance, the US identified: site visits, reporting requirements, internal procedures to assure agency review, and audits by private auditors. As for long-term follow-up, the US recalled that some terms in an agreement may automatically terminate (they may be temporary), others may be terminated by a further agreement between the parties as circumstances change. Thus, the need for extended follow up is somewhat limited. Also, it is the agency concerned that must follow up, seldom CFIUS itself. When a mitigation agreement concludes a CFIUS review, the company is said to have a "safe harbour" from CFIUS' reopening of the same review, and CFIUS is no longer involved. Nonetheless, if an investor misrepresents important information, or intentionally and materially breaches a mitigation agreement, CFIUS has authority to reopen a completed CFIUS review. If an investor intentionally or by gross negligence violates a material provision, CFIUS may impose civil penalties. Finally, for other breaches, CFIUS may have remedies under contract law.

4. Participants also discussed commitments to standstill made in the context of the G20, and reiterated the importance of monitoring these commitments.

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6 The press note is available at http://siadipp.nic.in/policy/changes.htm.

7 "Owned and controlled" here means that 50 percent of the company's equity is beneficially owned and a majority of the directors can be appointed by these resident Indian citizens and/or Indian companies that are owned and controlled by resident Indian citizens.

Investment policies and economic crises: lessons from the past

5. Participants discussed the investment implications of the present crisis in light of historical precedents, supported by background material supplied by the Secretariat. The main findings of this review of past crises were as follows:

- *Little sign of outright protectionism toward inward investment.* With the exception of the "beggar-thy-neighbour" tariff escalation and competitive devaluations during the Great Depression, there has been little evidence of outright prohibitions on foreign investment during past crises. Indeed, in crisis situations, governments have tended to place a premium on capital, regardless of its origin. As a result, past crises have sometimes opened up opportunities for foreign investors in national economies, especially in banking but also in other sectors or across the board.

- *Nationalism in crisis response measures.* While policies adversely affecting foreign investors have been rare in previous crisis situations, many emergency measures have raised the possibility of discrimination against foreign-owned firms operating in the local economy. Emergency measures with possible discriminatory effects have included bail outs, subsidies and government spending more broadly, as well as tax, trade and competition policies.

- *Restrictions on outward capital flows.* Crises have often led governments to try to keep domestic capital at home, without usually going so far as to restrict capital outflows. There have also been calls – both from the public and even within government – in the past to restrict outflows in order to preserve jobs at home.

- *Lasting effects of restrictiveness*. The long-term implications of policy measures enacted during a crisis have sometimes been more important than the short-term beneficial effects on the crisis itself.

6. Neither in the past nor at present have many measures been enacted to restrict inward international investment in the domestic economy. Participants agreed that there is nevertheless a risk that measures implemented in response to the crisis could have discriminatory effects. Restrictions could harm not only partner country economies and collective efforts to recover from the crisis but also the economy of the country applying the measures. Pressures to lower outbound flows (and keep jobs at home) are also an area of concern. Broad impacts, including competitive impacts, in other countries could be difficult to address. While noting that, under OECD investment principles, countries have significant "policy space" to enact emergency measures, Participants stressed that these "new" crisis-related forms of discrimination against foreign investors deserve greater attention, including monitoring and evaluation at the Roundtables themselves.

7. They highlighted the value of coordination between countries especially during crises, when the effects of policies and of the economic downturn itself can easily cross borders causing cascading effects elsewhere. In those areas where international commitments provide ample margins for government policy, the need for co-operation was seen as even more urgent because the usual disciplines are not fully applicable.

8. Participants emphasized the value of monitoring in this context. The European Commission recalled its dual mandate to monitor "state aids" as well as investment restrictions, and called for an even greater collaboration with OECD in light of the "special responsibility" to strengthen monitoring in the present crisis. While several countries participate in the G20 cooperation, monitoring of commitments made there is also needed.

9. Participants agreed that the next Freedom of Investment Roundtable will review the investment policy implications of crisis responses. To prepare this, Participants are invited to provide background information to the Secretariat on their crisis response packages in financial services, automotive industry, or across sectors. Participants also agreed that "exit strategies" should be examined.

The terms "public order", "essential security interests" and "national security" in international investment agreements and national policy practice: Proposed OECD Recommendation on Recipient Country Investment Policies Relating to National Security

10. In earlier Roundtables, Participants discussed whether it would be appropriate to apply guidance initially developed for recipient country policies relating to "national security"[8] to investment policies relating to "public order" and "essential security interests". That is, they asked themselves whether these terms have enough in common (shared meaning, shared use in a policy context) that this guidance could be considered equally relevant to them all. At the tenth Roundtable, Participants discussed this problem in greater detail, supported by a background note prepared by the Secretariat. The discussion involved a close examination of the language of the OECD investment instruments[9], and other multilateral and bilateral agreements and related jurisprudence.

11. Although all three terms "public order" "essential security interests" and "national security" evoke general considerations of protecting the security of a country, the safety of its citizens and key aspects of its way of life, their use in different policy contexts was found to be varied. It is particularly useful in this regard to examine the policy uses of the term "public order". The history and use of the term "public order" is highly complex and varied.

- *National legal systems*. It plays diverse roles in national legal systems: it is a term in constitutional law in France, Italy and Switzerland, where it has been subjected to country-specific interpretations through national jurisprudence. In Germany, public order is a fundamental legal concept (separate from, but almost always used in conjunction with "public security") referring to unwritten rules of individual behaviour in the public sphere that are considered indispensible for an orderly life of the people in a community. In the United States, it is most frequently used in criminal law, for example as a label for a category of offenses linked to disorderly behaviour.

- *International law*. The term "public order" has a long history of use in international law. There has been considerable debate in international law circles about the appropriate English language equivalent of the French *ordre public* – recent practice would translate it as "public policy" (its common law equivalent), but some international law texts in English continue to use "public order" or even the French *ordre public*. In addition, this fact-finding study's review of the use of the term in multilateral and bilateral international agreements provides no evidence that the treaties are underpinned by shared definitions of this term. Moreover, international private law principles call for treaty interpretations to refer to national conceptions of "public order", suggesting that the diverse national uses of the term provide the standard for international use in some contexts.

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8 Including the *OECD Guidelines for Recipient Country Investment Policies Relating to National Security* (brochure available at http://www.oecd.org/dataoecd/0/23/41456730.pdf).

9 The OECD Code of Liberalisation of Capital Movements, the OECD Code of Liberalisation of Current Invisible Operations, and OECD Declaration on International Investment and Multinational Enterprises (containing the "national treatment" commitment) are available at www.oecd.org/daf/investment/foi.

12. Appearing in many investment agreements, this term takes on meaning through international jurisprudence as well as through national legal traditions. Participants noted that some uniformity had been achieved among countries that are members of the European Union (for the purposes of investment rules under the European treaties), based on the "public policy" jurisprudence of the European Court of Justice and monitoring by the European Commission. One participant expressed a wish that European Union-type disciplines would inspire other countries to limit the scope of public order/public policy "exceptions." Roundtable participants agreed that there is a need to explore more thoroughly the meaning of "public order," with particular focus on clarifying its meaning in the OECD investment instruments.

13. Participants also raised larger legal issues relating security-related concerns in international investment law. One raised the issue of the role of customary international law in this area as well as the effect of having explicit security-related language in international agreements. Another country highlighted what it viewed as inconsistent results from dispute resolution bodies and the uncertainties that this creates for policy making.

14. Participants agreed to propose to OECD Council to adopt a Recommendation on Recipient Country Investment Policies Relating to National Security. The proposed text integrates in its annex the *Guidelines for Recipient Country Investment Policies Relating to National Security* (adopted in October 2008 at Roundtable VIII), and invites countries that are not OECD members to adhere to the Recommendation. Participants also agreed that a future Freedom of Investment Roundtable will explore whether or not it would be appropriate to apply the existing guidance (as it appears in the proposed OECD Recommendation), or a revised version of this guidance, to measures taken to maintain "public order."

Draft Report to 2009 OECD Ministerial: Building trust and confidence in international investment

15. Participants revised and adopted a Report recording results and conclusions of ten Freedom of Investment Roundtables, to be presented to the June 2009 Ministerial meeting (the "Report") [subsequently published as "Building Trust and Confidence in International Investment" available online at www.oecd.org/daf/investment/foi]. The Report reiterates a broad commitment to open investment policies, as the basis for long term growth, and sets out policy recommendations, including the use of peer reviews and regular monitoring of national policy measures. The Executive Summary of the Report is reproduced in Box 1.

Box 1. Executive Summary - "Building Trust and Confidence in International Investment"

The "Freedom of Investment, National Security and 'Strategic Industries'" (FOI) process helps member and non-member governments to preserve and expand an open environment for international investment while also safeguarding essential security interests and taking action to recover from the current crisis. Discussions under the FOI process have been taking place since 2006 and ten FOI Roundtables have been held involving the 30 OECD members countries and, so far, 17 non-members. The following themes have emerged from these discussions:

No trend toward protectionism, but a need for reinforced vigilance in preserving freedom of investment

Investment protectionism remains a threat, but so far governments have, for the most part, resisted protectionist pressures. Indeed no recent examples have been observed of countries taking deliberate action to erect barriers to inward investment. Nearly all governments continue to welcome inward investment and some have recently taken measures to liberalise their investment policies.

OECD investment principles promote commitments to openness and non-discrimination in recipient

country investment policies and, more generally, to transparent, accountable and effective public policy. The Roundtable participants completed guidance in October 2008 for investment policies addressing national security concerns. This guidance helps governments ensure that their security-related investment measures are effective in achieving their aims and are not disguised protectionism. It urges governments to use restrictive investment measures only as a last resort, when measures of general application are not adequate to address security concerns. If restrictive investment measures are deemed necessary for achieving security-related policy goals, governments should make such policies as non-discriminatory as possible and respect the principles of transparency, proportionality and accountability. Roundtable participants found it encouraging that several countries seem to have followed its guidance for recipient country investment policies relating to national security.

Reiterating commitments to openness and countering new forms of investment protectionism

All "Freedom of Investment" participants reiterated their commitments to open investment policy and noted that the current context creates new challenges for investment policy makers. Many governments have adopted measures to channel public sector investment and subsidies and they often have considerable discretion in their application. Under some programmes, they attach conditions to investment and subsidies that may discourage outward investment. If such measures are not carefully designed, there is a risk of a drift toward discriminatory policies that will ultimately be detrimental to a return to sustainable income and employment growth.

OECD investment principles provide for flexibility as governments shape their responses to economic crises. While acknowledging that governments are currently facing exceptional circumstances and that they may need to take exceptional measures, Roundtable participants also stress the need to ensure that such measures do not unduly impede investment flows or distort competition. Such measures should not be maintained longer than necessary and should be designed from the outset with an "exit strategy" in mind.

Strengthened peer monitoring

Preliminary indications suggest that governments are aware of the risks of "new investment protectionism" and are seeking to deal with the issues it raises (for example, by coordinating responses to the crisis). Roundtable participants have agreed to work toward enhanced peer reviews which would include more complete and readily accessible information on policy measures, supporting analysis on new forms of investment protectionism and deeper involvement of non-members as full partners in the Freedom of Investment process with equal rights and responsibilities as OECD members. Enhanced peer review will bring several benefits:

It will make recent policy measures more transparent and increase pressures on participants to lead by example in protecting "freedom of investment" and respecting their international commitments;

It will allow participating governments to learn from each other's experiences at a time when many governments are actively seeking models for good policy practice.

Governments and businesses working together to enhance public and private responsibility

Roundtable participants call on governments to work hand in hand with business to rebuild trust and confidence in international investment and to ensure that international investors conduct business with integrity and transparency.

Global Forum on International Investment 2009: draft programme

16. The draft preliminary programme for the 7-8 December 2009 *Global Forum on International Investment* (at OECD Headquarters in Paris, France) [10] was discussed and agreed by FOI Roundtable Participants. OECD and UNCTAD will once again co-host the event as they did in 2008.

17. Germany announced a 1-3 December 2009 separate and complementary event: a forum celebrating 50 years since its first bilateral trade agreement (in Frankfurt, Germany). This event is co-hosted with Pakistan, as it celebrates the Germany-Pakistan agreement. It will treat today's policy issues in three thematic areas: the importance of bilateral investment agreements, current substantive and procedural issues, and the changing face of investor-state arbitration.

[10] Information about the event is available at www.oecd.org/investment/gfi-8.