



Negotiating Group on the Multilateral Agreement on Investment (MAI)

Expert Group No.3 on “Special Topics”

PRIVATISATION

(Note by the Chairman)

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I. Introduction

1. As a high standards agreement, the MAI would need to contain binding disciplines on privatisation. Privatisation has become an important element of government structural reforms and budgetary policies in recent years. Foreign investors may bring to this process funds and know-how not available locally. Access to privatisation may also be an important factor for market access¹. The MAI could break new ground and produce "state of the art" provisions on this subject.
2. The decision to privatise should remain, however, the sovereign prerogative of the Contracting Parties. They should also have the possibility to lodge country-specific reservations with respect to non-conforming measures within the parameters proposed by Drafting Group n°1 (Section C of DAFPE/MAI(96)16).

II. Definition

i) Privatisation

3. Privatisation was generally understood to mean the transfer of the partial or complete control of a state activity and related assets to a private investor or investors. Privatisation may concern a public monopoly or a state enterprise operating in the private sector. It may take effect in one single operation or spread over time in tranches. Methods of privatisation include: public offering in domestic and international markets, direct sale to investors, management and employee buyout and mass privatisation through distribution of vouchers to the population.
4. A number of technical issues were identified by the Expert Group. There would appear to be a close link between the definition of privatisation and the "assets" based definition of "investment" envisaged for the MAI. While privatisation could involve the sale of shares and assets, it does not necessarily follow that it should extend to every type of asset, including real estate, government bonds and securities, as these operations may not qualify as the making of an investment. It was also recognised that entrepreneurial rights can be conferred without the transfer of assets while in other instances, the sale of assets may be indispensable to the creation of entrepreneurial rights.
5. A large majority of delegations were sceptical, however, about the desirability of extending the concept of privatisation to the granting of concessions or other contractual arrangements. This subject may

1 One delegation suggested that these remarks should appear in the preamble of the MAI.

deserve a "*sui generis*" treatment under the MAI. Concessions are one of the forms of "investment" that would need to be defined by Drafting Group n°3 (section A.1 of DAFPE/MAI(96)16).

6. Delegations also pointed to the existence of a grey zone between the granting of concessions and other contractual rights, on the one hand, and government procurement on the other hand. The general view was that the MAI should not reopen the difficult understandings reached under the GATT Procurement Agreement. It was also noted that, in some cases, a concession or a contractual arrangement to service or manage a public company may be more easily assimilated to a service activity than an investment activity. This could also have implications for WTO disciplines, notably the GATS.

7. Some delegations argued in favour of a definition of privatisation in the MAI. For example, this would bring greater certainty to the Contracting Parties' obligations. Furthermore, the definition could provide a "negative" list of operations or assets specifically excluded from it. **This definition should not be too wide (so as to include concessions, for example) or too narrow to prevent avoidance of MAI disciplines.**

8. This approach would have its drawbacks, however. Privatisation operations have considerably evolved in recent years and it might be difficult to conceive a non-static definition of privatisation that would adequately take into account all new forms of privatisation that might emerge in the future.

9. The Expert Group concluded that the issue of definition would need to be revisited once the MAI definition of "investment" and the obligations on privatisation and other related topics (such as monopolies and state enterprises) become clearer.

III. National Treatment and Most Favourable Nation Treatment

i) Right to participate in Privatisation

10. There was an emerging consensus that the MAI should ensure that foreign investors are given, as a matter of policy, the same rights in taking advantage of the investment opportunities created by a privatisation operation than those granted to national investors. This implies that the National Treatment and Most Favoured Nation (MFN) obligations of the MAI should, in principle, apply to both the initial sale and subsequent sales of the equity and assets that a Contracting Party would have decided to transfer to the private sector unless provided otherwise by the Agreement.

11. These provisions would not, by themselves, give ground to an investor to challenge every privatisation decisions solely on the basis that it failed to win a privatisation bid. **They should not constrain the efficient achievement of a privatisation operation.** This would require, however, that the privatisation programmes, as well as the rules and procedures governing their implementation, are fair and transparent and do not contain discriminatory provisions against foreign investors, whether they are already established or not.

12. One delegation reserved its position on this interpretation of the National Treatment and MFN provisions. Another delegation indicated it could not fully subscribe to the coverage of "initial sales" because future privatisations may give rise to political sensitivities in its country and its authorities need to retain some flexibility. One delegation indicated it could accept the proposed interpretation of the National Treatment and MFN obligations so long as they would not impose constraints on the structure of the privatised company. Another delegation noted that the National Treatment implied an element of comparison and this should be kept in mind in applying it to privatisation operations.

13. Those delegations which were in favour of a full-fledged application of National Treatment and MFN obligations in the area of privatisation suggested a number of additional clarifications points.

14. The National Treatment and MFN obligations should apply irrespective of the privatisation methods used by public authorities. They should therefore, in principle, apply to the direct sale to one or a group of investors as well public offerings in domestic and/or international markets.

15. Public offerings, notably in international markets, may be more transparent and offer a wider range of possibilities to foreign investors than direct sales. However, imposing a privatisation method over another would be inconsistent with the government freedom over privatisation decisions. **The issue is not so much the privatisation method used, but that of transparency and non-discriminatory treatment.**

16. Some of the practical problems encountered with direct sales are reminiscent to those encountered with Investment Incentives (DAFFE/MAI/EG3(96)3/REV1). It may be difficult to prove breach of the National Treatment and MFN obligations because the characteristics and circumstances of individual sales can vary. Direct sales also pose a challenge from the point of view of transparency because it may not be always feasible and economically viable to widely and effectively publicise them to foreign investors, notably when they are of a small size and involve individuals as opposed to enterprises.

17. These draw-backs were not generally considered to justify, however, a carve-out for certain types of privatisation operations². They would nevertheless argue in favour of strong transparency obligations in the MAI (or even a separate article to that effect - see section IV below). They may also require special attention in the context of the dispute settlement provisions of the Agreement, a matter for the Expert Group n°1.

18. The National Treatment and MFN obligations should also apply to all types of restrictions imposed on foreign investors such as ceilings on equity participation and resale, limitations on voting rights and membership in board of directors and management. In the latter case, consistency with the MAI disciplines on key personnel (see DAFPE/MAI/DG3(96)1/REV1) would need to be ensured.

19. The Expert Group discussed the application of the National Treatment and MFN provisions to those services (advisory services, underwriting, accounting...) contracted out by governments for the elaboration and implementation of privatisation operations, notably large-scale operations. Although this would be consistent with a comprehensive approach for the MAI, it would also risk encroaching upon GATT rules on government procurement and the GATS.

20. One delegation argued that country-specific reservations relating to privatisation should be limited to well-defined sectoral restrictions (for air transport for instance). Reservations of a more horizontal nature were not ruled out, however, by other delegations. **One delegation noted that such general reservations were contemplated for initial sales in the context of the ECT Supplementary Treaty discussions.** The practical difficulties of applying National Treatment and MFN at disaggregated sub-nationals levels of government (such as municipalities), **where substantial privatisation activity is currently taking place in some countries**, was also noted. **One delegation considered it essential to cover such privatisations under the MAI.** These issues deserve further attention.

2 One delegation argued in favour of de minimis rules -- excluding certain types of direct sales below predetermined thresholds.

ii) "Special shares" and other share arrangements

21. It was recognised that there could be privatisation operations where public authorities may wish³ to retain some influence or leverage on the new owners of the privatised firms. "Special" or "golden" share arrangements, with or without equity participation, giving governmental authorities veto voting rights over key business decisions of the enterprise may be one technique used. Governments may also seek specific commitments from certain private shareholders or hold their shares for a certain period of time to secure the stability in the privatised enterprise. The Expert Group considered important to provide clarification on the application of the National Treatment and MFN obligations to these areas.

22. A large majority of delegations shared the view that these special schemes should not be considered to be inconsistent with the National Treatment and MFN obligations unless they explicitly or intentionally discriminate against foreign investors. Recourse to these measures is, in any case, not so wide spread. Remaining government rights in the privatised company, such as "golden shares" are usually specified in privatisation laws. **One delegation stressed that the MAI should provide for transparency and the non-discrimination application of these schemes as well as adequate recourse to dispute settlement.**

23. One delegation held the opposite view, i.e. that special share or shareholder arrangements should *a priori* be considered to be inconsistent with the National Treatment and MFN obligations and, that as non-conforming measures they should be covered by country-specific reservations. The need for such reservations might be understandable for certain sensitive sectors and over a given period of time. According to this delegation, this approach would be the most appropriate to ensure transparency and avoid abuses.

24. One delegation observed that "special shares" and other share arrangement are rarely openly discriminatory and that there might be problems in proving *de facto* discrimination in this area. This would argue for the elaboration of an anti-abuse clause that would make it clear that these schemes could not be used to circumvent the National Treatment and MFN obligations. The same delegation suggested three criteria for carrying out this test. First, Contracting Parties would be required to justify the introduction of a share arrangement. Second, such arrangements would have time limits. Third, the importance of non-discrimination should be affirmed.

25. These criteria were opposed by one delegation because, in its view, they would amount to introducing into the MAI an authorisation procedure for every share arrangements. This would conflict with the recognised sovereign prerogatives of the state over privatisation decisions. This delegation did not object, however, to the idea of a general anti-abuse clause which would be applicable to all the obligations of the Agreement.

26. One Delegation suggested the alternative of a "best endeavour" clause which would discourage the recourse to special share arrangements, as well as the removal of existing arrangements. This proposal

3 There could be national security concerns but these should be taken care of the general exceptions Article of the MAI. Special shares may also be used, to prevent over, a transition period, an unfriendly take-over of the privatised enterprise and to give it time to adjust to the private sector environment. In other instances special shares have been issued to groups of investors willing to pay a premium for the enterprise or maintain their participation in the privatised enterprise for a minimum period of time. The objectives may vary: employment creation, regional development or the salvage of a public enterprise in financial difficulty among others.

was supported by another delegation which argued for a greater symmetry between the countries that make use of special share arrangements and those which don't.

27. One delegation suggested that golden shares deserve greater attention than the issue of special groups of shareholders. The former would appear to be more a direct substitute to government measures than the latter. Both types of measures can give rise, however, to market access issues beyond the reach of National Treatment and MFN. The Negotiating Group must still determine the role of the MAI in this area.

iii) Management buy-out and workers participation programmes

28. Management and workers participation in the privatised enterprise can also be made an intrinsic feature of a privatisation operation, for instance to reward managers and employees for their contribution to the performance of the public enterprise being privatised. They may be given first priority to buy a certain percentage of the shares of the enterprise. This offer may or may not be accompanied by preferential conditions.

29. A large majority of delegations felt that these programmes, which provide preferential treatment to certain categories of investors, (whether national or foreign) should not be considered to be contrary to the National Treatment and MFN obligations. **One delegation indicated that its government favoured the use of management buy-out and worker participation schemes for a given percentage of initial sales.** They would only violate them, if foreign managers or employees were excluded from them because they are foreign. One delegation noted, however, that the MAI would not guarantee in this case the "best" national treatment but the less favourable treatment given to nationals.

30. This interpretation was made subject to the requirement that there be no restrictions on secondary sales. In other words, local managers and employees should be free to sell to foreign investors the shares initially allocated to them.

31. The link with the MAI provisions on key personnel was also noted. Some delegations also saw the need for an anti-circumvention clause that would capture "*de facto*" discrimination and prevent abuse.

32. One delegation held the opposite view, namely that management buy-out and workers participation schemes should be considered to be inconsistent with National Treatment and MFN because their objective and effect is to subtract foreign investors from part of the equity and assets of the privatised firm. This constitutes a denial of market access. These schemes should therefore be covered by country-specific reservations. While not necessarily agreeing with this interpretation, another delegation noted that country-specific reservations would offer the best protection against future challenges under the dispute settlement provisions of the MAI.

33. Concerning preferential sales schemes in favour of a large participation of small investors, the Expert Group did not come to a definite view. The initial reaction was to consider them as a potential tool of discrimination against non-established foreign investors if they were available only to local residents. This would depend on the definition of "resident investors". This matter should be discussed further.

iv) Small-scale privatisations

34. The size of a privatisation operation may also, in itself, be an inhibiting factor to foreign participation. Small-scale privatisations may be more easily accessible to local investors or correspond

more closely to their abilities. They may often involve direct sales as opposed to public offerings. Cost considerations may not make it worthwhile to publicise these operations abroad.

35. A large majority of delegations considered that small-scale privatisation do not deserve special treatment under the MAI. Some difficult problems could be foreseen in creating a *de minimis* exception from the MAI obligations (levels of thresholds, sectors and firms concerned...). Transparency of such programmes remains, nevertheless, an important objective in this area.

36. Some delegations saw a direct link between the issue of a *de minimis* exception and that of the definition of privatisation and the assets to be covered by this concept (see section II above). The coverage of local governments and municipalities also needed further consideration in this context.

IV. Transparency

37. A large majority of delegations were inclined to consider more specific transparency rules for privatisation than those currently envisaged under the Transparency Article of the MAI [Section II.2 of DAFPE/MAI(96)16]. The investor may need to have access not only to relevant laws, policies and procedures governing a privatisation programme but also to the specific features of privatisation programmes and projects. It may require information on bidding procedures rules and procedures. It may also want to find out the criteria on which decisions have been made.

38. A few guidelines were suggested for elaborating these transparency rules. They should provide for a timely publication of the essential features and procedures for participating in a privatisation operation. Foreign investors should have the same access to the specific business and financial information on the enterprise to be privatised as any domestic investor. There could be a centralised office⁴ where all the information on privatisation programmes and individual privatisation transactions would be made available to interested investors. **The need for such an office may also depend on the information made available to investors from country to country.**

39. For public sales, **investors** could rely to a large extent on the financial and prudential rules that exist on domestic and international security markets. Direct sales **may** present greater challenges. One delegation suggested that the Group examine the transparency rules in the GATT Government Procurement Agreement since in its view, direct sales pose similar problems than those encountered with government procurement. **Another delegation considered that the transparency rules should be the same for public and direct sales.**

40. These transparency provisions would need to be kept within reasonable bounds however. They should not result in additional notification requirements than those that might generally be envisaged under other provisions of the MAI⁵. They should not unduly interfere with the privatisation process. Confidentiality of business information would also need to be protected. Public authorities should not be compelled to publicise abroad information on privatisation programmes or individual transactions.

41. A few delegations considered that the general transparency provisions of the MAI would be sufficient because they would require the publication of government laws, regulations and policies,

4 Reference was made to the provisions in the Energy Charter on the exchange of information the state and the investor.

5 This issue is expected to be taken up in the context of the role of the Parties Group.

relating to privatisation and state-to-state enquiries on specific aspects of these⁶. They also felt that Contracting Parties should not be obliged to provide detailed information of the financial or technical aspects of a privatisation or to justify their choice of the winning investors.

6 Section II.2 of DAFFE/MAI(96)16.