



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. The present Note discusses the possible configuration of MAI obligations in the area privatisation, drawing on the outcome of the orientation debate in the Negotiating Group in March 1996, which was carried out on the basis of a note by the Chairman and contributions by the United Kingdom and France.
2. The Negotiating Group concluded that, 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. Foreigners may bring to this process funds and know-how not available locally. Access to privatisation may also be an important factor for the penetration of new markets. Given the absence of multilateral disciplines on this area, the MAI negotiations could brake a new ground and produce "state of the art" provisions on this subject.
3. At the same time, the Negotiating Group agreed that the decision to privatise should remain the sovereign prerogative of each State.

II. Definition

4. Privatisation can involve the partial or total sale of a public enterprise to private interests. This can be done by the sale of its capital or its assets. The sale may pertain to a public monopoly or a state enterprise operating in the private sector. It may be realised in one single operation or spread over time in tranches. Clearly the enterprise being privatised cannot be considered to be a "private" enterprise unless the control of its activities and assets has been transferred to the private operator(s). But the opportunities for investment, as currently defined by the Drafting Group N°2, may cover the whole range of assets privatised by public authorities.
5. The United Kingdom Note DAFPE/MAI/RD(96)9 suggests that privatisation could also include the granting of a concession or other contractual arrangements to carry out an economic activity without the sale or transfer of ownership or control of the government assets necessary to perform the operations in question. Concessions also appear in the definition of an "investment" proposed by the Drafting Group n°2.

Question:

- **Is it necessary for the purpose of the MAI to provide a definition of privatisation either in the text of the Agreement or in an interpretative statement ?**

III. National treatment and Most favourable national treatment

i) Right to participate in Privatisation

6. The majority view in the Negotiating Group was that, once a decision to privatise has been taken, the MAI should ensure that foreign investors are given, as a general rule, the same opportunities to participate in the operation as domestic investors. This implies that the National Treatment and Most

Favoured Nation provisions defined by the Drafting Group n°2 DAF/MAI/DG2(96)2 would, in principle, apply to privatisation operations unless provided otherwise by the Agreement.

7. The non-discriminatory rule would concern, in principle, all privatisation methods used by public authorities. They would apply to the direct sale to one or a group of investors as well public offerings in domestic and/or international markets.

8. Public offerings, notably in international markets, may present the advantage to be more transparent and offer a wider range of possibilities to foreign investors than direct trade sales. Imposing a privatisation method over another would be inconsistent, however, with the government sovereign rights over privatisation.

9. Direct sales can, in certain circumstances, better serve the needs of the privatised firm. This may be the case of small scale privatisations or privatisation of enterprises in financial difficulties. Private sales may also facilitate the negotiation of guarantees from the buyer of the public enterprise whereas this might not be possible if private ownership were to be more widely spread.

10. These remarks suggest that the National Treatment and Most Favoured Nation provisions of the MAI cannot, by themselves, ensure the outcome of a privatisation operation i.e. which of the domestic or foreign investor would better perform in it. Nor would it be reasonable to allow an investor to challenge every privatisation decision solely on the basis it failed to win a privatisation bid. It should nevertheless be possible to ensure that the privatisation programmes, as well as the rules and procedures governing their implementation, do not contain discriminatory provisions against foreign investors, whether they are already established or not¹.

11. This obligation could extend to all types of restrictions such as ceilings on foreign ownership in privatised enterprises, limitations on voting rights and/or membership in board of directors and management. Its application to restrictions concerning board of directors and management would need, nevertheless, to be consistent with the MAI disciplines on key personnel (see DAF/MAI/DG3(96)1/REV1).

12. Another key issue discussed in the orientation debate is whether the MAI obligations should be limited to "permanent" restrictions maintained after privatisation (such as with respect to the *subsequent* sales of the shares to foreign investors) or cover discriminatory restrictions imposed on foreign participation in the privatisation operation itself.

1 This also argues for strong transparency provisions in the MAI. This subject is discussed in section V below.

13. Limiting the non-discrimination obligation to "permanent" restrictions would not add to the national treatment and most favoured nation provisions since these measures would, in any case, be captured by them as any other foreign investment restrictions². The real contribution that the MAI could make is to cover restrictions on the direct involvement of foreign investors in a privatisation operation³. This could also extend to the provision of supporting services (advisory services, underwriters, accounting firms...) by already established foreign firms.

Questions:

- **Should the National Treatment and Most Favoured Nation obligations apply to all stages of a privatisation operation unless provided otherwise by the MAI ?**
- **Should these obligations be recorded in a separate article in the MAI or would an interpretative note confirming the broad application of National Treatment and Most Favoured be sufficient?**

ii) "Special shares" and other share arrangements

14. The orientation debate recognised that governments may have legitimate reasons to maintain, after privatisation, some influence or leverage on the new owners of the privatised firms. The most frequent method used, short of the introduction of new regulations, is that of "special" share arrangements giving governmental authorities or investors of their choosing veto voting rights over key business decisions by the privatised firm. It was therefore considered important to clarify whether and how the National Treatment and Most Favoured Nation Treatment obligations would apply to these measures.

15. National security concerns were of one the motivations cited for the recourse to "special share" arrangements. As with other types of restrictions on foreign investment, however, these provisions would be taken care of by the general exceptions Article of the MAI. They would therefore not warrant any special attention in the privatisation context.

16. Public authorities have also kept special shares in the privatised authority 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 ("groupes d'actionnaires stables"). The objectives may vary: employment creation, regional development or the salvage of a public enterprise in financial difficulty among others.

17. These special share or shareholders arrangements, and the performance requirements they may lead to, need not to discriminate, however, between domestic and overseas investors. They can be viewed

2 It would also not add to the Code obligations. The Council minutes on the adoption of the Codes in 1961 states that it does not apply to "operations for a government's own account". If, however, a restriction is imposed on the resale to non-resident investors of equity holdings in a privatised company, the country concerned is required -- and permitted -- to lodge a reservation.

3 This would be more consistent with the National Treatment Instrument (NTI) although the MAI provision would be legally binding and apply as well to non-established foreign investors. The NTI provides that any restriction prohibiting or limiting the participation of an established foreign-controlled enterprise in a privatisation operation as compared to a domestic enterprise shall be notified as an exception to national treatment.

as the end-product of a bargaining process between the privatisation authority and prospective buyers of the public enterprise. In fact, they should not be viewed to be inconsistent with the MAI as long as no investor is precluded to make proposals to the privatisation authority on the basis of its nationality.

Question:

- **Should special share or shareholders arrangements be considered to be consistent with National Treatment and Most Favoured Nation Treatment unless they explicitly or intentionally discriminate against foreign investors and their investments ?**

iii) Management buy-out and other participation programmes

18. Management and workers participation in the privatised enterprise can also be made an intrinsic feature of a privatisation operation, for instance to reward 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.

19. These schemes would not appear to be discriminatory in nature since non-qualifying domestic investors might be as negatively affected as foreign investors. There could be a breach of the National Treatment and Most Favoured Nation Treatment, however, if foreign managers or foreign employees of the public firm were not entitled to the participation programmes because they are foreign. This may also depend how the obligations on key personnel might be defined.

20. It has been mentioned during the orientation debate that privatisation schemes favouring a large participation from the public, notably preferential sale schemes in favour of local residents, might help gain the popular support of sensitive privatisation operations. Public participation programmes limited to nationals would be contrary, however, to the National Treatment obligation. Public participation programmes favouring local residents would discriminate against non-established investors.

Questions:

- **Can it be generally assumed that management buy-outs and workers participation schemes would not be inconsistent with the National Treatment and Most Favoured Nation Treatment obligations as long as there is not discrimination against managers and workers on the basis of nationality ?**
- **Do public participation programmes deserve special treatment ?**

iv) Small-scale privatisations

21. The size of a privatisation operation may, in itself, be an inhibiting factor to foreign participation since it may not be economically viable to make public offerings abroad or to widely publicise the privatisation operation. Direct sales might be a more appropriate mode of privatisation than large privatisations (see also paragraphs 7-9 above). Foreign investors should nevertheless have access to whatever information is made available locally or be able to consult directly the privatisation authority.

22. A de minimis exception from the MAI obligations would, in any case, require determining the level below which the non-discriminatory provisions of the MAI would not apply.

Question:

- **Is it understood that direct sales in small scale privatisation programmes would not be considered contrary to the MAI if there is no explicit discrimination against foreign investors?**

IV. Transparency

23. In view of the complexity of the privatisation process and the various factors that may influence the outcome of a given privatisation, transparency can also make a difference in terms of foreign involvement. The investor needs not only to have access to relevant laws and procedures governing a privatisation programme but also to the specific features of individual privatisation operations. It may also need clarifications on how to make a submission. It may also want to have the possibility of finding out, within the limits of business confidentiality, the financial and technical grounds on which decisions have been taken.

24. As they presently stand, the transparency obligations of the MAI would require each Contracting Party "to promptly publish, or otherwise make publicly available, its laws, regulations, procedures and administrative rulings and judicial decisions of general application⁴" as far as they "may affect the operation of the Agreement". Each Contracting Party would also be obliged to promptly respond to specific questions and provide, upon request, information to other Contracting Parties on matters raised by the provisions of the Agreement. Confidentiality of business information would nevertheless be protected⁵.

25. These provisions would not require privatisation authorities to publicise abroad their privatisation programmes. Nor would they require them to respond to specific enquiries from interested foreign investors.

Question:

- **Is there a need for specific transparency rules in case of privatisation, notably as far as channels of communication between investors and privatisation authorities?**

4. No Contracting Party shall be required to furnish or allow access to where a Contracting Party establishes policies which are not expressed in laws or regulations or by other means listed in this paragraph but which may affect the operation of the Agreement, that Contracting Party shall promptly publish them or otherwise make them publicly available.].

5. One proposal made by the Drafting Group N°2 reads as follows:
“[No Contracting Party shall be required to furnish or allow access to information concerning particular investors or investments the disclosure of which would impede law enforcement or would be contrary to its laws protecting confidentiality].”