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**Negotiating Group on the Multilateral Agreement on Investment (MAI)**

**PRIVATISATION**

**(Note by the Chairman)**

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1. Privatisation can be defined as the total or partial transfer of a State undertaking, or of the State's share in the ownership or control of an undertaking, to a private entity. Privatisation may involve the sale of publicly-owned enterprises that *a)* operate in *competitive sectors* or *b)* operate government-designated *monopolies*.
2. Foreign investors have become important actors in privatisation programmes around the world because of their ability to provide funds and to bring know-how and expertise not available locally. But their access to these programmes has not been without limitations, some of a discriminatory nature.
3. The most frequent cases of *discrimination* are ceilings on foreign ownership in privatised enterprises, limitations on voting rights and/or membership in board of directors and management. These restrictions may be imposed at the time of the *initial* sale of the shares of the public enterprise or on the *subsequent* sales by the new owners of the privatised firm. They may result from the application of foreign ownership limitations already applied in the sector where the privatisation takes place. Participation in privatisation programmes may also be subject to reciprocity or conditional national treatment requirements.
4. The level of foreign investors' participation may also depend on the degree of involvement that a government may wish to retain, directly or indirectly, in a privatised firm. The government may choose, for instance, to keep a major stake in the privatised firm so as to maintain a decisive influence on its future activities. It may retain veto rights without equity participation ("golden shares"). It may also attribute controlling interests to a group of "core shareholders" in exchange of specific commitments regarding the operations of the privatised firm.
5. Some privatisation programmes may encourage the participation of the employees and managers of the firm to be privatised as well as that of small private investors. *Nationality* or *residency requirements* may be imposed on the membership in the boards of directors and senior management of privatised firms.
6. Most often, these arrangements are motivated by general policy considerations unrelated to foreign investment policy considerations (public services, protection against undesirable take-overs ...). But they could also at times be discriminatory.
7. Finally, opportunities for foreign participation may also be determined by the *privatisation methods* used. Privatisation can be realised through the *direct sale* to one or several investors. It may involve *public sales* on the domestic and/or foreign stock exchanges. It may be carried out in tranches or in one single operation. It may concern *various types* of investors (individuals, firms, institutional investors, other public enterprises). It may involve several intermediaries (financial advisers, underwriters

such as banks and security firms, accountants, lawyers...). Any decision taken in these areas has the potential to affect the level of participation of foreign investors.

### **Existing disciplines**

8. Neither NAFTA (for pre- and post establishment)<sup>1</sup> nor the ECT (post-establishment in the same sector or economic activity) contain special provisions on privatisation. This means that the general obligations of these agreements, notably national treatment and non-discrimination, apply to foreign investors' participation in privatisation programmes. The same core obligations are being considered in the context of the current negotiations of the Supplementary Treaty to the Energy Charter for the pre-establishment phase, subject to a number of exceptions: preferential sale schemes in favour of local managers, employees, local residents and the prevention of hostile take-overs.

9. The Capital Movements Code contains no disciplines on privatisation. The Council minutes on the adoption of the Code 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.

10. The requirement under the National Treatment Instrument (NTI), though non-binding, is somewhat broader: any restriction prohibiting or limiting the participation of an established foreign-controlled enterprise in a privatisation operation as compared to a domestic enterprise is considered as an exception to national treatment.

### **The MAI**

11. The decision whether or not to privatise is the prerogative of each State. Governments should thus enjoy the same freedom that private firms have in deciding when and how to sell or dispose of their investments.

12. Privatisation programmes will continue to be of particular interest to foreign investors in the future. Foreign investors would like to have the same investment opportunities as domestic investors, whether or not established in the host country. The national treatment and MFN/non-obligations of the MAI could apply to all phases of privatisation, including initial sales. The MAI need not be concerned, however, with the modalities of privatisation, so long as these do not discriminate against foreign investors and their investments.

13. Application of the national treatment and MFN/non-discrimination principles could, nevertheless, be subject to limited exemptions, for example, in the case of small-scale privatisations. It may also be noted that in many countries, workers and management are given special rights over the shares of privatised firms.

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<sup>1</sup> These obligations may be subject to country specific reservations. One country has lodged a broad reservation regarding the sale or disposal of the equity and/or assets of state enterprises or governmental entities.

## **Questions**

*a) Should the MAI contain specific provisions on the rights of foreign investors in privatisation operations?*

*b) In the absence of such provisions, is it understood that the obligations of national treatment and non-discrimination/MFN and the related mechanisms of standstill and roll-back would apply to privatisation operations? To the initial sales as well as the subsequent sales of privatised enterprises/assets? To non-established foreign firms as well as established foreign-owned or controlled firms?*

*c) Should any specific exceptions be allowed? If so, which ones?*

*d) Is it understood that special share arrangements such as "golden shares" or "group of stable shareholders" would not be contrary to the MAI obligations provided that they do not discriminate against foreign investors and their investments?*