OECD ROUNDTABLE

"FREEDOM OF INVESTMENT, NATIONAL SECURITY AND 'STRATEGIC' INDUSTRIES"

21 June 2006, OECD Headquarters Paris

SUMMARY OF DISCUSSIONS PREPARED BY THE SECRETARIAT

The OECD Investment Committee's *Roundtable on Freedom of Investment, National Security and 'Strategic' Industries* took place on 21 June 2006. The Roundtable was attended by members of the Committee, government representatives from a number of non-OECD countries, observers from BIAC and TUAC and a small number of specially invited experts from law firms, academia and business associations. The Roundtable was chaired by the Investment Committee's Vice Chair, Wesley Scholz and moderated by Peter Gumbel of Time Magazine.

Panellists included David M. Marchick, Partner, Covington and Burling; Laurent Assaya, Legal Council, Fried, Frank, Harris, Shriver & Jacobson; Yuri Lubimov, Senior Advisor, Russian Ministry for the Economy and Development; Patrick Juillard, Professor, Sorbonne University; Pascal Dupeyrat, Director, Relians Consulting; Heiko Willems, Director of Section, Federation of German Industries.

The discussions were organised around three main themes, namely (i) recent changes in national legislation and regulatory practices toward national security and other essential interests; (ii) the danger of protectionism and backtracking on previous commitments to liberalisation; and (iii) the role of international co-operation, and OECD specifically, in avoiding that legitimate concerns give rise to protectionist responses.

Protecting security and other national interests: New approaches to foreign investment?

The first session focused on recent legislative changes in France and Germany, and impending change in Russia and the United States. There was a brief discussion of the amendments to the German Foreign Trade Law by which the acquisition by foreigners of large stakes in sectors included on a short "closed list" is subject to a notification requirement. Participants did not consider the German measures onerous in international comparison, *inter alia* as their sectoral focus is very specific. They noted the fact that the changes in German law took place amid some opposition from the domestic business sector and, as such, could be considered as a regulation intended to be in the public interest rather than protection of national business interests.

Participants discussed the experiences with the US Exon-Florio provisions and recent congressional initiatives to amend them. Some took the position that, other things being equal, sectoral restrictions and "closed lists" may be more transparent and predictable. Whether they are in fact, may depend on the degree of discretion reserved to decision makers, how it is exercised by them ain practice, the extent that decision making process is open to input by the affected parties, and whether it is insulated from political influence. Participants noted that since Exon-Florio was promulgated the US administration has not often availed itself of its provisions to block investment. One investment project has so far been restricted and about 30 withdrawn by the would-be investors.

A feature of the Exon-Florio provisions that is valued by businesses is the predefined, and rather short, time period before a final decision must be communicated to investors. Concerning the changes under consideration in Congress, it was generally agreed that if implemented as proposed they would constitute a significant tightening of present practices. In particular, concerns were voiced over one of the proposed bills' disclosure requirements regarding ongoing reviews and investigations which could undermine the objective of confidentiality to protect the commercial interests of firms involved in a proposed transaction.

The French "Reform Law" and Decree No. 2005-1739, establishing a detailed list of "strategic" sectors in which foreign participation requires ministerial approval, were debated. The general view was that, by the letter of the law, the new restrictions may not have a significant adverse impact given the limited number of sectors identified and because some sectors where foreign participation was previously frowned upon are not included in the strategic list.

It was also noted by participants that the rhetoric that often accompanies would-be takeovers, including at the highest political levels, can also have an inhibiting effect on foreign investment by raising fears among investors in highly publicised takeover cases that they will face an organised resistance by other means than the ones foreseen in statutory regulation. The extent governments actually resort to means outside the formal regulatory framework will have a significant bearing on the overall impact on foreign investment.

The Roundtable was informed of the efforts of the Russian government to draft new legislation regarding the protection of "strategic sectors". The new law is expected to be submitted to parliament in the second half of 2006 and passed before the end of the year. The proposed law on strategic sectors would cover a few closed sectors and contain a list of approximately 39 sectors, including in particular arms and defence-related sectors as well as nuclear energy and aerospace industries, in which foreign investors would need governmental authorisation to acquire more than 50% ownership. In the view of the Russian authorities, the proposed law should be seen as an attempt to make the current situation more transparent and predictable by formalising existing restrictions and consolidating them into one law.

There was no unanimity to conclude that there is a trend toward more restrictive legislation and regulatory practices. Some participants argued that recent legislative change does little more than codify entrenched practices, and may in fact have helped enhance transparency. Others said that, while changes may not yet be of major significance, all recent revisions of national practices go in the direction of tightening. There was broader agreement that a heightened political awareness of security and essential interest may have important signalling effects vis-à-vis would-be investors, some of whom may have abandoned investment projects without seeking approval. Participants also argued that public statements by politicians and authorities not charged with investment regulation can have a significant impact.

Safeguarding an open international investment environment

There was broad recognition that, unless binding commitments under their international agreements provide for the contrary, sovereign governments have the right to take actions they consider necessary to safeguard national security and other essential public interests. Provisions in this respect persist amid a general trend toward increasingly liberal investment regimes, and should not be considered "illegitimate". At the same time, several participants recalled the non-trivial economic costs of invoking this sovereign right and argued that it should be used sparingly and abuses should be avoided.

The factors driving a rethinking of security and essential public interest in many countries seem to be threefold: the international security situation and its impact on views of what constitutes national security; concerns about a scarcity of natural resources; and the emergence of new players in the international economy. The first two of these concerns are not necessarily best addressed through investment regulation. Some participants held that other legislation targeting the concrete concerns, regardless of the nationality of investors, may in practice often be more effective.

One participant argued that the largest and technologically most advanced economies may perceive a need to define essential public interest more widely than others. Insofar as their international strategic position depends on the economic powers they wield, e.g. through control over natural resources or proprietary knowledge with respect to critical technologies, they may see it as a matter of important national interest to limit ownership of enterprises involved in these activities to their own nationals.

The national security concept is firmly established in US legislation. The same is not the case in most EU countries, some of which are in the process of pulling their regulatory practices together to form a more coherent approach. One participant argued that, given that one of the defining characteristics of the new international investment climate is the emergence of new major players, it is not in the interest of the countries most keenly concerned with the protection of strategic technologies or sectors that other advanced economies should be "too open" in this respect.

There was agreement among participants that an increasingly challenging problem for investment policy authorities is determining the nationality of the ownership and control of an investor. The evolving character of multinational enterprises and their complicated legal, ownership and governance structures make it a challenge to determine control on the basis of traditional notions of nationality, and even where it can be identified, it may not be as strongly indicative of the actions the enterprise may pursue.. The participation by large institutional investors (e.g., pension funds and hedge funds) and the use of offshore financial centres are among the factors contributing to the complexity and resultant challenges national authorities that seek to protect important national interests by assessing the potential threats posed by a particular transaction.

Several participants stressed the need to ensure that regulatory procedures are designed to maximise transparency and predictability, and minimise the costs to investors. There was little agreement on how best to go about achieve this in practice. Some suggested that "closed list" approaches are superior to screening mechanisms on account of transparency. Others argued that screening may impose no undue burden on investors provided procedures are well-designed, speedy and provide safeguards to protect corporate confidentiality. Many participants also stressed a need to avoid "regulatory duplication" addressing concerns through investment regulation that can be adequately dealt with by other regulatory means. In sum, each regulatory approach would have negative and positive aspects can produce similar or different outcomes depending on the underlying objectives and practices of the authorities.

Some participants noted that authorities' concerns about cross-border takeovers sometimes depend on the type of transaction involved. For instance, hostile takeovers may be subject to more intense regulatory scrutiny than invited bids. Particular concerns have also arisen when a foreign investor is government owned or otherwise close to the political process of the home countries. Likewise, investment by equity funds, hedge funds and other investors known to pursue "aggressive" strategies may be of greater concerns to authorities that more conventional takeovers.

In terms of avoiding protectionist pressures, participants agreed that rule-making at the international level and peer pressure to make countries revise their regulation toward one model is not a realistic option. International cooperation need to take as their starting point the fact that regulatory practices differ because of differences in legal and administrative traditions. Moreover, the relevant yardstick for an international comparison of practices should go beyond the letter of the law and statutory regulation. The strictness of practices – or protectionism, as the case may be – needs to be assessed on the basis of actual outcomes, with respect to individual transactions and the impact these results have on the decisions of investors with respect to future transactions.

Which role for the OECD?

Participants unanimously supported the idea that investment regulation to safeguard national security and other essential interest merits further analysis and joint review. Member countries and non-members alike opined that OECD is the best – if not the only – forum for such an undertaking. The OECD may play a role in influencing the international consensus and the public mood in its member countries. Participants also recognised that there are other important economic actors emerging on the world stage which will have a major impact in this area, including Russia, China and India. A consensus emerged that follow-up work would need to include three undertakings:

- Complete a stocktaking of statutory legal developments and policy practices in OECD and other countries. Participants expressed satisfaction at the background material provided for the Roundtable as a first step in this direction and noted that more could be done to enhance transparency regarding national practices.

- The development of a concise list of "good practices" that investment policy makers are invited to take into account in order to safeguard against abuses of regulation for protectionist purposes. Several participants mentioned that an attempt to establish the relative merits of countries' preferred methods of regulation is unlikely to be fruitful. Rather, one should attempt to agree on basic principles that should underlie any regulatory approach and ensure that attempts to safeguard essential national interests do not unduly discourage international investment. It is also important that such a document is not perceived as yardstick for "appropriate" regulation effectively discouraging policy makers from applying less restrictive practices.

- The commencement of a process of evaluation of actual regulatory practices and impact. Such a process should follow OECD's traditional model of peer surveillance and self evaluation, and build upon and complement the work on countries' positions under OECD's investment instruments.

Another universally shared view was that, in view of the evolving international investment environment, such a process should involve a number of non-OECD governments. In the words of one participant, one of the main issues is concerns about the levelness of the global playing field, so any discussion should necessarily have a global dimension. Non-OECD government representatives – including one from China who could not attend the first Roundtable – have indicated that they may be interested in participating.

The last part of this session focused on suggesting some guiding principles for good practices for regulation in the public interest that, presumably, participants would like to see included in future work. One participant raised the issue of regulatory proportionality, which in his national context is taken to mean: a measure has to be "suitable" (better results could not be obtained by other means); "necessary" (as un-restrictive as possible); and "appropriate" (weighing the impact of regulation against the hoped-for benefits).

Several participants made the point that any regulatory approach should be guided by three main concerns with regards to investors. First, it should be as transparent as possible, taking into account the need to protect classified information and sensitive business information. Second, it should be predictable in the sense that investors know beforehand the procedures to which they will be made subject. Third, regulation should be non-discriminatory, in the sense that while regulators may need to differentiate between categories of investors, such differentiation needs to be guided by objective criteria. Some more concrete suggestions on how to pursue these aspirations were:

- The principle of least-restrictive measures is enshrined internationally (e.g. in GATS). Guidance may be needed on how to do this in practice. In the case of "closed lists" this would probably boil down to defining the lists as narrowly as possible.

- The difference between voluntary and mandatory approaches could be explored. The differences may in practice by limited if the incentives built into a "voluntary" approach give investors grounds for caution.

- The financial cost of investors from regulation should be minimised. The time limits on administrative proceedings stipulated by Exon-Florio are a way of addressing this.

- The confidentiality of business information is a key concern. Companies will not apply for approval if they perceive a risk that confidential information will be made available to competitors or the general public.

- National security should not be used as a pretext for protectionism. This follows to some degree from the proportionality principle.

- The executive branch of government is better placed to balance the pros and cons of an investment project than the legislative branch. Parliamentary oversight with investment regulators is important, but the individual regulatory act must be independent.