



Negotiating Group on the Multilateral Agreement on Investment (MAI)

Expert Group No.3 on “Special Topics”

REPORT TO THE NEGOTIATING GROUP

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I am pleased to attach the report of Expert Group No. 3 in fulfilment of its mandate.

The Group has prepared an extensive commentary on all the issues identified in its mandate:

- a. Key Personnel
- b. Performance Requirements
- c. Incentives
- d. Privatisation
- e. Monopolies/State Enterprises
- f. Corporate Practices

Draft text, with square brackets around non-agreed words, has been prepared in the field of performance requirements. The Group also considered that the proposal by one delegation on temporary entry and stay of investors and key personnel provided a useful basis for future work and has made written comments on this text. In most other areas consensus is emerging that National Treatment, MFN and transparency obligations would apply.

The Group invites the Negotiating Group to give it a new mandate to carry this work further, in particular to produce text wherever necessary and appropriate.

Anders Ahnlid
Chairman

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KEY PERSONNEL

I. INTRODUCTION

1. The Group discussed possible disciplines concerning temporary entry, stay and employment of investors and other key personnel, employment requirements, and nationality requirements for boards of directors.

2. There is consensus that the MAI should contain provisions dealing with key personnel and that such provisions should not interfere with the normal application of national immigration laws or labour laws on key personnel. In addition, it has been suggested that MAI provisions should be "subject to" national laws and regulations relating to the entry, stay, and work of natural persons. The nature of the provisions (legally-binding obligations, best efforts commitments, or a combination of the two) will depend on the scope of the provisions --categories of persons covered and conditions applying thereto-- and the need to take account of national immigration and labour laws. The Group agreed to work on the basis of developing a binding MAI obligation and to look at the category of persons that could benefit from the provisions and under what conditions. Other options include the possibility of a best efforts approach, either in lieu of a binding obligation, or supplementary to it, depending on the category of persons.

3. The MAI will be a top-down agreement so the obligations or commitments will apply to all Parties. Generally, measures which do not conform to obligations would be listed as reservations; measures which are contrary to non-binding commitments would be notified for transparency purposes. Whether this will also apply to key personnel provisions remains to be decided. The Group agreed that the MAI should consolidate existing commitments in other international agreements¹, and where appropriate, go beyond those commitments. While these provisions might provide useful guidance, they address broader trade-related concerns. For the purposes of the MAI, there should be a clear link to investment.

4. At its meeting on 9 September, the Group considered a draft proposal by one delegation [DAFFE/MAI/EG3/RD(96)2]. The draft text, with comments reflecting the Group's discussion, is attached as an Annex to this note. Delegations considered that the draft text provided a good basis for discussion of temporary entry and stay. However, it does not address the other issues of employment requirements and nationality requirements for boards of directors which are also discussed in this report. One delegation reserved its position on this paper. Another delegation believes this draft goes too far in the area of intra-corporate transferees as it is based on the GATS approach. That delegation believes it more appropriate for the MAI, as it is an investment agreement, to cover only key personnel that are essential to investment.

¹ The overall relationship to other international agreements, in particular the GATS, and the implications for MFN commitments will be examined by the Negotiating Group in September.

II. TEMPORARY ENTRY, STAY AND WORK

1. *Investors*

5. The Group considered whether investors (i.e., natural persons²) should be permitted to enter and stay, and if so, the applicable criteria and conditions. Generally, investors would seek to enter the territory of a host country to ensure the establishment, development, administration or management of an investment or to advise on its operation. The movement of investors may be particularly important for the identification of investment projects. Concerns that a broad definition of investment might allow the setting up of letter-box companies or the entry of persons with no substantial investment interests could be addressed by requiring that an investor make a "substantial"³ investment⁴, or by providing for a denial of benefits provision⁵. Some delegations thought that there should be no additional criteria than that which is provided by the definition of investor in the agreement.

6. Provided that the agreed conditions are met, the MAI could confer a recognisable status of "investor" that would be entitled to benefit from an application process that facilitates their temporary entry, stay, and where applicable work, in MAI countries. This could mean that authorities agree to **waive** the application of certain requirements such as labour market (economic needs) tests, or entry quotas. Immigration authorities would not be prevented from applying administrative formalities to verify or ensure the validity of the status requested.

2. *Key Personnel of an Investment*

7. In addition to the investor, the MAI provisions could apply to other persons usually referred to as "key personnel"⁶. The Group agreed it would be difficult to arrive at agreed precise definitions of this term. However, certain categories could be identified, perhaps with criteria such as linkage to the functions to be carried out with respect to the investment.

-- Not all delegations agree on the categories which could be covered; however, they agreed to consider whether the key personnel provisions could apply to:

Executives (those with policy and decision-making responsibilities),

Senior managerial personnel (directors and supervisors)

Specialists (highly qualified experts)

² Some delegations have said that they would be prepared to consider extension of the right of entry under the key personnel provisions of the MAI to nationals of any MAI party regardless of whether they are the same nationality of the investor. This question might need further consideration by the Group.

³ It being understood that "substantial" has different meanings depending on the sector concerned.

⁴ The relation between the definition of investment for the purposes of key personnel provisions and certain types of capital market transactions are still under consideration.

⁵ Drafting Group 3 is currently examining whether a denial of benefits provision is a satisfactory solution to the issue of letter-box companies.

⁶ See footnote 2, above.

- provided, in each case, that the person's presence in the host country is essential to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposition of an investment. Some delegations would limit these investment activities to establishment, operation and liquidation.

8. The provision would be intended to allow an investor, or its investment, to bring in these categories of persons if the conditions set out in the MAI are met. These conditions could include, for example, the requirement that the work permit be directly related and limited to a specified job or that the application by the individual is supported by the requesting entity which would certify that the applicant falls into one of the permitted categories. The MAI Party could apply administrative formalities to verify or ensure the validity of this status. Some delegations believe there should be a clear link to investment in that the key personnel should be essential to the investment.

9. Some delegations consider if it is necessary to further specify what key personnel could be granted the right of entry, stay and work, the provision could impose a requirement that these persons be "intra-company transferees". Most OECD countries have made specific commitments with regard to the temporary entry of intra-company transferees in their country schedules in the GATS. One delegation, [DAFFE/MAI/RD(96)3], has made a specific proposal to facilitate at least the intra-group transfer of key personnel according to which the MAI would develop rules to facilitate the transfer of intra-group personnel by lessening the restrictions imposed by immigration laws and regulations. A number of delegations do not agree that the MAI should distinguish between intra-group transferees and other categories of key personnel.

10. If the MAI were to have a provision on intra-group transfers, it would be necessary to identify the category of persons that could be covered. If limited to executives, managers, and specialists with prior employment in the company, this approach would be more restrictive than the preceding one. However, it could also be extended to other personnel on the grounds that there is an existing employment relationship with the company. It would also be necessary to specify the conditions to be met before the provision on temporary entry for intra-company transferees could apply. These conditions need further consideration but could include:

- that the individual be already employed in the international group (intra-company transferee). Some countries would like to add a minimum prior employment requirement such as one year.
- that the work permit be directly related and limited to a specified job in a specific entity of the group. A few delegations think that this condition might be very difficult to implement.
- the application by the individual must be supported by the international group which would certify that the applicant falls into one of the permitted categories of key personnel under the MAI.

11. The MAI provision would operate to allow authorities to facilitate entry and work permits for the identified categories of persons, without the application of labour market (economic needs) tests, entry quotas, or other restrictions so long as the conditions laid down in the MAI were met. Parties would be permitted to verify the authenticity of the status requested.

3. *Spouses and minor children*

12. It was widely agreed that the MAI should include a provision granting temporary entry and stay to spouses and minor children. Some delegations said that key personnel provisions could be of little value if entry visas could be denied to spouses or dependent children. Others cautioned that such provisions might give rise *inter alia* to definitional problems and one delegation thought these provisions might impact negatively on national labour laws.

13. While a few delegations felt the granting of work permits to spouses could facilitate the movement of key personnel, the majority expressed serious concern that such a provision would give rise to problems relating to MFN and other issues. Some delegations believe this would also create greater rights for spouses than for investors or key personnel.

4. *Length of stay*

14. There are different views as to whether the MAI provisions on temporary entry and stay should include a limitation in time. Some delegations think that this is necessary to avoid an open-ended obligation and propose minimum periods between 2 and 5 years, or a maximum of period of, for example, 3-4 years. The MAI could provide for automatic renewals of permits provided that certain formalities necessary to verify continued eligibility are permitted. Others are of the opinion that the length of stay should extend for as long as the person is engaged in the same capacity and continues to meet all the conditions for the initial permission to enter and stay.

III. EMPLOYMENT REQUIREMENTS

15. The Group considered the inclusion of an employment requirements provision in the MAI. The Group noted that the ECT has a provision which addresses this issue (Article 11). The MAI provision would be aimed at covering natural persons already in the country who are holding valid resident/sejour and work permits and some delegations think it should also specify that employment must conform to the terms, conditions, and limitations of the relevant permits. The provision would permit an investor to hire persons without regard to nationality. Some delegations think that this provision is not necessary since the obligation would be part of the national treatment obligations of the agreement. Other delegations caution that such a provision might be needed particularly in the case of accession by non-Member countries which might impose mandatory requirements regarding employment of local labour.

16. If the application of national treatment is not considered sufficient to deal with nationality requirements that might be imposed by a Party, delegates will need to consider what kind of provision should be included in the MAI. This might depend on the categories of persons which are intended to be covered; either top personnel such as executives, managers and specialists or other persons lawfully in the country and holding valid sejour and work permits.

17. While the MAI provision should prevent the application of national employment quotas or labour market (economic needs) tests, it should not be used by a foreign investor to circumvent the application of certain national laws such as anti-discrimination laws. It should also not prevent a Party from ensuring compliance with its laws as concerns the conditions it attaches to the granting of sejour and work permits. However, any administrative practices necessary for purposes of verification should not be used to undermine or nullify the provision.

IV. NATIONALITY REQUIREMENTS FOR BOARDS OF DIRECTORS

18. Some countries maintain nationality requirements for boards of directors. If it is agreed that these requirements should not be permitted under the MAI, this could be done implicitly through the application of the national treatment obligation (perhaps with an interpretative note to that effect), or in a specific provision. This issue will need further consideration.

ANNEX

**PROPOSAL BY ONE DELEGATION FOR A DRAFT ARTICLE
ON TEMPORARY ENTRY AND STAY**

Temporary entry of investors and intra-corporate transferees

1. Each Contracting Party shall grant temporary entry and provide confirming documentation to a natural person of another Contracting Party who:

- (a) being an investor, seeks to establish, develop, administer or provide advice or key essential technical services to the operation of an enterprise to which the investor has committed, or is in the process of committing, a substantial amount of capital, or
- (b) being an employee of an enterprise of another Contracting Party for a period of not less than one year, seeks to:
 - i) establish a subsidiary or affiliate of that enterprise, to which the enterprise has committed, or is in the process of committing, a substantial amount capital, or
 - ii) render services to a subsidiary or affiliate of that enterprise,

in a capacity of executive, manager or specialist, provided that the natural person complies with applicable measures relating to public health and safety and national security applicable to temporary entry.

2. Each Contracting Party shall grant:

- (a) temporary entry and provide confirming documentation to the spouse and minor children of a natural person of another Contracting Party who have been granted temporary entry under paragraph 1, provided that they comply with applicable measures relating to public health and safety and national security applicable to temporary entry; and
- (b) authorisation to work to the spouse of a natural person of another Contracting Party who has been granted temporary entry under paragraph 1.

3. No Contracting Party may:

- (a) as a condition for temporary entry under paragraphs 1 and 2, require labour certification tests or other procedures of similar effect; or
- (b) impose or maintain any numerical restriction relating to temporary entry under paragraphs 1 and 2.

4. For the purpose of this article :

Natural person of another Contracting Party means a natural person having the nationality of or who is permanently residing in another Contracting Party in accordance with its applicable law;

Enterprise of another Contracting Party means a legal person or any other entity constituted or organised under the applicable law of another Contracting Party, whether or not for profit, and whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, joint venture, association or organisation, and a branch of an enterprise;

Executive means a natural person who primarily directs the management of an enterprise or establishes goals and policies for the enterprise or establishes goals and policies for the enterprise or a major component or function of the enterprise, exercises wide latitude in decision-making and receives only general supervision or direction from higher-level executives, the board of directors, or stockholders of the enterprise;

Manager means a natural person who directs the management of an enterprise, or department, or subdivision of the enterprise, supervises and controls the work of other supervisory, professional or managerial employees, has the authority to hire and fire or recommend hiring, firing, or other personnel actions and exercises discretionary authority over day-to-day operations at a senior level; and

Specialist means a natural person who possesses knowledge at an advanced level of expertise and who possesses proprietary knowledge of the enterprise's product, service, research equipment, techniques, or management.

COMMENTARY ON THE DELEGATION'S PROPOSAL ON

Temporary entry and stay of investors and intra-corporate transferees

1. Delegations considered the proposal a good basis for further work on a draft article dealing with the issue of temporary entry and stay. The text does not address the issues of employment requirements and nationality requirements for board of directors which have also been considered by the Group in the context of a key personnel provision in the MAI.

2. The Group is considering whether a chapeau to paragraphs 1 and 2 is necessary as an introduction, specifying that these provisions are subject to national immigration and labour laws. Some delegations questioned the implications of such a chapeau for the key personnel provisions, particularly its relation to paragraph 3.

PARAGRAPH 1

3. While several delegations supported including a requirement of a "substantial amount of capital" in subparagraph a) and b), others considered it would create uncertainties and could represent an important barrier to certain forms of investment. The Group would like to further reflect on a proposal which would provide a list of examples of what is meant by "substantial" and which would vary from sector to sector.

4. There was further concern that this qualification ("a substantial amount") would mean that "investor" as used in the key personnel provisions would have a different meaning than "investor" for the purposes of the rest of the agreement. One delegation noted that this differentiation is justified in this context.

5. Questions were raised as to the scope of subparagraph 1 b). Several delegations were concerned that it went beyond the concept of key personnel, or personnel who are essential to the present investment.

6. Also, subparagraph b) refers to an "employee of an enterprise". Some delegations thought that this should not be restricted to an "enterprise" but should be more broadly related to an "investment".

7. Some delegations considered that a requirement of prior employment for an employee of an enterprise b) can distort the investment process by impacting unfairly on new investors and small/medium enterprises without any corresponding benefit to the "admitting" country. Furthermore, these delegations believe that it may not correspond to the real needs of an investment and should not be used as a measure of whether an individual is essential to an investment. These delegations believe the level of specificity in subparagraph a) unnecessarily restricts the scope of the provision. One delegation emphasised the difficulties associated with the definition of "essential".

8. While there were different views as to the length of a prior employment requirement, several delegations thought it necessary to retain such a requirement if only because there is a corresponding requirement in their national immigration laws. One delegation thought it might be necessary to specify that the prior employment relation must be continuous and should not apply to an employee which had

been previously employed. Another delegation questioned whether the use of prior employment requirements to avoid circumvention of national immigration laws was effective.

9. The length of stay was addressed by some delegations which thought that the provision should specify a maximum period (e.g., 2-3 years). Others felt that if the provision were limited to essential personnel, the length of stay for any individual would be as long as that individual remained essential to the investment.

10. The Group agreed that more work is needed with regard to the categories of personnel that are to be covered.

11. Several delegations commented that they understood the last two lines of paragraph 1 as applying only to b) the employee and not to a) the investor. The delegation that is the author of the proposal, clarified that the first part of that phrase only applied to b) while measures relating to public health and safety and national security were relevant to both investors and employees.

PARAGRAPH 2

12. Many delegations believe this issue to represent a de facto barrier to the movement of key personnel and would be willing to grant temporary entry and stay to spouses and minor children. Some countries would go further and grant the right for spouses to work under the MAI. A major difficulty would be already to agree on what is meant by "spouse" which include un-married partners in a few countries but not in all.

13. Other delegations might consider a best efforts provision as concerns the temporary entry and stay of spouses and minor children but would have strong objections to authorising work permits. They are of the opinion that an MAI provision to grant work permits to spouses to work anywhere in the economy would create a "common labour market for MAI spouses" and give rights to the spouse that go beyond what the agreement grants to the investor. One delegation pointed to the need to ensure subsistence for spouses and children in order to grant temporary entry and stay. Some delegations expressed concern that not authorising work permits for spouses might reduce significantly the effectiveness of the provision.

PARAGRAPH 3

14. Some delegations thought that the term "labour certification" tests was somewhat vague. They could agree that if this meant economic needs tests and numerical restrictions, these should be prohibited under the MAI. If labour certification tests meant the ability to check professional qualifications, views were more divided. Some felt it important that countries not be prevented from checking the professional qualifications of key personnel seeking temporary entry and stay. Others thought that as long as the categories of key personnel were correctly defined, there should be less concern for qualifications tests especially, as pointed out by one delegation, the key personnel were often only serving as advisors to the investment.

15. Some delegations explained that their countries, for political reasons, would have to continue to impose economic needs tests and numerical restrictions. However, the quotas are set sufficiently high so that they do not represent an impediment. These countries would have to take a reservation if the MAI were to have a legally binding obligation not to impose economic needs tests or numerical restrictions.

PARAGRAPH 4

Natural person of a Contracting Party

16. There are different views as to whether, for the purposes of these provisions, natural persons covered should be restricted to nationals or permanent residents of another MAI Contracting Party. There was a discussion that for key personnel, nationality should not be a criteria as long as the key personnel is an employee of an MAI investment. Some delegations do not think it necessary to define this term here since it would be covered by the definition of investor elsewhere in the agreement. One delegation clarified that it could not accept the inclusion of permanent residents as concerns the provisions for temporary entry and stay although it agrees with the inclusion of residents for the purpose of the general definition of "investor" in the agreement.

17. One delegation has made a proposal for consideration which would multilateralise their bilateral treaty practice, as follows:

"Investors who are nationals of countries with whom we have certain treaty obligations (including our bilateral investment treaty partners) may, if they meet certain criteria regarding the nature of the investment, obtain visas to our country that permit them, and certain of their key employees who are also citizens of the same country, to enter and remain in our country while they are actively involved with the investment. There are known as "treaty investor", visas.

In the context of the Multilateral Agreement on Investment, it would seem inconsistent with its liberalising goals to require that key personnel of an investor be of the same nationality as the investor in order to qualify for a "treaty investor" visa. One approach we would be prepared to explore would be to permit issuance of a "treaty investor" visa to any key employee of a qualified MAI-country investor who was himself or herself a national of an MAI-country, whether or not an employee has the same nationality as the investor. Thus, assuming that Germany, France and our country all join the MAI, a French key employee of a German company would be eligible for a "treaty investor" visa if the German company were to make a qualifying investment in our country.

We do not propose expanding the criteria for eligibility for a "treaty investor" visa, either in terms of the nature of the investment requires, or in terms of the types of personnel who qualify. We merely are suggesting that nationality not be a limiting factor, provided that the investor, and the key employee seeking the visa, are both nationals of MAI-member countries. Nevertheless, such a change in the "treaty investor" programme would require an amendment to the legislation that authorises such visas."

18. Most delegations did not think that these provisions should include a definition of the "enterprise" of another Contracting Party since it is already defined in the general definitions of the agreement.

19. The definition of the categories of executive and manager are generally appropriate, except that there might be some cross-over between the two. The category of "Specialist" will need some further reflection. One delegation would like to include "trainers" in this category.

PERFORMANCE REQUIREMENTS

I. General considerations

19. As a high standards Agreement, the MAI would need to contain obligations on performance requirements (PRs). PRs are obligations imposed by governments on investors to secure certain economic benefits. They are of concern because some may interfere with business decisions and produce market distortions detrimental to the efficient use of investment funds.

20. The National Treatment and Most Favoured Nation Treatment obligations of the MAI would not suffice to address this problem. The MAI should attempt to prohibit as many PRs as possible with a view to minimising the distortions or restrictions they impose on investment activities. The MAI should try to go beyond the disciplines found in other agreements, such as the TRIMs Agreement, the ECT and the NAFTA. It would be important, however, to avoid creating conflicting obligations and forum shopping for the settlement of investment disputes (these issues are discussed by the Expert Group N°1).

21. At this stage of the discussion, the Expert Group decided to adopt a functional approach for distinguishing between two categories of PRs: those not associated with the granting of an advantage (for instance PRs attached to an authorisation) and those associated with the granting of an advantage. This should not prejudice, however, the adoption of a single list for both types of PRs, an option supported by some delegations.

22. It also agreed that the MAI obligations in this area should address those PRs that are mandatory or enforceable under domestic law or other administrative rulings or compliance with which is necessary to obtain an advantage. PRs may also be relevant to the issue of investment incentives (IIs) since a prohibition on a PR linked to an II may limit the use of that incentive. This should be kept in mind for the elaboration of disciplines in these two areas. It would also be necessary to keep in mind the provisions of the WTO Agreement on Subsidies and Countervailing Measures since it also has implications for investment incentives. The Expert Group decided that PRs imposed in the context of privatisation should be taken up in the context of the Group's discussion on the subject of privatisation.

23. It was considered that the draft text proposed in the Annex of this report is a good working basis for an MAI provision on PRs.

II. Performance Requirements not associated with the granting of an advantage.

24. It was generally felt that the MAI should cover PRs imposed or enforceable under domestic laws, regulations, procedures and administrative and judicial decisions of general application or established policies⁷. One delegation felt that it would suffice for the MAI to cover those PRs imposed or enforceable

⁷ This closely follows the language of the draft transparency article of the MAI which suggests that its obligations may apply to “laws, regulations, procedures and administrative rulings and judicial decisions of general application” as well as “established policies” not expressed in laws or regulations by other means. See consolidated text DAF/MAI(96)16, page 5.

under domestic law. The PRs concerned would relate to investors and investments as defined by the MAI⁸.

25. The great majority of delegations expressed a preference for a closed list of prohibited PRs. This would ensure clarity and certainty, for both governments and investors, on the exact nature and scope of the MAI obligations in this area. These are also legitimate policy objectives, particularly those found in labour laws, social security laws or environment laws, that most delegations considered should be taken into account. Two delegations wanted to maintain the open list concept until the shape of the MAI prohibition is better known.

26. The Expert Group agreed that the MAI prohibition should cover those PRs prohibited under the WTO TRIMs Agreement (namely items *b*) to *e*) of paragraph 1 of the Annex). A large majority of delegations considered that it should also cover export performance requirements even though this is not the case under the TRIMs Agreement and apply to both goods and services.

27. The general opinion of the Group is that neither the language of item a) nor that of item e) of the proposed article on PRs would prohibit export restrictions or exports bans or forced domestic sale requirements. These issues need to be discussed further.

28. Most delegations considered the MAI should also cover the two other PRs listed in Article 1106.1 of NAFTA, namely PRs requirements to transfer technology, production processes and other proprietary knowledge, and exclusive supplier arrangements. As to technology transfers (paragraph 1, item f of the draft article), some delegations believed it would be desirable to ensure consistency with existing intellectual property agreements since these may allow certain PRs (compulsory licensing for instance) under certain conditions. Other delegations did not necessarily agree with this view. This issue requires further analytical work.

29. A number of delegations felt, however, that even with these additions the focus of the PRs article would still be too centred on the trade-distorting effects of PRs and that a real attempt should be made to extend the coverage of this provision to those PRs more directly related to the capital and labour markets. One possibility would be to prohibit, in paragraph 1, item e) of the draft article, all PRs on local sales and not only those linked to exports or foreign exchange earnings. Manufacturing requirements and local hiring requirements could also be added to the list. A few delegations thought it would be more transparent to list as well local equity requirements or joint venture requirements even though these measures should, in principle, be captured by the National Treatment and MFN treatment articles.

30. One delegation suggested exploring whether the MAI could include some of the PRs explicitly excluded under Article 1106.4 of NAFTA and, more particularly, PRs to locate production, train or employ workers, construct or expand particular facilities. Local funding requirements were also mentioned in this context. Several delegations were attracted to this more ambitious approach, but it was also recognised that the broader the list, the greater the number of qualifications or limitations there are likely to be to preserve the ability of Contracting Parties to determine their own policies in these areas. This consideration should be kept in mind in future discussions.

31. There was a general consensus that no Contracting Party should be prevented from adopting or maintaining measures necessary to protect public health, safety and the environment provided that National Treatment and MFN treatment obligations are respected. However, it was noted there is no compelling reason that these concerns be addressed in the context of PRs. A large number of delegations

⁸ The proposals that have been made by the Drafting Group 2 are found in DAF/MAI(96)16, section A.1.

felt that it would not be necessary to retain the clarification found in Article 1106.2 of NAFTA concerning technical specification requirements imposed by domestic health, safety and environmental legislation or regulation which may be relevant to technology transfers. Some delegations reserved their position at this point.

III. Performance Requirements associated with the granting of an advantage.

32. While a large majority of delegations reserved their judgement as to how PRs associated with the granting of an advantage might be disciplined under the MAI, it nonetheless recognised that the circumstances which condition their existence are not entirely the same as for other PRs. There may be legitimate political and economic reasons for seeking concrete returns from government assistance programmes such as a good return for tax payers money. Subtracting an investor from the benefits of an incentive, even if linked to a PR, has different implications than the removal of PRs imposed by domestic law or regulation. Because of these differences, the list of prohibited PRs might be shorter for PRs associated with the granting of an advantage than for other PRs. Some delegations considered, however, that the list should be identical for the two categories of PRs.

33. Several delegations underlined the need for consistent and harmonious relations between MAI disciplines on PRs and those on Investment Incentives. Due account should also be taken of the WTO disciplines, notably the TRIMs Agreement and the 1994 GATT Agreement on Subsidies and Countervailing Measures. One delegation considered that these new agreements have yet to be tested and it would not be wise for the MAI to try to go beyond these instruments.

34. A number of delegations underlined, however, that the WTO Subsidies Agreement covers only the fiscal side of an investment incentive but not any related PRs. This leaves the MAI free to develop obligations on PRs associated with the granting of an advantage. The MAI would in any case need to cover those captured by the TRIMs agreement, namely those listed in items b) to e) of paragraph 1 of the Annex. As with the first category of PRs examined, a majority of delegations were in favour of prohibiting export PRs linked to the granting of an investment incentive.

35. A number of delegations were in favour of covering services as well as goods. This would also constitute an important step beyond the TRIMs Agreement. The Expert Group concurred, however, with the comments of a NAFTA delegation that the dividing line between contracted services (such as book-keeping, accountants and advertising) and employment requirements is not always easy to draw. This issue would need further consideration.

36. There were greater doubts that PRs linked to R&D incentives could be prohibited under the MAI given the nature of the incentives programmes currently in place in this area in OECD countries.

37. No other advantage-tied PR was singled out beyond those listed in the annexed draft article as a possible candidate for a prohibition obligation, but delegations were invited to reflect on Article 1106.4 of NAFTA. It was also decided to come back to the exceptions listed in Article 1108.8 of NAFTA after the list of prohibited PRs is firmed up. There was no general inclination to attempt to define the term "advantage", although a few delegations considered some definition desirable since "advantage" should not be limited to an opportunity to invest or to the granting of an operating license.

38. Some delegations proposed that provisions based on NAFTA Articles 1106 and 1108 be included in the draft article on PRs.

IV. Reservations and Exceptions

39. The Expert Group felt it premature to discuss whether any prohibition obligation under the MAI should be made applicable upon the entry into force of the Agreement (or after a transition period as under the TRIMs Agreement) or whether the Contracting Parties would be entitled to lodge reservations for non-conforming measures in accordance with the proposals that have been made in this connection. This issue also raises important questions for accession of non-OECD countries to the MAI. It would be desirable to come back to this issue at a later stage.

Draft Article on Performance Requirements⁹

Paragraph 1¹⁰

No Contracting Party may impose, enforce or maintain any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, operation, or conduct of an investment of an investor of a Contracting Party or of a Non-Contracting Party in its territory¹¹:

- (a) to export a given level or percentage of goods or services;
- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
- [(f) [to transfer technology, a production process or other proprietary knowledge to a natural or legal person in its territory] [except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of the Agreement];]
- [(g) to locate its headquarters for a specific region or the world market in a Contracting Party] or to supply one or more of the goods that it produces or the services that it provides to a specific region or world market exclusively from the territory of a Contracting Party;].

⁹ One delegation reserves its position on all obligations on performance requirements in the MAI that go beyond those in the TRIMs Agreement and the Energy Charter Treaty. Another delegation considers that this obligation should be limited to PRs found in laws, regulations, procedures, administrative rulings and judicial decisions of general application as well as established policies and should exclude contractual obligations between the investor and the state as there are invariably linked to advantage -- the subject matter of paragraph 2. Some delegations maintain a scrutiny reservation on the content and structure of the paragraph.

¹⁰ It is yet to be decided whether paragraphs 1 and 2 of this Article can be combined into one. Some Delegations propose that paragraph 1 should begin "Subject to paragraph 2 . . .".

¹¹ The place of this term is still to be determined in the National Treatment and Most Favoured Nation Treatment provisions [See DAFFE/MAI(96)16, A.II.1].

- (h)[to achieve a given level or value of production, investment, manufacturing, [sales]¹², employment, research and development in its territory];
- (i) [to hire a given level or type of local personnel];
- [(j) to establish a joint venture;] or
- [(k)(Others to be defined)¹³].

Paragraph 2

No Contracting Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory¹⁴ of an investor of a Contracting Party or of non-Contracting Party, on compliance with any of the following requirements:

- (a) [to export a given level or percentage of goods or services];
- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods [and services]¹⁵ produced in its territory;
- (d)to relate in any way the volume or value of imports to the volume of value of exports or to the amount of foreign exchange inflows associated with such an investment;
- (e)to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings; or
- [(f) others to be defined.]

Note: Several Delegations suggested that consideration be given to including text from NAFTA Articles 1106 and 1108 which are reproduced in an appendix to this draft article.

¹² Some Delegations considered that PR obligations should apply to minimum domestic sales requirements, for example in the event of a domestic shortage of oil. Other Delegations expressed concern that such requirements should not be included because that might undermine the right of Contracting Parties to impose export bans in appropriate circumstances.

¹³ Some Delegations suggested that local equity requirements should be added to the list because of the importance of such requirements as an obstacle to investments. Other Delegations expressed the view that such requirements would be covered by the National Treatment and MFN provisions.

¹⁴ See note 3.

¹⁵ It is yet to be determined how this provision would exclude contracted services.

Appendix

This appendix reproduces selected NAFTA provisions relevant to the question of performance requirements:

Article 1106: Performance Requirements

Paragraph 1

No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:

- (a) to export a given level or percentage of goods or services;
- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
- (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
- (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

Paragraph 2

A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.

Paragraph 3

No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

- (a) to achieve a given level or percentage of domestic content;
- (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;

- (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
- (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

Paragraph 4

Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

Paragraph 5

Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

Paragraph 6

Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:

- (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
- (b) necessary to protect human, animal or plant life or health; or
- (c) necessary for the conservation of living or non-living exhaustible natural resources.

Article 1108: Reservations and Exceptions

Paragraph 8

The provisions of:

- (a) Article 1106(1)(a), (b) and (c), and 3(a) and (b) do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;
- (b) Article 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply to procurement by a Party or a state enterprise; and
- (c) Article 1106(3)(a) and (b) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas.

INVESTMENT INCENTIVES

I. General considerations

40. The Expert Group considered that as a high standard agreement, the MAI should cover Investment Incentives (IIs) and try to develop disciplines on them. IIs are an important aspect of the treatment accorded to foreign investors and their investments. IIs can also have distorting effects on cross border investment flows and lead to costly competitive bidding among governments to attract foreign investment. Opinions varied, however, as to the possible nature and scope of MAI provisions in this area.

41. The discussion confirmed that IIs are both a politically sensitive and technically difficult subject. IIs can take various forms and cannot be easily defined. The nature and size of economic distortions they can create may vary. Existing international agreements such as the 1994 GATT Agreement on Subsidies and Countervailing Measures and the WTO TRIMs Agreement contain important disciplines on the trade effects of IIs, but it is not entirely clear whether, or to what extent, they adequately address "investment" related problems of IIs. IIs are also related to other subjects discussed under the MAI, including performance requirements and taxation.

42. In light of these considerations, the Expert Group examined two broad sets of issues namely a) the application of the National treatment, MFN treatment and Transparency to the field of IIs and b) the desirability and feasibility of including in the MAI specific disciplines on those IIs which may cause the greatest distorting effects on the international allocation of foreign investment.

II. Application of the Treatment obligations of the MAI

i) National Treatment and MFN Treatment

43. A majority of delegations considered that the obligations of National Treatment and MFN treatment should apply to all types of IIs (with due regard to the treatment of taxation issues under the MAI, which is being considered in the Expert Group n°2). They also considered that MFN treatment should apply where National Treatment is not provided. One delegation indicated, however, that these obligations should be limited to IIs that do not distort trade. Another delegation indicated that it remained opposed to MAI disciplines in the area of IIs.

44. Those delegations which were in favour of MAI disciplines considered, however, that non-conforming measures could be covered by country specific reservations in accordance with the procedures defined by Drafting Group N°2 [DAFFE/MAI/96(16)]. One delegation held the view that the Contracting Parties should have the right to lodge such reservations when new IIs programmes are created.

45. The application of these core obligations of the MAI should not present difficulties when the conditions for acceding to IIs programmes are clearly defined in domestic legislation or other legal texts. Some delegations noted, however, that it may not always be easy to make such a determination if responsible authorities are given some discretion in implementing these programmes. While this problem may not be confined to IIs, it is of particular significance in this case because of the subjective nature of

the assessment of the merits of an investment proposal. Other delegations noted, however, that this should not prevent the application of MAI obligations.

46. Delegations also discussed the situation of IIs tailored to a particular investment project, often referred to as "one-off" or occasional IIs. A number of delegations expressed doubts as to the applicability, in the absence of any appropriate point of comparison, of the National Treatment and MFN provisions since these are comparative terms. This type of IIs may amount to a major limitation to these obligations, particularly in view of the growing importance of these schemes in OECD countries in recent years.

47. Other delegations considered that this did not constitute a compelling reason for explicitly excluding occasional or one-off IIs from the coverage of the MAI. They argued, on the contrary, in favour of strong and comprehensive obligations on transparency and dispute settlement to prevent a weak interpretation and application of the National Treatment and MFN treatment obligations.

48. It would be desirable to reflect further on this problem.

ii) Transparency

49. A majority of delegations considered it unnecessary to develop specific disciplines on transparency in addition to those already envisaged under the transparency article of the MAI [DAFFE/MAI(96)16, section A.II.2]¹⁶. If, as proposed, IIs are made subject, in principle, to the National Treatment and MFN provisions, the Contracting Parties would be obliged "to promptly publish, or otherwise make publicly available, its laws, regulations, procedures and policies¹⁷" on IIs insofar as they "may affect the operation of the Agreement". They would be obliged to promptly respond to specific questions and provide, upon request, information to other Contracting Parties on matters raised by the IIs¹⁸. Some delegations also referred to the administrative burden already imposed by the transparency obligations of other international agreements, notably the 1994 GATT Agreement on Subsidies and Countervailing Measures. Another delegation felt this was not an overriding argument and, moreover, stated that transparency should be achieved at all levels of government, including sub-federal entities.

50. A few delegations questioned, however, whether this article would be sufficient with respect to IIs. It was not clear, in their view, whether the language would capture all modalities of implementation of IIs or, more importantly, the discretionary decisions of responsible authorities and the actual amount of aid disbursed. Additional provisions could provide, as in the Energy Charter, that one-off IIs programmes be reported to the implementing authorities of the MAI in order to be scrutinised. Transparency would appear to be a minimum obligation for this type of II. A few delegations felt that individual foreign companies may also be given the right to have answers provided concerning specific questions they may

¹⁶ It was noted that the issue of tax havens and dependencies is under consideration in the OECD Committee on Fiscal Affairs.

¹⁷ ... and administrative rulings and judicial decisions of general application as well as international agreements which may affect the operation of the Agreement. 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.

¹⁸ Contracting Parties would not be required to disclose confidential business information, however.

have on IIs. As regards transparency in the disbursement of IIs, one delegation argued that this was not only a highly sensitive issue, but a very difficult obligation to implement.

51. The Expert Group agreed that these issues need further consideration.

III. Additional disciplines

i) Positive discrimination

52. It was acknowledged that the National Treatment and MFN obligations (including the provision of according investors the better of National Treatment and MFN) would not prevent Contracting Parties from offering, in their respective territories, "more favourable" IIs to foreign investors than to national investors. A large number of delegations felt that it would not be wise to prohibit positive discrimination in favour of foreign investors in respect of IIs. This could create confusion over the meaning of the National Treatment obligation under the MAI and raise the question of why positive discrimination is not prohibited in other fields. Some delegations felt that such an obligation would create difficulties for those countries which actively engage in foreign investment promotion.

53. Other delegations argued, however, that it should be possible to incorporate in the MAI a provision prohibiting positive discrimination. This approach would have the advantage, if applied across the board, of not requiring a general definition of IIs. IIs programmes could gain in fairness and acceptability at the national or local levels. It would render the grant of an II more costly to governments since both domestic and foreign investors would be entitled to the same benefits. It would be compatible with a high standard MAI. Some delegations suggested that positive discrimination could be forbidden for some incentives (such as subsidies). These delegations noted this approach would be welfare enhancing in countries which practice positive discrimination. A number of delegations suggested that further work would be necessary if it were to be decided to pursue this option on IIs further.

ii) Specific limitations on the use of IIs

54. A large majority of delegations considered that it would be very difficult, if not impossible, within the time table set for the MAI negotiations to devise any specific limitations on the use of IIs beyond National Treatment, Most Favoured Nation and Transparency. A number of considerations were in support of this position.

55. The problems involved in defining and quantifying IIs are very complex. Moreover, there is not sufficient information concerning the nature, scope and magnitude of the economic effects of IIs. IIs may take a variety of forms, some specific (grants, subsidies, tax advantages...) as well as more general forms (infrastructure or R&D facilities, differences in regulatory requirements). These forms may vary over time and between countries. They can be provided by different levels of government (state, local, municipalities). They may be based on a variety of considerations (job creation, regional development...). Individual tax and non-tax incentives are also often interchangeable. Extensive ground work would, therefore, appear necessary to determine priorities for additional disciplines in this area.

56. Caution was also recommended over duplicating or re-opening disciplines agreed in other fora. It was noted, in particular, that the GATT Subsidies Agreement contains provisions on certain types of "trade" distorting investment incentives. It would be desirable to assess the extent to which these disciplines cover "investment" distorting IIs and, in particular, those which cause the greatest distortions to international investment.

57. Some delegations indicated that the MAI should not aim at consolidating these disciplines, but rather at addressing possible gaps in the treatment of investment distorting IIs. This too could require extensive analytical work.

58. At a more general level, it was underlined that quantitative or qualitative limitations on IIs would conceptually represent a new approach from that embodied in the National Treatment and MFN provisions. While the purpose of the latter is to confer rights to foreign investors, the imposition of constraints on the use of IIs would inevitably take away certain benefits from certain investors. Several delegations indicated they were not prepared to consider this approach since it could also reduce their ability to attract those foreign investments that could benefit their economy. Other delegations questioned the rationale for disciplining IIs of MAI Parties in the absence of similar disciplines on non-MAI Parties. This would entail the risk of negatively affecting the competitive position of the former in relation to the latter.

59. A number of delegations expressed unease, however, over the prospect of not tackling at all the problem of distortionary IIs during the MAI negotiations. A few delegations considered that it should be possible to draw on work done elsewhere, notably in the GATT and the OECD, to draft specific provisions on both tax and non-tax IIs. Article 1 of the 1994 Agreement on Subsidies and Countervailing Measures could provide a basis for defining such IIs. It would also be desirable for the MAI to focus on IIs that are specific to an enterprise, industry, or locality. Article 2 of the GATT Agreement could also provide a useful starting point for defining such a specific requirement. With regard to the disciplines that could be envisaged, this delegation suggested that stand-still and roll-back could constitute effective means for reducing the global distortion of investments caused by IIs. It invited the Expert Group to examine the suggestions made in its Note DAF/MAI/EG3/RD(96)1.

60. One delegation suggested that Article 10 of the Energy Charter on Investment Promotion and Protection could provide an alternative option for including provisions on IIs in the MAI. A best endeavour clause could encourage MAI Parties to practice restraint in the allocation of IIs and to inform the Parties Group of the specific modalities of any existing or new IIs programmes. This article could also specify a programme for further work on IIs after the coming into force of the MAI. This approach would be less ambitious than the GATT approach, but it would present the advantage of securing more time for both necessary analytical work as well as the basis of the potential elaboration of provisions on the basis of the analysis.

61. Delegations were less attracted by the approach in the OECD Instrument on International Incentives and Disincentives although they did not want to discard it completely for now. One delegation suggested, nevertheless, that non-binding guidelines might be the best approach for the use of certain IIs. Some Delegations thought it might be worthwhile to study the merits of the procedures of the OECD Arrangement on Guidelines for Officially Supported Export Credits.

62. Delegations remained unconvinced by the need for special consultation procedures for IIs, although final judgement would need to await the decisions taken on the coverage of the MAI. The presumption was that, as with other agreements, consultations would be the first procedural step of the dispute settlement mechanism of the MAI. Consultations could also be part of the Parties Group's functions. It should be possible to revisit the adequacy of the provisions on dispute settlement and the role of the Parties Group when their configuration is better known. One delegation questioned whether the dispute settlement mechanism of the MAI could apply to investment distorting IIs or to IIs granted illegally. These questions would also deserve further attention.

63. The Expert Group concluded that National Treatment and MFN obligations should apply to investment incentives¹⁹. While noting the concerns raised, for example, in paragraphs 10 and 16 of this report, the Group also concluded that further consideration could be given to the need for and nature of a specific transparency provision and the need for, and possible nature of, other provisions/disciplines on incentives. Further work in the field might, for example, identify issues to be addressed in the MAI and issues that might be addressed after the MAI enters into force²⁰. A number of delegations considered that it would be important in future work to take account of relevant information available from other fora. The Expert Group noted one delegation's offer to provide a paper on definitional and transparency issues. This paper, together with the Secretariat's paper [DAFFE/MAI/EG3(96)14] on treatment of investment incentives in existing agreements, could be considered at a future meeting.

¹⁹ One delegation reserved its position on this first sentence because of the uncertainty surrounding the definition of investment incentives including interaction with obligations in the field of taxation.

²⁰ While noting that the agenda and mechanism for doing further work on incentives was for the Negotiating Group to decide, some delegations suggested that work after the MAI enters into force might be part of a "built-in agenda". Other delegations believe that the Expert Group should identify areas for possible future work, but that proposing specific mechanisms goes beyond the mandate of the Expert Group.

PRIVATISATION

I. Introduction

64. 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 access. The MAI could break new ground and produce "state of the art" provisions on this subject.

65. 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*

66. Privatisation was generally understood to mean the transfer of the partial or complete control²¹ of publicly-owned assets to an investor or investors²². Privatisation may concern a public monopoly or a public enterprise. 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.

67. 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" under discussion in Drafting Group N° 3. Not all sales or disposal of publicly-owned assets are privatisations (e.g. sale of government bonds). 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. Some delegations are not convinced that the transfer of real estate should be regarded as a privatisation.

68. 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 deserve a "*sui generis*" treatment under the MAI. The concept of concessions is under discussion in Drafting Group n°3 [section A.1 of DAFPE/MAI(96)16].

²¹ The concept will require further consideration.

²² The question of how to capture the privatisation of service activities remains to be determined. A number of delegations suggested that the word "private" be added before "investor" or "investors".

69. 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.

70. 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.

71. 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.

72. 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 Favoured Nation Treatment

i) Right to participate in Privatisation

73. There was an emerging consensus that the MAI should ensure that foreign investors are given, as a matter of policy, the same rights for participating in a privatisation operation as 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. Further consideration will need to be given to whether and how to translate this emerging consensus into draft text.

74. These provisions would not, by themselves, give ground to an investor to challenge every privatisation decision solely on the basis that it failed to win a privatisation bid. This would require, however, that the privatisation programmes, as well as the rules and procedures governing their implementation, are fair, transparent and non-discriminatory against foreign investors, whether they are already established or not.

75. Some delegations felt that MAI privatisation obligations should preserve the government's freedom to ensure the efficiency of privatisation operations and to obtain maximum profit from the sales, while protecting, at the same time, the necessary business confidentiality of the privatisation process.

76. 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. Another delegation shared the concerns on the "initial sales" issue, but 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 privatisation of the company.

77. 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 clarification points.

78. 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.

79. 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.

80. Problems encountered with direct sales are reminiscent to those encountered with the so-called one-off 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.

81. These draw-backs were not generally considered to justify, however, a carve-out for certain types of privatisation operations²³. 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.

82. 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 DAFFE/MAI/DG3(96)1/REV1] would need to be ensured.

83. 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.

84. Some delegations argued that country-specific reservations relating to privatisation should be limited to well-defined sectoral restrictions (for air transport for instance). One delegation noted that such general reservations were contemplated for initial sales in the context of the ECT Supplementary Treaty discussions. Reservations of a more horizontal nature were not ruled out by other delegations.

85. 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. Some delegations considered it essential to cover such privatisations under the MAI. These issues deserve further attention.

²³ Some delegations argued in favour of de minimis rules -- excluding certain types of direct sales below predetermined thresholds.

ii) "*Special shares*" and other share arrangements

86. It was recognised that there could be privatisation operations where public authorities may wish²⁴ to retain some influence or leverage on the new owners of the privatised firms or to pursue other policy goals. "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.

87. 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. Some delegations stressed that the question for the MAI is not to know whether recourse to these measures are wide-spread, but whether the MAI should provide for transparency and the non-discriminatory application of these schemes as well as adequate recourse to dispute settlement.

88. Some delegations 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 these delegations, this approach would be the most appropriate to ensure transparency and avoid abuses. The need for a balance of commitments in these areas between the countries that make use of special arrangements and those which do not was also noted.

89. Some delegations 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. Some criteria were suggested for carrying out this test. Contracting Parties could be required, in this case, to give reasons for the introduction of a share arrangement. Such arrangements should have time limits. This proposal would require further consideration.

90. These criteria were opposed by some delegations because, in their 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. These delegations did not object, however, to the idea of a general anti-abuse clause which would be applicable to all the obligations of the Agreement.

²⁴ Certain concerns should be taken care by the general exceptions Article of the MAI. Other provisions under discussion in the MAI, including a possible provision on prudential matters, would need to be taken into account. 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.

91. 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.

92. Concerning preferential sales schemes in favour of a participation of small investors, including private persons not employed by the company, 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.

iii) Management buy-out and workers participation programmes

93. 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.

94. 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.

95. 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.

96. 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.

97. 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.

iv) Small-scale privatisations

98. 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.

99. 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.

100. 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

101. 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 DAF/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. The investor may require information on bidding rules and procedures in the case of direct sales. The investor may also want to find out the criteria on which decisions have been made.

102. 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 office²⁵ 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. One delegation considered that governments should be free to organise a privatisation process while providing for transparency.

103. 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 under a bid process pose problems similar to those encountered with government procurement bid procedures. Another delegation considered that the transparency rules should be the same for public and direct sales.

104. 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 MAI²⁶. 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.

105. 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.

²⁵ Reference was made to the provisions in the Energy Charter on the exchange of information the state and the investor.

²⁶ This issue is expected to be taken up in the context of the role of the Parties Group.

106. 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, relating to privatisation and state-to-state enquiries on specific aspects of these²⁷. 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.

V. Conclusion

107. There seems to be an emerging consensus in favour of the view that the core provisions of the MAI should apply to privatisation operations. However, there might be a need to draft texts, notably with respect to definition, National Treatment and MFN, special share arrangements and anti-abuse²⁸, and transparency.

²⁷ Section II.2 of DAFFE/MAI(96)16.

²⁸ Taking into account the view expressed in paragraphs 89-91.

MONOPOLIES/STATE ENTERPRISES

I. Introduction

108. The existence of a monopoly is not contrary to National Treatment since both domestic and foreign investors face the same " market access limitation" to the investment opportunities captured by the monopoly.

109. In considering the possible nature and scope of MAI obligations on monopolies and state enterprises, the Expert Group focused on the questions of whether and how the actions taken by government-designated monopolies could interfere with or frustrate the effective application of the National Treatment and MFN Treatment obligations. It also examined the issue of Transparency.

110. Great care was taken in limiting the analysis to the field of investment policy and to avoid undue encroachment in other areas, in particular trade policy, competition policy and government procurement policy.

II. Monopolies

1. Definition

111. The need for a definition on monopolies was considered to be closely related to nature of the MAI obligations in this area. If a specific provision was drafted, a definition would be required for the understanding of the obligations.

112. There was agreement that the focus should be on government-designated monopolies. Some aspects for describing these entities could be found in Article XVII of the GATT on State Trading Enterprises²⁹, Article VIII of the GATS³⁰ and Article 1505 of NAFTA³¹. Caution should be exercised, however, not to take the definitions found in these agreements out of context since they were not drafted with the sole investment perspective in mind and, indeed, embodied trade and competition elements.

²⁹ Article XVII of the GATT defines a state enterprise as "government and non-government enterprises (...) which have been granted exclusive or special rights or privileges, including legal or constitutional powers (...).

³⁰ Under the GATS, a "monopoly supplier of a service" means "any person, public or private, which in the relevant market of the territory of a Member is authorised or established formally or in effect by that Member as the sole supplier of that service". The GATS also covers the cases of "exclusive service suppliers, where a member formally or in effect, (a) authorises or establishes a small number of suppliers and (b) substantially prevents competition among those suppliers in its territory".

³¹ Under NAFTA, a monopoly means "an entity, including a consortium or government agency, that in any relevant market in the territory of a Party is designated as the sole provider or purchaser of a good or service". It covers therefore any monopoly permitted or regulated in some manner by the government. NAFTA excludes however from the concept of monopoly " any entity that has been granted an exclusive intellectual property right solely by reason of such grant or monopolies based on "natural advantage".

113. A number of delegations were attracted by a definition of monopolies along the lines of "any person, public and private, designated by a government authority as the sole supplier or buyer of a good or service in a given market in the territory of a Contracting Party." This person may be a natural person, an enterprise, a consortium, a state enterprise, or a government agency. There was also some support for including the notion of a "limited" number of suppliers which are substantially prevented from competing amongst each other by a Contracting Party. This again would depend on the question of designation by government authorities.

114. The Expert Group took note of the explanation provided by one NAFTA delegation as to why the NAFTA definition of a monopoly excludes "any entity that has been granted an exclusive intellectual property right solely by reason of such grant". Patents are not granted to transfer regulatory powers, but to protect intellectual property rights. This is a different issue from discrimination that may result from the exercise of delegated powers by government-designated monopolies. The Expert Group also took note that the NAFTA definition excludes monopolies solely based on a "natural advantage".

115. The Expert Group also had a brief discussion on the definition of concessions and whether this subject could be considered to fall in the area of monopolies or private investment on the basis of the note [DAFFE/MAI(96)RD(96)11]. It agreed that this was an important issue that it will need to be addressed on its own merits. It was noted that concessions is one of the items listed in the proposed definition of "investment" in the MAI.

2. *Possible obligations on Monopolies*

a) To act in a manner not inconsistent with the Agreement

116. There was an emerging consensus that if a Contracting Party decides to delegate one or several of their regulatory, administrative or other governmental powers to a government-designated monopoly, this does not mean that it could escape its obligations under the MAI. This is a distinct issue from that of the designation of monopolies [see section d) below]. This interpretation would be fully consistent with the MAI objective to discipline discriminatory treatment against foreign investors and their investments. Some delegations stressed that delegated powers should cover sub-national as well as national authorities.

117. It remained an open issue whether the MAI should contain an anti-circumvention clause, and, if so, whether it should be a general clause or whether a specific provision was needed concerning monopolies. The majority of the delegations considered that if the latter approach was chosen, such an anti-circumvention clause could be developed around Article 1502.3a) of NAFTA:

"Each Contracting Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any monopoly it maintain or designates acts in a manner that is not inconsistent with the Contracting Party's obligations wherever such monopoly exercises any regulatory, administrative or other governmental authority that the Contracting Party has delegated to it in connection of the monopoly good or service".

118. A few delegations reserved their position on the grounds that the obligations of the MAI have not all been defined and that it would be more appropriate to discuss this proposal at a later date. A number of delegations noted that the core obligations of the MAI (National Treatment and MFN, in particular) have already been sufficiently defined. One delegation wondered if the language "not being inconsistent with the Contracting Parties'" obligations was precise enough to avoid different interpretations. One delegation wondered whether an anti-circumvention clause would be necessary at all

given the possible recourse to dispute settlement. It admitted, nevertheless, that this would facilitate the interpretation of the MAI.

119. The Expert Group also discussed the option of extending the scope of the anti-circumvention clause to every action taken by government-designated monopolies, and not only those resulting from delegated powers. This is the approach of Article VIII of the GATS. The GATS Article 1 also deals with circumvention, albeit only through delegated powers. The GATS deals with cross border trade, but only in services sectors. The GATS approach is less precise than the NAFTA. Therefore, the GATS language is not directly transferable to an investment agreement such as the MAI. If the MAI were to cover the general behaviour of monopolies, it would inevitably enter the field of competition policy. One delegation argued this option could not be entirely discarded at this stage.

b) Sale and purchase practices of monopolies

i) Sales

120. Some delegations thought the MAI should contain a non-discrimination provision covering the sales practices of government-designated monopolies regarding monopoly goods or services. Equal access to raw material (coal, oil...) or infrastructure services (water, electricity transmission, railways, roads services) was mentioned as an essential component to the viability of a business operation.

121. One delegation argued that such an obligation should follow automatically from the application of the anti-circumvention clause discussed in section II.a and that it would be superfluous to create another layer of clarifications. A few delegations argued that, on the contrary, a specific provision was needed since the non-discrimination obligation they had in mind would not be limited to situations where a monopoly acts on behalf of a public authority, but to every sale of the monopoly good or service in the relevant market. One delegation suggested that "*de facto*" or "natural monopoly" goods or services should be covered as well by this obligation.

122. Some delegations felt that the MAI need not to be concerned with this issue since it was normally covered by national competition rules, at least in OECD countries. One delegation noted, however, that even in some OECD countries national competition rules have excluded so far certain monopolistic areas, e.g. utilities, from their application. One delegation indicated it could not subscribe to a full-fledged non-discrimination provision in this area given the special circumstances (shortage of supply...) that may be encountered in the provision of a monopoly good or service. Two other delegations noted that such concerns might be taken care of by differentiating between private consumers and investors.

123. For the same reasons as those recalled in section ii) below, the Expert Group decided not to pursue the idea of including an additional provision along the lines of article 1502.3(b) of NAFTA that would require government-designated monopolies to act solely in accordance with "commercial considerations" with respect to their sales of monopoly good or services. Some delegations still considered this matter to be an open issue.

ii) Purchases

124. Some delegations recognised that certain purchase practices of government monopolies are covered by the GATT Government Procurement Agreement and that there would be no value added in reproducing its provisions in the MAI. The procurement policies of monopolies would appear to be of

more direct interest to the trade field than to investment field. There was also no interest for discussing the purchase practices of other types of monopolies (natural monopolies, de facto monopolies).

125. One delegation indicated its readiness to go beyond the understandings reached in the WTO through the incorporation into the MAI of a non-discrimination provision for government-designated monopolies, provided others delegations would be prepared to do the same. In its view, the purchase practices of monopolies can also have a major impact on the choice of the investment activities that foreign investors may undertake in a given country.

126. There was support to apply the MAI obligations to the monopolistic purchases of certain government-designated monopolies not uncommon in certain sectors (marketing boards in agriculture, energy...). It was noted that this is translated, in NAFTA article 1502.3(c), in the obligation:

"to ensure, through regulatory control, administrative supervision or the application of other measures " that any government-designated monopoly provides "non-discriminatory treatment to investments of investors, to goods and to service providers of a another Contracting Party in its purchase or sale of the monopoly good or service in the relevant market".

Some delegations indicated their readiness to consider an obligation such as that contained in this NAFTA article.

127. Some delegations reserved their position on this proposal on the grounds that it might intrude into competition policy.

128. The Expert Group was not inclined to consider a broader provision along the lines of article 1502.3(b) of NAFTA that would require government-designated monopolies "to act solely in accordance with commercial considerations in its purchase of the monopoly good or service in the relevant market". Some delegations wondered how a government-designated monopoly could be obliged to act according to "commercial or sale" considerations since, by definition, its operations are not subject to market rules. Some delegations still considered this matter to be an open issue.

c) Abuse of dominant position

129. A consensus emerged that the issue of the abuse of dominant position by monopolies could not be adequately tackled within the time available for the MAI negotiations and that it should not be pursued further by the Expert Group. This subject clearly belongs to the competition policy field. Some delegations indicated their readiness to consider an obligation to "ensure against anti-competitive practices" by officially-designated monopolies (see NAFTA Article 1502, paragraph 3d). One delegation would not use the "abuse of a dominant position" language found in certain countries national competition.

130. It was acknowledged during the discussion that monopolies have the capacity to interfere with an investor's rights and to introduce market distortions, notably by cross-subsidising their business activities in competitive sectors. The impact of these practices may, in fact, be as detrimental to foreign investment as the exercise of delegated regulatory powers. It would be desirable, however, to leave these problems to competition policy.

131. This would not preclude that they be considered at a later stage after the MAI enters into force. They could not, in any case, be dealt with under a single article on abuse of dominant position. Competition policy experts would necessarily need to be involved. One delegation agreed that the

proposals it has made on the separation of monopolistic and non-monopolistic activities [DAFFE/MAI/RD(96)11] could be addressed in that context provided the treatment of monopolies in the MAI is deemed overall to be satisfactory.

d) Right to designate a monopoly and demonopolisation rules

132. The Expert Group agreed that the right of governments to create, allow or maintain monopolies could not be challenged under the MAI. Governments shall also remain sovereign with respect to "demonopolisation" matters.

133. Using similar arguments as those made during the privatisation discussion [DAFFE/MAI(96)5]), a few delegations expressed a preference for the inclusion of a declaratory provision in the MAI recognising these sovereign rights. It would provide the assurance that they could not be questioned under the dispute settlement provisions of the MAI.

134. One delegation suggested that the need for a specific provision might be more obvious should the MAI contain market access disciplines. Another delegation commented that even in such case, the sovereign rights of governments could not be challenged.

135. One delegation pointed out that the creation of new monopolies should be subject to the non-discriminatory obligation of the MAI. Selection of the candidate to receive the monopoly franchise should not be made outside of the National Treatment and MFN rules in the absence of a country-specific reservation or exception.

136. The Expert Group also discussed the merits of clarifying the rules pertaining to access to investment opportunities created during a demonopolisation process. A number of delegations considered this to be unnecessary since the National Treatment and MFN obligations would start to apply as soon as a given monopoly is broken down. Some delegations felt that it would be useful to confirm explicitly the application of the National Treatment and MFN provisions to these new situations in view of the fact that market access to demonopolised activities has been traditionally been subject to reciprocity.

137. Other delegations felt this interpretation needed further reflection given the political sensitivity of certain demonopolisation activities. An unqualified application of National Treatment could not be contemplated in the absence of a proper balance between the liberalisation commitments of the Contracting Parties. One delegation reserved its position over a possible abandonment of reciprocity in the context of demonopolisation.

138. It was recognised that some of these concerns could be taken care of in the context of the Contracting Parties' individual reservations to the MAI. One delegation argued that demonopolisation would provide the Contracting Parties with the opportunity to make positive liberalisation commitments during the negotiations. It also was of the view that in the absence of country-specific reservations, the National Treatment and MFN obligations would automatically apply to the new investment opportunities created by demonopolisation. One delegation recalled that the Drafting Group N°2 considered that if MAI obligations were expanded, new reservations would come into play with respect to the new or enlarged obligations³². There was, however, no definite conclusion; delegations agreed to pursue the discussion.

³² See DAFTE/MAI(96)16, section C.

III. State enterprises

139. A large majority of delegations considered that state enterprises would not deserve special attention under the MAI unless they exercise a delegated governmental authority. In their view, there is no apparent need for separate provisions on state enterprises since it should prove possible to regroup eventual obligations on delegated governmental authority under a single heading. Some delegations believed that sales by state enterprises might be governed by commitments to accord non-discriminatory treatment (see attached NAFTA Article 1503.3 and Article 22, paragraph 1 and 2 of the Energy Charter Treaty).

140. The issue in this case³³ is how to ensure that Contracting Parties do not escape their MAI obligations as a result of the powers transferred to state enterprises. The general view was that this problem could be resolved by a general anti-circumvention clause, such as the one envisaged for government-designated monopolies.

141. One delegation reserved its position on the eventual extension of the MAI to state enterprises exercising delegated regulatory, administrative or other governmental authority. This delegation wanted to make sure that only industrial and commercial activities would be covered. Another delegation felt that the anti-circumvention clause should also apply to private enterprises exercising a governmental authority since these entities too could be used to circumvent the MAI. The model provided by the Energy Charter would appear to be preferable to the NAFTA model.

142. Delegations did not come to a definite conclusion as whether the MAI should be concerned by the actions taken by the state as a shareholder in a company. It was recognised that these actions could be dictated by genuine business consideration, but they could also provide ground for discrimination against foreign investors. One delegation argued that the state could not escape its MAI obligations when exercising its ownership rights, particularly when holding a controlling interest in the enterprise.

143. A large majority of Delegations considered that the MAI should not include a provision applying to the purchases and sales practices of state-owned enterprises. The Agreement should not, in their view, duplicate or attempt to improve upon the GATT Government Procurement Agreement. One delegation felt that the question of overlap with the GATT Agreement needs to be carefully examined before ruling-out any MAI involvement in this area. Some delegations believed that sales by state enterprises might be governed by commitments to accord non-discriminatory treatment (see attached NAFTA Article 1503.3 and Article 22, paragraph 1 and 2 of the Energy Charter Treaty).

IV. Transparency

144. A number of delegations were of the view that the MAI should contain specific transparency rules for monopolies above those already foreseen by the general transparency article of the MAI [section II.2 of DAFTE/MAI(96)16]. Notification of government-designated monopolies could help assess their

³³ It should not be confused with the treatment accorded to state enterprises as "investors" of a Contracting Party and the obligations the Contracting Parties would have under the MAI. The proposed inclusion of "a legal person or any other entity constituted or organised under the applicable law of a Contracting Party...whether ...government owned or controlled" into the MAI definition of "investor" [Section A.1 of DAFTE/MAI(96)16] implies that state enterprises would be entitled to all the benefits of the MAI. One delegation believes that a definition on state enterprises might be necessary.

economic importance and signal to foreign investors the economic activities excluded from normal competition.

145. Notification requirements could be limited, however, as with OECD instruments, to existing or new government-designated monopolies, but should not extend to state enterprises operating in a competitive environment.

146. It would also appear logical to envisage the same transparency rules for privatisation and demonopolisation. They could eventually be combined into one single provision.

147. Some caution was expressed about not overburdening Contracting Parties with reporting obligations. It would be wise to hold off final judgement on transparency rules for monopolies (and demonopolisation and privatisation) until agreement is reached on the general transparency article and the role of the Parties Group.

Annex

NAFTA

Article 1502: Monopolies and State Enterprises

1. Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly.
2. Where a Party intends to designate a monopoly and the designation may affect the interests of persons of another Party, the Party shall:
 - (a) wherever possible, provide prior written notification to the other Party of the designation; and
 - (b) endeavor to introduce at the time of the designation such conditions on the operation of the monopoly as will minimize or eliminate any nullification or impairment of benefits in the sense of Annex 2004 (Nullification and Impairment).
3. Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates:
 - (a) acts in a manner that is not inconsistent with the Party's obligations under this Agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges;
 - (b) except to comply with any terms of its designation that are not inconsistent with subparagraph (c) or (d), acts solely in accordance with commercial considerations in its purchase or sale of the monopoly good or service in the relevant market, including with regard to price, quality, availability, marketability, transportation and other terms and conditions of purchase or sale;
 - (c) provides non-discriminatory treatment to investments of investors, to goods and to service providers of another Party in its purchase or sale of the monopoly good or service in the relevant market; and
 - (d) does not use its monopoly position to engage, either directly or indirectly, including through its dealings with its parent, its subsidiary or other enterprise with common ownership, in anticompetitive practices in a non-monopolized market in its territory that adversely affect an investment of an investor of another Party, including through the discriminatory provision of the monopoly good or service, cross-subsidization or predatory conduct.

4. Paragraph 3 does not apply to procurement by governmental agencies of goods or services for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods or the provision of services for commercial sale.

5. For purposes of this Article "maintain" means designate prior to the date of entry into force of this Agreement and existing on January 1, 1994.

Article 1503: State Enterprises

1. Nothing in this Agreement shall be construed to prevent a Party from maintaining or establishing a state enterprise.

2. Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges.

3. Each Party shall ensure that any state enterprise that it maintains or establishes accords non-discriminatory treatment in the sale of its goods or services to investments in the Party's territory of investors of another Party.

The Energy Charter Treaty

STATE AND PRIVILEGED ENTERPRISES

(1) Each Contracting Party shall ensure that any state enterprise which it maintains or establishes shall conduct its activities in relation to the sale or provision of goods and services in its Area in a manner consistent with the Contracting Party's obligations under Part III of this Treaty.

(2) No Contracting Party shall encourage or require such a state enterprise to conduct its activities in its Area in a manner inconsistent with the Contracting Party's obligations under other provisions of this Treaty.

CORPORATE PRACTICES

I. Introduction

148. Government restrictions are not the only impediments to foreign investment. Actions taken by individual firms, that is "corporate practices", can also negatively impact on foreign investment. These practices can be made explicit and obligatory, notably in the companies' articles of association and/or by-laws, or they may result from the day-to-day activities of enterprises³⁴. They can discriminate against foreign investors or apply to particular categories of investors, including nationals.

149. A majority of delegations shared the view, however, that the fundamental vocation of the MAI is to discipline discrimination by governmental authorities. Discriminatory corporate practices imposed by domestic laws, regulations, administrative practices and policies³⁵ or any other government action³⁶ should, therefore, be made subject to MAI obligations. Some delegations also sought to have corporate practices that were allowed explicitly or implicitly by governments to be subject to the MAI.

150. The Group underlined that it had had limited time to discuss the subject of corporate practices and therefore the views expressed in this report need to be considered as preliminary.

II. National Treatment and Most Favoured Nation Treatment

151. The Expert Group considered that the National Treatment and Most Favoured Nation Treatment (MFN) obligations would apply to domestic laws and other government measures which explicitly require that locally-incorporated companies (or to-be-locally incorporated companies) impose or administer restrictions against foreign investors, be it in their statutes, by-laws or day-to-day operations. Examples of such corporate practices are restrictions on foreign investors' participation in the equity or capital base of an enterprise or on the resale of its shares to foreign investors or limitations on the participation of non-nationals on boards of directors and in management.

152. Such corporate practices required by national laws and other government measures could be covered by country specific reservations in accordance with the procedures that have been proposed to the Negotiating Group [DAFFE/MAI/96(16), section C]. One delegation noted that article 1107 of the NAFTA reproduced in Annex 2 might be a useful provision in setting out what is and is not acceptable from the perspective of limits and country-specific reservations concerning management.

153. Most delegations considered that these obligations should not extend to corporate practices that are not contrary to the Contracting Parties' laws, regulations and policies even where these practices could result in discriminatory equity restrictions or limitations in participation on boards of directors and in the management of a company. Some delegations noted that to prohibit such practices would interfere with

³⁴ Reference was made to the list of corporate practices annexed to the document [DAFFE/MAI(96)10].

³⁵ The coverage of administrative practices and policies is under consideration by Drafting Group No. 3.

³⁶ One delegation reserved its position on the concept of government action.

the right of an enterprise to freely contract. There would be practical difficulties in creating obligations in this area since governments do not normally compile detailed information on these practices. These practices may vary from firm to firm. There was no consensus as to whether the MAI could or should capture discriminatory corporate practices that are explicitly permitted, but not required, under the contracting Parties' laws, regulations, and policies.

154. A few delegations argued that the MAI should not totally discard the possibility of disciplining in some way discriminatory corporate practices in company statutes and by-laws not imposed by domestic laws or other government measures. An outright prohibition would appear to be the most effective means of addressing the problem and should be examined further. Further thought could also be given to the merits of including a best endeavour clause into the MAI that would encourage Contracting Parties to legislate or regulate in favour of the removal of discriminatory elements in company statutes and by-laws or to avoid encouraging (or invite) enterprises (not) to adopt discriminatory provisions.

155. Some delegations considered that a list of corporate practices should be subject to National Treatment and MFN obligations. This would involve government prohibition of such practices. Such a list should include the corporate practices identified in substantial previous OECD work as listed in the Annex to DAF/MAI(96)10. One delegation indicated that it could not contemplate a provision that would encourage Contracting Parties to undertake legislative or regulatory action in this area.

156. Some delegations also felt the MAI could not fall below the provisions developed in other agreements, and particularly those of Article IX of the GATS. An MAI provision inspired from this article could recognise that certain corporate practices may negatively affect foreign investors and their investments. It could also provide for consultation procedures aimed at addressing problems that may arise from the existence of corporate practices in a Contracting Party.

III. Transparency

157. A majority of delegations considered that, under the clarification of the scope of application of the National Treatment and MFN obligations in paragraphs 3-4 above, the draft transparency article proposed in section II.2 of DAF/MAI/96(16) would adequately capture laws and regulations requiring companies to impose restrictions on foreign investors and their investments inconsistent with these provisions³⁷. There would, therefore, be no need for specific transparency rules for corporate practices in the MAI.

158. A few delegations felt, however, that these requirements would not capture all corporate practices of concern and that complementary avenues should be explored to include transparency provisions on discriminatory measures found in company statutes and by-laws. The GATS Article IX approach would encourage Contracting Parties to supply publicly available non-confidential information to Contracting Parties with concerns about particular corporate practices. This information could also be made available under the dispute settlement mechanism of the MAI and more particularly, under the consultation procedures envisaged by Expert Group No. 1 [DAF/MAI/EG3(96)5]. Another possibility might be the compilation of company statutes and by-laws in a centralised register. Many delegations noted that this approach would entail considerable practical difficulties. Since company statutes are

³⁷ Contracting Parties would be obliged to " promptly publish, or otherwise make publicly available, its laws, regulations, procedures and policies ... which may affect the operation of the Agreement". They would also be obliged to promptly respond to specific questions and provide, upon request, information to other Contracting Parties on matters raised by corporate practices.

usually public documents, they could be made accessible to the Contracting Parties and their investors. By-laws, however, are not usually public documents. Some delegation argued that balance of commitments and clarification of laws and practices amongst Contracting Parties would have to be found before contemplating transparency obligations for restrictions formulated in by-laws. Another delegation did not consider it necessary to establish specific transparency or consultation procedures regarding corporate practices.

159. The Expert Group concluded that further consideration should be given to the issue of whether or how the techniques developed under existing OECD instruments to bring greater transparency on corporate practices could be taken up under the MAI. Some delegations expressed, in particular, extensive interest in including the subject of corporate practices in future MAI "peers" country reviews by the Parties Group.

Annex 1

Article IX of the GATS

Business Practices

1. Members recognise that certain business practices of service suppliers, other than those falling under Article VIII³⁸, may restrain competition and thereby trade in services.
2. Each Member shall, at the request of any other Member, enter into consultation with a view to eliminating practices referred to in paragraph 1. The Member addressed shall accord full and sympathetic consideration to such a request and shall co-operate through the supply of publicly available non-confidential information of relevance to the matter in question. The Member addressed shall also provide other information available to the requesting Member, subject to its domestic law and to the conclusion of satisfactory agreement concerning the safeguarding of its confidentiality by the requesting Member.

³⁸ This article pertains to *Monopolies and Exclusive Services Suppliers*.

Annex 2

NAFTA

Article 1107: Senior Management and Boards of Directors

1. No Party may require that an enterprise of that Party that is an investment of an investor of another Party appoint to senior management positions individuals of any particular nationality.
2. A Party may require that a majority of the board of directors, or any committee thereof, of an enterprise of that Party that is an investment of an investor of another Party, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment.