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Laws and Policies Regulating Foreign Investment In Ten Countries

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COMPARATIVE SUMMARY

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

Most countries have some provision in their laws that allow the government to block foreign direct investment on national security grounds. However, the extent and operation of these laws vary to such an extent that the surveyed countries cannot readily be broken down into categories. The following introduction offers a brief comparative overview, while subsequent individual summaries highlight the separate reports.

Introduction

The attached reports covering ten countries and the European Union show that there are considerable differences in how foreign governments control foreign direct investment (FDI) on national security grounds. One common feature is that most of the countries have some provision in their laws that enables one or more government departments to disallow foreign investments that might compromise security interests, but there are some exceptions. The relevant Canadian law only provides for the blocking of FDI that would be inconsistent with national industrial, economic, and cultural policies. The United Arab Emirates does not have provisions for disallowance of proposed FDI, but does have general nationality requirements that preclude foreign takeovers of industries.

Of the countries that have laws respecting FDI and national security, some are very limited and some are fairly extensive. Germany's law is limited to the armaments sector and the Netherlands law is limited to aviation and shipping. The United Kingdom has a very broad law giving the Secretary of State powers to disallow foreign investments on national security grounds, acting upon the advice of the Office of Fair Trading and the Competition Commission, but this law does not attempt to define what industries are considered to be particularly sensitive. France's law is much more detailed. In that country, a decree identifies eleven sectors of the economy that are subject to a prior approval process. This process is regulated by specific rules and regulations which establish deadlines and timetables. Canada's Investment Canada Act also establishes a formal review process for reviewable investments. In India, approval for investments in industries engaged in defense production is granted by a board and licenses to operate are granted by a separate agency.

China and the Russian Federation control FDI through complex and often confusing mixes of laws, regulations, catalogs, guidelines, and treaties. However, it appears that in both of these countries, the weighing of proposals for FDI is a highly political process often done at high levels within the government. In both of these countries, the government has recently introduced reforms to make the process more transparent and open, but still restrictive in areas considered to be of importance to national security. The Russian Federation's law is expected to be enacted this year.

One common feature of the review processes described in the country reports is that they are all conducted within general governmental departments having responsibilities in the areas of industry, finance, or defense. None of the surveyed countries has a separate foreign investment review agency or department to consider FDI proposals. Canada had a Foreign Investment Review Agency to make decisions on FDI in accordance with its own statute and regulations, but the agency's review responsibilities were transferred to Industry Canada and the Department of Canadian Heritage in 1985.

Canada

Canada has an Investment Canada Act which provides for the review of certain investments either by Industry Canada or the Department of Canadian Heritage. The general threshold for investments from individuals or entities from World Trade Organization countries is now approximately Can$280 million. Investments in what are considered to be cultural industries are subject to much lower thresholds due to the fact that the Canadian Government considers cultural industries to be in need of special protection. The Investment Canada Act does not specifically prohibit investments in industries engaged in the production of armaments or war materials or in industries that might be vital to national security. One of the factors Industry Canada is directed to consider in weighing an application for approval is whether the investment would be consistent with national industrial, economic, and cultural policies. The extent to which this factor is viewed as covering national security concerns is not set out in any regulations, orders, or decrees. Thus, there is considerable ambiguity as to whether the extant Canadian law places controls on FDI on national security grounds.

China

China presently does not have a formal foreign investment review agency, but Chinese authorities are considering establishing a special inter-agency review mechanism for mergers and acquisitions through FDI. Growing concern with foreign investment led to the issuance of Guiding Opinions of the State-Owned Assets Supervision and Administrative Commission (SASAC) on Advancing State-Owned Assets Adjustment and Reorganization of State-Owned Enterprises at the end of 2006. On December 18, 2006, SASAC declared that the state should maintain absolute power of control over vital trade and key sectors that are related to national security. Included in these sectors are armaments, telecommunications, and civil aviation.

Under the Provisions on Guiding the Direction of Foreign Investment, the National Development and Reform Commission, the Ministry of Commerce, and other government ministries formulate a Catalog for Guidance of Foreign Investment Industries and a Catalog of Priority Industries for Foreign Investment in the Central and Western Regions. These two catalogs are the basis for guiding the examination and approval of foreign investment projects.

In 2006, new Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors were formulated. These provisions introduced a new screening requirement for cross-border mergers and acquisitions if the acquisition has or may have an impact on national security. It has been reported that new limits are to be imposed on FDI in nuclear power equipment, shipbuilding, general purpose equipment, and the petroleum and steel industries. The impetus behind the new merger and acquisition guidelines was the proposed takeover of a construction company by the Carlyle Group and several other controversial deals involving FDI.

The European Union

Under the EC Treaty, the Member states of the EU retain the right under Article 46 to impose restrictions on the right of establishment and on the free movement of capital on grounds of public policy or public security. The term “public security” has been interpreted by the European Court of Justice to mean a genuine and serious threat to a fundamental interest of society. Additionally, Article 296 of the Treaty specifically allows EU countries to take necessary measures for the protection of their security connected to the production of trade in arms, munitions, and war material. These restrictions are subject to requirements that they do not constitute arbitrary discrimination or a disguised restriction on the free movement of capital.

Article 296 is supplemented with a provision in the merger regulations which allows Member states to take appropriate measures to protect “legitimate interests.” Public security is considered to be a legitimate interest, but Members may not take measures to affect competition in products which are not specifically intended for military purposes.

France

France has a prior authorization regime which was reformed and refined in 2004 and 2005. The Monetary and Financial Code provides that prior authorization of FDI from the Ministry of the Economy is required when it even occasionally involves activities affecting public order, public safety or national defense or activities involving the research, production or trading of arms, munitions, or explosives. Decree 2005-1739 identifies eleven sectors of the economy that are subject to the prior approval requirements. Included among these are providing private security, fighting the unlawful use of pathogens by terrorists, monitoring equipment, computer security, technologies that have dual civilian and military uses, cryptology, repositories of defense secrets, research and production of arms, ammunition, explosives, or other military equipment, and activities carried out by certain companies that have entered into a design or supply contract with the Ministry of Defense. In some of the categories, the takeover rules are relaxed for EU investors.

The Ministry of the Economy can attach conditions to any authorization to ensure that the FDI will not infringe upon national interests. The Ministry can disallow proposed investments if it believes the investor may engage in acts of terrorism or the financing of terrorism. The Ministry can also refuse to allow FDI if it would threaten the continuation of industrial capacities, the security of the supply chain, or the performance of defense contractors. Decisions of the Minister of the Economy can be appealed to the administrative courts.

French law provides for the imposition of strong sanctions against persons who violate the Monetary and Financial Code. Investments can be voided and investors can, in certain circumstances, be imprisoned for up to five years and fined up to twice the amount of the investment. Legal entities can be fined up to five times the amount specified for a natural person.

Decree 2005-1739 has been strongly criticized by the European Commission as violating the EC Treaty rules on the free movement of capital. The European Commission has recently asked France to modify it.

Germany

Germany has a liberal trade policy and the only statutory restriction currently in force respecting FDI applies to the armaments industry. Since 2004, the Foreign Trade Act has allowed for restrictions in order to ensure essential security interests, prevent a disturbance of peaceful international coexistence, or prevent significant disturbance of foreign relations. Restrictions may be placed on legal transactions concerning enterprises that produce war weapons or other armament-related goods and the acquisition of shares in such enterprises. The approving agency is the Ministry for Technology and the Economy, but it must act in agreement with the Ministry of Foreign Affairs and the Ministry of Defense. The 2004 restrictions on investments in the armaments sector were applied against a French firm to block the takeover of Atlas Elektronic Gmbh by the French-based multinational defense corporation Thales. Sixty percent of Atlas was acquired by Thyssen Krupp and forty percent by another French firm in which Germany owns a participatory share.

The city-state of Hamburg is proposing to privatize 49.9 percent of its port facilities. Dubai Ports World is among the bidders. It appears that the city-state would prefer a domestic partner, but there is no law prohibiting the investment by Dubai Ports World.

India

Since the mid-1980s, India has liberalized its foreign investment laws. One sector in which FDI is still prohibited is atomic energy. Investments in industries retained under compulsory licensing are subject to review. Industries engaged in the production of aerospace and defense equipment, explosives, and hazardous chemicals fall within this class. There does not appear to be a catch-all category for industries related to national defense or security. Approval for investments in the listed fields can be given by the Foreign Investment Promotion Board and licenses for operations are granted by the Secretariat for Industrial Assistance in the Department of Industrial Policy and Promotion**.**

Japan

Japan has a Foreign Exchange and Foreign Trade Law and a Foreign Direct Investment Order. Under these instruments and related ministerial notifications, FDI in industries relating to national security, public order, and public safety are reviewed by the Ministry of Finance and the ministry having jurisdiction over the involved industry. Specifically covered by advance notification requirements are investments in industries engaged in the production of aircraft and aircraft parts, explosives and munitions, atomic power, space development, and biological weapons. The ministries generally have one month to review the proposal, but this period can be extended. If the ministries conclude that the proposed investment might imperil the national security or disturb the maintenance of public order or public safety, they must seek an opinion from the Committee on Customs and Foreign Exchange. After receiving the opinion, the ministries can prohibit the investment or advise the investor to modify it. Appeals against negative decisions can be taken to the courts**.**

The Netherlands

The Netherlands has a Foreign Investment Agency that is primarily engaged in encouraging FDI in the country. This Agency does not engage in a review process for approving foreign investments and the Netherlands does not have a law that generally prohibits FDI in defense industries. However, it has been reported that the government does commonly include nationality requirements in defense contracts. There are also restrictions on FDI in aviation and shipping applicable to persons who are not Dutch residents or nationals of an EU country**.**

Russian Federation

The Russian Federation has a 1999 Foreign Investments Law that specifically allows the government to enact regulations to control FDI for the defense of the country or the security of the state. However, the government has not issued regulations specifically for this purpose and presently issues investment permits on a case-by-case basis. The Russian Federation has signed a Bilateral Investment Treaty with the United States which has not yet been ratified. If the treaty does go into force, it will take precedence over other laws. The Treaty lists areas in which restrictions on FDI are allowed. National security is not specifically mentioned, but several related areas, including uranium production and natural resources are. The Russian Federation has forced foreign oil companies to sell their stakes in projects to the national gas monopoly by threatening to invoke environmental protection measures.

The Government of the Russian Federation has agreed on a legislative proposal that would establish a procedure for regulating FDI in strategic organizations. The proposal lists forty areas of activity by strategic organizations in which capital may be invested with governmental permission. It appears investments will be reviewed by the Ministry of Energy and Industry. The government expects the legislature to pass this law prior to the 2007 summer recess.

United Arab Emirates

The UAE does not have a law that places restrictions on FDI specifically for national security purposes. The country, however, does have general nationality requirements. Agency agreements are restricted to UAE citizens and companies and licenses for industrial projects are limited to companies that are at least fifty-one percent owned by UAE nationals. Partners in joint-liability companies are also covered by a nationality requirement and a ministerial order extends it to government purchases, tenders, and contracts.

United Kingdom

The United Kingdom does not have an agency for reviewing foreign investments, but its Industry Act does give the Secretary of State authority to issue orders to prohibit the change of control of a UK enterprise to a non-UK resident on the very broad grounds that it would be contrary to the interests of the UK. There are no special rules for enterprises deemed to be vital to national security. In the case of mergers, the Secretary of State can refer cases to the Office of Fair Trading for investigation as to whether they would be contrary to the public interest on national security grounds or because they involve government contractors who may hold or receive confidential information or material relating to defense. The Office of Fair Trading can refer a case to the Competition Commission for a decision as to whether the Secretary of State should take any action. This power was recently employed in the takeover of the Insys Group Ltd. by Lockheed Martin. The Ministry of Defence stated that the takeover would be against national security interests, but the case was resolved with Lockheed Martin giving a number of undertakings. The UK also maintains "golden shares" in certain privatized industries that are important to the security of the country.

Conclusion

The country reports show that virtually all countries are concerned that certain types of FDI could be potentially injurious to national security interests. The manner in which they have sought to control FDI, however, vary considerably. In some countries, the process is almost entirely political and in others it is governed by more detailed legislation. In some countries, national security concerns are limited to such specific industries as the armaments industries, while in others what constitutes a threat to national security interests and national policies is left undefined.

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CANADA

FOREIGN CONTROLS OVER DIRECT INVESTMENTS TO PROTECT NATIONAL SECURITY INTERESTS

Executive Summary

Canada does not have a law that is specifically aimed at controlling direct investment to protect national security interests. Canada does have a more general law that requires certain investments to be reviewed by a government agency to determine whether they would be a net benefit to Canada. Canada also has some laws designed to limit investment in certain industries to protect sensitive economic sectors, such as agriculture, mining, and real estate. Many of these specific laws have been created by provincial governments.

I. History of the Investment Canada Act

Throughout the 1960s and early 1970s, there was much concern about the level of foreign, particularly American, investment in Canada. This concern led the government of former Liberal Prime Minister Trudeau to enact the Foreign Investment Review Act in 1974. This law provided that virtually all new investments and all takeovers of existing businesses had to be approved by the Foreign Investment Review Agency.[1] This Act was generally unpopular with the Progressive Conservative Party. After former Prime Minister Mulroney took office, his government, in 1985, replaced the extant Act with the Investment Canada Act (ICA).[2] The new title was chosen to emphasize that Canada was still "open for business" and the new law made a number of major changes to the law. Monetary thresholds for reviewing investments were established, exemptions were created, the special review agency was abolished, and the test that an investment had to be shown to be of "significant" benefit to Canada before it could be approved was replaced with a "net benefit" test. In 1988, the Canada-U.S. Free Trade Agreement raised the thresholds for U.S. investments even higher. These favorable thresholds were maintained by the North American Free Trade Agreement in 1992, but were extended to investors from all members of the World Trade Organization (WTO) in 1994, as is required by the rules of that organization.

II. What is Currently Reviewable

The general rule under the ICA is that foreign takeovers of Canadian businesses having assets of Can$5 million or more must be reviewed. Foreign takeovers of foreign businesses that control a business that has assets of Can$50 million or more are also reviewable. However, the general rules are subject to major exceptions. As is also required by the WTO agreement, indirect acquisitions are not generally reviewable for WTO investors and the threshold for foreign direct investments by WTO investors is approximately Can$280 million. There are exemptions from the new investment rules and higher WTO thresholds for a number of industries, including uranium properties, financial services, transportation services, cultural businesses, real estate, and petroleum and mining. These industries are generally considered to be more sensitive and in need of greater protection. Thus, the non-WTO thresholds apply in these cases even in the case of investments by NAFTA partners. There is not a general exemption for industries engaged in the production of armaments, weapons, ammunition, or materials that might be

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[1] Foreign Investment Review Act, 1973-74 S.C. c. 46.

[2] I nvestment Canada Act, R.S.C. c. 28 (1st Supp. 1985).

needed in wartime. Therefore, investments in heavy industries or by foreign defense contractors are generally exempt from review; direct acquisitions are subject to review when the value of their assets exceed Can$280 million.

III. Standards for Review

Decisions on applications for review are made by Industry Canada, except in the case of cultural industries. Decisions on applications to acquire a cultural business are made by the Department of Canadian Heritage. The standard for review of investments covered by the ICA is whether they are likely to be of net benefit to Canada. The factors that are to be considered by Investment Canada are fairly lengthy, but can be summarized essentially to cover:

- economic activity and employment;
- Canadian participation;
- the effect on productivity and efficiency;
- the effect on competition;
- national industrial, economic and cultural policies; and
- the effect on Canadian competitiveness abroad

As can be seen, these factors do not cover national security interests specifically. The provision respecting national industrial policies, however, could be read to justify Investment Canada rejecting a foreign investment that could pose a danger to Canada's safety and security or Canada's ability to respond to a danger to its safety and security. One commentator has written as follows:

> How are the policy objectives of the government determined? It would appear that some reasonably formal policy at a senior level of government, and not simply a bureaucratic whim, is required. Even so, there may be considerable ambiguity because the Federal cabinet sometimes makes policy pronouncements which, while implemented on an ad hoc basis by governmental officials, are not public documents. Of course other legislation is the clearest form of policy.[3]

The rules for when the standards of review are to be applied are fairly complex. The ICA and its regulations contain fairly detailed tests for determining who is a Canadian, what is a Canadian business, and what constitutes an acquisition.

IV. Cultural Industries

Within Canada, the nationalist sentiments that led to the creation of what is now the Investment Canada Act are mostly focused on cultural industries. The ICA defines "cultural businesses" generally to include the publication of books, magazines, and newspapers, film production, music production, and broadcasting.[4] The Act also authorizes the government to enact regulations to permit the Federal cabinet to recommend otherwise non-reviewable transactions relating to cultural heritage or national identity to be reviewed. The regulations currently prescribe as reviewable upon recommendation otherwise non-reviewable investments in the publication of books, magazines, or newspapers, film production, music production, and the distribution of books, magazines, newspapers, publications, films, and music. In these cases, acquisitions of businesses of any size are reviewable.

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[3] Douglas C. New, *Regulation of Foreign Investment in Canada*, in DOING BUSINESS IN CANADA, para. 3.02[5][d] (2007).

[4] Investment Canada Act, R.S.C. c. 28 , s. 2 (1st Supp. 1985).

While the issue of the protection of cultural industries under the ICA, the WTO, and NAFTA is very important to many persons involved in various types of arts in Canada, the special rules respecting cultural industries would not appear likely to intersect with national security concerns.

V. Other Laws

In addition to the ICA, Canada has placed restrictions on foreign investments in several other laws. For example, the Bank Act places restrictions on the acquisition of financial institutions by foreign entities.[5] The Canada Transportation Act also provides for review of mergers and acquisitions that involve air transportation by the Minister of Transportation.[6] However, there are no special rules for the acquisition of defense industries or other types of businesses that may be deemed to be vital to national security.

Canada's ten provinces have also enacted laws regulating foreign investments. The provinces would not appear to have constitutional jurisdiction to disallow foreign investments for security reasons because national defense is a federal responsibility, but they have been able to exercise their jurisdiction to place some limitations on the acquisition of such properties or businesses as agricultural lands, real estate, fisheries, and pharmacies. Several provinces previously have had restrictions in foreign investments in mining.[7] These laws, however, have been repealed.

VI. Suggested Questions for GAO Meeting With Industry Canada

1. Are the actions Canada has taken since September 11, 2001 in the war on terrorism, including the enactment of the Anti-Terrorism Act,[8] viewed as constituting national policies that could affect Industry Canada's determination as to whether a reviewable foreign investment should be allowed?

2. Have any proposed foreign investments been disallowed on national security grounds under the ICA or the previous Foreign Investment Review Act?

3. Has the current government given consideration to the issue of whether Canada should amend its laws to specifically limit foreign investments for national security reasons?

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[5] Bank Act, 1991 S.C. c. 46, s. 522, as amended.

[6] 1996, S.C. c. 10, Part II.

[7] Douglas C. New, *supra* note 3, at para 3.03(6).

[8] Anti-Terrorism Act, 2001 S.C. c. 41.

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CHINA

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

There is no provision in Chinese foreign investment law that mirrors the Exon-Florio Amendment to the U.S. Defense Production Act of 1950 nor a formal inter-agency review body like the Committee on Foreign Investment of the United States; the current Chinese political-legal system apparently makes it unnecessary. The Chinese Communist Party (CCP), as stipulated in the Constitution in the People's Republic of China (PRC), is the paramount source of power and sets overall policy, and the Standing Committee of the CCP Politburo has the power to veto any foreign direct investments (FDI) it might deem a threat to national or economic security. The PRC political-legal system exerts a wide range of controls over FDI, and also restricts or prohibits FDI in targeted industries. The PRC is in the process of studying the establishment of a special governmental inter-agency review mechanism for foreign mergers and acquisitions in specific strategic and sensitive industries.

I. Introduction

The People's Republic of China (PRC) is an authoritarian state in which the Chinese Communist Party (CCP), as stipulated in the Constitution, is the paramount source of power[1] and sets overall policy. Under the PRC Constitution, socialist public ownership of the means of production is still the basis of the PRC's socialist economic system; the state-owned economy is "the leading force in the national economy." Nonetheless, the "individual, private and other non-public economies…are major components of the socialist market economy" and foreign enterprises, other foreign economic organizations, and individual foreigners are permitted by the Constitution "to invest in China and to enter into various forms of economic co-operation" with Chinese economic entities.[2]

There is no provision in Chinese foreign investment law that mirrors the Exon-Florio Amendment to the U.S. Defense Production Act of 1950, nor does the PRC have a formal inter-agency review body like the Committee on Foreign Investment of the United States. The Standing Committee of the Politburo of the CCP, as the most powerful body in China, has the authority to control and affect executive, legislative, and judicial matters; there is no separation of powers in the country like that in Western democracies, and so its powers go beyond that of the U.S President, for example. Thus, it would ultimately be within the Politburo Standing Committee's purview to block perceived threats to the PRC's economic or national security from foreign direct investment at any time in the FDI approval process.

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[1] U.S. Department of State, Bureau of Democracy, Human Rights, and Labor, *China (Includes Tibet, Hong Kong, and Macau)*, COUNTRY REPORTS ON HUMAN RIGHTS PRACTICES – 2005 (Mar. 8, 2006), *available at* http://www.state.gov/g/drl/rls/hrrpt/2005/61605.htm.

[2] Arts. 6, 7, 11, & 18, PRC Constitution (2004). For the Chinese text, *see* XINBIAN ZHONGHUA RENMIN GONGHEGUO CHANG YONG FALÜ FAGUI QUANSHU (2006 NIAN BAN) [NEWLY COMPILED COMPLETE BOOK OF COMMONLY USED LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA (2006 EDITION)], 1-2 – 1-4 (State Council Legislative Affairs Office, comp. Beijing, China Legal Affairs Press, 2006) (official source). For an online English translation, *see, for example*, *China Constitution*, International Constitutional Law Web site, http://www.oefre.unibe.ch/law/icl/ch00000_.html (unofficial source) (last visited Feb. 16, 2007).

Therefore, the basic premises and framework of FDI controls in the PRC are very different from the U.S. review process of foreign direct investment in the context of Exon-Florio provisions. The mechanisms of FDI control in the PRC might be viewed as part of an essentially controlled and opaque system, rather than of an essentially relaxed and open system as in the United States and Europe. The PRC is the third-largest trading partner of the United States but there is neither a treaty of commerce and navigation nor of bilateral investment between the two countries.[3]

Various PRC policies, laws and regulations, and practices control foreign investment in general, and some reflect more specifically concerns about national security and/or economic security. Mergers and acquisitions at present represent only a very small percentage of FDI in China, but they may involve strategic or sensitive industries.[4]

II. Recent Policy Documents Related to FDI and Economic/National Security

In 2006 there began to be signs of possible tightening of policy and law regarding foreign takeovers of Chinese companies. The CCP-drafted Outline of the Eleventh Five-Year Plan of the PRC for National Economic and Social Development, adopted at the National People's Congress (NPC) meeting of March 2006, stated that while China will adhere to the policy of opening up, it will "earnestly protect national economic security."[5] In his annual report to the NPC, Premier Wen Jiabao echoed this concern,[6] as did the 2006 Draft Plan for National Economic and Social Development, adopted by the March 2006 NPC.[7]

On November 9, 2006, China set forth a new policy toward cross-border acquisitions in its "Eleventh Five-Year Plan" for Utilizing Foreign Investment, issued by the National Development and Reform Commission (NDRC).[8] The plan states that emerging monopolies by foreign-invested enterprises pose a potential threat to the PRC's economic security. It outlines an industrial policy that prioritizes geographical areas, industrial sectors, technology levels, environmental protection, and efficient use of natural resources. Responding to "perceived rising concern over foreign acquisitions of leading Chinese

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[3] Edward M. Graham & David M. Marchick, US National Security and Foreign Direct Investment 102 (Washington, D.C., Institute for International Economics, May 2006). *See also* the United Nations Conference on Trade and Development (UNCTAD), Bilateral Investment Treaties 1959-1999 8 (New York & Geneva, United Nations, 2000) (UNCTAD/ITE/IIA/2, and UNCTAD's Investment Instruments Online: Bilateral Investment Treaties online database, http://www.unctadxi.org/templates/DocSearch____779.aspx (last visited Mar. 21, 2007).

[4] For an overview of FDI in China in 2006, *see, for example*, the US-China Business Council, *Foreign Investment in China*, Feb. 2007, *available at* http://www.uschina.org/info/forecast/2007/foreign-investment.html.

[5] *RMRB Carries Abstract of 11th Five-Year Plan Outline (Draft), Part 2*, Renmin ribao, Mar. 9, 2006, Open Source Center online subscription database, No. Cpp20060309501005. For the Chinese text of the Outline of the Eleventh Five-Year Plan, *see* People's Daily Online, Mar. 16, 2006, *available at* http://politics.people.com.cn/GB/1026/4208451.html.

[6] *Full Text: Government Work Report (2006*), GOV.cn [Chinese Government's official Web portal], Mar. 14, 2006, *available at* http://english.gov.cn/2006-03/14/content_227247.htm. Wen's remarks were based on the CCP's Outline of the Eleventh Five-Year Plan for National Social and Economic Development, which was approved by the NPC in March 2006 along with Wen's work report. For an online text in English of the Outline of the Eleventh Five-Year Plan for National Social and Economic Development (Profile), *see* NDRC Web site, http://ghs.ndrc.gov.cn/15ghgy/t20060529_70793.htm (last visited Mar. 21, 2007).

[7] *Full Text: China's Economic and Social Development Plan – III*, People's Daily Online, Mar. 15, 2006, *available at* http://english.people.com.cn/200603/15/eng20060315_250830.html. The quotation is from Part III, point number 8.

[8] For the Chinese text of the "Eleventh Five-Year" Plan for Utilizing Foreign Investment, *see* the NDRC Web site, http://www.ndrc.gov.cn/wzly/zcfg/wzzczh/W020061111378836365555.doc (last visited Mar. 19, 2007). For an English translation, *see The 11th Five-Year Plan on Foreign Capital Utilization*, Invest in China Web site, http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=68109 (last visited Mar. 19, 2007).

firms in critical sectors, the plan provides for increased supervision of sensitive acquisitions to ensure that what are termed 'critical industries and enterprises' remain under Chinese control."[9]

In December 2006, at a meeting on foreign investment issues, Zhang Xiaoqiang, vice-chairman of the NDRC, stated that China must gradually change the current preferential policies in utilization of foreign capital, shift away from extensively attracting foreign business and capital, regardless of costs, and use fair competition and market pressure to foster foreign capital enterprises' increased focus on intensive operations. Zhang declared, "we must formulate a national 'strategic and sensitive' industry list and establish a special review mechanism for mergers and acquisitions, conscientiously maintaining barriers we should maintain and easing restrictions we should ease and ensuring that national economic security and industrial safety are safeguarded."[10] Previously, a report compiled by the NDRC Investment Research Institute stated that China should establish a permanent body for review of foreign investment mergers and acquisitions comprising relevant personnel of different ministries and commissions such as the Ministry of Commerce (MOFCOM), the NDRC, and the Ministry of Finance, who would only carry out their duties for such a body when a review was needed.[11] The joint body would reportedly examine proposed mergers and acquisitions in the manufacturing and machinery industries.[12]

The "Guiding Opinions" of the State-Owned Assets Supervision and Administration Commission (SASAC),[13] issued on December 5, 2006, call for enhancing the concentration of state assets in vital trades and key sectors and in strengthening control of the state-owned economy. "Vital trades and key sectors" mainly include: trades involving national security; major basic facilities and vital mineral resources; trades that provide vital public goods and services, and vital core enterprises among pillar industries and high and new technology industries. The relevant departments must determine the specific trades and sectors and issue corresponding industry and enterprise catalogs. In calling for speeding up reform of the share structure of state-owned enterprises, the Guiding Opinions state that those that are large-scale enterprises must all gradually change their structure into multiple shareholding companies, with the exception of enterprises involving national security, enterprises that must be state-operated monopolies, and companies exclusively engaged in state assets management and administration.

In addition, on December 18, 2006, SASAC openly declared for the first time that the state-owned economy should maintain absolute power of control over vital trades and key sectors that are related to national security and the national economic lifelines. These include the seven major trades of armaments, power grids and electricity, petroleum and petrochemicals, telecommunications, coal, civil aviation, and merchant shipping. By 2010, moreover, it is planned that the number of central state-owned enterprises

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[9] Recent Developments in China's Policies Towards Cross-Border Mergers and Acquisitions (M&A) (Supplement to the 2006 Investment Policy Review of China) 2 (Dec. 2006), Organisation for Economic Co-operation and Development Web site, *available at* http://www.oecd.org/dataoecd/1/26/37808943.pdf.

[10] For the NDRC statement, *see* Year 2006 Annual Meeting on the Nationwide Development and Reform System and Foreign Investment Work Convenes in Haikou, Dec. 26, 2006, NDRC Web site (in Chinese), *available at* http://www.ndrc.gov.cn/zjgx/t20061226_102687.htm.

[11] The Ministry of Commerce Will Issue a Document on the Strict Review of Foreign Investment Mergers and Acquisitions, NDRC Web site, Feb. 5, 2007, *available at* http://www.ndrc.gov.cn/zwjjbd/fgdt/t20070205_115813.htm (in Chinese).

[12] He Qinglian, *Sweeping Changes to Foreign Investment in China*, THE EPOCH TIMES, Nov. 28, 2006, *available at* http://en.epochtimes.com/tools/printer.asp?id=48644; *see also China to Set Up Special M&A Review Mechanism*, CE.CN, Dec. 27, 2006, *available at* http://en.ce.cn/Business/Macro-economic/200612/27/t20061227_9902873.shtml.

[13] State Council Circular Transmitting and Issuing the Guiding Opinions of SASAC on Advancing State-Owned Assets Adjustment and Reorganization of State-Owned Enterprises, Dec. 5, 2006, SASAC Web site (in Chinese), *available at* http://www.sasac.gov.cn/gzjg/xcgz/200612180138.htm.

(SOEs) be reduced to 80-100 from the current 161 by means of mergers and that among them 30-50 internationally competitive conglomerates should emerge. The statement was made with reference to SASAC's Guiding Opinions issued on December 5, 2006, described above.[14]

III. Some Legal Provisions and Practices Related to FDI and National and Economic Security

Foreign investment projects are categorized by industry sector in the *Catalog for Guidance of Foreign Investment Industries* as "encouraged," "permitted," "restricted," or "prohibited." This classification "impacts both the investment approval process and the permissible level of foreign equity holding. Majority Chinese equity may be required in some restricted sector transactions, while wholly foreign-owned enterprises may be prohibited in others." Therefore, before undertaking foreign investment activities in the PRC, it is necessary to determine the classification of the target industry in the Catalog, especially because recent regulatory changes have "only confirmed" its controlling nature.[15]

Under the Provisions on Guiding the Direction of Foreign Investment,[16] the NDRC and MOFCOM, in conjunction with other government ministries concerned, formulate the Catalog for Guidance of Foreign Investment Industries[17] and the Catalog of Priority Industries for Foreign Investment in the Central and Western Regions[18] and promulgate them after they have been approved by the State Council. The two catalogs are the basis for guiding the examination and approval of foreign investment projects and for the policy application of foreign investment enterprises (article 3).

In regard to the regulation of mergers and acquisitions (M&A) in the PRC, it has been observed that in the PRC, government involvement in such transactions "is far more extensive than is typical in other jurisdictions," and that government agencies play a much broader role than just acting as regulators of competition. Rather, they substantively review and approve the specific arrangements of the deals. Their concerns are not limited to the transaction's competitive consequences and formalities, but will often be

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[14] Reported in Year 2006 Ten Major Events in China's State-Owned Economy, SASAC Web site, Jan. 23, 2007, *available at* http://www.sasac.gov.cn/gzyj2/200701230036.htm (under item 2). *See also* Lan Xinzhen, *State Seeks Control of Vital Industries*, BEIJINGREVIEW.COM (No. 2, Jan. 11, 2007), *available at* http://www.bjreview.com.cn/print/txt/2007-01/09/content_52480.htm. The December 18 statements, attributed to Li Rongrong, the head of SASAC, were apparently made during an interview. *See* The Responsible Person of SASAC Answers Reporters' Questions on the 'Guiding Opinions' on the State-Owned Economy, XINHUA, Dec. 18, 2006, *available at* http://news.xinhuanet.com/fortune/2006-12/18/content_5504268.htm (in Chinese).

[15] Edwarde F. Webre, *Merger & Acquisition Practice in China*, THE METROPOLITAN CORPORATE COUNSEL, Dec. 2006, *available at* http://www.metrocorpcounsel.com/current.php?artType=view&artMonth=December&artYear=2006&EntryNo=5988.

[16] The Provisions on Guiding the Direction of Foreign Investment were approved and promulgated by the State Council on February 21, 2002. For an online Chinese text, *see for example* State Administration of Industry and Commerce (SAIC) Web site, http://wzj.saic.gov.cn/pub/ShowContent.asp?CH=ZCFG&ID=36 (last visited Feb. 20, 2007); for an online English translation, *see* CHINA DAILY Web site, http://www.chinadaily.com.cn/bizchina/2006-04/18/content_570818.htm (last visited Feb. 20, 2007) (unofficial source).

[17] For an online Chinese text of the Catalog for Guiding Foreign Investment Industries, *see* the NDRC Web site,http://wzs.ndrc.gov.cn/zcfg/wszjtzp/t20050714_36199.htm (last visited Mar. 21, 2007). For an online English translation of the Catalog, *see* Invest in China Web site, http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51089 (unofficial source) (last visited Mar. 14, 2007). For a discussion of the differences between the 2000 Catalog of Priority Industries for Foreign Investment in the Central and Western Regions and the 2002 Catalog for Guiding Foreign Investment Industries and their 2004 counterparts, *see China: Foreign Investment Catalogues Updated*, HG.ORG, Feb. 25, 2005, *available at* http://www.hg.org/articles/article_495.html.

[18] For the Chinese text of the Catalog of Priority Industries for Foreign Investment in the Central and Western Regions, *see* the NDRC Web site, http://www.ndrc.gov.cn/wzly/zcfg/wzzczjtc/t20050714_36225.htm (last visited Mar. 21, 2007). For an English translation of the Catalog, *see, for example, Catalogue of Priority Industries for Foreign Investment in the…*, SINOCAST.COM, http://www.sinocast.com/getRegulationArt.php?regulaid=1980 (unofficial source) (last visited Mar. 15, 2007).

political and social concerns unrelated to the deal's economics. Moreover, "[p]ervasive approval requirements are a distinctive feature of M&A transactions in China. The required discretionary approvals are not mere formalities and may take considerable effort to obtain … ."[19]

The government agency that plays the most significant role in foreign-related M&A transactions in the PRC is MOFCOM, which has the primary responsibility for supervising these transactions. Other key government agencies involved are the NDRC and SASAC, which play a major role in transactions involving state-owned assets. The China Securities Regulatory Commission supervises M&A transactions that involve listed companies. In addition, depending on the targeted industry sector and the type of transaction, industry-specific and specialized administrative agencies may be involved, with specific regulations stipulating the approval process.[20] Under the PRC political-legal system, it seems inconceivable that these government agencies would act contrary to the express policy of the CCP Politburo, but the process of approval is essentially opaque insofar as the role of the CCP is concerned.

In 2006, new Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors (hereinafter M& A Provisions) were formulated. The new provisions clarify some issues, but controls on foreign M&A transactions remain.[21] One stated purpose of the new M&A Provisions is to "safeguard fair competition and national economic security" (article 1).[22] Most significantly, the 2006 M&A Provisions, compared with the 2003 set of interim M&A provisions, incorporate a new screening requirement for cross-border mergers and acquisitions in which the foreign investor gains the controlling rights of a domestic enterprise, if the acquisition involves a major industry, has or may have an impact on national security, or may result in the transfer of famous trademarks or traditional Chinese brands (article 12).[23] There are no definitions of these terms in the provisions. It has been reported, however, that, new limits are to be imposed on the extent of foreign investment in seven manufacturing sectors: nuclear power equipment; power generating equipment; power transformer equipment; shipbuilding; gears; general purpose equipment; and the petroleum and steel industries. There will also be a list of twenty to forty key sectors that the State Council will protect directly in connection with the M&A Provisions. Key enterprises will be defined on the basis of market share, capitalization, production output, and sales revenue.[24] In addition, in late 2006, numerous new regulations were adopted that impose restrictions on foreign investment in a variety of sectors, such as banking, insurance, real estate, retailing, and shipbuilding.[25]

One well-known example of a foreign merger and acquisition extensively delayed by the PRC on grounds of national security is that of the Carlyle Group and the Xugong Group Construction Machinery Co. Ltd. In March 2006, MOFCOM, out of alleged concern for potential threats to China's economic security, refused to approve the planned purchase by the Carlyle Group, a U.S. private equity firm, of a

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[19] Webre, *supra* note 15.

[20] *Id.*

[21] *China: Open Policies Towards Mergers and Acquisitions 2006*, OECD INVESTMENT POLICY REVIEWS (OECD 2006) (SourceOECD online subscription database).

[22] For an online Chinese text of the M&A Provisions, *see* the MOFCOM Web site, http://www.mofcom.gov.cn/aarticle/b/c/200608/20060802839585.html (last visited Mar. 21, 2007). For an English translation, *see,* the MOFCOM Web site, http://english.mofcom.gov.cn/aarticle/policyrelease/domesticpolicy/200610/20061003434565.html (unofficial source) (last visited Mar. 9, 2007).

[23] For a detailed comparison between the 2006 and 2003 M&A Provisions, *see* the "Annex" to Recent Developments in China's Policies Towards Cross-Border Mergers and Acquisitions (M&A), *supra* note 9, at 6-11.

[24] He Qinglian, *supra* note 12.

[25] Ariana Eunjung Cha, *China Gets Cold Feet for Foreign Investment*, WASHINGTONPOST.COM, Feb. 2, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/02/01/AR2007020101700.html.

controlling eighty-five-percent stake in the state-owned Xugong Group. The deal had been submitted for approval in December 2005. Xugong is the PRC's largest manufacturer and distributor of construction machinery. In a new deal, signed on October 16, 2006, Carlyle agreed to reduce its stake to fifty percent. The planned takeover reportedly sparked debate in the PRC about the potential effect of foreign investors controlling leading Chinese manufacturing firms and drew attention to other controversial deals, such as the proposed takeover by the Germany-based Schaeffler Group of the Luoyang Bearing Corporation. It purportedly was also the impetus behind the promulgation of the new M&A Provisions.[26]

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[26] China's *Halt to Carlyle-Xugong Deal Seen as 'Step Back' for Capital Markets*, AFX NEWS LIMITED, Apr. 9, 2006, *available at* http://www.forbes.com/home/feeds/afx/2006/04/09/afx2657764.html; *Carlyle Drops Controlling Share in Chinese Machine Firm as New Deal Awaits Approval*, PEOPLE'S DAILY ONLINE, Oct. 18, 2006, *available at* http://english.peole.com.cn/200610/18/eng20061018_313034.html.

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EUROPEAN UNION

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS TO PROTECT NATIONAL SECURITY INTERESTS

Executive Summary

The internal market of the EU with its four basic freedoms, movement of goods, capital, labor, and services, represents an open and hospitable environment for foreign investments. Member States have the right to impose restrictions on foreign investors based on reasons of public policy, security, and public health. In the case of mergers affecting domestic markets, the national authorities of Member States may prohibit such mergers on grounds of public security, plurality of the media, and prudential rules.

I. Introduction

Until 1992, foreign direct investment within the European Union was an issue that fell exclusively within the ambit of the national laws and policies of the Member States. The Maastrict Treaty, which entered into force on November 1, 1993, brought dramatic changes to the regulatory environment for foreign companies.[1] The Treaty abolished restrictions on the movement of capital among Member States, as well as between Members and third countries.[2]

The single market encompasses four basic freedoms: free movement of goods, capital, labor, and services. The European Economic Area (EEA) agreement, which entered into force in January 1994, extended the single market to Iceland, Lichtenstein, and Norway.[3] Thus, the four basic freedoms of the single market now also apply to these three countries. In addition, the competition rules of the EEA are similar to the EU rules on competition.[4]

The EU is committed to maintaining an open investment climate that actively encourages investment, growth, and competition. The European Commission's objective, as highlighted in its "internal Market Strategy 2003-2006," includes a ten-point plan to remove remaining barriers and make it easier, not only for domestic companies, but also for companies from third countries, to invest in an enlarged EU.[5]

In spite of the harmonization and liberalization of the single market rules, some EU Members apply more restrictions than others. Thus, according to the Organization for Economic Cooperation and Development (OECD), the countries with the fewest restrictions include Belgium, Denmark, Germany, Ireland, Italy, the Netherlands, and the United Kingdom. Iceland (EEA) qualifies as the country with the

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[1] Treaty of Maastrict on European Union, signed in Maastrict on Feb. 7, 1992; *see* official text of consolidated version 2006 OJ C321W/1, *available at* http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf; summary *available at* http://europa. eu/scadplus/treaties/maastrict_en.htm.

[2] *Id.* See arts. 56 & 57, Maastrict Treaty.

[3] The Agreement was signed in 1992 between the Community, the then Member States, and seven Members of the European Free Trade Agreement. Subsequently, Switzerland decided not to participate and three other countries joined the EU.

[4] European Economic Area (EEA), External Relations, official site *available at* http://ec.europa.eu/comm/ external_relations/ eea/index.htm (last visited Mar. 21, 2007).

[5] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions final , *Internal Market Strategy 2003-2006* COM(2003) 238, (2003).

highest number of restrictions, with Finland, Norway (EEA), and Spain also having relatively many restrictions.[6]

II. Basic Treaty Provisions on Foreign Direct Investment

The following articles of the European Community Treaty of 1957, as amended have a bearing on foreign direct investment:

- Article 43: EU Members must allow investors from other Members and third countries that have been duly registered according to domestic laws to establish and conduct business in other Member States.

- Article 48: Companies or firms formed in accordance with the legislation of a Member State and having their registered office, principal place of business, or central administration within the Community, will be treated in the same way as natural persons who are nationals of Member States.

- Article 56: All restrictions on the movement of capital between member States and between Member States and third countries and all restrictions on payments between Member States and third countries shall be prohibited.

- Article 57: Restrictions which existed prior to 1993 in respect of movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services, or the admission of securities to capital markets are retained. Consequently, as of January 1994, Member States are prohibited from establishing new restrictions on foreign investment in the above areas.

- Article 296: Member States are allowed to take any necessary measures for the protection of the essential interests of their security which are connected with the production of or trade in arms, munitions, and war material; such measures must not have an adverse impact on competition in the common market regarding such products which are not intended specifically for military purposes.

Under the EC Treaty, Member states retain the right to impose restrictions on the right of establishment, on the free movement of capital, and on the right to services on the grounds of "public policy, public security, or public health."[7]

In many instances, EU Members have exhibited anti-competitive tendencies and have erected barriers not only to investments originating from third countries, but also to cross-border investments within the EU. The ground that is most commonly used as justification is national security. Since the second half of 2005, France, Germany, Luxembourg, and the Netherlands have taken action to either prohibit a merger or prevent a perceived-hostile takeover by another European company.[8] The European Commission, as the EU enforcer of community legislation, took immediate action against the Members involved, and in some cases, it brought actions before the European Court of Justice.

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[6] *Measures of Restrictions in Inward Foreign Direct Investment for OECD Countries* , 99 OECD, Economic Studies No. 36, 2003.

[7] Art. 46, EC Treaty as amended, *supra* note 1.

[8] James Canter, *EU Court Acts to End Barrier to Takeovers*, INTERNATIONAL HERALD TRIBUNE, Sept. 28, 2006, *available at* http://www.iht.com/articles/2006/09/28/business/golden.php.

According to the Commission, any restrictions imposed on the above grounds must not "constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments." Furthermore, restrictive measures are valid only in so far as they are compatible with other general principles of EU law, including the principle of proportionality.

The European Court of Justice has played a prominent role in interpreting and clarifying the scope of treaty provisions related to the four freedoms for investment purposes among Member States. Its judgments also have implications for investors from third countries, outside the EU. In the case of *Eglise de Scientology*, the European Court of Justice ruled in favor of the Church of Scientology and against France. In this case, the Court found that France violated the article on free movement of capital between Member States, because it subjected the transfer of funds from abroad to the French Church of Scientology to restrictions on the grounds of public security. The Court interpreted the notion of "public security" narrowly. It specifically stated that

> the requirements of public security, as a derogation from the fundamental principle of free movement of capital must be interpreted strictly, so that their scope cannot be determined unilaterally by each Member State without any control by the Community institutions. Thus, public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society.[9]

III. Mergers - Restrictions on Foreign Direct Investment

In 2005, approximately 2,500 cross-border mergers and acquisitions transactions involving EU companies occurred, at a value of close to 240 billion *euro*. Half of these cases involved a company from a third country.[10] According to European Commissioner for Internal Market and Services Charlie McCreevy, these statistics prove the "openness of the investment climate not only within the single market but also from outside."

Regulation No. 139/2004, on the Control of Concentrations between Undertakings,[11] applies to concentrations[12] (mergers) with a Community dimension. Concentrations have a Community dimension where:

a) the combined aggregate worldwide turnover of all the undertakings concerned is more than five billion *euro*; and
b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than 250 million *euro*. [13]

Under Article 21 of Regulation 139/2004, the European Commission has exclusive competence to assess the competitive impact of concentrations with a Community dimension. Since that Regulation's adoption, EU Members have had no authority to apply their domestic legislation to any merger that has a

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[9] Case C-54/99, Judgment of the Court, Mar. 14, 2000, official site *available at* http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&Submit=Rechercher&alldocs=alldocs&docj=docj&docop=docop&docor=docor&docjo=docjo&numaff=C-54/99%20&datefs.

[10] Speech, Charlie McCreevy, London, Oct. 10, 2006. *available at* http://www.europa.eu/rapid/press ReleasesAction.do?reference=SPEECH/06/583&formate=HTML.

[11] 2004 OJ L 24 1.

[12] Concentration is a broad term that includes: a) mergers of two or more independent undertaking or parts of undertakings or b) the acquisition by one or more persons already controlling at least one undertaking whether by purchase of securities or assets, by contract or by any other means of direct or indirect control of the whole of parts of one or more other undertakings (art. 3, Regulation, *id.*).

[13] Art. 2, Regulation, *id*.

community dimension. However, they do apply national rules to mergers that do not meet the threshold required by the Regulation. Any decisions of the Commission on these matters are subject to review by the Court of Justice.

The Regulation contains a clause which allows EU Members to take appropriate measures to protect "legitimate interests" and prohibit pending mergers. When a Member State claims any other public interest as grounds to refuse the merger, the member must communicate this to the Commission. The Commission will then examine whether the public interest claim is compatible with other relevant provisions of Community law. Within twenty-five days of receipt of the notification by the Member, the Commission will inform the Member of its decision.

The following fields are considered as falling within the scope of "legitimate interests":

- Public security;
- Plurality of the media; and
- Prudential rules

The above grounds have been interpreted by the Commission as follows:[14] The notion of public security in a strict sense includes aspects of national security as described in Article 296 of the EC Treaty, as amended.[15] Under this article, Members have the right to take any measures they deem necessary in cases of mergers to prohibit a concentration which could be contrary to the essential interests of their security and which are connected with the production of or trade in arms, munitions, and war material. Members may not take measures which adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.[16]

Public security in the broader sense and as interpreted by the European Court of Justice includes internal unrest that affects the maintenance of law and order, war, and serious international tension that amounts to a threat of war.[17]

As far as the plurality of the media, the Commission has clarified that it includes the legitimate concern to maintain diverse sources of information for the sake of plurality and a wide spectrum of differing views.[18]

As a rule, the legitimate interests clause must be compatible with the general principles and other provisions of Community law. The Commission has further expanded on the notion of such interests and has clarified that application of this clause is subject to the following Community principles:

- Member States do not acquire any new powers; application of this clause simply reaffirms the capacity of the EU Members to either prohibit a concentration or to subject it to more onerous conditions and requirements;

- Member States may not justify their grounds based on reasons that the Commission will itself take under consideration in reviewing mergers under Community law;

[14] Notes on Council Regulation (EEC) 4064/89, European Commission, 1998, official site *available at* http://ec.europa.eu/comm/ competition/mergers/legislation/regulation/notes.html (last visited Mar. 21, 2007).

[15] Former article 223 of the Treaty.

[16] Communication, *supra* note 5, at 4.

[17] Art. 297 of the Treaty.

[18] Communication, *supra* note 5, at 4.

- Prohibitions or restrictions placed by the Member States on mergers must not form arbitrary discrimination or a disguised restriction in trade between Member States;

- Any measures taken by the Member States must satisfy the principles of proportionality, necessity, and efficacy; thus, when Members have a choice, they must impose measures which are the least restrictive to achieve the same objective.[19]

Banking

As stated above, EU Members have also the right to prohibit mergers among banks and other institutions in the financial sector. In the absence of specific criteria to assess the suitability of the acquirer, national authorities have a lot of discretion to either discourage or oppose the acquisition. The European Commission, in an effort to provide more clarity and transparency in this area, has recently come up with a proposal on Procedural Rules and Evaluation Criteria for the Prudential Assessment of Acquisitions and Increase of Shareholders in the Financial Sector.[20] Under the proposal, national authorities must follow five criteria for sound and prudent management and must clear any acquisition within sixty working days.

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[19] *Id.*, at 3.

[20] The Directive amends the following existing Directives: the Banking Directive (92006/48/EC), the Third Non-Life Insurance Directive (92.49/EEC), the Recase Life Assurance Directive (2002/83/EC), and Directive 2006/48/EC on Markers in Financial Instruments.

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FRANCE

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

Prior authorization is required for certain types of foreign investments in eleven sensitive sectors of activities that could affect public policy, public security, or national defense. The scope of the authorization procedure is more extensive for investments originating from third countries, as opposed to those originating from Member States of the European Union. The European Commission, however, is challenging the French legislation as being incompatible with the free movement of capital and the freedom of establishment principles laid down by the European Community Treaty.

I. Introduction

Enhancing France's attractiveness to foreign investors has been a stated priority for the French government. The 2005 Report on Foreign Direct Investment prepared by the French Agency for International Investments (*Agence Française pour les Investissements Internationaux*) confirms France's openness to foreign investments.[1] These investments generated more than 33,000 jobs in 2005. In addition, of all countries mentioned, France was listed in fourth place, behind United Kingdom, China, and the United States, with forty billion euros in foreign direct investment. Four hundred and twenty one French firms were taken over by foreign companies. [2] The two most important sources in terms of jobs created were Western Europe (58.6%) and North America (30.6%). The United States remained the most important country source, accounting for twenty nine percent of jobs created. [3]

The general principle set forth by the Monetary and Financial Code is that "financial relations between France and other countries shall not be subject to restrictions."[4] There are, however, certain exceptions that are viewed as necessary to insure the protection of France's national interests.[5] Some operations may be subject to a statistical or administrative declaration, or even a prior authorization in certain sensitive sectors of activities that could affect French public order, public security, or national defense interests.

This report focuses on the prior authorization regime, which was reformed by Law 2004-1343 of December 9, 2004,[6] and further defined by Decree 2005-1739 of December 30, 2005, regulating

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[1] French Agency for International Investments, 2005 Report on Foreign Direct Investment in France, 7, *available at* http://www.investinfrance.org/France/newsroom/Publication/publication_2006-05-10_en.pdf.

[2] *Id.* at 20-23.

[3] *Id.* at 24-25.,

[4] CODE MONETAIRE ET FINANCIER (CMF) art. L151-1, *available at* http://www.legifrance.gouv.fr (Les Codes), (unofficial source, but used by French attorneys).

[5] Id. art. L151-2.

[6] Law 2004-1343 of December 9, 2004 on the Simplification of the Law, JOURNAL OFFICIEL [Official Gazette of France, J.O.], Dec. 10, 2004, 20857.

Financial Relations with Foreign Countries and Implementing Article L.151-3 of the Monetary and Financial Code.[7] This Decree has been strongly criticized by the European Commission as violating the European Community Treaty rules on the free movement of capital and the right of establishment. The European Commission recently asked France to modify it. In the case of non compliance, the matter may be referred to the European Court of Justice. [8]

II. Prior Authorization Regime

General provisions

The Monetary and Financial Code provides:[9]

> Prior authorization from the Ministry of Economy is required for foreign investments in an activity in France, which even only occasionally affects the exercise of public authority or concern one of the following:
> a) Activities that may affect public order, public safety or national defense interests;
> b) Activities involving the research, production or trading of arms, munitions or explosives powders or substances.

This provision was implemented by Decree 2005-1739 that introduces a distinction between foreign investments emanating from Member States of the European Union (EU investors) and third countries (non-EU investors). The Decree specifies which activities sectors are subject to the prior approval requirement and sets forth the process for approval.

Types of investments subject to prior authorization

The Decree provides that three types of investments in a company whose registered office is located in France are subject to prior authorization where they emanate from a private individual who is a national of a non-Member State of the European Union, or a legal entity whose corporate headquarters are located in a non-Member State, or a French national residing in one of the non-Member States. They are:[10]

1. Acquiring control, within the meaning of Article L.233-3 of the Commercial Code, of a company whose corporate headquarters are located in France;[11]

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[7] Decree 2005-1739 of December 30, 2005, J.O. Dec. 31, 2006, 20779 (official source). A translation of Decree 2005-1739 from French into English prepared by the U.S. Department of State, Office of Language Services is used throughout this report.

[8] Europa (European Union website), Press release IP/06/438, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/438&format=HTML&aged=1&language=EN&guiLanguage=fr, and Press release IP/06/1353, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1353&format=HTML&aged=0&language=EN&guiLanguage=en.

[9] CMF, art. L151-3 (I).

[10] *Id.* art. R.153-1.

[11] Art. L. 233.3 of the Commercial Code provides that:
I. - For the purposes of sections 2 and 4 of the present chapter, a company is deemed to control another company where it:
1. holds, directly or indirectly, a percentage of the capital giving it a majority of the voting rights at shareholders' meetings of the second company; 2. has alone a majority of the voting rights in that company pursuant to an agreement entered into with other partners or shareholders which is not contrary to the interest of the company; 3. determines in fact, through the voting rights it holds, decisions made at the shareholders' meetings of that company; 4. Is a partner in, or shareholder of, that company and has the power to appoint or dismiss the majority of the members of that company's administrative, management or supervisory bodies.

2. Acquiring, either directly or indirectly, in full or in part, a branch of activity of a company whose corporate headquarters are located in France; or

3. Holding, directly or indirectly, more than 33.33 percent of the capital or voting rights of a company whose corporate headquarters are located in France.

Where the investment is undertaken by a private individual who is a national of a Member State of the European Union, or a legal entity whose corporate headquarters are located in a Member State, or a French national residing in one of the Member State, only the two first types of investments require prior authorization.[12]

Sectors of activities covered

The decree identifies eleven sectors of activities that are subject to prior approval by the Ministry of the Economy:

(1) gambling activities;

(2) regulated activities in the area of private security;

(3) the research, development or manufacture of means to fight the unlawful use of pathogens or toxic substances by terrorists, and to prevent the health–related consequences of such use;

(4) equipment designed to intercept correspondence and monitor conversation, as authorized by article 226-3 of the Penal Code;

(5) services for the evaluation of security of computer systems;

(6) production of goods, supply or services relating to the security of the information systems of public or private-sector companies managing critical infrastructures;

(7) dual-use (civil and military) technologies;

(8) cryptology;

(9) activities carried out by companies that are repositories of defense secrets;

(10) research, production, or trade in arms, ammunition, powders, explosives or other military equipment; and

(11) activities carried out by companies that have entered into a design or equipment supply contract with the Ministry of Defense, whether directly or through a subcontractor, and concerning goods and services for one of the sectors referred to in sectors 7 to 10 listed above.[13]

Prior authorization is required for both non-EU and EU investors for the eleven sectors. The scope of the first seven sectors, however, varies in accordance with the EU or non-EU origin of the investors. They are more narrowly drafted where the investments emanate from the EU.[14] For example,

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II. - It is presumed to exercise this control where it holds, directly or indirectly, more than 40% of the voting rights, and where no other partner or shareholder directly or indirectly holds more voting rights. III. - For the purposes of application of the same sections of the present chapter, two or more companies acting in concert are deemed to be jointly controlling another company, where, in practice, they determine the decisions taken at shareholders' meetings.

[12] CMF, art. R.153-3.

[13] *Id*. arts. R.153-2, R.153-4 and R.153-5.

[14] *Id*. art. R.153.5.

the first sector "gambling activities" is limited to "casino activities but only to the extent that investment control is required as part of the campaign against money laundering" when it comes to EU investors.[15] In addition, only investment in the form of acquisition of a branch of activity of a company whose corporate headquarters are located in France is covered in the case of EU investors. Takeovers by EU investors have been excluded by the Decree in these seven sectors.[16]

The last four sectors are considered extra-sensitive and their scope is the same, regardless of whether the investor is of EU or non-EU origin.[17]

Authorization procedure

The procedure is identical for both EU investors and non-EU investors. The request for authorization must be sent to the Ministry of Economy prior to the proposed operation. The Ministry has two months to answer[18] and may rely on international cooperation to verify the accuracy of the information provided by the requester.[19] Failure to respond within this period is deemed to constitute approval.[20] The Ministry may attach certain conditions to any authorization granted to ensure that the operation will not infringe upon national interests.[21] These conditions must be proportional to the national interest being safeguarded. They include: (1) the investor's guarantee of the continuation of the activities of the company; (2) the protection of the company's industrial, research, and development capabilities, associated know-how, and supply chain; and, (3) the investor's guarantee that the company will meet its obligations under its entered-into procurement contracts.[22]

Prior authorizations are deemed granted when the investment is made between companies belonging to the same group, i.e., companies in which more than fifty percent of the capital or voting rights is owned, either directly or indirectly, by the same shareholder. This rule, however, does not apply when the purpose of the investment is to transfer abroad all or part of a branch of activity of one of the eleven strategic sectors, in the case of non-EU investors, or a branch of sectors eight to eleven in the case of EU investors.[23] Prior authorizations are also deemed to be granted when an investor who has already been authorized to acquire more that 33.33 percent of the capital or voting rights of a company or of a group of related companies is seeking to increase its ownership share.[24]

The Ministry may refuse to authorize the reported operation if it finds that there is serious reason to believe that the investor could commit one of the following criminal offenses: drug trafficking, criminal exploitation of a person's weakness or ignorance, procuring and related offenses, money

[15] *Id*.

[16] *Id*.

[17] *Id*. art. R.153-4.

[18] *Id*. art. R.153-8.

[19] *Id*. art. R.153-12.

[20] *Id*. art. R.153-8.

[21] *Id*. art. L.151-3 (II).

[22] *Id*. art. R.153-9.

[23] *Id*. art. R.153-6 (I).

[24] *Id*. art. R.153.6 (II).

laundering, acts of terrorism or financing of terrorism, corruption and influence peddling, or participating in a conspiracy. [25]

In addition, the Ministry may refuse its authorization if the conditions that it is entitled to attach to any authorization are not sufficient to ensure the protection of national interests to the extent that: (1) the continuation of the activities, industrial capacities, research and development capabilities and associated know-how could not be guaranteed, (2) the security of the supply chain could be jeopardized; and, (3) the performance of the contractual obligations of companies that have their registered office in France, whether as prime contractor or subcontractor in public contracts or contracts involving public safety, national defense interests or research, the production of or trade in weapons, ammunition, powders or explosives could be compromised.[26]

The Ministry of the Economy decisions are subject to "full review" by the administrative courts, meaning that the administrative judges may substitute their decisions for the decisions of the Ministry of the Economy.[27]

Sanctions

An investment made without prior approval or in violation of the conditions imposed by the Ministry of Economy may be enjoined. Investors may be ordered not to proceed with the operation, to modify it, or to return to the *status quo ante* at their own expenses.[28] The period of time granted to restore the *status quo ante* cannot exceed twelve months. Failure to comply with an injunction may result in a maximum civil fine of twice the amount of the investment. The fine must remain proportional to the seriousness of the offense committed.[29] The Monetary and Financial Code further provides that any agreement or contractual provision purporting to realize directly or indirectly a foreign investment in one of the sectors listed in the Decree without the proper authorization is null and void.[30] Finally, criminal sanctions may be imposed. The investor who violates the laws or regulations on financial relations between France and other countries risks imprisonment up to five years, the confiscation of the *corpus delicti*, and a fine of up to twice the amount of the investment. If the offender is a legal entity, a fine of up to five times the amount specified for a natural person may be imposed.[31]

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[25] *Id*. art. R.153-10.

[26] *Id*. art. R.153-10.

[27] *Id*. art. L151-3 (III).

[28] *Id*.

[29] *Id*.

[30] *Id*. art. L. 151-4.

[31] *Id*. art. L.165-1, cross-referencing articles 459 and 451 of the Custom Code.

2007-03850

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GERMANY

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

The only restriction on foreign investments that exists in Germany is a reporting requirement for foreign acquisitions of substantial participations in German armament firms. Such deals must be reported to the federal authorities and can be prohibited.

I. Statutory Provisions

Germany is a strong proponent of free trade and has a remarkable tradition of not impeding foreign investments. This tradition dates back to 1961, when the Foreign Trade Act [1] replaced post-occupational foreign currency and trade restrictions with a legal framework that allowed for the imposition of restrictions on foreign trade for various domestic and international purposes, but made such interferences with the free flow of capital and goods an exception to the otherwise prevailing liberal foreign trade policy.[2] Currently, the only statutory restriction on foreign investments applies to the armaments industry. It was enacted in 2004[3] and it amends sections 7, 28, and 31 of the Foreign Trade Act, which, in their currently valid version[4] are described, summarized, or translated below.

The authorization for restricting foreign direct investments in the armaments industry is provided in article 7 of the Foreign Trade Act, which is translated as follows:

Sec. 7. Protection of Security and of Foreign Affairs Interests [Partial Translation]

> (1) Legal transactions and other activities that relate to foreign trade may be restricted, in order to
>
> 1. ensure essential security interests of the Federal Republic of Germany,
> 2. prevent a disturbance of the peaceful international coexistence, or
> 3. prevent a significant disturbance of the foreign relations of the Federal Republic of Germany.
>
> (2) The following, in particular, may be restricted in accordance with paragraph 1:
>
> [numbers 1 through 4 authorize restrictions on the export and import of weapons and related objects and rights].

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[1] Aussenwirtschaftsgesetz [AWG], Apr. 28, 1961, BUNDESGESETZBLATT [BGBl, official law gazette of the Federal Republic of Germany] I at 481, as amended and as repromulgated Jun. 26, 2006, BGBl I at 1386.

[2] AWG, § 1.

[3] Elftes Gesetz zur Änderung des Aussenwirtschaftsgesetzes und der Auyssenwirtschaftsverordnung, Jul. 23, 2004, BGBl I at 1859.

[4] The Foreign Trade Act was amended several times after July 2004, but these amendments made only slight editorial changes in the provisions dealing with direct investments. The summarized and translated provisions of this report are taken from the currently valid repromulgated version of the Act [*see* footnote 1].

5. Legal transactions concerning domestically residing enterprises that produce or develop war weapons or other armaments-related goods, or produce cryptographic systems that have been approved by the Federal Office for Information Technology Security, with the consent of the enterprise, for a transfer of governmentally classified material, or

   legal transactions relating to the acquisition of shares in such enterprises [may be restricted] in order to ensure significant security interests of the Federal Republic of Germany; this shall apply in particular, if the acquisition endangers interests of the Federal Republic of Germany that relate to security policy or to preventive security for the military.

In addition to this authorization of restrictions, section 28 of the Foreign Trade Act designates the German agencies in charge of approving such foreign direct investments. The approving agency for such transactions is the Federal Ministry for Technology and the Economy, but it must act in agreement with the Ministry of Foreign Affairs and the Ministry of Defense. In addition, for enterprises producing cryptographic products, the Federal Ministry of the Interior must also be consulted. The latter is entrusted with the protection of domestic security.

It is remarkable that this restriction on direct investments in armaments does not take the form of an *a priori* licensing requirement. Instead, the acquisitions must be reported to the Federal Ministry for the Economy and Labor. That Ministry may prohibit the acquisition within a period of one month that begins to run with the submission of all relevant documents to the Ministry. Once that period has expired, the transaction becomes valid. Before that time, the transaction is conditionally valid, pending approval by lapse of time. Subject to this regime are transactions that grant foreigners twenty-five percent or more of the voting rights of a qualifying enterprise.[5]

II. Background Information

Germany is well-known for guaranteeing freedom of investment to foreigners. In fact, the Heritage Foundation's 2007 Index of Economic Freedom gives Germany a ninety percent rating for its performance on investment freedom, criticizing only that the government is somewhat skeptical of takeovers of key German companies by foreign groups.[6] In recent years, Germany has provided increasing opportunity for foreign investments due to the privatization of former government monopolies. Thus, sixty-eight percent of Deutsche Telekom, the German telecommunications company that was a governmental monopoly until 1996, is now owned privately.[7]

A more recent example of German privatization is the pending offer of the city-state of Hamburg for the sale of a 49.9 percent participation in the port of Hamburg that aims at raising capital for necessary improvements and enlargements of the port facilities. Dubai Ports World, a company owned by Dubai in the Arab Emirates is among the bidders, and there are no legal restrictions against this bid; yet it appears that the city of Hamburg and German trade unions are less than enthusiastic about this foreign bidder, preferring a domestic partner, like the privatized German Railroad that is also among the bidders.

[5] This is provided in AWG, § 31 in conjunction with section 52 of the Foreign Trade Regulation, i.e., Aussenwirtschaftsverordnung, repromulgated Nov. 22, 1993, BGBl I at 1934, as amended, § 52.

[6] *Country report "Germany"*, HERITAGE FOUNDATION, 2007 INDEX OF ECONOMIC FREEDOM, *available at* the foundation's website, http://www.heritage.org/index/ . *See also* J. Sidak, *Acquisitions by Partially Privatized Firms: The Case of Deutsche Telekom and Voicestream,* 54 FEDERAL COMMUNICATIONS LAW JOURNAL 1 (2001).

[7] Deutsche Telekom, *Die Deutsche Telekom AG auf einen Blick*, http://www..telekom.de (last visited Feb. 20, 2007).

However, it remains to be seen how this bidding war will end, particularly if Dubai were to outbid its competitors by large amounts.[8]

The restriction on the foreign ownership of German armament firms was enacted in 2004 because there was growing concern over the purchase of such firms by foreigners, among them two purchases by U.S. firms.[9] By enacting a restriction on foreign acquisitions in the sensitive industries of crypto-technology and weaponry, Germany also intended to follow the example of the United States, France, Spain, and the United Kingdom.[10]

The restrictions that were enacted in 2004 were intended primarily to protect against American takeovers and investments,[11] while German experts believed that closer cooperation within Europe, particularly with France, was necessary in the armaments sector, in order to compete internationally.[12] Ironically, however, the German government employed the armament investment restriction against France in the fall of 2005, by blocking the acquisition of a German defense electronics firm, Atlas Elektronik GmbH, by the France-based multinational defense corporation Thales.[13] Instead, sixty percent of Atlas Elektronik was purchased by the German corporation Thyssen Krupp, and up to forty percent by the France-based multinational corporation EADS, in which Germany also owns a share.[14]

Further troubles between Germany and France have recently resulted from plans of EADS to restructure its subsidiary Airbus; these may involve plant shutdowns in Germany. To gain a better bargaining position, German governments and industries cooperated in a consortium that bought 7.5 percent of the EADS shares from Daimler Chrysler AG. Since this transaction, French and German investors have an equal ownership in EADS, and Germany expects that this will give Germany a better bargaining position in negotiating plant closures in Germany.[15] This transaction shows how Germany sometimes may use cooperation between government and industry to forestall foreign investments.

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February 2007

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[8] B. Nicolai, Das Tor zur Welt öffnen; Hamburger Hafen Die Welt 13 (Dec. 12, 2006), at LEXIS/Library News/File Zeitng.

[9] Between 2002 and 2004, American firms acquired the German shipyard Howaldtswerke Deutsche Werft AG and the German producer of engines and drive systems MTU. See T. Roth, *Schutzwall für deutsche Rüstungsunternehmen*, FRANKFURTER ALLGEMEINE ZEITUNG 23 (Feb. 4, 2004).

[10] *Id.*

[11] M. Zippe, *Rüstungsindustrie unter Kontrolle,* TAZ, DIE TAGESZEITUNG 8 (Sept. 18, 2003), LEXIS/Library News/File Zeitng

[12] M. Hedtstück, *M@A Markt im Focus*, FINANCE – DER MARKT FÜR UNTERNEHMEN UND UNTERNEHMER 64 (Apr. 28, 2007), LEXIS/Library News/FileZeitng.

[13] The German government announced its intent to block this purchase, and Thales withdrew its offer [*Id.*].

[14] EADS, *Gemeinsame Übernahme von Atlas abgeschlossen*, at the company's website: http://www.eads.net (last visited Feb.20, 2007).

[15] *Deutschland wahrt Einfluss bei EADS*, VWD WIRTSCHAFTSNACHRICHTEN (Feb. 9, 2007), LEXIS/Library News/FileZeitng.

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INDIA

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

India has a liberal and transparent policy on Foreign Direct Investment (FDI). Barring a few sectors, FDI up to 100% is permitted under the automatic route, without the need to obtain permission. In cases not covered under the automatic route for investment, proposals for approval are regularly and expeditiously considered by the Foreign Investment Promotion Board (FIPB), which is directly under the authority of the Prime Minister's office.

I. Introduction

In 1947, when India gained independence, it had little, or only a limited, technology base and skills in entrepreneurship. Therefore, it welcomed FDI. Under the first year plan, investors were assured of remittances of profits and compensation in case of acquisition. This changed in the second five-year plan (1956-61) when the Indian government became more restrictive toward FDI and asserted self-reliance in economic development. The Foreign Exchange Regulation Act, 1973 (FERA),[1] imposed a ceiling of forty percent in equity by foreigners in Indian companies leading to the flight of foreign investment in the late 1970s.

In a reversal of this policy in the mid-1980s, India began liberalization of its economic policy, followed by removal of restrictions, controls and conditions on entry of FDI, as well as establishment of trans-national corporations (TNCs). However, full-scale liberalization followed the announcement of a new Industrial Policy in July 1991. For modernization of the Indian economy, the participation of foreign corporations was sought. The Reserve Bank of India allowed automatic approval for priority industries. The Foreign Investment Promotion Board (FIPB) was established for approval of investments not covered by the automatic route. The Foreign Exchange Management Act, 1999[2], that replaced FERA, eliminated the shareholding and business restrictions on foreign corporations. Further, policies on technology purchase and licensing were liberalized. Thus, foreign investment began flowing into the country.

II. Current FDI Policy

India now has a liberal and transparent policy on FDI, allowing up to 100% FDI under the automatic route in all activities/sectors except the following, which require prior approval of the Government:

1. such sectors that are prohibited for FDI;
2. activities or an item that require an industrial license;
3. a proposal in which the foreign collaborator has an existing financial/technical collaboration (venture/tie-up) in India in the same field;

[1] Act No. 46 of 1973.

[2] Act No. 42 of 1999.

4. a proposal of acquisitions of shares in an existing India company in the financial service sector where the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, are applicable;[3] or
5. all proposals falling outside notified sectoral policy/CAPS under sectors in which FDI is not permitted.

Prohibited sectors for FDI include:–

1. retail trading except Single Brand Product retailing;
2. atomic energy;
3. a lottery business;
4. gambling and betting; or
5. agricultural or plantation activities of agriculture (excluding floriculture, horticulture, development of seeds, animal husbandry, pisiculture and cultivation of vegetables, mushrooms, and similar crops, under controlled conditions and services related to agro and allied sectors), and plantations (other than tea plantations).

Most sectors fall under the automatic route for FDI. In such sectors, investment can be made without approval of the Central Government. For sectors that are not processed through the automatic route, investment requires prior approval of the Government. Approval is granted by the FIPB which has been set up to invite and facilitate investment by international companies.

The FIPB is especially empowered to engage in purposive negotiation and consider proposals free from predetermined parameters. The Secretary in the Department of Industries is the Chairman of the FIPB, with Secretaries for Finance, Commerce and the Secretary (Economic Relations) of the Ministry of External Affairs being the other members.

The FIPB is liberal in its approach for considering investment in all sectors and all types of proposals, because it examines the totality of the package proposed. The Reserve Bank of India (RBI) has granted it general permission under the Foreign Exchange Management Act in respect to proposals approved by the Government. After the grant of approval for FDI by the FIPB or for the sectors falling under the automatic route, FDI can take place upon obtaining regulatory approval from the state government and local authorities for such items as construction of buildings, providing water, and environmental clearance.[4]

FDI in sectors/activities, to the extent permitted under the automatic route, does not require any approval either by the Government or the Reserve Bank of India. The investors are only required to notify the regional office of the Reserve Bank of India within thirty days of receipt of inward remittance and file the required documents with the office within thirty days of issue of shares to foreign investors.

III. Industrial Licensing

In keeping with the Government's liberalization and economic reform program initiated in July 1991, the extensive bureaucratic control of industrial licensing was largely curtailed. Under the new policy, reforms removed restrictions on expansion and facilitated easy access to foreign technology and foreign direct investment. Under the Industries (Development and Regulation) Act, 1951,[5] an industrial license, presently, is required only for the following:

1. industries retained under compulsory licensing;

[3] V.L IYER, TAXMANN'S SEBI PRACTICE MANUAL 1497 (2003).

[4] Foreign Direct Investment Policy, April 2006.

[5] Act No. 65 of 1951.

2. manufacture of items reserved for small scale sector by larger units; and
3. when the location of the proposed industry in the specific area is restricted.

Industries for alcoholic drinks, cigarettes and tobacco products, electronic aerospace and defense equipment, explosives, and hazardous chemicals are subject to compulsory licensing under the above legal provisions. The license is granted by the Secretariat for Industrial Assistance in the Department of Industrial Policy and Promotion.[6]

Industrial undertakings that are to be located within twenty-five kms of the standard urban area in the twenty-three cities having a population of one million (according to the 1991 census) require an industrial license. An industrial license, even in such cases, is not required if a unit is located in an area designated as an industrial area before 1991 or is a non-polluting industry.

Entrepreneurs, however, are required to obtain statutory clearances, relating to pollution control and the environment, as may be necessary for setting up an industrial project for thirty-one categories as stipulated by the Department of Environment and Forests under the Environment (Protection) Act, 1986.

IV. Statutes Affecting Foreign Investment

India has enacted a number of statutes that affect foreign investment in the country. A few of the major enactments are:–

* The Foreign Trade (Development and Regulation) Act, No. 22 of 1992

  The Act encourages foreign trade, import and export, because India considers foreign trade a national priority for economic growth. Increase in exports is vital for growth whereas imports stimulate the economy. Foreign trade policy is implemented by the Director General of Foreign Trade, who serves as a bridge between trade and industry on the one hand and the Government of India on the other. The Act also regulates foreign collaboration and equity participation.

* The Industries (Development and Regulation) Act, No. 65 of 1951

  Its objective is to assist the Government in the implementation of its industrial policy. The Act brings under central government control those industries whose activities affect the development in the country. The licensing of industries, which has now been limited to a few industries, helps keep future development sound and balanced.

* The Foreign Exchange Management Act, No. 42 of 1999. (FEMA)

  In order to consolidate and amend the law relating to foreign exchange, and to facilitate external trade and payments, the Act enables the Reserve Bank of India control the maintenance of the foreign exchange market in India. Under FEMA, an Indian company with foreign equity participation is treated at par with other locally incorporated companies. Accordingly, the exchange control laws and regulations for residents apply to foreign-invested companies as well.

* The Special Economic Zones Act, No. 28 of 2005. (SEZ)

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[6] A.M. CHAKRABORTI, INDUSTRIAL LICENSING AND IDR ACT: LAW, PRACTICE & PROCEDURE (1986)

The Act sets up Special Economic Zones (SEZs) where 100% FDI may be permitted under the automatic route or with the approval of the FIPB. In the SEZ's economic laws are more liberal than the country's typical economic laws. A number of SEZs have been approved and some others await approval.

* The Competition Act, 2002, No.12 of 2003

In pursuit of globalization, while responding to opening up its economy, removing controls, and resorting to liberalization, India enacted this law to face competition from within and outside. Its main objective is to prevent practices having an adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers, and to ensure freedom of trade carried on by other participants in markets in India. A commission has been constituted under the law to carry out its objectives.

The Companies Act, 1956 regulates corporations and their management in India. In addition, the new Industrial Policy of 1991 lays down the policy and procedure for foreign investment. The new Industrial Policy has simplified investment procedures.

The attachment contains guidelines for consideration of FDI proposals by the FIPB and also the permitted sector-specific investments. The FIPB, however, is not bound by these parameters and may allow higher foreign participation.

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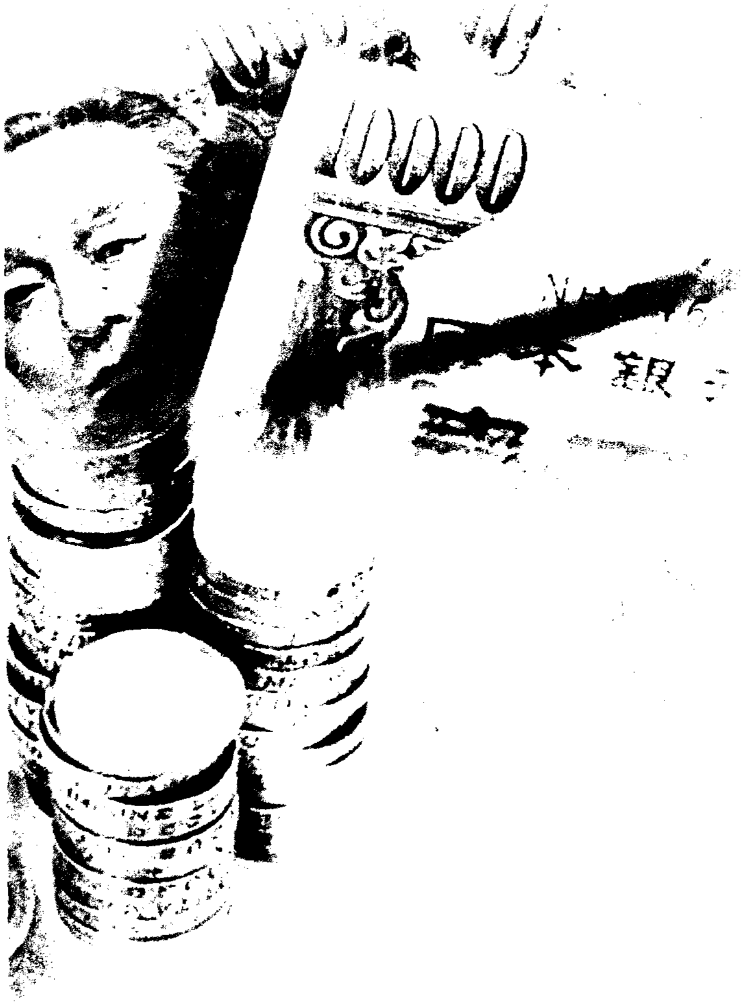

Foreign Direct Investment Policy
April 2006

सत्यमेव जयते

Department of Industrial Policy & Promotion
Ministry of Commerce & Industry
Government of India

POLICY ON FOREIGN DIRECT INVESTMENT (FDI)

I. Sectors prohibited for FDI

i. Retail trading (except Single Brand Product retailing)

ii. Atomic energy

iii. Lottery business

iv. Gambling and Betting

II. All Activities/ Sectors would require prior Government approval for FDI in the following circumstances:

i. where provisions of Press Note 1(2005 Series) are attracted:

ii. where more than 24% foreign equity is proposed to be inducted for manufacture of items reserved for the Small Scale sector.

III. In Sectors/Activities not listed below, FDI is permitted up to 100% on the automatic route subject to sectoral rules / regulations applicable.

IV. Sector-specific policy for FDI : In the following sectors/activities, FDI upto the limit indicated below is allowed subject to other conditions as indicated:

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
1.	**Airports-**				
a.	Greenfield projects	100%	Automatic	Subject to sectoral regulations notified by Ministry of Civil Aviation www.civilaviation.nic. in	PN 4 / 2006
b.	Existing projects	100%	FIPB beyond 74%	Subject to sectoral regulations notified by Ministry of Civil Aviation www.civilaviation.nic. in	PN 4 / 2006
2.	**Air Transport Services**	49%- FDI; 100%- for NRI investment	Automatic	Subject to no direct or indirect participation by foreign airlines. Government of India Gazette Notification dated 2.11.2004 issued by Ministry of Civil Aviation www.civilaviation.nic. in	PN 4 / 2006

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
3.	**Alcohol- Distillation & Brewing**	100%	Automatic	Subject to license by appropriate authority	PN 4 / 2006
4.	**Asset Reconstruction Companies**	49% (only FDI)	FIPB	Where any individual investment exceeds 10% of the equity, provisions of Section 3(3)(f) of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 should be complied with. www.finmin.nic.in	
5.	**Atomic Minerals**	74%	FIPB	Subject to guidelines issued by Department of Atomic Energy vide Resolution No. 8/1(1)/97-PSU/1422 dated 6.10.98.	
6.	**Banking - Private sector**	74% (FDI+FII)	Automatic	Subject to guidelines for setting up branches / subsidiaries of foreign banks issued by RBI. www.rbi.org.in	PN 2 / 2004
7.	**Broadcasting**				
a.	FM Radio	FDI +FII investment up to 20%	FIPB	Subject to Guidelines notified by Ministry of Information & Broadcasting www.mib.nic.in	PN 6 / 2005
b.	Cable network	49% (FDI+FII)	FIPB	Subject to Cable Television Network Rules (1994) Notified by Ministry of Information & Broadcasting www.mib.nic.in	
c.	Direct-To-Home	49% (FDI+FII). Within this limit, FDI component not to exceed 20%	FIPB	Subject to guidelines issued by Ministry of Information & Broadcasting www.mib.nic.in	

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
d.	Setting up hardware facilities such as up-linking, HUB, etc	49% (FDI+FII)	FIPB	Subject to Up-linking Policy notified by Ministry of Information & Broadcasting www.mib.nic.in	PN 1 / 2006
e.	Up-linking a News & Current Affairs TV Channel	26% FDI+FII	FIPB	Subject to guidelines issued by Ministry of Information & Broadcasting www.mib.nic.in	PN 1/ 2006
f.	Up-linking a Non-news & Current Affairs TV Channel	100%	FIPB	Subject to guidelines issued by Ministry of Information & Broadcasting www.mib.nic.in	PN 1 / 2006
8.	**Cigars & Cigarettes-** Manufacture	100%	FIPB	Subject to industrial license under the Industries (Development & Regulation) Act, 1951	PN 4 / 2006
9.	**Coal & Lignite mining** for captive consumption by power projects, and iron & steel, cement production and other eligible activities permitted under the Coal Mines (Nationalisation) Act, 1973.	100%	Automatic	Subject to provisions of Coal Mines (Nationalization) Act, 1973 www.coal.nic.in	PN 4 / 2006
10.	**Coffee & Rubber processing & warehousing**	100%	Automatic		PN 4 / 2006
11.	**Construction Development projects,** including housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, townships.	100%	Automatic	Subject to conditions notified vide Press Note 2 (2005 Series) including: a. minimum capitalization of US$ 10 million for wholly owned subsidiaries and US$ 5 million for joint venture. The funds would have to be brought within six months of commencement of business of the Company.	PN 2 / 2005 & PN 2 / 2006

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
				b. Minimum area to be developed under each project- 10 hectares in case of development of serviced housing plots; and built-up area of 50,000 sq. mts. in case of construction development project; and any of the above in case of a combination project. [<u>Note</u>: **For investment by NRIs, the conditions mentioned in Press Note 2 / 2005 are not applicable.]**	
12.	**Courier services** for carrying packages, parcels and other items which do not come within the ambit of the Indian Post Office Act, 1898.	100%	FIPB	Subject to existing laws and exclusion of activity relating to distribution of letters, which is exclusively reserved for the State. www.indiapost.gov.in	PN 4 / 2001
13.	**Defence production**	26%	FIPB	Subject to licensing under Industries (Development & Regulation) Act, 1951 and guidelines on FDI in production of arms & ammunition.	PN 4 / 2001 & PN 2 / 2002
14.	**Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, aqua-culture, cultivation of vegetables, mushrooms, under controlled conditions** and services related to agro and allied sectors.	100%	Automatic		PN 4 / 2006

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
15.	**Hazardous chemicals,** viz., hydrocyanic acid and its derivatives; phosgene and its derivatives; and isocyanates and diisocyantes of hydrocarbon.	100%	Automatic	Subject to industrial license under the Industries (Development & Regulation) Act, 1951 and other sectoral regulations.	PN 4 / 2006
16.	**Industrial explosives-** Manufacture	100%	Automatic	Subject to industrial license under Industries (Development & Regulation) Act, 1951 and regulations under Explosives Act, 1898	PN 4 / 2006
17.	**Insurance**	26%	Automatic	Subject to licensing by the Insurance Regulatory & Development Authority www.irda.nic.in	PN 10 / 2000
18.	**Investing companies in infrastructure / services sector (except telecom sector)**	49%	FIPB	Foreign investment in an investing company will not be counted towards sectoral cap in infrastructure/services sector provided the investment is up to 49% and the management of the company is in Indian hands	PN 2 / 2000 & PN 5 / 2005
19.	**Mining** covering exploration and mining of diamonds & precious stones; gold, silver and minerals.	100%	Automatic	Subject to Mines & Minerals (Development & Regulation) Act, 1957 www.mines.nic.in Press Note 18 (1998) and Press Note 1 (2005) are not applicable for setting up 100% owned subsidiaries in so far as the mining sector is concerned, subject to a declaration from the applicant that he has no existing joint venture for the same area and/or the particular mineral.	PN 2 / 2000, PN 3 / 2005, & PN 4 / 2006

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
20.	**Non Banking Finance Companies- approved activities**				
i) ii) iii) iv) v) vi) vii) viii) ix) x) xi) xii) xiii) xiv) xv) xvi) xvii) xviii) xix)	**Merchant banking** **Underwriting** **Portfolio Management Services** **Investment Advisory Services** **Financial Consultancy** **Stock Broking** **Asset Management** **Venture Capital** **Custodial Services** **Factoring** **Credit Reference Agencies** **Credit Rating Agencies** **Leasing & Finance** **Housing Finance** **Forex Broking** **Credit card business** **Money changing business** **Micro credit** **Rural credit.**	100%	Automatic	Subject to: a. minimum capitalization norms for fund based NBFCs - US$ 0.5 million to be brought upfront for FDI up to 51%; US$ 5 million to be brought upfront for FDI above 51% and up to 75%; and US$ 50 million out of which US$ 7.5 million to be brought upfront and the balance in 24 months for FDI beyond 75% and up to 100%. b. minimum capitalization norms for non-fund based NBFC activities- US$ 0.5 million. c. foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities subject to bringing in US$ 50 million without any restriction on number of operating subsidiaries without bringing additional capital. d. joint venture operating NBFC's that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities subject to the subsidiaries also complying with the applicable minimum capital inflow. e. compliance with the guidelines of the RBI.	PN 2 / 2000, PN 6 / 2000, & PN 2 / 2001

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
21.	**Petroleum & Natural Gas sector**				
a.	Other than Refining and including market study and formulation; investment/ financing; setting up infrastructure for marketing in Petroleum & Natural Gas sector.	100%	Automatic	Subject to sectoral regulations issued by Ministry of Petroleum & Natural Gas; and in the case of actual trading and marketing of petroleum products, divestment of 26% equity in favour of Indian partner/public within 5 years. www.petroleum.nic.in	PN 1 / 2004 & PN 4 / 2006
b.	Refining	26% in case of PSUs 100% in case of Private companies	FIPB (in case of PSUs) Automatic (in case of private companies)	Subject to Sectoral policy www.petroleum.nic.in	PN 2 / 2000
22.	**Print Media-**				
a.	Publishing of **newspaper and periodicals** dealing with news and current affairs	26%	FIPB	Subject to Guidelines notified by Ministry of Information & Broadcasting. www.mib.nic.in	
b.	**Publishing of scientific magazines/ specialty journals/ periodicals**	100%	FIPB	Subject to guidelines issued by Ministry of Information & Broadcasting. www.mib.nic.in	PN 1 / 2004
23.	**Power** including generation (except Atomic energy); transmission, distribution and Power Trading.	100%	Automatic	Subject provisions of the Electricity Act, 2003 www.powermin.nic.in	PN 2 / 1998, PN 7 / 2000, & PN 4 / 2006
24.	**Tea Sector**, including tea plantation	100%	FIPB	Subject to divestment of 26% equity in favour of Indian partner/Indian public within 5 years and prior approval of State Government for change in land use.	PN 6 / 2002

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
25.	**Telecommunications**				
a.	Basic and cellular, Unified Access Services, National/ International Long Distance, V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS) and other value added telecom services	74% (Including FDI, FII, NRI, FCCBs, ADRs, GDRs, convertible preference shares, and proportio-nate foreign equity in Indian promoters/ Investing Company)	Automatic up to 49%. FIPB beyond 49%.	Subject to guidelines notified in the PN 5 (2005 Series).	PN 5 / 2005
b.	ISP with gateways, radio-paging, end-to-end bandwidth.	74%	Automatic up to 49%. FIPB beyond 49%.	Subject to licensing and security requirements notified by the Department of Telecommunications. www.dotindia.com	PN 4 / 2001
c.	ISP without gateway, infrastructure provider providing dark fibre, electronic mail and voice mail	100%	Automatic up to 49%. FIPB beyond 49%.	Subject to the condition that such companies shall divest 26% of their equity in favour of Indian public in 5 years, if these companies are listed in other parts of the world. Also subject to licensing and security requirements, where required. www.dotindia.com	PN 9 / 2000
d.	Manufacture of telecom equipments	100%	Automatic	Subject to sectoral requirements. www.dotindia.com	PN 2 / 2000

S.No.	Sector/Activity	FDI Cap / Equity	Entry Route	Other conditions	Relevant Press Note issued by Deptt. of IPP www.dipp.gov.in
26.	**Trading**				
a.	Wholesale/cash & carry trading	100%	Automatic	Subject to guidelines for FDI in trading issued by Department of Industrial Policy & Promotion vide Press Note 3 (2006 Series).	PN 4 / 2006
b.	Trading for exports	100%	Automatic		
c.	Trading of items sourced from small scale sector	100%	FIPB		
d.	Test marketing of such items for which a company has approval for manufacture	100%	FIPB		
e.	Single Brand product retailing	51%	FIPB		
27.	**Satellites - Establishment and operation**	74%	FIPB	Subject to Sectoral guidelines issued by Department of Space/ISRO www.isro.org	
28.	Special Economic Zones and Free Trade Warehousing Zones covering setting up of these Zones and setting up units in the Zones	100%	Automatic	Subject to Special Economic Zones Act, 2005 and the Foreign Trade Policy. www.sezindia.nic.in	PN 9 / 2000, PN 2 / 2006 & PN 4 / 2006

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JAPAN

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Japan requires foreign investors to give an advance notice of foreign direct investment (FDI) for certain areas of investment only. The OECD Code of Liberalization of Capital Movements allows OECD member countries to enact regulations in general or specific to a country's needs.

I. Overview

Japan has promoted foreign direct investment (FDI) into Japan. Japan has established the Japan Investment Council (JIC) as a ministerial-level council to promote FDI in July 1994.[1] JIC has recommended measures to promote FDI. Japan's Foreign Exchange and Foreign Trade Law (FEFTL)[2] is the primary law pertaining to FDI. The provisions of the Law that relate to FDI were amended when FEFTL was amended in 1991. Though FEFTL was modified by a major amendment in 1997, the provisions relating to FDI were not changed at that time. Therefore, the U.S. GAO report published in 1996 (GAO/NSID-96-61 Foreign investment) is still mostly current.

II. Definition of Foreign Investment

The FEFTL defines foreign investment. According to the generalized definitions in the law, a foreign investment in Japan involves a foreigner's act of:

(1) having foreign ownership of any shares in an unlisted company;[3]

(2) having ten percent or more foreign ownership of shares in a company listed on a Japanese stock exchange;[4]

(3) consenting to change the corporate objectives of a domestic company with one-third or more foreign ownership;[5]

(4) establishing a branch or other business office and changing the purpose or kind in Japan, except for branches or other business offices of banking and other businesses specified in the Order;[6]

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[1] What is the JIC, Investment in Japan Information Center, http://www.investment-japan.go.jp/jic/index.htm (last visited Mar. 7, 2007).

[2] Gaikoku kawase oyobi gaikoku bōeki hō [Foreign Exchange and Foreign Trade Law], Law No. 228 of 1949, *as amended*. "Control" in the title of the law, Foreign Exchange and Foreign Trade Control Law, was removed when the law was amended in 1997 (Law No. 59 of 1997).

[3] *Id*. art. 26, para. 2, items 1 and 2.

[4] *Id*. art. 26, para. 2, item 3; Tainai chokusetsu tōshi tō ni kansuru seirei [Order Concerning Foreign Direct Investment], Order No. 261 of 1980, *as amended*, art. 2, para. 5. An unofficial English translation of the Order by the Japanese government is available at http://www.cas.go.jp/jp/seisaku/hourei/data/idi.pdf (last visited Mar. 1, 2007).

[5] FEFTL, Law No. 228 of 1949, *as amended*, art. 26, para. 2, item 4.

(5) lending more than 200 million *yen* in case the due date comes more than one year later and on or before five years from the lending date or 100 million *yen* in case the due date comes after five years from the lending date to domestic companies, excluding lending by a bank or other financial institution;[7] or

(6) other acts similar to any one of the preceding items and designated by the Order.[8]

III. Report and Notification of FDI

FEFTL provides for *ex post facto* reporting requirements for FDI. A foreign investor must file a report with the Ministry of Finance and the ministry with jurisdiction over the industry through the Bank of Japan within fifteen days after a transaction occurs.[9] Prior notification by a foreign investor is required if the FDI is subject to the specified concerns listed in FEFTL and if the Ministry of Finance and other relevant ministries specify the kind of FDI in the Order.[10] The Ministries enacted the Foreign Direct Investment Order, which specifies the general categories of FDI, which are reviewed.[11] Additionally, further details of FDI to be reviewed are actually specified in the Ordinances and ministries' notifications:

1. The FDI is in the (a) industries relating to national security, public order, and public safety; or (b) industries reserved through Article 2, b of the Organisation for Economic Co-operation and Development (OECD) Code of Liberalization of Capital Movements.[12] [(a)] is the industries, which are allowed not to liberalize under article 3 of the OECD Code. The ministries' notification lists details of the industries: aircraft and aircraft parts, explosives and munitions, atomic power, space development, electricity, communications, drug manufacturing, biological weapons manufacturing, agriculture, forestry and fisheries; oil; leather and leather products manufacturing are included. [13]

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[6] *Id*. art. 26, para. 2, item 5; Order Concerning Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 2, para. 6.

[7] FEFTL, Law No. 228 of 1949, *as amended*, art. 26, para. 2, item 6; Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 2, paras. 7 and 8; Tainai chokusetsu tōshi tō ni kansuru meirei [Ordinance Concerning Foreign Direct Investment], Prime Minister's Office, Ministry of Finance, Ministry of Education, Ministry of Health and Welfare, Ministry of Agriculture, Forestry and Fishery, Ministry of International Trade and Industry, Ministry of Transportation, Ministry of Postal Service, and Ministry of Labour, Ministry of Construction Ordinance, No. 1 of 1980 (Nov. 20, 1980), *as amended*, art. 2, para. 1.

[8] FEFTL, Law No. 228 of 1949, *as amended*, art. 26, para. 2, item 7; Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 2, para. 9.

[9] FEFTL, Law No. 228 of 1949, *as amended*, art. 55-5; Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 6-3.

[10] FEFTL, Law No. 228 of 1949, *as amended*, art. 27, para. 1.

[11] Order Concerning Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 3, para.2.

[12] *Id*. art. 3, para. 2, item 1.

[13] Ordinance Concerning Foreign Direct Investment, Prime Minister's Office, MOF, Ministry of Education, Ministry of Health and Welfare (MHW), Ministry of Agriculture, Forestry and Fishery (MAFF), Ministry of International Trade and Industry (MITI), Ministry of Transport, Ministry of Postal Service, and Ministry of Labour, Ministry of Construction Ordinance, No. 1 of 1980 (Nov. 20, 1980), *as amended*, art. 3, para. 3; Cabinet Office, Ministry of Internal Affairs and Communications, MOF, Ministry of Education, Culture, Sports, Science and Technology (MEXT), Ministry of Health, Labor and Welfare, MAFF, Ministry of Economy, Trade and Industry (METI), Ministry of Land, Infrastructure and Transport, and Ministry of Environment Notification No. 1 of 2002 (Sept. 20, 2002), *as amended by* the Notification No. 1 of 2004 (Mar. 25, 2004).

2. The FDI is proposed by an investor from a country for which Japan does not have reciprocity concerns.[14] The countries are listed in Annexed Table 1 of the Ordinance Concerning Foreign Direct Investment.[15]

3. The FDI involves a capital transaction, which is subject to permission from the Minister of Finance under article 11, paragraph 1 of the Foreign Exchange Order[16] and specified by MOF Notification No. 99 of 1998, as amended.[17] For instance, any capital transactions with the Taliban, terrorists, and persons involved in North Korean missile development and Iran's nuclear weapons development are included.

IV. The Review Process

The foreign investors who gave an advance notice of their investment to the Minister of Finance and other ministers who have jurisdiction over the FDI business must wait thirty days for completion of a review from the date the ministers received the report.[18] If the investor has not received a response within that time, the transaction under review is considered approved and may be completed. The following information must be provided for consideration in the report form: the information on the investor; the purposes of the business using the FDI; the date and amount of the FDI; the reason for the FDI transaction; and other information, if specified by the ministries in their ordinances.[19] The ministries may extend the review period for up to four months if they believe further inquiry is necessary.[20] Where the ministries have concluded there is no problem with the FDI, the ministries may shorten the waiting period. If the ministries have concluded the FDI falls within one of the categories listed below, they must ask an opinion of the Committee on Customs and Foreign Exchange. In some cases, after obtaining an opinion of the Committee, the ministries may advise the investor to cease or modify the investment. When the Committee requests it, the ministries may extend the review period one more month.[21] The Committee is appointed by the Minister of Finance to provide an opinion on direct investment and other matters.[22] The ministries may prohibit or modify an FDI where:

(1) The FDI may, unless a treaty or an international agreement obliges Japan not to restrict it,

a. imperil the national security or disturb the maintenance of public order or public safety; or

b. adversely and seriously affect the Japanese economy.[23]

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[14] Order Concerning Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 3, para.2, item 2.

[15] Ordinance Concerning Foreign Direct Investment, Prime Minister's Office, MOF, Ministry of Education, MHW, MAFF, MITI, Ministry of Transport, Ministry of Postal Service, and Ministry of Labour, Ministry of Construction Ordinance, No. 1 of 1980 (Nov. 20, 1980), *as amended,* art. 3, para. 4 and Annexed table 1.

[16] Gaikoku kawase rei [Foreign Exchange Order], Order No. 260 of 1980, *as amended*.

[17] Order Concerning Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 3, para.2, item 3.

[18] FEFTL, Law No. 228 of 1949, *as amended*, art. 27, para. 2.

[19] Order Concerning Foreign Direct Investment, Order No. 261 of 1980, *as amended*, art. 3, para. 5.

[20] FEFTL, Law No. 228 of 1949, *as amended*, art. 27, para. 3.

[21] *Id*. art. 27, para. 6.

[22] Kanzei gaikoku kawase tō shingikai rei [Committee on Customs and Foreign Exchange Order] Order No. 276 of 2000, *as amended*, art. 3.

[23] *Id*. art. 27, para. 3, item 1.

(2) The FDI is proposed by an investor from a country for which Japan does not have reciprocity concerns and it is necessary to make the FDI from the investor from the country subject to the same conditions as the FDI made by a Japanese in the country.[24]

(3) A part of the FDI is a capital transaction that needs the Minister of Finance's permission because:

a. the transaction may disturb fulfillment of an international agreement or contribution to international peace by Japan; [25]
b. it might make the maintenance of the equilibrium of Japan's balance of international payments difficult;
c. it might result in a drastic fluctuation of our currency's foreign exchange rates; or
d. it transfers funds between Japan and foreign countries in a large volume, and thereby might adversely affect Japan's financial or capital market.[26]

Foreign investors may appeal the decision of the ministries. FEFTL provides for a public hearing if an investor wishes to contest the result of the ministerial review.[27] After the ministerial review based on the public hearing, an investor may appeal to the Japanese courts to try to overturn the decision.[28]

V. Other Matters

Japan recognized the importance of the promotion of mergers and acquisitions (M&A) by foreign investors to promote FDI. The Japanese government improved the rules on M&A. The New Company Law, which will be effective in May 2007, makes possible a merger utilizing the stocks of the parent company as compensation.[29]

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[24] *Id*. art. 27, para. 3, item 2.

[25] *Id*. art. 27, para. 3, item 3 and art. 21, para 1; gaikokukawase oyobi gaikoku bōeki hō dai 21jō dai 1kō no kitei ni motoduku zaimu daijin no kyoka o ume nakereba naranai shihon torihiki o shiteisuru ken [Regarding designation of capital transactions that are required to receive permission of the Minister of Finance based on article 21, paragraph 1 of FEFTL], MOF Notification No. 99 of 1998 (March 1998).

[26] FEFTL, Law No. 228 of 1949, *as amended*, art. 27, para. 3, item 3; art. 21, para 2.

[27] FEFTL, Law No. 228 of 1949, *as amended*, art. 56.

[28] FEFTL Law No. 228 of 1949, *as amended*, art. 57.

[29] MITI, Whitepaper on International Trade and Industry], 349 (2006), *available at* http://www.meti.go.jp/english/report/index.html. .

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NETHERLANDS

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

The Netherlands generally encourages foreign investment and has established a Netherlands Foreign Investment Agency. Foreign companies are given tax and other incentives just as domestic companies are, and there are no restrictions on ownership of land and buildings. Restrictions are placed on investment in a few industries, including shipping, aviation, and in certain defense contracts.

I. Foreign Investment in the Netherlands

The Netherlands actively encourages foreign investment. The Ministry of Economic Affairs has established a Netherlands Foreign Investment Agency (NFIA), with offices in the Netherlands and in China, India, Japan, Korea, Taiwan, the United Kingdom, and at several locations in North America. It is designed to help potential investors learn about opportunities. In 2006 alone, the Agency was involved in 113 foreign investment projects, with planned capital investment of about $460 million and notable growth in the research and development sector. Among the new projects, twenty-four were in the area of information technology, ten were in electronic components, and seven were in medical equipment and instruments.[1]

In general, the Netherlands does not discriminate between foreign and domestic investors and permits foreign ownership of land and buildings. The same business privileges and obligations apply to both national and foreign enterprises. These include tax exemptions for corporations when they qualify for "substantial holding company" status, a status that is reached when a company that is not an investment firm owns five percent of the par value of the paid up capital of a foreign company.[2] New companies that are located near Amsterdam's port and airport will benefit from a fifty percent subsidy toward recruiting and training costs for unskilled workers in the areas of logistics, production, and assembly operations.[3]

Investments may be in a variety of forms, including establishing branches in the country and forming joint ventures with Dutch businesses. Under Dutch commercial law, there are public limited liability companies and private limited liability companies. The NFIA has published information on the ease of the procedures for establishing a foreign-invested business in the country and the advantages and

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[1] Press Release, NFIA, The Netherlands Attracts 113 Foreign Direct Investment Projects in 2006 (Jan. 31, 2007), *available at* http://biz.yahoo.com/prnews/070131/phw024.html?.v=101&printer=1.

[2] *Netherlands*, 2 Global Guide to Investment Incentives and Capital Formation 77-25 (2001-).

[3] NFIA, *New Amsterdam Companies Will Receive 50% Subsidy*, NETHERLANDS: GATEWAY TO EUROPE, http://www.nfia.com/ (last visited Feb. 15, 2007).

disadvantages of each form of organization.[4] Foreign investments have been made preponderantly in mining, quarrying, and petroleum.[5]

II. Restrictions on Foreign Investments

Although the government has the power to restrict foreign investment in any trade or industry, it has used this power sparingly. No restrictions are placed on the amount of capital a foreigner may invest or the percentage of foreign ownership of subsidiaries located in the Netherlands.[6]

There are, however, restrictions in place for certain industries. There is a requirement of Dutch residency or EU nationality to own shipping businesses[7] and a similar stipulation for aviation.[8] In addition, the right to operate an airline strictly within the Netherlands is reserved for national carriers.[9] It has been reported that nationality restrictions are commonly provided in contracts in the defense industry.[10] There is no special legislation governing takeovers of existing businesses in sectors of national interest, except in the area of national culture. Special procedures must be followed to sell items considered to be uniquely important to the Dutch heritage.[11] In the Index of Economic Freedom developed by the Heritage Foundation, the Netherlands is given an overall ninety percent rating for investment freedom, which is well above the world average.[12]

Certain government subsidies may not be available to a company if it has merged with a foreign, parent company and taken on a subordinate status. These subsidies may be for relocation expenses, research and development, or environmental action.[13]

One additional type of provision that might conceivably be invoked to limit certain types of foreign investment is the kind of special provisions that may be included in legal instruments connected with the privatization of government-owned corporations. The purpose is to prevent the enterprises from undesirable takeovers. For example, when the postal and telecommunications company, the Royal PTT Nederland NV (KPV), was privatized, the government was given approval rights over fundamental alterations in the company related to issuance of shares, mergers, and large capital expenditures.[14]

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[4] NFIA, *Q & A on Legal Issues, Taxation, and Corporate Structure*, NETHERLANDS: GATEWAY TO EUROPE, http://www.nfia.com/qanda/legaltaxcorp.php (last visited Feb. 15, 2007).

[5] *Netherlands: Foreign Investment*, ENCYCLOPEDIA OF THE NATIONS, 2006, *available at* http://www.nationsencyclopedia.com/Europe/ Netherlands-FOREIGN-INVESTMENT.html .

[6] 2 Global Guide to Investment Incentives and Capital Formation, s*upra* note 2, at 77-23.

[7] Commercial Code, art. 311, 1835 STAATSBLAD [Statute Book] 44, as amended. Cited in STEVEN R. SCHUIT, *et. al.*, DUTCH BUSINESS LAW: LEGAL, ACCOUNTING AND TAX ASPECTS OF DOING BUSINESS IN THE NETHERLANDS 14-10 (1996-).

[8] Act on Aviation, art.16, 1958 STAATSBLAD 47, as amended. Cited in SCHUIT, *id.*

[9] Political Risk Services, NETHERLANDS: COUNTRY CONDITIONS, INVESTMENT CLIMATE, Oct. 1, 2006, via LEXIS/NEXIS, EUROPE Library, PRSRPT File.

[10] Described in SCHUIT, *supra* note 7.

[11] Act on the Preservation of National Culture, art. 7, 1984 STAATSBLAD 49, as amended. Cited in SCHUIT, *id.*, at 14-11.

[12] Netherlands, Index of Economic Freedom, http://www.heritage.org/index/country.cfm?id=Netherlands (last visited Feb. 9, 2007) (unofficial source).

[13] Described in SCHUIT, *supra* note 7, at 14-117.

[14] Described in SCHUIT, *supra* note 7, at 14-11.

III. Future Plans

It had been reported that in 2006 the Netherlands intended to privatize a minority share of the Amsterdam airport. The facility was one of a number of state monopolies in which no private investment, foreign or domestic, has been allowed. These monopolies also include the Netherlands Central Bank, the railways, and public broadcasting.[15] In February 2007, however, reports indicated that the Government has decided not to go forward with privatization.[16]

IV. Contact Information

The NFIA maintains a website at http://www.nfia.com/ and can be reached at info@nfia.com. There are several offices of the Agency in the United States, including one in New York, located at One Rockefeller Plaza, 11th Floor, NY, NY, 10020. The telephone number is (212) 246-1434, the fax number is (212) 246-9769, and the Executive Director is Michael Ooms.

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[15] Political Risk Services, s*upra* note 9.

[16] *Dutch PM Sets Coalition Course for Centre Ground*, FINANCIAL TIMES (London), Feb. 8, 2007, via LEXIS/NEXIS, EUROPE Library, CURNWS File.

* The Law Library does not a present have a Dutch legal specialist on staff. The report was written based on available English-language materials.

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RUSSIAN FEDERATION

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

Executive Summary

Russian investment legislation provides that the state may restrict foreign participation in projects relevant to national security or other widely understood national strategic interests. Because no procedural regulations pursuant to the legislation yet exist, quasi-legal methods of regulation presently are used. The government drafted a bill setting out legal procedure for government authorization of foreign investment in strategic organizations. The bill is to be submitted to the legislature in early Spring 2007, and is expected to be passed before the legislature's summer recess.

I. Fundamentals of Foreign Investments Legislation

The principal legislative act regulating the regime of direct foreign investments within the territory of the Russian Federation is the 1999 Federal Law on Foreign Investments in the Russian Federation.[1] Many constituent components of the Russian Federation have adopted their own foreign investment laws to augment or elaborate on the 1999 Federal Law. Depending upon the territory where the investment is to be made, the investor will need to determine whether there is relevant applicable legislation of the constituent component of the Russian Federation. Also, the Federal Law on Investment Activity in the Russian Federation Effectuated in the Form of Capital Investments[2] is relevant. Bilateral investment treaties, which take precedence over inconsistent provisions of Russian legislation, also constitute a significant source of legislation.

The principle of a national regime is the foundation for the legal treatment of foreign investing. The 1999 Foreign Investments Law states that both the legal regime governing the activity of foreign investors and the use of profit received from investments may not be less favorable than those granted to Russian investors. As for "more favorable," the legislature has declared a policy of limiting such incentive exceptions in order to promote the "interests of the socio-economic development" of Russia. There are six categories of foreign investors: foreign citizens; stateless persons residing outside Russia; foreign legal entities whose legal capacity is determined under laws of the state in which they are registered; foreign organizations which are not legal entities; international organizations which, according to an international treaty of the Russian Federation, have the right to invest in Russian territory; and foreign states, which may become investors in Russia in accordance with the procedure determined by federal laws.

II. Existing Foreign Direct Investment Restrictions Based on National Security

Article 4 of the 1999 Foreign Investments Law states that foreign investments may be subject to exceptions established by federal legislation to the extent that is necessary to defend the foundations of the constitutional system, morality, public health, the rights and legal interests of other persons, the defense of the country, and the security of the state. However, this issue is not yet regulated in all areas of

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[1] SOBRANIE ZAKONODATELSTVA ROSSIISKOI FEDERATSII [Colelction of Russian Legislation, official gazette, SZ RF] 1999, No. 28, Item 3493, with amendments SZ RF 2006, No. 23, item 2382.

[2] SZ RF 1999, No. 9, Item 1096; 2000, No. 2, Item 143; 2004, No. 35, Item 3607; 2006, No. 6, Item 636.

investment by any one federal enabling law, so that a number of government regulations define the areas where foreign investments are permitted upon governmental approval, especially in the field of natural resources and dual-use technologies. Presently, investment permits are issued on a case-by-case basis following the recommendations of responsible governmental agencies. The approval process is long and cumbersome, and often depends on provisions included in the bilateral investment protection treaty. The U.S. – Russian Bilateral Investment Protection Treaty signed on June 17, 1992 but not yet ratified,[3] provides for the right to the repatriation of ruble profits in hard currency, non-discriminatory treatment for U.S. investments, effective compensation in case of expropriation, and international arbitration in the event of a dispute between a U.S. investor and the Russian Government.

The Treaty is supplemented by a list of areas that can be restricted from foreign investment. According to this Agreement, Russia can establish or preserve exceptions from the national regime in the following areas of industry: electric power production, the generation of uranium and its products; land property; use of natural resources; fishery, including in the exclusive economic zone; construction; building and management of communications systems; real estate operations and management; exploration and development of precious metals and stones; air and water transport; banking and credit operations; operations with securities; obtaining state and municipal property during the course of privatization; mass media; and private detective and security activities.

In the absence of legislation, the government uses non-legal instruments to regulate foreign investments. In Fall 2006, when the Government decided to tighten control over the country's energy industry, it forced the Royal Dutch-Shell Group to sell its major stake in the Sakhalin Island oil and gas project to the Russian state controlled natural gas monopoly, Gazprom, and used environmental protection issues to threaten projects run by Exxon Mobil, BP, and Total.[4] In October 2006, the Law on State Regulation of Aviation Development was amended to include a provision that expands the share of foreign participants.[5] The new amendment allows participation of foreign investors in development, production, testing, exploitation, and repair of aviation equipment in an amount not exceeding twenty-five percent while Russian citizens will manage the investment project.

III. New Legislative Proposals

On January 31, 2007, the Government of the Russian Federation agreed on the procedure for foreign investment in strategic organizations. It is expected that this decision will be submitted to the State Duma (lower house of the legislature) for consideration as a legislative proposal. The basic principle underlying the new procedure will be "the approach of permissions," which implies preliminary coordination of the transactions that may lead to the foreign investor's control over a commercial organization of strategic significance for national security. The Government has defined forty areas of activity by strategic organizations in which foreign capital may be invested upon governmental authorization. These include organizations working in such fields as aerospace, aviation equipment, nuclear energy, natural monopolies, agents of infections, the development and production of armaments and military equipment, the production of metals and alloys from them, and the exploration of natural resources from the fields of "federal significance." Simultaneously recommended amendments to the Federal Law on Subsoil designate ten oil fields with reserves of no less than 513 million barrels each, twenty-six gas fields with reserves of no less than fifty billion cubic meters, and areas of gold and copper exploration. For gold, the minimal level of reserves is 50 metric tons, and for copper 500,000 metric tons. One gold and five copper exploration fields were designated as strategically important. This list can be changed later by amending the Law in accordance with Government recommendations.

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[3] U.S. Department of State, Bilateral Investment Treaty Program,http://www.state.gov/e/eb/rls/fs/2006/22422.htm (last visited Feb. 21, 2007).

[4] *See, e.g.*, Andrew Kramer, *Shell Bows to Kremlin Pressure on Sakhalin Project*, INTERNATIONAL HERALD TRIBUNE, Dec. 11, 2006, *available at* http://www.iht.com/articles/2006/12/11/business/shell.php?page=2.

[5] SZ RF, 2006, No. 45, Item 4862.

It appears that when this proposal is adopted as a law, a government commission under the auspices of the Federal Ministry of Energy and Industry will be created in order to make the decisions regarding the possibility of foreign investments. The list of investors includes foreign nationals, regardless of their residency, and Russian investors under foreign control. The authorization will be required in the case of a foreign investor with more than fifty percent of the shares who wants to conduct operations. However, if the investor represents the interests of a foreign state or international organization, operations with more than twenty-five percent of the shares owned by a foreign state or government are subject to governmental control. The Bill provides for the imposition of additional obligations on a foreign investor. These may include requirements that state secrets be protected; that only Russian citizens who have clearance may serve on executive bodies of the organization; and a mandatory agreement to continue the government defense contract if the federal executive security authority does not express its objection. If even the imposition of investor obligations does not prevent threats to national security, the Commission will recommend that the Government deny the request for investments. The Bill also contains a clause that states that an investment in a strategic organization will not be authorized if the investor is a foreign state or a legal entity controlled by a foreign state. All investments into strategic organizations will be considered null and void if such investments were made without preliminary authorization.

The decision regarding an investment authorization shall be made within a three-month period. Under exceptional circumstances the decision-making period can be extended for an additional three months. If the decision is not made by the end of this period, investment authorization shall be granted automatically. Negative decisions shall be made by the Prime Minister of the Russian Federation.[6]

Also, on December 15, 2006, the State Duma considered amendments to the Federal Law on Banking Activity. The Bill allows foreigners to buy up to twenty percent of the shares of Russian banks without receiving preliminary approval from the Russian Central Bank; the Bill, however, introduced the requirement to inform the Central Bank about any operations between a foreign investor and a Russian credit organization. Presently, the Law requires mandatory disclosure only for the purchase of five percent or more of the shares.

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[6] For more information, *see* Greg Walters, *Moscow Restricts the Exploration of Strategically Important Fields by Foreigners*, WALL STREET JOURNAL, Feb. 1, 2007, at 12.

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UNITED ARAB EMIRATES

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATIONAL SECURITY GROUNDS

The United Arab Emirates (UAE) business laws contain provisions that restrict foreign investment in the country. The aim of these provisions is to maximize opportunities for the nationals of the UAE to be involved in and benefit from commercial and trade transactions. The UAE, however, does not have legislation similar to the United States' Exon-Florio amendment providing restrictions on foreign investment for national security purposes. The UAE provisions are summarized in the following paragraphs.

Commercial Agency Law

Article 2 of the Commercial Agency Law No. 18 of 1981, as amended by Federal Law No. 14 of 1988, provides that the conduct of commercial agencies in the State shall be restricted to UAE citizens or companies which are wholly owned by UAE citizens.

The Law on Regulating Industrial Affairs

Article 8 of Law No. 1 of 1979 concerning the regulation of industrial affairs provides that no licenses shall be issued for establishing industrial projects except to nationals of the UAE or companies in which the national shareholding capital is not less than fifty-one percent and in which either the manager who is in charge is a national or the majority of the board of directors are nationals.

Other Laws and Regulations

There are other laws and regulations that contain similar restrictions, such as article 25 of the Commercial Companies Law No. 8 of 1984, which provides that all partners in a joint-liability company or partnership shall be UAE nationals. Similarly article 8 of Ministerial Order No. 16 of 1975 regulating government purchases, tenders, and contracts provides that the supplier or contractor, whether an individual or company, shall be a UAE national.

Nationals of the Gulf Cooperation Council States

Law No. 2 of 1984 gave permission to nationals of the Arab Gulf Cooperation Council States to conduct economic activities in the UAE, as well as to practice medical, legal, and other professions that normally are reserved to UAE nationals.

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UNITED KINGDOM

GOVERNMENT CONTROLS OVER FOREIGN DIRECT INVESTMENTS ON NATONAL SECURITY GROUNDS

Executive Summary

Foreign direct investment is a significant contributor to the economy of the United Kingdom and is actively encouraged by liberal laws and government organizations that assist companies seeking to invest. Restrictions are in place on mergers that may affect the public interest of the United Kingdom. Any restrictions are considered on a case by case basis, often being resolved merely through behavioral and structural undertakings. The continued use of golden (or special) shares on the grounds of national security allows the government to retain a certain degree of authority over privatized key companies.

I. Introduction

Foreign direct investment (FDI) has been actively encouraged by the UK government to a largely successful degree. Levels of FDI inflow in the United Kingdom in the year 2005 were reportedly the highest in the world, reaching £106.5 billion, although this was largely due to a number of mergers and acquisitions.[1] Inward flows of FDI have increased from the year 2004 from £30.5 billion to £106.5 billion in the 2005, with the United States and the Netherlands being the largest inward foreign investors in the UK.[2]

UK Trade and Investment, a government organization that helps businesses locate in the UK, has noted that there are generally no protectionist measures that would amount to restrictions on investing in the UK and that no formal screening mechanism for investors is in place[3] because the UK "prizes…competition over protectionism."[4] More than twenty-five percent of businesses located in London are currently under foreign ownership.

II. Strategic Protections

The Industry Act 1975 continues to operate and permits the Secretary of State to make an order prohibiting change of control to a non-UK resident if a manufacturing undertaking of special importance to the UK is about to change its control in a manner contradictory to the interests of the UK or any substantial part of the UK.[5]

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[1] National Statistics, Foreign Direct Investment 2005, Dec. 2006, available at http://www.statistics.gov.uk/PDFDIR/fD1206.pdf.

[2] UNCTAD, *World Investment Report 2006* data available at: http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1, cited in House of Commons Library Research Paper, Economic Indicators: November 2006, Nov. 2006, HC 06/52.

[3] UK Trade and Investment, *A Guide to Foreign Direct Investment*, Oct. 2006, *available at* http://www.ukinvest.gov.uk/10400/en_GB/0.pdf.

[4] UK Trade and Investment, *The UK is Open for Business*, Mar. 2006, *available at* http://www.ukinvest.gov.uk/2/d/172/en/US/1.0.html.

[5] Industry Act 1975, c. 68, §§ 11-13.

The Enterprise Act 2002 substantially overhauled the framework for mergers in the UK and replaced virtually all of the Fair Trading Act 1973. The Act has removed virtually all government Ministers' responsibility to investigate mergers and acquisitions and provided this duty to the Office of Fair Trading and the Competition Commission, thus 'de-politicising' merger decisions. The Secretary of State does, however, retain the authority to intervene in certain mergers and refer them for investigation to the Office of Fair Trading on the grounds of public interest, defined in the act as national security, or if the merger involves "certain government contractors (or subcontractors) who may hold or receive confidential information or material relating to defence."[6]

To intervene, the Secretary of State must issue a special intervention notice that provides details of the case as well as the public interest considerations. The case is referred to the Office of Fair Trading that then conducts a preliminary investigation that relates solely to the public interest considerations, rather than the grounds of competition, and then reports to the Secretary of State whether it believes that the case should be referred to the Competition Commission. During the investigation, the Office of Fair Trading receives representations from interested parties in the case. The Secretary of State must then decide whether to refer the case to the Competition Commission, which must determine, then decide whether the merger "operates or may be expected to operate against the public interest"[7] and, if so, whether the Secretary of State should take any action to remedy or mitigate any adverse effects.[8]

This power was recently utilized in August 2005 when the Secretary of State issued a special intervention notice over the proposed acquisition of Insys Group Ltd, a specialized defense engineering and research and development company, by Lockheed Martin Corporation. The Ministry of Defence provided representations that the proposed transaction would adversely affect the UK's public interest on the grounds of national security, notably the maintenance of strategic UK capabilities; the protection of classified information; and the protection of exploitation of technology and information. The case was ultimately resolved with Lockheed Martin agreeing to a number of undertakings that the Secretary of State was satisfied would not adversely affect the public interest of the UK, for example, that the Board of Directors would substantially be composed of British citizens.[9]

III. Golden Shares

The use of golden shares to maintain control over strategic British companies was subject to a number of adverse decisions from the European Court of Justice in 2002-2003 which ruled that the use of Golden Shares are acceptable only in specific circumstances and with very strict conditions.[10] The Court stated that:

> Golden shares are compatible with EU law only if they are (1) based on narrowly interpreted exceptions to the free movement rules set out in the EC treaty or identified by the ECJ; (2) necessary and proportionate; (3) objective, non-discriminatory and transparent; and (4) subject to legal remedy … the ECJ condemned the golden shares as incompatible with the right of establishment and the free movement of capital.[11]

The UK continues to use golden shares on the grounds of national security to maintain a certain degree of control over privatized industries that are important to the national security of the UK. The UK

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[6] Enterprise Act 2002, c. 40, Explanatory Notes, ¶ 190.

[7] Enterprise Act 2002, c. 40, § 63(3).

[8] Enterprise Act 2002, c. 40.

[9] Office of Fair Trading, *Enterprise Act 2002: Undertakings*, http://www.oft.gov.uk/shared_oft/mergers_ea02/undertakings/insysundertakings.pdf (last visited Mar. 15, 2007). See also Marc Israel, *Politics is being kept out of national merger control*, Aug. 2005, CLI 4.15(12).

[10] Commission v Portugal C-367/98; Commission v France, C-483/99; and Commission v Belgium C-503/99.

[11] Nelson Jung, *Combating Economic Patriotism*, Jan, 2007, CLI 6 1 (3).

government has noted in Parliamentary debates that it does not intend to dispose of its golden share in certain areas,[12] which gives the government the authority to "veto any transactions that we do not regard as being consistent with the British interest."[13]

There currently appears to be no planned changes to the policies, practices, or laws for controlling FDI based on national security interests in the UK.

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[12] 27 Jan. 2007, PARL. DEB. H.L. (5th ser.) 694.

[13] 27 Jan. 2007, PARL. DEB. H.L. (5th ser.) 679.