DELEGATION
OF THE
COMMISSION OF THE EUROPEAN COMMUNITIES

441.2(103)
Special file

The Delegation of the Commission of the European Communities and the Embassy of France present their compliments to the Department of State and wish to refer to the proposed Regulations issued by the Department of the Treasury implementing Section 5021 of the Omnibus Trade and Competitiveness Act of 1988.

Section 5021 gives the President powers to investigate the effects on US national security of mergers, acquisitions and takeovers which could result in foreign control of legal persons engaged in interstate commerce in the United States. These investigatory powers have been delegated to the interagency Committee on Foreign Investment in the United States. Should the President decide that any such transactions threaten to impair the national security, he may take action to suspend or prohibit them.

The proposed Treasury Regulations are intended to implement Section 5021, by defining, inter alia, what transactions are subject to the provisions of Section 5021, the nature of the assets concerned, the nationality of participants in such transactions for the purposes of Section 5021, and the rules concerning the notification of transactions to the above-mentioned Committee.

The European Community understands the wish of the United States to take all necessary steps to safeguard the national security. However, it wishes to express its concern that the scope of application of the proposed Regulations appears to go beyond what is necessary to protect essential security interests.

European investors, who currently account for more than half of total direct foreign investment in the United States, anticipate difficulty over the wide scope of the definitions in the Regulations and over the lack of a definition of national security. There is serious uncertainty as to which transactions are notifiable under Section 5021. As currently drafted, the Regulations are so broad in scope that it would be imprudent for foreign investors not to file notice. This would be virtually equivalent to prescreening and notification of all new foreign investment. Given that the President has powers to block acquistions and, if necessary, to require divestment of property at any time in the future

/...

without assured compensation, the effects upon the free flow of investment capital could be far-reaching. A schedule detailing some general concerns on the content of the Regulations as currently proposed is annexed to this note.

The European Community would therefore request that the United States take steps to ensure that normal business activities may continue without the threat of investigation and possible Presidential action, and that the US Administration apply the principles of national treatment and freedom of establishment which the United States has in various contexts sought to assure for European subsidiaries of United States companies posessing assets in essential economic sectors in the EEC Member States.

It is noted in this context that the intention of Congress, as detailed in the relevant Conference Report, was "in no way.....to impose barriers on foreign investment".

The European Community agrees with the United States that Investment flows should be determined by market forces. The formulation of international disciplines on trade-related investment measures is an important objective in the Uruguay Round negotiations. In this context it is noted that the US Administration has expressed its opposition to measures taken by other governments considered to interfere with investment flows and has taken steps against a third country under Section 301 of the 1974 Trade Act, as amended by the Trade and Competitiveness Act of 1988. The Government of the United States has furthermore sought stronger OECD disciplines on national treatment for foreign investment, and in the OECD has consistently criticised disincentives to investment.

The Delegation and the Embassy would further point out that European direct investment in the US in 1988 amounted to nearly $200 billion, while US investment in the Community reached almost $130 billion, with substantial mutual benefit in terms of employment, revenues, and export earnings. Given the importance of these flows to overall relations between the Community and the United States, the Department of State is requested to take whatever steps are necessary, with the Government

/...

Departments concerned, to reduce the potential inhibiting effects of these draft regulations on investment in the US.

The Community and its Member States reserve their rights to raise this matter in appropriate international fora.

The Delegation of the Commission of the European Communities and the Embassy of France avail themselves of this opportunity to renew to the Department of State the assurance of their highest consideration.

COMMISSION OF THE EUROPEAN COMMUNITIES
DELEGATION
WASHINGTON, D.C.

Washington, D.C.
27 September, 1989

The difficulty of defining in legal terms concepts which were intended to apply in general terms ("control","national security") is recognised. However, in order to meet the stated objective of avoiding disruption to investment, the least possible interference in market forces is desirable. Among the areas where the scope of the implementing Regulations would need to be made more precise, and their scope of application limited, are the following:

Definition of national security

1.1 It is a generally recognised principle in international agreements which contain national security clauses that these be invoked as narrowly as possible.

1.2 In accordance with the legislative history of the amendment, there is no definition of national security in the Regulations.

The guidelines in the OECD Council's Recommendations on International Investment and Multinational Enterprises* are relevant here.

1.3 At the same time, it is suggested by the Treasury that the Regulations are not intended to cover cases where the entire output of a company to be acquired consists of products or services which have no relation to national security. The illustrative list of such cases is so narrowly drawn that it creates the presumption that industries not on the list should automatically notify. Rather than a negative list, the Regulations could stipulate a positive list of industries where notification may be made, these being industries generally considered as forming part of the defence base. For other industries a presumption of non-notification would be the guideline. Alternatively, the negative list could be extended to cover a much larger number of industries.

Notification

2.1. The Regulations state that notification can be made at any time, even well after the completion of the investment, and that divestment could be required in such circumstances. This draconian provision has very far-reaching ramifications and virtually obliges companies to file notice in the interests of legal certainty. One way of reducing this uncertainty might be to examine the introduction of a time limit on notifications. Some procedures would need to be envisaged which would allow speedy elimination from the system of transactions which have no obvious consequences for the national security (see para 3.2 below).

2.2. The notification system as proposed could also have the effect, however unintended, of distorting competition. A company which is the target of a hostile bid from a foreign company, and a US competitor, may file notice simply to deter the foreign bidder. The statute could also be used against foreign lenders, on the grounds that an investigation could be triggered in the event of bankruptcy of the borrower (see 3.1. below).

* 16 July 1986: published in the Acts of the Organisation, 1986, Vol. 26, p.317

/....

2.3 In this context, the information which parties to a given transaction must supply is not always available to the foreign party: the requirement to supply "known or reasonable available" information is drawn so broadly that it can represent a built-in bias. The regulations would certainly create less difficulty if it were made clearer what is considered an "acceptable" notification.

2.4 Where notification is required, in order to avoid trade distortions each party should be invited to supply information relating exclusively to its part of the transaction, on a basis of equality, and at the same point in time.

2.5 Under the rules set out in Section 800.402, the Chairman of CIFUS retains the right to reject voluntary notices if, after the notice has been submitted, there is a material change in the transaction to which notification has been made. The definition of 'material' should be elaborated so that investors are clear what is intended. In addition a more precise definition is necessary where it is alleged that the parties omitted 'material' information from a Section 800.601 transaction subject to examination. Without such a definition, investors could never be sure that any review or investigation was "final".

Definition of transactions

3.1 As drafted, any transactions would be covered which could lead to 'foreign control' of a US legal person or of assets belonging to a US legal person engaged in interstate commerce, virtually independent of issues such as the nationality of the owners and of the board members. Acquisitions covered would include proxy arrangements or any contractual provisions which could allow 'foreign' participation in business decisions. This would apply even to bank loans, if a foreign bank was obliged to foreclose on a loan or in situations where a foreign bank, even unwittingly, became the owner of assets in a bankrupt US company. The provisions could also be applied to joint ventures, although it is not clear that Congress intended this. These ought therefore to be excluded.

3.2 The instances where such normal business transactions would affect national security would probably be very few - far too few to justify such general coverage. Given the vast number of transactions which could be placed in question, in order to avoid these requirements developing into a significant trade barrier - some limitation would need to be placed on the definition of 'control' and indeed on the value of the assets concerned. It would seem reasonable to use as yardstick for control possession of a substantial percentage of the voting securities, and to exempt low-value transactions.

3.3 The list of transactions exempt from coverage is a short one. It includes stock held "solely for investment", provided the foreign person concerned holds less than 10%. This rule of thumb, if applied strictly, would effectively deter shareholders from acquiring more stock, however little, if by doing so they could trigger the Section 5021 provisions.

It is also unclear how the authorities would be able to determine when stock is held "solely for investment".

/.....

Acquired rights

4. Furthermore, there is at present no exemption foreseen for foreign controlled corporations which have been established in the USA over long periods without creating difficulties for national security. This would infringe the nationally and internationally recognised legal principle of the protection of acquired rights.

Extraterritorial application

5. Acquisition of one foreign corporation by another outside the USA could trigger an investigation if the party acquired owned a branch or subsidiary in the USA. Given also the government's powers to subpoena information from other parties (see point 7 below) this could represent an unacceptable extension of US domestic law into the affairs of other countries, and could seriously affect foreign companies' competitive strategies.

Penalties

6.1 The President may exercise the penalties provided for in the statute if there is "credible evidence" that "the foreign interest exercising control might take actions that threaten to impair the national security".

6.2. It is a matter of concern that no compensation is specifically provided for if limitations are placed on the use of assets acquired legally and in good faith, or if a 'foreign person' is divested of such assets. Nor is guidance given to the President in determining the circumstances in which such measures should be resorted to. This adds to the concern over the provision in the statute that the President's decisions are not subject to judicial review.

Confidentiality

7. Once notification is given, the US government may subpoena commercially confidential information from other parties. This information would very possibility include details of that party's activities outside the USA. Furthermore, any information supplied pursuant to a notification and/or investigation may under Section 5021 be made available to members and staff of Congress. However well intentioned the recipients of such information may be, the confidentiality of widely distributed information cannot be completely guaranteed: the deterrent effect should not be underestimated. Therefore confidentiality needs to be assured.