Study on State Control
of Strategic Defence Assets
(EUROCON)

FINAL REPORT to DG Enterprise

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Study on State Control of Strategic Defence Assets (EUROCON)

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Country Report

– France –

1st September 2010

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1 INTRODUCTION

In France, like in most of the countries producing defence equipment, building up military capabilities is a longstanding process. It requires performing numerous studies and preliminary work to prepare "the future". In this respect, France has invested billion of Euros to develop its industrial capabilities to enable the development of its military capabilities.

In support of this effort, France has implemented a set of regulations in order to control foreign investments of strategic assets, including those of defence. The aim of this control is first to ensure the continued access to those national industry capabilities by safeguarding the know-how resulting from national investments, and second to prevent proliferation of any sensible technology. The French public authority also adds the control of defence and security information to the authorization given to receive classified information as a way to assure the control of strategic defence assets

Besides a general regulation on the control of foreign investments, a specific regulation allows the setting up of special rights in the form of "specific action" (granted to the State by the privatisation law of 1986 modified by the law of 1993). Thales is currently the only company subject to a special rights provision.

The French Government recognises that there are other direct or indirect means of control and influence such as the monopsony position of the French Government and the prominent amount of its orders in the defence market, which helps to deter possible unfriendly financial operation or defence procurement policies.

Even if it is legitimate to mitigate the risk for national interests by controlling potential foreign investments concerning strategic assets, it is also necessary to find investment sources fulfilling the above criteria for companies, mainly SME/SMIs, which need it in the case of financial difficulties (as it is presently the case due to the international financial crisis). This is a main concern in France, because SME/SMIs, which are source of innovation, are more vulnerable in terms of finances, than well established prime contractors.

Even if it is not said, State owned companies like Nexter, in the land armament sector, and DCNS, in naval armament sector, are viewed as in transition before their restructuring and privatising at a national or European level.[1] So State-ownership is not considered per se by the French Officials as a tool to ban foreign investment.

Golden shares ("special share" in literal translation from French) are used only for one company in the defence sector: Thales. However, the Government is using another tool that is akin to special rights, namely arrangements with other shareholders. In the cases of Safran, EADS and MBDA the Government has entered into shareholder agreements, in order to protect French deterrence assets. All French defence companies fall under the general investment control regulation of 2005.

In our interviews, French officials have expressed interest in a European regulation with the objective to create a strong European Defence Technological and Industrial Base (EDTIB) including poles of excellence and security of supply rules.

2 CONTEXT

2.1 The French defence industry

In the first part of the 20th century, the French defence industry was half public, in land and naval sector, and half private in the new sector of aerospace. Later it became subject of nationalization and privatisation. In 1935, in order to support the French Franc, the Government decided to limit the profit of private companies providing defence systems to the armed forces. In this respect, the decree-law of October 30th, 1935 was passed to install Commissioners of the Government on the boards of companies in order to control the profitability of defence contracts.

Throughout French history nationalization was undertaken for three times:

[1] On 4th May 2010 on the occasion of the launch of the first Franco-Italian frigate (Fremm), the President of the Republic Nicolas Sarkozy declared that "he would be pleased if a major industrial take a part of the shareholding of DCNS". Speech on occasion of the launch of the Frigate « Aquitaine » in Lorient: www.elysee.fr

1. For the "old industry", naval industry and ordnance, companies were created by Colbert in the XVII century. For this reason Giat industries (land armament) and DCNS (naval armament) were still public entities within the French army at the end of the eighties, part of the State budget with civil servant employees.
2. The aeronautic industry was nationalised before the Second World War, in 1936, in response to the threat of Nazi Germany.
3. Finally, François Mitterrand, from the Socialist party, nationalized Matra and Thomson CSF in 1981(today Thales). In 2010, these two companies were privatised once again.

After this period, two laws of privatisation were passed when right-wing political parties were leading the country in 1986 and 1993 respectively. Later, in 1997, the socialist Prime Minister, Lionel Jospin, did not opt to reverse these laws. Instead, he promoted the privatisation of Thomson CSF and Aérospatiale.

After the last wave of privatisations in the late nineties, the French State has progressively withdrawn from the major defence contractors. The two main companies, EADS and Thales, are now European.

- EADS: it is a Dutch registered company and is the result of the merger of French, German and Spanish companies, i.e. Aérospatiale/Matra, DASA and CASA.
- Thales is a "multi-domestic company": even if it is a French company, as its head office is located in France and the French Government maintains close ties to it, the other main European units are located in the UK, the Netherlands, Germany, Italy, Spain and Greece.

Currently, the capabilities of the French industry cover the whole scope of national requirements for defence, including nuclear deterrence, through main contractors and equipment manufacturers. In 2007 the estimated turnover of the French defence industry amounted to € 15 billion with employment reaching: 165,000 direct employees within the ten major companies and about 100 SMEs.

The French industry can be divided in two types of companies.

A: The first type concerns prime contractors with more than one billion Euro turnover. These companies are system integrators or major platform builders in one or

all of armament sectors (air, land, naval). There are eleven main companies in this first group, which can be distinguished into two following sub-groups:

Multinational companies

An important part of the French defence industry is included in multinational companies formed together with firms from other EU countries.[2]

- EADS Astrium (DE, ES, FR, UK). Astrium is a subsidiary owned 100% by EADS aggregated turnover € 4,8 billion in 2009. Its activity is in the space sector. Astrium manufactures the Helios military observation satellite and the M51 missile of the French deterrence.
- EADS NV (DE, ES, FR). EADS builds defence and security systems. This company is involved in the Eurofighter aircraft. Its military turnover was about € 8.6 billion in 2008.
- Eurocopter (DE, ES, FR) Eurocopter is a subsidiary owned 100% by EADS. Eurocopter produces both military and civilian helicopters. Its military turnover was roughly € 2 billion in 2008.
- Airbus Military (DE, ES FR) is a subsidiary owned 100% by EADS. Airbus Military was created in April 2009 and produces the A400M, A330 MRTT, C295, CN235 C212 and Surveillance & Security aircrafts. The turnover was worth 2,24 billion euro in 2009
- MBDA (DE, FR, IT, UK). MBDA is owned 37,5% by EADS, 37,5% by BAE Systems, and 25% by Finmeccanica. Its activity is in the missiles and missile systems sector. The company's military turnover amounted to about € 3 billion in 2008.
- Thales (FR with national units in several European countries like the UK, the Netherlands, and Italy). Thales is a system integrator specialised in electronics. Thales holds 25% of the shares in the French naval military company DCNS. Its military turnover was about € 6.2 billion in 2008.

[2] All figures are taken from SIPRI (2009) *SIPRI Yearbook 2009. Armaments, disarmament and international security* (Oxford: Oxford University Press).

National companies

- Dassault Aviation, whose activity is in the sector of military aircraft, builds the Rafale aircraft. Its military turnover is € 1.6 billion in 2008.
- DCNS, whose activity is in the military maritime sector, builds surface ships, submarines (nuclear attack submarines and deterrence submarines equipped with nuclear missiles) and aircraft carriers for the French navy. DCNS exports surface ships and classic powered submarines. Its military turnover was € 3.8 billion in 2008.
- Nexter, whose activity is in the land sector. Nexter builds the main battle tank Leclerc and armoured vehicle VBCI with a total turnover of € 600 million in 2008.
- Safran, whose activity is in the electronics, UAV, security and propulsion sectors, had a military turnover corresponding to € 5.3 billion in 2008. Safran builds engines for the Ariane launcher and for nuclear ballistic missile M51. Safran also builds avionics for military aircraft and tactical UAV.
- ATR joint venture between EADs/Finmeccanica; Some aviation defence activities even though minor. Not considered as being part of the "defence industry" by French Officials
- SNPE, whose activity is in the propulsion and ammunition sector had military sales of about € 640 million in 2008.

B: The second type of French defence companies, concerns small and medium sized companies. In France, there are only few medium companies that are not necessarily only dedicated to defence products. In addition, there exists smaller companies in the supply chain some, supplying high technology products, others as simply subcontractors for prime contractors. All in all there are about 100 SMEs active in the defence field, equally divided between high technology niche products and sub-contractors products. There also medium-sized companies, which have high capabilities in engineering, the most important being CS systems and Cegelec.

Small and medium sized high technology companies are carefully observed by the French DGA as they may be key companies in terms of security of supply. Medium

and small companies are all private companies as opposed to, for the time being, a few prime contactors.

2.2 The scale of defence procurement

The key goals in terms of France defence equipment procurement policy are to ensure the security of supply. That means no restriction in the operational use of equipments.

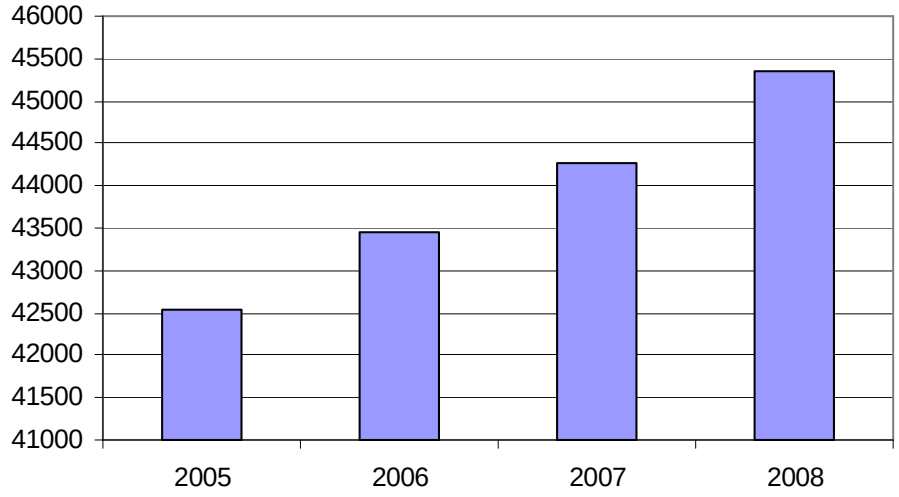
The French procurement agency, the DGA, is in charge of proposing, establishing and implementing the Industrial Strategy. This strategy relies on principles identified in a guidance document released in 2004 on the defence procurement policy, which develops the so-called "*autonomie compétitive*" concept.[3] These principles are then concretely applied at the level of industry competence domains.

For each armament "operation", a procurement strategy identifies how to apply the framework policy. At each major milestone of armament programmes, related procurement strategies are reviewed in order to guarantee coherence between the objectives of the programme and the access to the technological and industrial capacities required to achieve those programmes.

Since 2005 the French defence budget has steadily increased from € 42 billion in 2005 to more than € 45 billion in 2010. France and the United Kingdom are clearly the EU country spending the most on defence.

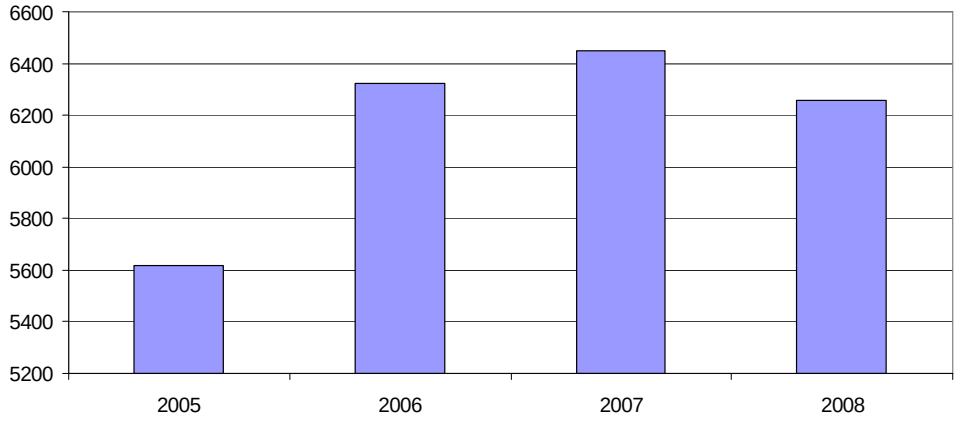
[3] Defence, F.M.o. (2004) 'Pour une autonomie compétitive en Europe: La politique d´acqisition du ministère de la défense'. available at <http://www.dicod.defense.gouv.fr/dga_old/layout/set/print/layout/set/popup/content/download/46886/465664/file/la_politique_dacquisition_du_ministere_de_la_defense_pol_acq_mindef_fr.pdf>.

Figure 2.1: Development of the French defence budget – 2005-2008 in million €[4]



The French defence equipment budget has also increased over the same period, albeit at a small pace.

Figure 2.2: The French defence equipment budget – 2005-2008 in billion €[5]



The defence R&T budget has equally been raised from € 695 million in 2005 to reach € 814 million in 2010, with the objective to progressively reach the goal of € 1

[4] EDA (2010) 'European Defence Agency. Defence facts'. available at <http://www.eda.europa.eu/facts.aspx>.

[5] EDA (2010) 'European Defence Agency. Defence facts'. available at <http://www.eda.europa.eu/facts.aspx>.

billion.[6] This effort concerns SMEs for about € 130 million. More than 17% of R&T spending has been devoted to European cooperative projects.

As for the future of procurement, the French defence procurement policy recognises that a still growing part of defence systems would be developed and produced at European level, taking into account the armed forces' concern on security of supply and the necessary competitiveness of systems and equipment.

The guidance document "*Pour une autonomie compétitive*" emphasizes three "circles", or steps of procurement – and the new defence and national security White Paper, adopted in June 2008, has re-affirmed the same classification.

1. In the first circle, we define the equipments necessary to the assure French sovereignty;[7]
2. The second circle is larger and comprises the equipment where the policy of procurement is that of European interdependency;
3. In the third circle where there is no problem of security of supply France opts for off the shelf procurement.

The French Government considers that the development of defence industrial capabilities aiming at guaranteeing an appropriate level of security of supply must be performed in a European perspective. In this respect the Government supports an EDTIB development around centres of excellence to which she would contribute a reasonable French component. According to French policy makers, the European approach will have to manage a well-balanced supply chain between all European actors.[8]

In the following section we will briefly review the French defence industrial policy and outline the main issues that are currently debated with a special focus on the control of strategic defence assets.

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6 Fromion, Y. (2005) *Rapport d'information sur la recherche de défense et de sécurité*, (Paris: Assemblée Nationale).

7 The domain is not specified but it includes deterrence equipment.

8 The balance has to be established by taking contractors and sub-contractors into account.

2.3 National defence industrial and market policies

While for most of the history of the State of France the production of war material has been administered by the government, the capitalistic participation of the French State in the defence industry is no longer an issue for debate. Since 1997, when Lionel Jospin the socialist Prime Minister privatised Aérospatiale and Thomson CSF, there has been a large national consensus on this topic between the major political parties. The market has been accepted as the basic principle governing the current French policy in this field.

Today all privatised and State owned defence companies are listed on the stock-exchange and are managed in the same way with the necessity to earn profits. However, the level of State control differs depending on whether it is a State owned company or whether the State is a minority shareholder.

The legal framework for the privatization are Law n°86-912 of 6th August 1986 and Law n° 93-923 of 19th July 1993, which listed the companies subject to privatisation: Thomson CSF, which became Thales in 2000, and Aérospatiale, now included in EADS. The privatization was an industrial policy driven by the French Government with two goals in mind:

- First, to create a more concentrated French arms industry as defence equipment budgets were decreasing by 30% after the end of the Cold War. The privatization was guided by a rationale in which a State owned company and a private company would merge leading to privatization and at the same time to concentration and consolidation. The shareholders of the private defence firms only agreed, to this industrial policy ("*meccano industriel*") if the strategy of the new company was, henceforth, decided by the management of the private defence firms. For example, the privatisation of Aérospatiale was the result of the merger with the private company *Matra Défense* in which the management was made up of personnel from the Lagardère Group (Matra) and not Aérospatiale. Similarly, the privatisation of Thomson CSF was the result of the merger with two private companies, Alcatel and Electronique Serge Dassault.
- Second, to prepare a restructuring at the European level, where other European governments would only accept privatized firms as partners for their defence contractors. The Declaration of Head of States on December 9th 1997 gave the

political signal that it was possible and necessary to restructure the aeronautic and defence industry at a transnational level.[9] The British and German governments and industries were opposed to mergers with French companies if they were State owned.[10] This fact is also reflected in the structure of EADS. Given the German government's reluctance to accept the French Government as a shareholder in the company, the SOGEPA juridical entity represents the French State in EADS.[11] For the same reason the French Government accepted an undertaking with Daimler in which the French State agrees not to hold more than 15% of the capital of EADS.[12]

France plans to proceed in the same manner in the naval and land armaments sectors. But due to the lack of co-operative programs, the companies of these sectors – DCNS for maritime sector and Nexter for land armaments sector – remain State owned – even though Thales acquired 25% of DCNS in 2005. However, in the beginning of the 21st century, the French Government has periodically spoken about a project of "EADS naval" with its German counterpart.[13]

In other words, privatization depends of the opportunity to realize new restructuring. For example, with the new military planning law passed in June 2009,[14] SNPE, whose activity is related to the sector of ammunition and propulsion, will be privatised in order to restructure the propulsion sector with Snecma in the Safran Group.

More generally, all interviewed experts from both industry and government, agree that the State's role as a contractual partner (customer) is the best instrument to maintain

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9 This declaration was signed by the head of states and Government from France Germany and UK, Jacques Chirac, Lionel Jospin, Helmut Kohl and Tony Blair.

10 Maulny, J.-P.M.I., Schmitt, B.I. and Taylor, T.U.d.C. (1999) *Restructuring models of the arms industry in Europe* (Brussels: European Commission DE Enterprise).

11 Interview with a representative of a French industrial company.

12 EADS (2008) 'EADS registration document'. available at <www.eads.com/xml/content/OF00000000400004/1/09/42508091.pdf>..

13 La Tribune (2009) 'Interview Hervé Morin'. *La Tribune, 17th December*, Le Figaro (2003) 'me Lenoir, ministry of European affairs declares that the EADS naval is a key important file for the franco-german council of ministry the 18th of September'. *Le Figaro, 3 September*.

14 *Loi n°2009-928 du 29 juillet 2009 relative à la programmation militaire pour les années 2009 à 2014 et portant diverses dispositions concernant la défense.*

the control on defence assets. Even the golden share[15] the French Government holds in Thales is not perceived as the example to follow, since it is seen as a too rigid and "national" a way to control a company.[16]

Arrangements with other shareholders or undertakings with the defence company are regarded as powerful means to bolster the control capacity of the government. For example, during the merger of Aerospatiale/Matra and DASA to form EADS, the German shareholder of DASE (Daimler) and the German Government asked the French Government to abandon the "golden share" in Aérospatiale Matra. The French Government entered into an undertaking on ballistic missiles in order to continue to guarantee the security of supply of the deterrence technology and equipment.

In addition the French Government established several arrangements with the other shareholders of EADS. This contractual partnership between Daimler, Lagardère, SEPI and the French State will end. EADS requested a group of lawyers to think of the possibility of introducing a golden share in EADS. However, at the end of the study, the lawyers' report concluded that the European commission could refuse such an instrument. In addition, press news reports confirm informally the negative position of the European commission in this regard[17]. Thus EADS is thinking of a functional equivalent or a "new type of golden share" that will uncouple voting and other (economic) shareholder rights, the idea being to limit voting rights linked to shareholdings higher than 15% is still considered.[18] The main goal is to favour investments without receding control of the company to a major shareholder like an investment fund[19] and to avoid a hostile takeover[20]. While there is no official French position regarding the future governance of EADS and the golden share, one possibility would be to modify the golden share anchored in French privatisation laws n° 86-912 – article 10 of 6 August 1986 and to receive the agreement of European authorities.

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15 The name use in France is "*action spécifique*" which is more or less the same thing than "golden share".

16 The golden share in Thales is discussed in more detail further below.

17 European commission rejects EADS golden share idea : www.news.bbc.co.uk 7 mars 2008

18 Le Figaro (2008) 'Challenges'. *Le figaro , 21th march 2008*.

19 Interview with a representative from EADS.

20 Les échos (2007) 'Interviews Louis Gallois, chairman of EADS'. *Les échos 14 October*.

The policy of entering special arrangements with industrial investors has also been applied in the case of Dassault and with European foreign investors, where in most cases, the Government of the country in which the investors was based, had had close collaborative ties with the French government.[21] In the future, the problem in France will be to know how to maintain the security of supply with a minimum implication in the capital of defence companies, and the eventual need to dilute shareholding, as it happened in the UK.

In 2009 the French State put in place the *Fonds stratégique d'investissement* (FSI) It is presented as "the answer of the public authority to the requirement in cash flow of the companies which are promising in growth and competitiviness"[22]. The fund can be regarded as a way to acquire equity of private companies. But it is not dedicated to defence companies even if FSI invested in two dual-use companies which are considered as part of the defence supply chain such as DAHER and Mécachrome. Currently, about € 20 billion are dedicated to FSI.[23]

By way of conclusion we can say that State ownership in defence companies is a transitional situation in France, which can be expected to disappear in the future due to the necessity of concentration and restructuring of the defence industry at the European level. Officially the French State shareholding policy is explained in the "French State as shareholder report" published each year by the *Agence des participations de l'Etat*.[24] Moreover, we can consider that State shareholding is not necessary to control defence assets. In the case of MBDA we can see that a special arrangement to protect the assets of deterrence without any State shareholding has

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[21] As for example the German Government in the case of EADS.

[22] For more information see www.fonds-fsi.fr

[23] There are three conditions to benefit of the investments of the FSI: it is a temporary involvement in the capital of these companies; it is a minority shareholding; the activity of the company is interested in terms of development and innovation www.fonds-fsi.fr

[24] "*As a shareholder in many of our country's companies, the French Government constantly urges these firms to take into account three of its priorities: contributing to France's industrial future, creating value for our economy and securing employment as well as career development opportunities for the 1.5 million people on their payroll." Christine Lagarde, minister for the economy industry and employment, French State as a shareholder, Report 2009, Agence des participations de l'Etat, www.ape.monefi.gouv.fr*

been put in place. The current situation (France State shareholder of some companies) appears the legacy of the history. We can consider that the only interest in this is to permit the French State to be associated in the evolution of the shareholding and to the restructuring of the European arms industry as DTIB is a part of the French defence and foreign affairs policy. .

In the future, the question is to determine if the investment control legislation from 2005 (decree n° 2005-1739 of 30th December 2005), with its two different levels of control (control of the company in the sense of French commercial code or acquisition of some activities), is sufficient to acquiesce governmental concerns in the cases of Thales and EADS or whether there is a need for a specific instrument like the EADS proposal of decoupling social and voting rights.

3 NATIONAL PRACTICES OF STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

There are still three State owned/controlled defence companies in France (Nexter, SNPE and DCNS), and three main private companies with public minority shareholdings (Safran, Thales, EADS). All the other defence firms are privately held. Even if two small companies with activities in the defence supply chain – Daher and Mecachrome – have minority public shareholding due to the investments of the FSI we cannot conceive this public shareholding as a way to control defence assets.[25]

The six companies with significant publish shareholding are:

- NEXTER System: 100% owned by the French government. Nexter is specialised in land armament and ammunition. Like DCNS and SNPE, Nexter has been part of the French army since the 17th century. Originally created by the Minister of

[25] Interviews with representative of « Fond stratégique d'investissement « and with representative from "*Agence des participations de l'Etat*".[date, if possible names]

Finance under King Louis XIV, Colbert, it was know throughout the twentieth-century as "GIAT-Industries" and is since 1989 fully owned by French State.

- SNPE: 100% owned by the French Government and specialised in ammunition and propellant for missiles and the Ariane launcher. Like Nexter and DCNS, SNPE has been part of the French army since the 17th century. It became a fully State owned company in 1971. The *Programmation Law*[26], adopted by the French parliament in July 2009, stated that the company will be privatized in the process of the restructuring of the propellant industry in France.
- DCNS: 75% of the equity is held by the French government, 25% owned by THALES. DCNS is specialised in naval ships, both surface and submarine. It became a State owned company in 2003 when Thales merged its French naval entity with DCN taking a 25% shareholding in the new entity. Thales has the possibility to increase its participation to 35%.
- SAFRAN: 30% of the shares belong to the French government. Safran is the company created in 2005 by the merger of a French State owned company, Snecma, and a French private company Sagem. Snecma builds military and civil aeronautic engines and engines for the M51 ballistic missile and launcher Ariane. Sagem produces items for the security market, UAV and avionics.
- THALES: 27% of the equity is held by the French government. Thales is a company specialised in defence electronic, in naval, air and land systems. The company, whose name was Thomson at this date, was nationalised in 1982 by the socialist government. It was also a socialist Prime Minister, Lionel Jospin, who privatised Thomson in 1997. The defence part of Thomson, Thomson CSF, was merged at this time with Alcatel Defence and Electronique Serge Dassault. In 2008, Alcatel sold its participation to Dassault with the agreement of the French government. Thales made major acquisitions in UK, Netherlands and Italy.
- EADS NV, which actually is a Dutch company, 15% of which are held by the French government. Before World War II, a few aerospace companies in France were nationalized by the Government of the "*Front Populaire*" in 1936 due to the

[26] "Loi n°2009-928 du 29 juillet 2009 relative à la programmation militaire pour les années 2009 à 2014 et portant diverses dispositions concernant la défense".

necessity to build military aircraft to counter the nazi threat. These State owned companies merged progressively after the war to create Aérospatiale in 1970. Aérospatiale was privatised in 1998 in the process of the merger with Matra Défense. In 1999, Aérospatiale Matra merged with the German company DASA and with the Spanish company CASA to constitute EADS. The company has activities in civil aircraft (Airbus), helicopters (Eurocopter), space and missile assets (satellite Helios, ballistic missile M 51, military aircraft (Eurofighter) and defence and security systems.

Before 2004, the State shareholding was directly managed by the State within the Ministry of the Economy. Since the reform of 2004, the minority State owned company and the minority shareholdings have been managed by an agency, called the "*Agence des participations de l'Etat*," whose role is to

- exercise close oversight of the quality and fairness of financial statements and accounting disclosures;
- assess the suitability of major investments, external growth operations and disposals from an industrial and strategic standpoint;

improve their performance with an eye to the long-term interests of the shareholder.[27]

The general manner in which the French Government uses its shareholding is defined in the report by the *Agence des participations de l'Etat*, mentioned above. In fact, the process is rather complex and varies from company to company. In general, in a State owned company the management defines and proposes the strategy of the company which must be accepted by the French state. It is the Ministry of Defence in most cases who confirms the strategy. Once confirmed, execution of the strategy is undertaken by the management. For example, when DCNS negotiates agreements with the German naval industry, it is based on proposals of the management of DCNS but it is supported by French government

In case of Thales and EADS where the French State has a minority shareholding, the private shareholders define the strategy and the French State has only the possibility to veto certain decisions, albeit in very limited cases. The right of veto results from

[27] Agence des participations de l'Etat (2009) *French State as a shareholder* (Paris: Ministère de l'économie de l'industrie et de l'emploi).

the necessity of the unanimity vote due to contractual partnership agreement. In the case of Safran, the strategic assets of the company are limited to the propulsion of the ballistic missile M 51 and the Ariane launcher.

As detailed below, there are also specific agreements due to the protection of deterrence assets in three companies: EADS, Safran, and MBDA, but as the last one has no public shareholding, we can conclude that this instrument to protect defence assets is not linked to public shareholding.

As for future, State ownership in defence firms can be expected to reduce further, in some cases leading to link ups with companies from other European countries. The "*Loi n°2009-928 du 29 juillet 2009 relative à la programmation militaire pour les années 2009 à 2014 et portant diverses dispositions concernant la défense*" authorized the privatization of SNPE.[28] The DCNS shareholder agreement foresees an increase of Thales' participation up to 35% of the equity. As for the other companies under State ownership, there are today no concrete plans for privatisation. Only a genuine industrial project for Nexter could lead to partial privatisation.

A link up with industrial partner from other EU countries remains an important option for the French government. As mentioned above, on occasion of the launch of the first Franco-Italian frigate, the President of the Republic Nicolas Sarkozy declared that "he would be pleased if a major industrial take a part of the shareholding of DCNS". He added "we believe in the European arms industry but not at any price: we believe in it if our German friends want to work with us like our Italian friends". The last sentence explains without doubt that French President wants to have shareholding links with the German naval industry but only on the condition to conclude a military co-operative program with the German government.[29]

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[28] According to the French constitutional law, the privatisation of a company requires a law to be passed in by the French Parliament.

[29] Speech on occasion of the launch of the Frigate « Aquitaine » in Lorient: www.elysee.fr

3.2 Special rights

Action spécifique or golden share

Historically, the special rights provisions are based on the privatisation law of 1986, amended in 1993. In other words, the control on strategic assets can be traced back to 1986 when the French Parliament adopted the "privatisation laws". Every privatisation case is to be addressed by a specific decree. The generic provisions of the Law n° 86-912 of 6 August 1986 – article 10 stipulate that the French State will claim an "*action spécifique*" – best translated as "golden share", as it will grant the right

- to require a prior agreement of the minister in charge of the Economy for a third party to enter capital by multiple of 10% thresholds, directly or indirectly;
- to appoint of one or two of the state's representatives on the board of the privatised companies, without vote right;
- to appeal against decisions to sell well-identified assets of the company or its subsidiaries.

These provisions were applied for the privatisation of Thomson CSF in 1997[30] with the decree n°97-190 of 4 March 1997, and the privatisation of Aerospatiale in the process of the merger with Matra in 1998.[31]

How have the special rights been used in the case of Thales? Among the three rights attached to the golden share, the Government has always made used of the second right and appointed a representative of the board.[32] No use has been made of the other two rights yet. When Thales Broadcast and Multimedia was sold to Thomson in 2005, there was no examination of this transfer as this branch of Thales is not specified by

[30] For details see below section 4.1.1.

[31] For further details about the specific share of Thales and the agreement between Dassault, which is the major private investor in Thales, please refer to the Annex 5. The text of the decree (cf. Annex 6) instituting a golden share is available on the website of the "*Agence des participations de l'Etat*" which manages the public participation of the French State www.ape.minefi.gouv.fr.

[32] Currently the Deputy National Armaments Director.

the list of assets requiring the approval of the French Government on the basis of *Decree* n°97-190, of 4 March 1997.[33]

Undertakings between the Government and the defence company

Undertakings or specific arrangements are private contracts signed by the French State with private companies in order to protect specific strategic defence assets linked to France's deterrence capability. There are different origins for these arrangements but the objective (to protect the defence assets) and the mechanism of protection (a veto right and a call option in case of sale of the branch) are always the same. In case of discrepancy the regulations of the Public Code are applicable.

- For EADS the "Ballistic missiles contract" results from the transformation of the golden share that the French State held in Aérospatiale. The "Ballistic Missiles Contract" was signed by the French State and EADS upon the creation of EADS in 2000. In this case, the special right means a call right for the French State on the ballistic missile business unit of EADS, which may be used as a veto right and a call option in case EADS plans to sell the ballistic missiles activity.[34]
- SAFRAN: At the time of the merger between SNECMA and SAGEM, in 2005, which was de facto the privatisation of SNECMA, a tripartite convention was signed by the state, SNECMA and SAGEM in order to safeguard the nuclear deterrence activity of the new group SAFRAN. Concretely, all asset disposals concerning any nuclear deterrence activity shall obtain the agreement of the French authorities. When SNECMA and SAGEM merged, it was decided not to use a golden share due to the experience of the creation of EADS where the German State asked for the cancellation of the specific share in Aérospatiale Matra which was replaced by the ballistic missile agreement.
- MBDA: An arrangement aiming at safeguarding the activities related to the airborne nuclear component was signed when MBDA was created, in 2001, with the French state.

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[33] The 1997 decree needs to be reformed regarding the third right, i.e. the possibility to appeal against decisions regarding well-identified assets disposal for subsidiaries, the list of subsidiaries was established in 1997 when the name of the company was still Thomson CSF and not Thales.

[34] EADS (2008) 'EADS registration document'. available at <www.eads.com/xml/content/OF00000000400004/1/09/42508091.pdf>.

3.3 Regulation of foreign acquisitions of defence assets

In addition to public shareholding, special rights and specific arrangements, there is a general regulation to control the foreign investments in strategic assets including defence companies.

The 2005 French law originated in a debate following the acquisition of Gemplus, a company developing and producing smart cards, by an U.S. American competitor and of Saft battery, manufacturing thermal batteries used in missiles. In reaction to this transaction it was felt in 2003 that the 1989 general regulation on foreign investments was not sufficient to protect those defence assets that were located in companies other than those which were privatised and benefited from control of a golden share.

The Decree 2005-1739 became also necessary because of the ECJ ruling, on referral from a French court, in the Scientology case C-54/99 where the Court ruled "*Article 73d(1)(b) of the EC Treaty (now Article 58(1)(b) EC) must be interpreted as precluding a system of prior authorisation for direct foreign investments which confines itself to defining in general terms the affected investments as being investments that are such as to represent a threat to public policy and public security, with the result that the persons concerned are unable to ascertain the specific circumstances in which prior authorisation is required.*"

Since 2006, the European Commission has scrutinized French laws establishing authorisation procedure for foreign investments in certain sectors. The Commission is concerned that the authorisation procedure detailed in the French decree lacks the required proportionality with regard to these objectives. The key question is the fact that companies established in the EU but under the control of third-country investors could be submitted to more stringent procedures than those applicable to third-country companies, whereas that a company legally and genuinely established in a Member State should normally be treated as a national of that Member State. Due to this the French State is examining the possibility of modifying the decree and plans to do so. However, the French evaluation is that in cases where foreign investment in a EU company can not be secure in terms of security of supply and in terms of proliferation, due for example to the fact that there is no regulation or insufficient regulation in the country where the company is located, full examination in the case of non-EU investment country must be undertaken. The French feel that the current situation is

not perfect and that the only way to avoid this problem is to act at the European level.[35]

More importantly, the 2005 Decree, as it presently stands, is referred to in a press release of 12.10.2006 Commission calls on France to modify its legislation establishing an authorisation procedure for foreign investments in certain sectors of activity.[36]

On the notion of "national security interest"

There is no real synthetic definition of security interests in regards of the French regulation. The definition security interests results from the addition of:

- The scope of the activities of the companies subjects to control of investments. In reference to the points 8 to 11 of the article R-153-2 decree n°2005-1739 30 December 2005;
- The aim of the control in reference to the article R-153-9 decree n°2005-1739 30 December 2005.

Both are discussed in the following section and under "Assessment criteria" respectively.

On the notion of "strategic assets"

In the French regulation, there is a legislative part (art 151-1 to art 151-4 of the "C*ode Monétaire et Financier*" modified with the Law n°2004-1343 9 December 2004) and an executive part (*Décret* n°2005-1739 30 December 2005).

The French regulation controls foreign investments in two types of activities: (a) activities which can have an impact on public order, security, or national defence interest and (b) activities in research, production, sales of arms, ammunition, and explosives (Art L151-3 *Code Monétaire et Financier*).

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[35] Interview with a representative of the French Ministry for Economy, Employment and Industry responsible for the application of the French regulation of the control of defence assets, January 2010.

[36] For further information see (http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1353&format=HTML&aged=0&language=EN&guiLanguage=en).

The Decree n°2005-1739 30 December 2005 details these activities in eleven types, four of which refer specifically to defence activities while the first six points do not deal with defence. Points 8 to 11 are specifically related to defence:

- Activities of cryptology, mentioned in paragraphs III, IV of the art. 30 and I of the art. 31 of the law number 2004-575 of the June 21st of 2004, which deal with confidence in numeric economy.
- Activities carried out by enterprises which deal with classified information « *secret défense* », in accordance with decree number 98-608 of 17 July, concerning protection of secrets of national defence.
- Activities of research, production, or trade of ammunitions, gunpowder, explosive substances, regulated by title III or title IV of book III, in the second part of the defence code.
- Activities carried out by enterprises which have a study or equipment contract with the Minister of Defence.

Scope of the French legislation

Each new investor must request and complete an application procedure before being authorized to invest.

There are two different types of control: one for non-EEA countries, the other one for EEA countries. In reference to the article R153-1, for an investor coming from a third (i.e. non-EEA) country, there are 3 kinds of controlled investment activities:

1. Taking control of 40% of capital or voting rights in the case of article L233-3 of the trading code;
2. A direct or indirect acquisition of a part or a whole of an enterprise's activities;
3. Acquisition of 33.33% or more of direct or indirect holding of capital or voting rights of an enterprise.

In reference to the Article R153-3, if the investor comes from a Member State of the European Union, there are only two cases of control:

1. Taking control of 40% of capital or voting rights in the case of article L233-3 of the trading code;

2. A direct or indirect acquisition of a part or a whole of an enterprise's activities.

In other words, in the case of an EEA country, the control is done only if the foreign investment has the objective to take the control of the company or to acquire a branch of the company.

The following table presents the last two points in a summary:

Table 3.1: Types of investments and investors falling under control legislation

Definition of foreign investments subjected to authorisation process	**Investors from EU or EEA states**	**Investors from non-EU states**
Strategic defence sectors: it covers all the types of activities related to defence: study, research, products of war materials in the sense of the European list, activities cover by defence secret and dual-use produce listed in the annex IV of the regulation (CE) n°1334/2000 22 june 2000: points 8 to 11 (see Annex 2)	• Takeover of a FR company • Acquisition of activity branch of a FR company	• Takeover of a FR company • Acquisition of activity branch of a FR company • Acquisition of 33.33% and more of a FR company
Strategic other sectors: points 1 to 7 (see Annex 2)	• Acquisition of activity branch of a FR company	• Takeover of a FR company • Acquisition of activity branch of a FR company • Acquisition of 33% and above of a FR company

Organization in charge of the review

The Minister of Economy is in charge of all controls. The *Direction Générale de l'Armement* (DGA) of the Ministry of Defence (*Direction de la Stratégie/Service des affaires Industrielles et de l'Intelligence Economique*) is in charge of processing the review for "defence" cases on behalf of the Minister of Economy, who remains the only decision-making authority. Within two months the conclusions shall be forwarded to the *Ministère de l'Economie, de l'Industrie et de l'Emploi* (MinEIE) / DGTPE for the final decision.

Assessment criteria

The aim of controls is to assure

- preservation of sustainability of activities, of industrial capacities, of capacities for research and development or associated know-how,
- security of supply or
- the execution of contractual obligations of the enterprise.[37]

For each request, the investor or its council must declare the investment and complete an application. This request depends on the prior consultation of the *Direction générale du Trésor et de la politique économique* (DGTPE).[38]

During of review process the officials in charge are paying particular attention to the ongoing national or cooperative armaments programmes, to guarantee the security of supply of defence goods. This work is performed in close consultation with all stakeholders, officials and industry.

In addition they aim at preventing a risk of proliferation, bearing in mind the objective of the European Union Member States to strengthen the European Defence Technological and Industrial Base. Though the LoI countries have agreed to cooperate closely on the review of investment cases, all experts interviewed for the purpose of this study told us that there is little end even no result.

Timing and process

The Minister of Economy has a maximum of two months after the record's reception. (*Article 4, decree of March 7th, 2003*, in case of non respect of the Minister of Economy's deadline, the authorisation is considered as granted).[39]

Possible outcomes of the review

As a result of the review the Minister of Economy can take three decisions:

- Authorisation granted;

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[37] Art. R153-9.

[38] Art. R153-7

[39] Art. R153-8

- Authorisation granted with conditions to be fulfilled;
- Authorisation refused by duly documented decision.

In case of authorisation with conditions the investor is requested to sign a binding letter with the French public authority.

If the Minister of Economy considers that an investment has been made without respecting the necessity to ask for an authorization, the Ministry of Economy can ask for a discontinuation of the investment, to modify it or to restore the former situation. If it is not done the ministry of economy can impose a pecuniary sanction with a maximum amount of double of the irregular investment's amount. The amount of the pecuniary sanction must be proportional to the severity of the tort.

Possibility of an appeal

The decision of the Minister of Economy to authorise (with conditions or not) or not to authorise an investment is communicated only to the investor as the matter deals with commercial or defence secrets. There is a possibility for an appeal within common law for abuses of power which fall within the jurisdiction of the State Council, as it is an administrative decision.

Concerning sanctions, the code says that in case of a complaint, the law makes provisions for penalties according to Article L 151 3 of the *Code monétaire et financier*. It is recourse to a legal agreement. In this case, judges have extensive powers to investigate the case i.e. the outcome of an appeal is not a simple "yes" or "no" but the judge can repeal the decision, which puts the applicant in a (formally and legally) strong position.

Publication of outcomes of the review and of the appeal

According to the French Authorities, the details related to Government decision on acquisition by foreign investors are not publicly available, since the information are classified (both for commercial and defence purposes). But the publicity and the motivation of the decision are given to those who ask for authorization to invest in a defence company.

Practical application of the legislation - type of company

Few statistics are available regarding the type of companies in which an attempted investment has been reviewed. In the interviews with officials from the MoD we found that cases of attempted investments in leading high-tech companies are specifically well investigated. In practice the foreign investor or the French company which could be acquired solicit the advice of the French political authority. If the preliminary discuss show that there is no veto at the political level the project of foreign investment is formally submit and controlled under the basis of the 2005 decree.

Regarding larger defence companies, the question is examined *before* the request for investment is made to the Ministry of the Economy and Finance – at a political level. An investment may be refused during the preliminary contacts at the political level. Those interviewed insist on the fact that the same practice exists in the other LoI countries, especially those with the more important arms industries i.e. the UK and Germany.

Alternative investment sources for high-tech SMEs

In order to offer an alternative source for financial means for French strategic defence companies the French Government has set up a specific fund for high-tech SME seeking investors. It was established in 1993 with the support of the Ministry of Defence and the Ministry of Finances, "*La Financière de Brienne*",[40] whose main shareholders are currently companies in the defence and the banking sectors.[41] The nature of this fund can be best described as a Risk Capital Investment Fund. It is aimed to put money into the capital of those High Tech SME-SMIs, which need it as a minority shareholder. Currently, 24 SME-SMI are concerned.

[40] For further information see http://www.financiere-de-brienne.com

[41] 60% *Défense Conseil International Group*, 40% private shareholders.

4 CASE STUDIES

In addition to the practices of State control of strategic defence assets outlined above we wish to add here some information on the application of the legislation for the control of foreign investments. It has to be noted, however, that it proved extremely difficult to obtain any data on concrete transactions, their review and the conditions that were imposed on investors.

Based on the expert interviews we can conclude that

- Defence cases represent about 80% of all cases reviewed under the investment control legislation;
- There are about 30 and 40 cases examined each year. The number was 40 in 2007, down to 15 in 2009 due to the economic crisis;
- Investments are rarely refused (we were informed that only 1 transaction has been denied in the last 20 years);
- In average, the French Ministry of Finance grants 30% authorisations and 70% authorisations with conditions. As for the latter cases, even if we have no the details, we can say that in the majority of cases the French Government requires security of supply assurances for some specific components for a limited period of time.[42]

4.1 Acquisitions by a company from another EU country

There have been numerous acquisitions of French companies by investors from other EU countries since the law was adopted in 2005. For example, in 2007 the European investment fund Argos Soditic bought the company Alkan from MBDA acquiring 100% of the equity. Alkan builds pods for combat aircrafts.

[42] Given that the technology and the products subjected to restrictions are covered by legislation on defence secrets, it was not possible to obtain more details of these cases.

4.2 Acquisition by a company from a non-EU country

There are some cases of acquisition of French companies by non-EU countries. American or Chinese entities were authorized to takeover French companies, with two of them working in the ballistic missiles domain. For example in 2007, the American company Flir Systems bought the French company Cedip specialized in infra-red camera, and more recently Moteurs Beaudoin (diesel military engines), by the Chinese group Weichai.

The most famous case of foreign investment in France is the creation of Thales-Raytheon systems, a company specialized in air operation command and control systems, surveillance radars, and ground-based weapon-locating radars. It is a 50/50 joint venture between the American company Raytheon and the French company Thales, which was created in 2000.

There has been no rejected attempted acquisition by a company from a EU country.[43]

4.3 Rejected attempted acquisition by a company from a third country

For the last twenty years there has been one attempted transaction targeting a French company that was rejected. It concerned a European single source in a very specific defence domain, which was intended to be taken over by one of its American competitor. The French authorities denied this transaction in order to sustain the security of supply in this sensitive technical area.

[43] Interview with a representative of the DGA responsible for the examination of FDI in defence companies.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

French officials we interviewed for the purpose of this study were generally very interested in the outcome of the project and to get to know the scope and way in which other countries manage the control of foreign investments of strategic defence assets.

As to the relative openness[44] of other countries French officials regard the United States as well-protected with Exon Florio amendment regulation and CFIU.S. The United Kingdom is considered as having an efficient control, however the process is perceived to be little transparent. Germany is seen to be quite closed to foreign investments in its defence industry and as lacking efficient control mechanisms as the cases of HDW and MTU showed.

In this context it is interesting to note that a representative of the French industry who made an investment in Germany (that is why his comment was not about merger and acquisition openness but about the German regulation) described the German regulation as “efficient”.

The perception of the French industrial representatives interviewed for the purpose of this project is in general more diverse than that of Government officials. Industry representatives are often unaware of the regulation in other countries; consequently, their point of view is about the openness towards mergers and acquisition. They think that there is a relative bilateral openness between the UK and the U.S. Germany, and to a lesser extent, Italy are perceived as not open to mergers and acquisitions in the defence sector. Spain is considered to be open only for investments from U.S. American companies.

[44] In the interviews the interlocutors preferred to give a qualitative evaluation of their perceptions rather than a ranking expressed in numbers.

5.2 On the need for EU level action

The current situation of investment control is not considered to be suboptimal for two reasons. The main concern of French officials is the lack of control of strategic assets of some EU countries.[45] According to French experts the control of defence investment is not hampering the European defence industrial consolidation; however, the absence of control of non-EU investors could be an obstacle to strengthening the EDTIB. The development of co-operative programmes and of common investments in research and technology can strengthen the EDTIB. But as it is necessary to share the pole of excellence in the entire European Union, it is necessary to harmonize or to have coherent regulation in order to guaranty the security of supply for each country of the European Union.

However, even countries with national control legislation, need to balance investment requirements with their wish to safeguard strategic interest. In addition, the major defence contractors are concerned by the integrity of their European supply chain. The sum of national control mechanisms is considered to be insufficient to "live up to this problem". Moreover, in some cases, even with the French regulation of investment control, France lost the control of technology – which is the final objective of control of defence assets

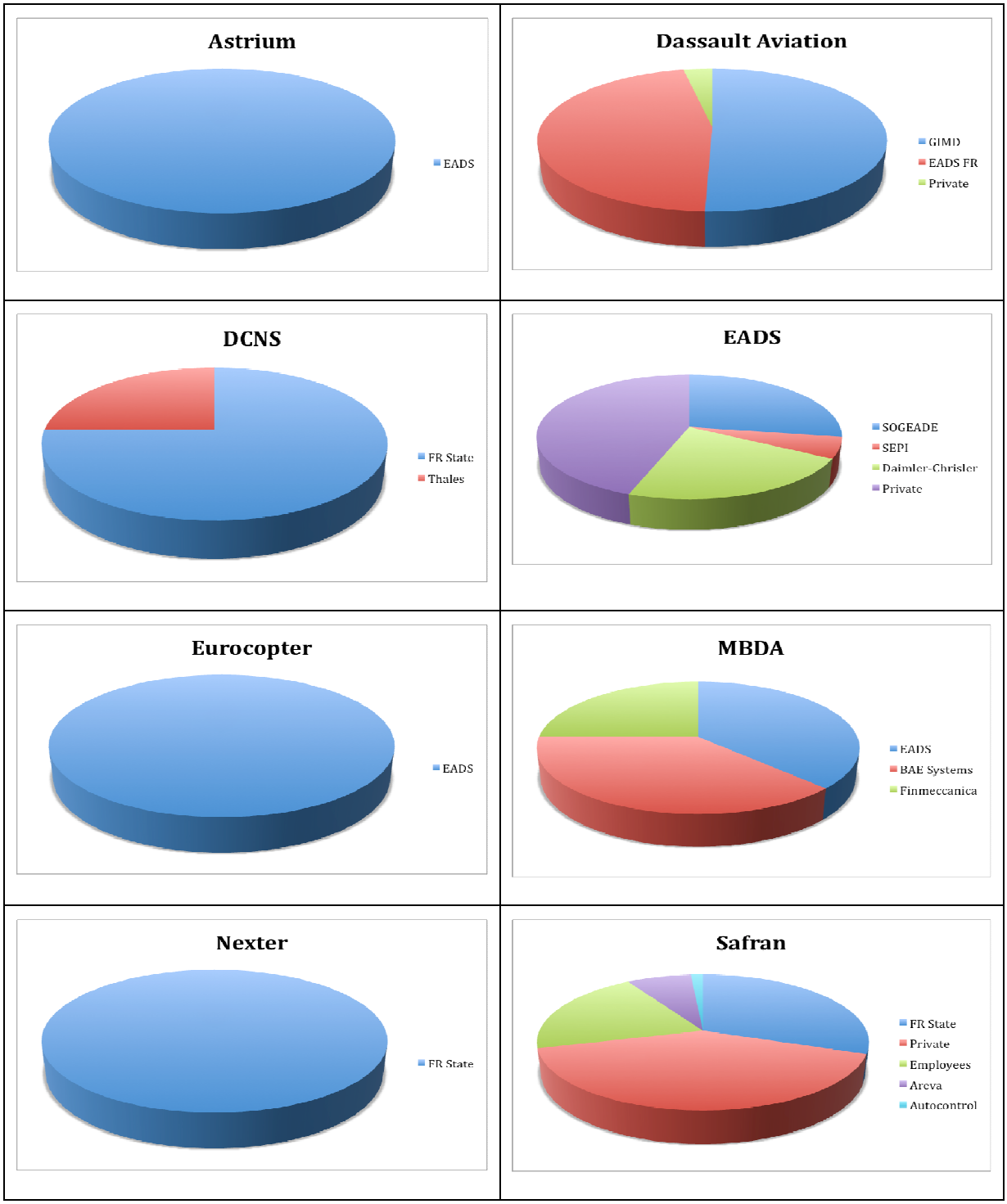
Although there is no clear perception from French officials of what should be an "EU level mechanism for control", there is a consensus that such a mechanism is required. EADS is interested in the idea of decoupling the vote from the social rights in order not to deter foreign investment and at the same time retain control of defence assets. At the official level, the minimal step could be a reciprocal consultation on defence investment.

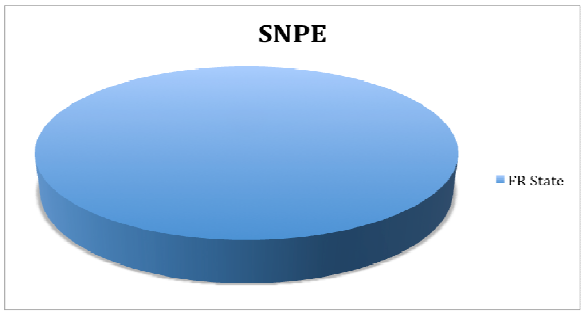
Another added value of a EU level solution consists in the eyes of French officials in the fact that it can serve as a catalyst to make all Member States understand the legitimacy of a control on foreign investments in strategic assets and become aware of its importance.

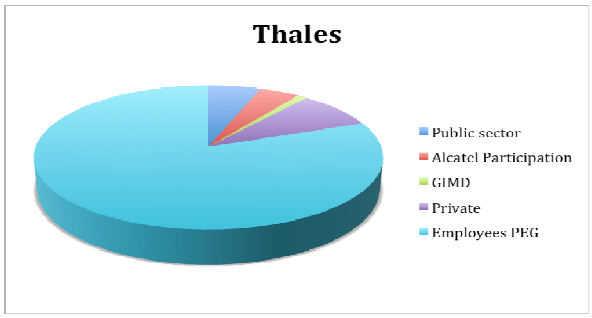
[45] The DGA said that a specific critical analysis would be useful on this topic.

6 ANNEX

6.1 Ownership structure of main French defence contractors




SNPE
FR State


Thales
Public sector
Alcatel Participation
GIMD
Private
Employees PEG

6.2 Executive summary of the French control legislation

Decree n° 2005-1739 of 30 December 2005

List of the activities under French State control, regarding foreign investments (Décret Loos)

1. Gambling, insofar as the investment control is requested to face money laundering
2. Private security, when concerned companies:
    a. Provide services to public or private operator of vital importance according to the French Code of Defence
    b. Take part in security missions for civil aviation and seaports
    c. Or intervene in protected or reserved areas to safeguard national defence secrets
3. R&D and production related exclusively to:
    a. Pathogen, zoonosis and toxic substance identified by the EU - regulation (CE) n° 1334/2000 of the Council) establishing a Community regime on control of dual-use items and technology exportation
    b. Means to fight against chemical weapons in accordance with the Convention of Paris on 13 January 1993

    insofar as the investment control is requested by the necessity to fight against terrorism and to prevent any sanitary consequence
4. R&D production or business related to equipments for correspondences interception and remote detection of conversations, insofar as the investment control is requested by the necessity to fight against terrorism and crime
5. Services in the framework of accredited evaluation centres for safety of IT systems provided by companies to French State departments, and insofar as the investment control is requested by the necessity to fight against terrorism and crime

6. Production of goods or services for security of IT systems provides by company contracted by public or private operator using facilities of vital importance according to the French Code of Defence
7. Activities on dual-use items and technology according to the regulation (CE) n° 1334/2000 of the Council, of 22 June 2000, establishing a Community regime on control of dual-use items and technology exportation, and performed by companies related to national defence.
8. Cryptology
9. Activities performed in companies accredited *Secret Défense*
10. Research, production, business related to weapon, ammunitions, powder and explosive substances
11. Activities performed by companies contracted by the minister of defence, either directly or subcontracting, to provide equipments or services related to § 7 to 10 above.

Article L. 151-3 of the monetary and financial code,

Decree n°2005-1739 of the December 30th of 2005 regulating foreign financial relations

1. A principle of freedom

Art L151-1of the monetary and financial code: « Financial relations between France and foreign entities are free ».

2. Exceptions: some foreign investments are subject to a prerequisite authorisation and controls

However, in reference to Art L151-3, some activities are subject to a prerequisite authorisation from the Minister of Economy when the foreign investments deals with an activity which comes under public authority or one of the following areas:

- Activities which can disrupt public order, public security or national defence interests.
- Research activities, production or marketing of weapons, ammunitions, gunpowder and explosive substances.

3. List of controlled sectors

The investor's origin determines the type of control to which investors are subject.

The controlled sectors are defined by 11 points in the article R-153-2.

The first six sectors do not deal with defence

The 7th sector deals with activities related to dual-use products. (*Attached IV in the rules of June the 22nd of 2000, when dual-use products are made by enterprises working in areas of national defence*).

Points 8 to 11 are specifically related to defence. The list of defence activity is precisely defined in the following four points:

- Activities of cryptology, mentioned in paragraphs III, IV of the art. 30 and I of the art. 31 of the law number 2004-575 of the June 21st of 2004, which deal with confidence in numeric economy.

- Activities carried out by enterprises which deal with classified information « *secret défense* », in accordance with decree number 98-608 of 17th of July, concerning protection of secrets of national defence.
- Activities of research, production, or trade of ammunitions, gunpowder, explosive substances, regulated by title III or title IV of book III, in the second part of the defence code.
- Activities carried out by enterprises which have a studiy or equipment contract with the Minister of Defence.

4. Who is in charge of controls?

The Minister of Economy in charge of all controls. Each new investor must request and complete an application procedure before being authorized to invest.

Since the State's security of supply in defence equipment and defence technology's independence is concerned, it is the DGA at the Minister of defence who is charged with the investment's control.

5. What are the targets of the controls?

The origin of the investor determines the type of controls. Currently, France considers that if the control of a European company is under a non-EU investor, the control of investment by this EU company is done under the rules of non-EU investment.

5.1 : Control For non EEE countries

In reference to the article R153-1, if the investor comes from a third country there are 3 kinds of controlled operations:

1: taking control, in the sense of the article L.233-3 of the code of commerce, of a company whose corporate headquarters is located in France (in the article L.233.3 of the code of commerce control is taken when one acquires at least 40% of capital or voting rights)

2: A direct or indirect acquisition of a part or a whole of an enterprise's activities.

3: Beyond 33.33% of direct or indirect holding of capital or voting rights of an enterprise.

5.2 Control for EEA country investors

In reference to the art. R153-3, if the investor comes from a Member State of the European Union, there are only two cases of control

1: taking control, in the case of article L.233-3 of the code of commerce, of a company whose corporate headquarters is located in France (in the article L.233.3 of the code of commerce you take the control when you have 40% of capital or voting rights).

2: A direct or indirect acquisition of a part or a whole part of an enterprise's activity.

So in the case of an EEE country the control is done only if the foreign investment has for objective to take the control of the company

6. Aim of the controls

The article R 153-9 defines the aim of control:

"The minister of the economy investigates whether the preservation of national interests as defined by article L. 151-3 can be obtained through the authorization of one of several conditions.

These conditions are principally concerned with the investor's preservation of sustainability of activities, of industrial capacities, of capacities for research and development or associated know-how, security of supply or the execution of contractual obligations of the enterprise which is headquartered in France, as licensee or sub-contractor in the framework of public contracts or of contracts concerning public security, interests of national defense or research, the production or arms trade, munitions, powders or explosive substances."

The article R-153-10 defines the case when the ministry of economy can refuse a foreign investment précising the aim of the regulation define in the article R-153-10 :

"the ministry of economy refuses, with a motivated decision, the project of foreign investment if he considers, after having examine the project that :

i. That there is serious presumption that the investor is likely to commit one of the infractions listed in the article 222-34 to 222-39, 223-15-2, 225-5, 225-6, 225-10, 324-1, 421-1 to 421-2-2, 433-1, 450-1 and 450-2-1 of the Code penal ;

ii. Or that the putting in place of the conditions defined at the article R-159-9 is not sufficient itself to guaranty the preservation of the national interests defined in the article L-153-3 as :

1. the follow-on of the activities, of the industrial capabilities, of the research and development capabilities and of the associated know-how would not be protected ;
2. or that the security of supply would not be guaranty ;
3. or that the contractual obligations of the company, whose corporate headquarters is located in France, linked to a public contract or as subcontractor to a public contract dealing with public security, defence national interests or research, fabrication or export armaments, ammunition, powder or explosive devices, would be compromised

7. Procedure, motivations and publication of the decision

In reference to art. R153-7: For each request, the investor or its council must declare the investment and complete an application. This request depends on the prior consultation of the « DGTPE ».

In reference to art. R153-8, Minister of Economy has a maximum of two months after the record's reception. (*Article 4, decree of march the 7th, 2003*, in case of non respect of the Minister of Economy's deadline, the authorisation is considered as granted).

Decisions of the Minister of Economy are motivated as recourse is possible. The decision to authorise or not the investment is communicated only to the investor as the matter deals with commercial or defence secrets.

8. Recourse

There is a way of recourse within common law for abuses of power which fall within the jurisdiction of the State Council (public jurisdiction), as it is an administrative decision.

In this case, judges have more powers (the answer is not only yes or no) meaning that they have the ability to re-form the decision as the decision has to be proportionate to the aim of the control. It is a real advantage for the applicant.

9. Sanctions / endorsement

In reference to art. L151-3, if the Minister of Economy considers that an investment has been made without respecting the necessity to ask for an authorization, the Ministry of Economy can ask for a discontinuation of the investment, to modify it or to restore the former situation. If it is not done the ministry of economy can impose a pecuniary sanction with a maximum amount of double of the irregular investment's amount. As mentioned above, the amount of the pecuniary sanction must be proportional to the severity of the tort.

6.3 Special arrangements regarding EADS

The special rights in EADS have two objectives:

- to maintain a stable shareholder which control the decisions of the company ;

-to avoid the disappearance of some activities regarding the French deterrence capabilities (as defined in the Ballistic missiles agreement)

These special rights are organised at two levels :

-a French level with the Sogeade shareholder's agreement ;

-the participation agreement involving Daimler, DASA AG, Lagardère, Sogepa, Sogeade ;

To these agreements we add the ballistic missile agreement between EADS and the French State which is in fact the original "action spécifique"(i.e. golden share) included by the French State when Aérospatiale was privatised due to the merger of Aérospatiale and Matra in 1998.

All these agreements are not in the public domain. But their provisions are in the registration document of EADS, the last one published in 2008[46]

The Sogeade Shareholder Agreement

The French State, not being a party to the Participation Agreement, entered into a separate agreement at the national level. The French State maintains that neither it nor any of its undertakings will hold any shares directly. The State is represented through Sogepa in the Sogeade agreement.

"Sogeade is a French partnership limited by shares (*société en commandite par actions*) the share capital of which is split between Sogepa (60% french state) and Desirade (40%) a *French société par actions simplifiée* (40%). The share capital of Désirade is itself wholly owned by Lagardère. Lagardère hence owns indirectly 40% of Sogeade

[46] Registration document EADS 2009, www.eads.com/xml/content/OF00000000400004/1/09/42508091.pdf

Sogeade Gérance's Boards of Directors consists of eight directors, four nominated by Lagardère and four by Sogepa. The decisions are taken with a simple majority of directors except some cases where a qualified majority of six directors is required. These cases are :

- acquisitions or divestments of shares or assets the individual value of which exceeds € 500 million;
- agreements establishing strategic alliances , or industrial or financial co-operation;
- a capital increase of EADS of more than €500 million to which no preferential right to subscribe for the shares is attached;
- any decision to divest or create security interest over the assets relating to prime contractor status, design, development and integration of ballistic missiles or the majority shareholdings in the companies Cilas, Sodern, Nuclétudes, and the GIE Cosyde (decisions contemplated on d also governed by the ballistic missiles agreements).

"When a vote of Sogeade Gérance's board does not reach the qualified majority of six directors by reason of any of the Sogepa-nominated directors casting a negative vote, participants are obliged to vote against the proposal"[47]. This means that the French States as the owner of Sogepa can veto any decisions on these matters within EADS Participation and in turn within EADS as long as the Sogeade Shareholder's Agreement remains in existence.[48]

In other words, agreement gives an indirect right of veto to the French Government through Sogeade. It is an effective right of inspection.

The Participation Agreement of EADS

The participation agreement was signed on July the 8th of 2000 at the time of the formation of EADS. It was modified after the agreement was reached on July 16,2007 between the principal shareholders.

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[47] EADS (2008) 'EADS registration document'. available at <www.eads.com/xml/content/OF00000000400004/1/09/42508091.pdf>..

[48] The Sogeade Shareholder's Agreement shall finish if Lagardère or Sogepa ceases to hold at least 20% of the capital of Sogeade

The control of defence assets in the EADS Participation Agreement

The principal agreements governing the relationships between the founders of EADS are an agreement, *The Participation Agreement*, entered into a Completion between Daimler, DASA AG, Lagardère, Sogepa, Sogeade and SEPI and a Dutch law agreement, the *Contractual Partnership Agreement*. "The indirect EADS Shares held by Daimler, Sogeade and SEPI have been pledged to EADS participation BV that has been granted the exclusive power to exercise the voting rights attached to the pledged shares in accordance with the *Contractual Partnership Agreement*."[49]

This agreement allows both the French and the German States to have a stable shareholding in the capital of EADS, and in this way, to protect the strategic assets of the nation.

French and German State have equal rights in the Boards of Directors

The Board has an equal number of directors nominated by Daimler and by Sogeade. They each name two directors (SEPI has the right to nominate one, as long has its shareholding is 5% or more).

Both Daimler and Sogeade have the right to nominate and remove the Chairman and the Chief Executive Officer. In other words, *they have equal nominating rights*. The quorum for transacting any business at a meeting of the Board of Directors of EADS Participation BV is one Sogeade director and one Daimler director being present.

The French State via Sogepa is indirectly represented at the Board of EADS.

The appeal to a pre-emption right

Any sale on the market of EADS shares in accordance with the *Participation Agreement* shall be conducted in an orderly manner so as to ensure the least possible disruption to the market of EADS shares. To this effect, the parties shall conduct consultationswith each other before any such sale. In the event that such a pre-emption right is not exercised, the indirect EADS shares may be sold to an identified third party subject to Lagardère's or Sogepa's consent and also to Daimler's consent

[49] EADS (2008) 'EADS registration document'. available at <www.eads.com/xml/content/OF00000000400004/1/09/42508091.pdf>.

and if such consent is not obtained, the indirect EADS Shares may be sold on the market.

In this way, each of the principal shareholders has a pre-emption right to sell their respective EADS shares on the market in the same proportions as the respective indirect share held by the relevant parties bear to each other[50].

The partners dispose of a pre-emption right in case of a hostile takeover bid by a third party, which is described by the principal shareholders as an investor, which has a direct or indirect interest in EADS shares equal to 12.5% or more. Members of EADS shall exercise all means of control and influence in relations to EADS to avoid such hostile takeovers by a third party increasing its right or powers in relations to EADS.

Besides, if one of the principal shareholders accepts an offer by a third party undergoing a change of control, such an offer shall be immediately notified to other contributors. This offer shall be only accepted with the consent of the other principal shareholders.

The Ballistic Missiles Agreement

Pursuant to an agreement entered into force between EADS and the French State, EADS has granted a *veto right* and subsequently a call option on the ballistic missiles activity exercisable in the event that a third party which is not affiliated to the Daimler or Lagardère group acquires, directly or indirectly, either alone or in concert, more than 10% or any multiple thereof of the share capital or voting rights of EADS, or the sale of the ballistic missiles assets, or of the shares of such companies carrying out such activity is considered after the termination of the Sogeade Shareholder's Agreement and a right to oppose the transfer of any such assets or shares during the duration of the Sogeade Shareholder's Agreement.

This agreement, which is called the Ballistic Missiles Agreement, allows the French State to secure the ballistic missiles supply, which is the centre of the French defence strategy, the nuclear deterrence.

[50]EADS registration document 2008, page 108

Agreement between the French State and Daimler

There is also a specific agreement between the French State and Daimler where The French State undertakes to hold an interest of no more than 15% of the entire issued share capital of EADS through Sogepa, Sogeade and EADS participations B.V.

6.4 Special rights in Thales[51]

Golden Share of Thales ("action spécifique")

Thales is a private company.[52] It is the only French company subject to special right provisions. Its board of directors is governed by the French legislation.

Decree n° 97-190 of 4 March 1997 established the State's participation agreement in the Thales capital. The rights attached to this agreement are as follows:

The crossing of the threshold of holding, directly or indirectly, a tenth or tenth's multiple of the capital or the voting rights of the company, by a physical or moral person, acting by itself or working in conjunction with others, independent of the nature or the legal framework, must be approved beforehand by the Minister of Economy.

This approval must be renewed if the beneficiary plans to act with a participation agreement, is subjected to change of control, or if the identity of one or several of the members of the participation agreement, changes.

In addition, all crossing of the threshold as individuals by an entity acting with other entities must be subject to a prerequisite control.

- A State's representative named by decree based on the proposal of the Defence Minister is a member of the board of directors of the company without a voting right.
- Considering the conditions of the decree n° 93-1296 of December the 13th of 1993, there is a right to oppose any decisions of cession or allocation as a

[51] Analysis basis on publicity on the clauses of a shareholders agreement (art L233-11 code de commerce), declaration of crossing of a threshold (art 233-7 code de commerce), information due to scrutiny of the consequences of the change of participations in a participation agreement, Autorité des marches financiers Thales Euronext 29th may 2009 scrutiny of the consequences of the change of the participations in a participation agreement (art 234-7 and 234-10 general reglement, Thales Euronext, 27th November 2008.

[52] Composition of the shareholding as May the 20th of 2009: State, TSA (including Sofivision), Sogepa: 27, 05 %; Dassault Aviation: 25, 93 %; Fluctuate 47, 02 %; Employees 3, 08 %; Auto-controlled 1, 89 %.

guarantee of those assets that are named in an attachment to the decree and of direct subsidiary companies of the group[53].

Participation Agreement of Thales after Dassault Aviation acquired Alcatel Lucent's stake

In 2009, Dassault Aviation acquired Alcatel-Lucent's stake in Thales and is now the Group's main private shareholder and industry partner. Alcatel-Lucent and Dassault-Aviation signed, in December 2008, an agreement for the purchase of the 20, 5% of the stake hold by Alcatel- Lucent, and of the 5 % held by GIMD in Thales.

The participation agreement which had been signed between Thales and Alcatel on December 28th of 2006 has been modified in order to be adapted to Dassault's acquisition. The aim is to protect the strategic assets of the State. On May, the 19th of 2009, the new participation agreement came into force and allows:

1. A shared strategy

"Dassault Aviation has expressly undertaken to forego the exercise of the veto right which it has, by virtue of the agreement, over some strategic operations of Thales ; this decision concerns a series of potential acquisition or disposal operations ; in return, the public sector has foregone its rights to terminate the agreement in the event of persistent disagreement regarding as strategic operation likely to adversely impact its strategic interests (acquisitions or disposals identified by the French State as likely to be significant with regard to its strategic defence interests and the objective of which is to consolidate France's industrial and technological defence base)"[54]

2. A stable shareholding

Dassault acts together with TSA and Sofivision in Thales

The State is engaged to keep a minimum of 10% of Thales' participation and voting rights, after that the agreement comes to an end. This right is available until the

[53] The State only directly holds 2022 shares (including the special agreement). Consolidate participation of the State in Thales, in May the 20th of 2009, was held by the TSA companies, by 26,5%, and Sogepa by 0,5%. Both of the companies are 100% held by the State.

[54] Thales annual report 2009 page 173 www.thalesgroup.com

following dates: December, the 31st of 2014, three years after the end of the agreement, the day Dassault Aviation would hold less than 15% of Thales's capital.

The agreement expires on December, the 31st of 2011 or if Dassault Aviation holds less than 15% of Thales' equity. After December 31st of 2011 the participation agreement can be tacitly extended for a period of five years

3. Specific rights of the French State

The French State has

1. the right to denounce the participation agreement;
2. the right to ask for Dassault to reduce its participation under the threshold of 10% or to suspend the voting rights above the threshold of 10% in two cases:
    a) in case of change of control in Dassault aviation company (currently Dassault is owned by Dassault family) and
    b) in the case of the violation of the agreement on the protection of strategic interests.

4. Specific Convention for the protection of strategic assets

The "*convention spécifique*" was signed between Thales and the State on December 28th of 2006 when Alcatel merges with Lucent. Due to this merger United States citizens would normally be part of the board of Thales with the risk that these citizens would have access to classified information. At this time the French State decided more or less the same proviso that exists in the United Sates. When, Dassault-aviation succeeded to Alcatel-Lucent, the company accepted the same convention which deals with the protection of national strategic assets of Thales. It is still in force and has not been modified. The convention decrees:

- The executive direction and the head office must remain in France;
- Governors of Thales proposed by Dassault Aviation must be citizens of the European Union;
- Access to sensitive information of Thales will be strictly controlled inside Dassault Aviation;

- Representatives of Dassault Aviation in the board of Thales must be French nationals.

If Dassault do not respect the provision of the convention, the French Government has the rights cited under the point 3.

This convention was due to the merger of Alcatel, the former industrial investor in Thales, with Lucent an American company. It was a sort of proxy like we can find in American regulation to control foreign investment in defence assets. The French State considers that it was more simple and useful to keep this convention with new industrial investor Dassault even it is a company located in France.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– Germany –

1st September 2010

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1 INTRODUCTION

This report describes the German legislation with respect to monitoring foreign investment in German strategic defence assets or companies. It will provide the basis for assessing to what extent certain EU initiatives in this field would be useful.

Germany has the third largest defence industry in the EU. With more than two thirds of the armaments production being sold abroad Germany is a major arms exporter in world markets. However, neither the defence sector nor defence exports represent a significant share in the overall German economy or export performance. Several peculiarities deserve to be mentioned by way of background information to fully appreciate the German approach to State control of defence assets.

First, unlike in all other EU countries with a significant arms industry there has as yet not been a material centralized national research and development effort in the armaments field in Germany.[55] Nevertheless the German industry stresses that it has been and remains one of the most important agents of innovation in Germany – with worldwide leading technologies. Second, the country has a long tradition of private ownership in the defence industry and, compared to all other Western European countries, the federal Government has taken a rather low profile in its development. Historically arsenal production was complemented and substituted for provisions by private companies. Ever since, the Government has relied on private capital and risk taking for its arms supplies. Third, for most of the time since the end of World War II German arms production has been limited and controlled by the allies. In this context industry has participated and benefited from many international collaborative armaments projects such as the Tornado multirole fighter aircraft, the NH90 helicopter, or the Meteor family of missiles.

Against this background it comes as no surprise that the Government currently holds neither special rights nor equity in any German defence firm, except for two marginal public private partnerships. As for legislative means of control of strategic defence assets Germany has two complementary sets of control rules:

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[55] Lock, Peter. (2000) Perspektiven Der Rüstungsindustrie in Deutschland.

- In 2004 Germany adopted legislation designed to control the acquisition of certain domestic defence-related companies by non-German investors ("the defence-related control regime")[56];
- In 2009 Germany moreover adopted rules designed to control foreign investments in the interest of public order and security ("the wider security regime")[57] applying in theory to the entire German economy but meant only for "*rare and isolated cases*".

Both instruments are applied with care and reservation and so far no transaction has been denied. Neither the rules nor the practice take into account a European dimension of security. However, the "wider security" regimes takes other European interests into account, in that it correctly protects the "public order and security of the Federal Republic of Germany in accordance with Articles 46 and 58(1) EC [now Articles 52 and 65(1) FEU]" as interpreted by the European Court.

2 CONTEXT

2.1 The German defence industry

The German defence and security industries have an annual turnover of around €17 billion and export some 70 percent of their production.[58] They employ a highly qualified workforce of around 80,000. The three traditional sub-sectors "air, land and sea" are well represented, with the aerospace industry having the greatest importance. The IT/electronics branch is gaining significance. The German aerospace industry (172 companies) has a total turnover of €22.7 billion (2008), of which €5.7 billion are defence-related.[59]

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[56] See English version of this regime in the Annex

[57] See English version of this regime in the Annex.

[58] German Industry Association (Bundesverband der deutschen Industrie - BDI) at http://www.bdi.eu/2095.htm.

[59] Source: German Aerospace Industries Association (BDLI).

The German Government and the industry have moreover jointly defined certain national military core activities.[60]

The following ownership structures prevail in the German defence and security-related sectors:

- Several entities engaged in both sectors are organised as public limited companies (AG) with their shares listed. This is the case for Thyssenkrupp AG (TK), its affiliate Marine Systems AG (TMKS), and Rheinmetall AG.
- Others are organised as private limited companies (GmbH, KG or GmbH & Co KG). This is not only the case among the numerous component suppliers but also applies to the companies held, directly or indirectly, by EADS NV, such as EADS GmbH, Astrium GmbH, Airbus Deutschland GmbH and Eurocopter GmbH, as well as to Diehl and Krauss-Maffei Wegmann (KMW).

2.2 The scale of defence procurement

German defence procurement is in the hands of the Federal Office of Defence Technology and Procurement (*Bundesamt für Wehrtechnik und Beschaffung* – BWB). This Office is part of the Federal Defence Administration and in charge of adequately equipping the German Army (*Bundeswehr*) with state-of-the-art technology on competitive terms. Procurement is designed to cover the needs of the German army. The procurement rules and procedures to be followed are summarised in the BWB brochure "Organisation, contract award, contract details".[61]

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[60] See the joint declaration of the MoD and the section defence of the German industry association concerning national military core activities, of 20 November 2007.

[61] Federal Office of Defence Technology and Procurement (BWB), (2010) 'Organisation Auftragsvergabe Vertragsgestaltung' (Organisation Contract Award and Contract Details). at <http://www.bwb.org/fileserving/PortalFiles/02DB022000000001/W26DVFZP486INFODE/Auftraggeber%20Bundeswehr%20-%20Januar%202010.pdf>.

Table 1: The German defence budget 2006-2009 in billion €[62]

	Total Defence	Procurement equipment
2006		
2007	31,090	4,806
2008	31,735	4,609
2009	31,180	5,360

The Ministry of Defence announced that in 2010, operation maintenance expenditure will be increased by for ships, aircraft and new weapon systems[63], that however defence expenses will altogether be decreased as a result of abandoning certain categories of armament.[64] The Ministry of Finance announced in May 2010 that in order to stabilise the German budget the defence budget will be considerably reduced.

Currently, the military air transport program A400M is of particular importance. Germany is involved in two ways, as the biggest customer, and with 11,000 people working on this program in the country (out of a total of 40,000 in Europe).[65] Moreover, the restructuring and consolidation of the German maritime defence sector is seen as necessary for safeguarding German essential security interests.[66] Finally, with respect to equipment, which is either imported or exported, emphasis is placed on the absence of offset practices.

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[62] Federal Ministry of Finance and EDA website as well as EDA defence data at http://www.eda.europa.eu/defencefacts/.

[63] Ministry of Defence at <http://www.bmvg.de/portal/a/bmvg/ministerium/verteidigungshaus-halt_2005?yw_contentURL=/C1256F1200608B1B/W27ZWBNQ399INFODE/content.jsp>.

[64] See FAZ of 26 March 2010.

[65] Federal Ministry of Economics and Technology (2009) 'Report of the coordinator of the German aerospace industry' (Bericht des Koordinators der deutschen Luft-und Raumfahrt). available at <http://www.bmwi.de/BMWi/Navigation/Ministerium/Minister-und-Staatssekretaere/Visitenkarten/visitenkarte-hintze,did=309210>.html.

[66] See Federal Ministry of Economics and Technology (2009) 'Report of the Federal Government on the maritime coordination policy', at <http://www.bmwi.de/BMWi/Redaktion/PDF/-Publikationen/bericht-maritime>.

2.3 National defence industrial/market policies

The government's industrial defence policy is aimed primarily at adequately equipping the German Army (*Bundeswehr*) with high performance and innovative technology, and in more abstract terms at ensuring security of supply. This policy is closely linked to the government's strategy to preserve a high degree of autonomy of the German Defence and Technology base.

Simultaneously, the Government aims at concentrating the army's competences on a "core" of activities, and those other tasks which it can accomplish at a lesser cost than competing civilian operators. Moreover, the Government pursues and actively supports the defence-related objectives of the European Union; i.e. to create a European market for defence equipment, apply State aid rules in the area of defence and security, and establish jointly with the other Member States an autonomous EDTIB. Finally, and in contrast to several other Member States, the Government aims at the abolition of any offset policy or practice.

In general the German defence industry is critical of State ownership of defence assets. It claims the European-wide establishment of fair conditions of competition in the defence and security markets. To that effect, public policy at national and EU levels should endeavour to restrict State influence and limit the use of public property in these sectors. The Government is supportive of this industry position. Public ownership in the defence sector is moreover viewed as an obstacle to the consolidation of the European defence industry.

German procurement policy does not differentiate according to the origin of the products, whether domestic or imported.

3 NATIONAL PRACTICES OF STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

In Germany no defence company is in public ownership, except for certain public-private Partnerships (PPP). In pursuit of its policy to concentrate the army's competences, the Government has recently created two mixed PPPs for certain "supportive" activities related to the operation of the German Army. They have been given the status of private limited companies (GmbH).

The following companies resulted from this orientation:

- **BWI Informationstechnik GmbH (BWI IT)** was formed in 2006 by the Government jointly with Siemens and IBM in order to modernize and manage its non-military information and communications technology (see e.g. the Herkules software project). The Government holds 49.9% of the shares, Siemens IT Solutions and Services 50.05% and IBM Deutschland 0.05%.
- **HIL Heeresinstandsetzungslogistik GmbH,** created in 2005, is a joint venture where the Government holds 49% and HIL *Industrie-Holding* GmbH holds 51%. Three private defence and security-related companies hold the shares of the private partner. The company was created to ensure the daily availability of certain weapon systems within the Army's logistic system.

In this context also the following joint venture may be mentioned:

- **BwFuhrparkService GmbH**, created in 2002, a mobility service provider that manages the Bundeswehr vehicle fleet. The Ministry of Defence holds 75.1% and DB Dienstleistungen GmbH the remaining 24.9%.

This is a public-public joint venture.

The three joint ventures clearly represent a move towards outsourcing and privatisation rather than standing as examples of public ownership of the German Government in the defence sector. There are currently no plans for privatisation of these companies.

3.2 Special rights

According to EU practice and language, "special rights", also referred to as "golden shares", are shares which confer upon the State rights that are disproportionate to the shareholding they represent and may therefore have a dissuasive effect on investors. If they are referred to in national legislation, they represent State measures with general application.[67]

No German defence-related company is subject to special rights of the German State. Accordingly, the remaining questions do not require a reply.

3.3 Regulation of foreign acquisitions of defence assets

As mentioned above the Germany has two complementary sets of control rules: one addressed at all non-German investors and applying to German producers of strategic defence assets defined *inter alia* by the German War Weapons List and the other addressed to non-EEA investors and applying in theory to the entire German economy. The latter has only recently been added.

The defence-related regime was included into the FTP legislation by amendment of 23 July 2004, which entered into force on 29 July 2004. Since that time, this regime applying to all non-German investors has remained essentially unchanged. In 2009, Germany amended its abovementioned FTP legislation in order to be in a position to review or even ban non-EEA investment potentially in all sectors of the German economy. The amendment entering into force on 24 April 2009[68] is designed to guarantee the public order and public security of the Federal Republic of Germany with relation to investments from third countries concerning German operators active in the wider security area.

The question arises whether the wider security regime also applies to the defence sector, more precisely whether it may "fill the gaps" that are possibly left by the

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[67] See the "golden share" case law of the ECJ, e.g. in Cases C-98/01 *Commission v UK* ECR(2003) I-4641; C-463/00 *Commission v Spain* ECR(2003) I-4581; C-483/99 *Commission v France* ECR(2002) I-4781; C-112/05 *Commission v Germany* ECR(2007) I-8995; Opinion AG of 2 December 2009 Case C-171/08 *Commission v Portugal* ECR(2010) 0000.

[68] Federal Law Gazette 2009 I Nr. 20, of 23 April 2009 p. 770.

defence related regime which is limited to defined goods, i.e. in essence to "war weapons" and certain other items.

In the absence of any decision or jurisdiction, the following considerations support the applicability of the wider security regime to the defence sector:

- Applying the wider security regime to potentially all sectors but not to the most strategic of all would be wholly inadequate;
- The ECJ recognises that "public security" within the meaning of the TFEU means both internal and external security.[69] Accordingly, the notion of "public security" under the TFEU includes the notion of the "essential security interests" of Member States under Article 346 TFEU.
- In line with this case law, the Government recognises (in the explanatory memorandum) that the defence-related regime is specific ("*lex specialis"*) to the wider security system.[70]

Accordingly, the defence-related regime continues to apply to the products expressly referred to in Article 7(2)5 FTP Act (in particular those of the War Weapons list) whereas the wider security regime applies potentially to all other defence goods, provided its conditions are met. These may likewise be "strategic defence assets" within the meaning of the Study.

That said, we have no choice but to discuss both regimes. Instead of presenting one regime after the other, we will, for sake of better comparison present parts of both regimes according to specific characteristics.

Relevant national legislation and their provisions

Control under the defence-related regime:

Articles 7(1)1-3 and (2)5 FTP Act read together with Article 52 FTP Regulation entitle the Government to review the acquisition of at least 25 percent of the voting

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[69] Since Case C-367/89 *Richardt* ECR (1991) I-4261, 4652, paragraph 22.

[70] See Government of the Federal Republic of Germany, 'Explanatory Memorandum to the thirteenth amendment of the Foreign Trade and Payments Act', p. 3. at http://www.bmwi.de/BMWi/Redaktion/PDF/Gesetz/englische-begruendung-eines-dreizehnten-gesetzes-zur-aenderung-aussenwirtschaft,property=pdf,bereich=bmwi,sprache=de,rwb=true.pdf.

rights of a resident company producing or developing defined defence-related goods. It aims at protecting the vital (essential) security interests of Germany.

Investors concerned: The regime applies to investors having their seat or residence in another EU or EFTA Member State or a third country (non-German investors). It applies moreover to resident investors in which a non-resident (company) has at least 25 percent voting rights (i.e. to "*the acquisition of a resident company, or the direct or indirect participation in such a company […] by a non-resident or a resident company in which a non-resident has at least 25 percent voting rights*"). We would add here that this latter extension of the notion of a non German investor conflicts with the TFEU rules on the freedom of establishment, in particular Article 54 TFEU, if applied to residents of other Member States. The application of this rule to EU investments should be limited to cases where indications of circumvention exist, as this has been foreseen in the wider security regime (see below).

Scope or strategic assets concerned: German companies producing certain defined defence equipment, see below under **5.4.2**.

Threshold: The direct or indirect acquisition of 25 percent or more of the voting rights. It is not clear whether asset deals are likewise caught. The threshold is broadly applied, as follows:

- Existing participations have to be included, also of other members of a group of companies. The voting rights of third parties with whom the non-resident purchaser has agreed on the joint exercise of voting rights are attributed to the purchaser (Article 52(1)4 FTP Regulation).
- Moreover, for the calculation of the 25 percent, the shares of another company in the target are added to those of the purchaser, provided he holds 25 percent of the voting rights in the other company.
- Accordingly, where a German affiliate is indirectly affected by a take over taking place in another Member State, the German authorities apply the control rules even where the foreign purchaser's indirect aggregate participation in the German affiliate does in fact not reach 25 percent.

Test: whether the political and security interests or the military precautions of Germany are jeopardized as a result of the purchase.

Notification is obligatory and to be made within 3 months from the conclusion of the contract. The information to be communicated to the Ministry of Economics and Technology has been defined by ministerial announcement.[71]

Procedure: the authority has 1 month from receipt of complete documents to decide. In the absence of a decision the transaction is deemed to be cleared (**Clearance).**

Authorities in charge: The Federal Ministry of Economics and Technology acting in agreement with the Foreign Office and the Federal Ministry of Defence and eventually the Federal Ministry for Internal affairs.

Decision: The authority can issue orders, ban a transaction and may impose collateral clauses.

Appeal: to the Administrative Court in Berlin within one month from receipt of the decision.

Application: Since entry into force in July 2004 14 defence related cases have been examined, no transaction has been denied. Procedures are not public, decisions not published nor is there a press release.[72]

Control under the wider security regime:

Article 7(1) and (2) number 6 FTP Act read together with Article 53 FTP Regulation allow the restriction and prohibition of the acquisition of at least 25 percent of the shares or the voting rights in a resident company in those cases where as a result of the acquisition the public order and security of the Federal Republic of Germany is jeopardized.

Investors: Investors resident in countries other than EEA.[73]German investors or investors from EEA States in which persons or companies from a non-EEA country hold at least 25 percent may only be included in the control under specified conditions, i.e. if there are indications of circumvention. More precisely the purchase

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[71] See Ministerial Announcement 13/2004 of the Federal Ministry of Economics and Technology of 27.8.2004, Federal Bulletin 2004 p.19565 of 9 September 2004.

[72] According to one Germany official there are three to four cases a year out of which approximately one case might have a Community dimension. By comparison there is a "three digit" number of cases requiring consultation among EU Member States under the EU Code of Conduct on Armaments Exports.

[73] EEA= EU + Liechtenstein, Iceland and Norway.

of a Community-resident company or a direct or indirect participation in such a company by a Community-resident company in which a non-Community resident holds at least 25% of the voting rights may only be examined "*if there are indications that an abusive arrangement or circumvention transaction has taken place in order to circumvent an examination pursuant to sentences 1 and 2*".[74]

Sectors concerned: German undertakings from all sectors including defence-related companies not already caught by the defence-related regime.

Threshold: The direct or indirect acquisition of 25 percent or more of the shares or the voting rights in a German company is subject to authorisation. Existing participations from other members of a group of companies have to be included.

Procedure: The authorities have 3 months from the contract or the public offer to open proceedings *ex officio* and request information from the purchaser. However, upon receipt of a voluntary and complete "notification", the authority has only two months to open proceedings. In the absence of an opening decision the transaction is deemed to be cleared (Certificate of non-objection).

Test: whether the acquisition jeopardizes public order and security within the meaning of Articles 46 and 58(1) EC [now Articles 52 and 56(1) FEU] as interpreted by the Court of Justice of the European Union.

Authority: The Federal Ministry of Economics and Technology is the authority in charge, other ministries concerned have to be consulted, issuing orders or banning the acquisition requires the consent of the federal government.

Decision: the authority has two months from the receipt of the complete documents to prohibit the transaction or issue orders, acting in coordination with the government.

Appeal: within one month of receipt of decision to the Administrative Court in Berlin.

Application: Since July 2009, 20 cases have been dealt with, all notified voluntarily. Not one proceeding was opened, none concerned defence, and no prohibition was issued. Any decisions will **not be published**.

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[74] This provision was included after negotiations between the Commission and the German authorities.

Reasons for review or restriction

Reasons for review under the defence-related regime:

Under Article 7(2)5 FTP Act, restrictions are possible in order to

- guarantee the essential security interests of the Federal Republic of Germany,
- prevent a disturbance of the peaceful coexistence between nations, or
- prevent a major disruption of the foreign relations of the Federal Republic of Germany.

In essence, the regime aims to guarantee the essential security interests.

Reasons for review under the wider security regime:

The reason for the restrictions under Article 7(1)4 FTP Act is to guarantee the public order and security of the Federal Republic of Germany within the meaning of Articles 46 and 58(1) EC [now Articles 52 and 56(1) FEU].

These criteria are strictly applied. According to the Explanatory Memorandum of the bill, the regime "can be applied only in rare and isolated cases".[75]

Types of defence assets/industrial sectors covered by the legislation

Types of assets under the German defence-related regime:

This regime applies to German companies producing

- goods specified in the German "War Weapons List",
- specially designed motors or gears for combat tanks or other armoured military tracked vehicles, and
- cryptographic systems admitted for the transmission of governmental classified information by the Federal Office for Information Security Technology with the company's approval.

Under satellite-related legislation are moreover concerned companies which

[75] See Government of the Federal Republic of Germany, 'Explanatory Memorandum to the thirteenth amendment of the Foreign Trade and Payments Act', p. 3. at http://195.99.1.70/si/em2004/uksiem_20042949_en.pdf.

- manage a high value satellite data system ("Erdfernerkundungssystem").[76]

The War Weapons List is the list formed by part B of the Annex to the German War weapons control Act[77]. It enumerates 62 military items. In practice, certain parts, elements or components of those listed items are likewise caught by this legislation.

The German War Weapons List is neither inspired by nor identical to the EU "military list" drawn up by the Council in 1958 and referred to in Article 346 FEU. Moreover the German list has been adapted to technical development. However, the two lists overlap in part.

The German export control of weapons relates to yet another larger list annexed to the FTP Act. This so-called Exports List (listing the defence products the export of which requires authorisation under this Act) comprises the 62 items from the War Weapons List and 22 "other defence goods". For details, see the most recent Government report.[78]

Sectors concerned by the wider security regime:

German companies from all sectors may in theory be caught by this regime, including companies from the defence sector producing or developing goods other than those caught by the defence-related regime.

Notion of "national security interest" used

"National security interest" under the defence-related regime:

This set of rules is aimed at protecting the "essential security interests" of the Federal Republic of Germany. This objective includes:

- The prevention of a disturbance of the peaceful coexistence between nations;
- The prevention of a major disruption of the country's foreign relations;

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[76] See Articles 10(1) and 24(3) of the Satellite Data Security Act of 23 November 2007 (Federal Law Gazette I p. 2590), which entered into force 1 December 2007.

[77] See this List in the Enclosure to this Report.

[78] Federal Ministry of Economics and Technology (2009) 'Report by the Government of the Federal Republic of Germany on its policy on exports of Conventional military equipment 2007'.

- The prevention of military security precautions being jeopardized as a result of the sale (see Article 7(1)(2) FTP Act).

Accordingly, the essential security interests may be at risk for instance if German companies important for the country's military security of supply, and thus for its autonomous defence base, come under foreign influence.

The German notion of "essential security interests" in this set of rules corresponds to the similar notion in Article 346 FEU. This provision provides for derogation of the general rules of the TFEU to the extent necessary to protect national essential security interests. Even though the German defence-related regime does not expressly refer to this Treaty Article, the latter provision places limits upon the notion of national security interests - as it does in relation to all EU Member States.

"National security interest" under the wider security regime:

This regime aims at protecting the "public order and security of the Federal Republic of Germany within the meaning of Articles 46 and 58(1) EC [now Articles 52 and 65(1) TFEU]". The notion of "public order and security" in this regime (see **5.2.3** above) is expressly bound to the corresponding notion in European law.

Articles 52 and 56 TFEU provide for derogations from the general rules of the Treaty which have to be narrowly construed.[79] Accordingly, the German regime has a narrow scope.

In legal terms, Germany rightly recognises that also non-EEA investors can rely on the EU rules e.g. on free capital movement, Articles 63 et seq. TFEU. It binds itself vis-à-vis these investors to respect correctly the limits which European law places upon the Member States in the field of capital freedom.

"European interests" and special consideration of other EU Member States

As to a European dimension in the defence-related regime:

This question seeks to know whether European security interests are taken into account. The answer is that the German set of rules does not refer to a European dimension of security. However, according to the German authorities in charge the

[79] Case 72/83 *Campus Oil* ECR(1984) 2727, 2751; Case C-503/99 *Distrigaz* ECR(2002) I-04809.

European security interests are indirectly taken into account when examining and assessing German essential security interests.

The TFEU gives the German regime a European dimension requiring that German essential security interests have to be balanced against other European interests, *inter alia* the European interest and also the interest of other Member States in free capital movement, see Articles 63 et seq. TFEU.

As mentioned, the German notion of "essential security interests" corresponds to the notion of the "essential security interests of the Member States" in Article 346(1)(a) and (b) TFEU.[80] Under this Article, Member States may only refrain from respecting the general Treaty rules if this is necessary for the protection of their essential security interests. As any derogation, this provision has to be narrowly construed.[81] Accordingly, it places limits on the application of the German regime, in particular with relation to other EU Member States, prohibiting above all any protectionist application.

The defence-related regime differentiates between German and non-German residents. It does not differentiate between EU (EEA) and non-EU (non-EEA) investors. The authorities in charge emphasize that no distinction between "EU" and "non-EU" is made. The differentiation criterion is the residence or seat of the investor.

<u>As to a European dimension of the German wider security regime:</u>

Similar considerations apply to this German regime. It does <u>not</u> refer and in fact is <u>not</u> applied so as to take European security interests into account.

However, as mentioned, it takes other European interests into account, in that it correctly protects the "public order and security of the Federal Republic of Germany only within the meaning of Articles 46 and 58(1) EC [now Articles 52 and 65(1) FEU]" as interpreted by the European Court. This European dimension limits the scope of the national rules and prohibits in particular any protectionist application.

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[80] European Commission (2006) 'Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement' COM(2006) 779'. Brussels, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006DC0779:EN:HTML>.

[81] See ECJ Case 72/83 *Campus Oil* ECR(1984) p. 2727, 2751;

Let us add that the express reference to the Treaty in this wider security regime is also designed to demonstrate clearly the compatibility of the German wider security regime with the European law.

The wider security regime differentiates between EEA and non-EEA: control is limited to non-EEA residents. EEA residents are not at all concerned: they are "afforded the same treatment as EU residents". The differentiation criterion is the residence or seat of the investor in the EEA or not. By the way, any application of this latter regime to EU residents would risk being incompatible with the TFEU and secondary EU legislation.

Neither under the defence-related regime nor under the wider security regime would the interests of other Member States play a particular role. A consultation of other Member States that are indirectly concerned by a transaction is neither provided for nor would it take place in practice.

Approval conditions or mitigation agreements

Appropriate measures under both regimes are e.g.

- binding agreements between the Government and the purchaser
- divestiture of the strategic military assets or affiliates
- compulsory licences.

Moreover, the exercise of voting rights may be limited or else a trustee be appointed in order to reverse a purchase that has already taken place.

In one of the cases under the defence-related regime the authority entered into contractual arrangements with an overseas company acquiring a German provider of sensitive defence capabilities; the security of supply was apparently a decisive element here.

4 CASE STUDIES[82]

4.1 Acquisition by a company from a EU country

Thales and Diehl create German joint venture in 2006

In 2006 Thales SA and Diehl Stiftung set out to create a joint control of the fuze businesses of the groups of Diehl and Thales. Thales is a French group active in defence, aerospace and civilian security technology. Its total worldwide turnover amounted to approximately €11 billion. Diehl Stiftung is a German group active in metals, controls, defence and aviation. Its total worldwide turnover amounted to approximately €2 billion.

The joint venture Microtec GmbH & co KG, Germany of which 49% are held by Thales and 51 by Diehl, brought together the fuze activities of the firms: TDA Armements SAS, Thales Munitronic BV, Forges de Zeebrugge, Junghans Feinwerktechnik GmbH & Co KG, all active in the fuze business. When the transaction was announced it became subject to two reviews.

The European Commission reviewed the case under the Merger Regulation as the thresholds of regulation 139/2004 on merger controls were met. It did not object to the transaction.

The German Government reviewed the case under Article 7(2)5 FTP Act read together with Article 52 of the German FTP Regulation - the defence-related regime - because the joint venture was concerned with the production of “war material” and thereby met the criteria given in the German legislation for a review.

The creation of the joint venture by Thales and Diehl implied the direct acquisition by Thales SA of 49 %, i.e. more than 25 %, of the German company Microtec and the indirect acquisition by Thales of the abovementioned companies now held by Microtec which Thales did not own before, among which the German company Junghans Feinwerktechnik in which Microtec holds 100%.

[82] The two case studies below report only facts which are in the public domain.

The German Government examined whether the acquisition threatened the essential security interests of Germany and did not raise objections to it either.

4.2 Acquisition by a company from a non-EU country

OEP acquires control of HDW

The German company HDW has been in 2002 and in 2004 and now again is the target of a purchaser from a third country.

In 2002 One Equity Partners LLC (OEP) acquired 100% of Howaldtwerke Deutsche Werft GmbH (HDW). This was (and still is) a shipyard active in naval construction, repairs, upgrades and mid-life conversions. The company is known in particular for its construction of non nuclear submarines with air-independent fuel-cell drive.

The acquirer OEP is a U.S. finance investor which at the material time was affiliated to the J.P.Morgan Chase Corporation, USA. It was a friendly transaction.

The operation was completed prior to the entry into force of the German rules on the control of foreign acquisitions of defence assets.

A public political debate arose as to the necessity of a control of foreign investment in strategic defence assets. The public reaction was rather negative. In particular the fact was criticised that an important German company having developed a novel technology was going to be "sold out".[83] The German authorities feared the loss of military know-how and technology. This debate contributed to the adoption of Article 7(2)5 FTP Act on the control of certain defence assets which entered into force in July 2004.

In October 2004, OEP and ThyssenKrupp AG (TK), Munich agreed on the creation of an alliance of shipyards according to which TK would form a new group under the command of its affiliate ThyssenKrupp Marine Systems AG (TKMS), Hamburg. OEP

[83] See e.g. Handelsblatt, 2 June 2002 "Berlin tolerates the sell-out of HDW".

agreed to contribute to TKMS 100 percent of the shares it held in HDW. TKMS had in 2008 a turnover of some 2 billion €.[84]

In return for this sale of HDW, OEP obtained 25 percent of the shares in TKMS[85] (controlling HDW) in 2005.

The EU Commission cleared the acquisition of control of HDW by TK by decision M.3596 of 10.12.2004 under the merger control regulation. The FTP Act was inapplicable to TK as a German purchaser but applicable to the acquisition by OEP of 25 percent in TKMS.

The German authorities examined the transactions under which OEP had initially full direct control of HDW and acquired subsequently a participation of 25% in HDW's parent company under the defence-related rules.

The transaction was subject to European merger control because the thresholds of Regulation 139/2004 were met and to a review under Article 7(2)5 FTP Act read together with Article 52 of the German FTP Regulation because it was within the scope the defence-related regime.

The Ministry of Economics and Technology entered into arrangements with OEP that were aimed at preventing any transfer to OEP of defence-related technology developed by HDW, as well as any use of such technology by OEP and others. Under these conditions the transaction was cleared.

The German authorities have adopted a decision rejecting an attempted acquisition neither by a EU company nor by a non-EU company.

Ongoing Project: ABU DHABI MAR/HDW:

TKMS, parent of HDW, is said having concluded in October 2009 a Memorandum of Understanding with Abu Dhabi MAR concerning the sale of certain of its shipyards or their assets.[86]

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[84] Federal Ministry of Economics and Technology (2009) 'Report of the Federal Government on the maritime coordination policy', at <http://www.bmwi.de/BMWi/Redaktion/PDF/-Publikationen/bericht-maritime> p. 22.

[85] See Commission decision COMP/M.3590 ThyssenKrupp/HDW at p. 2 and OEP Press release of 7 October 2004 at <www.oneequity.com/pages/press/release4html>.

[86] Handelsblatt, 14 December 2009, 'Abu Dhabi first choice for HDW'.

Abu Dhabi MAR, a shipyard group registered in Abu Dhabi in the United Arab Emirates, is a strong player in the "mega-yacht sector". It is jointly owned by Al Ain International Group and Privinvest. Recently it entered into a partnership with TK. The partnership involves a 50:50 joint venture that will make naval surface ships including frigates, corvettes and offshore patrol vessels.

Abu Dhabi MAR is said to seek moreover a stake in HDW[87] which might remain slightly below 25 percent.[88] Given the legal threshold of 25 percent, control would be avoided. The German authorities may agree to the project under conditions excluding any transfer or use of HDW's special technology.[89] As yet, this possible transaction has not even been notified.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

The control procedures in Germany as well as in some of the other Member States are seen by industry representatives as a bureaucratic burden. Member States with a defence industry held in large parts by the public sector are seen as the most closed.

The German authorities submit that the national measures existing in other Member States do not have restrictive effects for the German defence industry. Vice versa the existence of the German rules would not have effects upon investors from other Member States.

The most important factors limiting further consolidation in the EU defence industry are according to representatives of the industry offsets and the lack of a level European playing field. This view is shared by the German authorities.

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87 Bloomberg, 9 December 2009 'Abu Dhabi is seeking stake in HDW submarine Maker'.

88 Bloomberg, 9 December 2009 'Abu Dhabi is seeking stake in HDW submarine Maker'.

89 Frankfurter Allgemeine Zeitung, 4 February 2010, p. 4.

In our contacts with industrial stakeholders we received the following indications as to the relative openness of the 9 States mentioned.

Table 5.1: Ranking of countries according to perceived openness:

Country	**Rank** **1= most open-9= most closed**	**Comment**
France	5	
Germany	1	
Italy	4	
The Netherlands	2	
Poland	9	
Spain	4	
Sweden	3	
United Kingdom	5	
United States	9	

The explanations were as follows: Germany is seen as the most open country. Even though the authorities make a detailed analysis of those cases which present a substantial strategic interest this control does not have the effects of a real obstacle. The Netherlands are seen as similarly open. With respect to Sweden and Poland the influence of a high “engagement” of the U.S. is mentioned as a factor which affects the openness. With respect to France and Italy it is the strong State influence which is seen as affecting the ranking. The United States are qualified as a country which has the possibility to invest everywhere but which is rather closed in relation to other countries (except for the UK).

5.2 On the need for EU level action

The German authorities expressed their satisfaction with the existing national regimes. In their view, a European initiative in this field cannot materialise because it would inevitably give the world the impression of a "Fortress Europe". Moreover, they stressed that there are only few cases which effectively imply a security risk. They doubted whether these few cases are worth the efforts required for establishing a specific European instrument. They pointed out that Germany welcomes foreign investment and that even though a number of investments have been assessed in accordance with the defence related rules entered into force in 2004, no investment has been prohibited by the government.

As far as Member States do assess foreign investments in the light of their national security interests, the existing regimes differ from each other and thereby reflect the varying experiences and diverging interests of those Member States. As a consequence, the German authorities find it difficult to establish the need for action at the European level.

The German Government strongly supports any efforts to abolish obstacles to free trade. However, in relation to the defence sector the German authorities believe that detrimental national regulations are best viewed and tested against the already existing European law. As national legislation must be compatible with European law, companies and their interests are already sufficiently protected.

Finally the German authorities add that up to now a need for consultation of other Member States has not arisen but should that be the case they could be held at any time even without a EU instrument to that effect.

The representatives of enterprises engaged in the defence and security sectors who were available for interview expressed their preference for legislation over public ownership. One of them qualified the German defence-related regime and the way it is applied as "liveable" but deplored the bureaucratic burden which it imposes upon the enterprises. The other qualified the regime as detrimental to the tradability and the value of the companies' shares and assets suggesting that it would best be altogether abolished. At least within the EU, freedom of investment should be ensured. In the alternative, control, if any, should be limited to third-country investors, preferably at the EU level.

6 ANNEX: GERMAN LEGISLATION

6.1 Introductory Remark KRB on the relevant German legislation

The relevant legislation on the review of foreign investments in German defence- and security-related industries is laid down in certain provisions of the **Foreign Trade and Payments Act** (Außenwirtschaftsgesetz)[90] and its implementing regulation, the **Foreign Trade and Payments Regulation** (Außenwirtschaftsverordnung)[91].

The following is a translation into English[92]

- of Section 7 on the Protection of Security and External Interests, Section 27 on the Issue of Statutory Orders, Section 30 on Authorisations, and Section 31on Legal invalidity of certain acts, **of the Foreign Trade and Payments Act**
- and of two provisions of the **Foreign Trade and Payments Regulation** which implement Section 7 of the Foreign Trade and Payments Act, i.e. Section 52 on the Restriction under Section 7(1) and (2) number 5 of the Foreign Trade and Payments Act and Section 53 on Restrictions under Section 7(1) and (2) number 6 of the Foreign Trade and Payments Act.

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[90] Außenwirtschaftsgesetz (AWG), Foreign Trade and Payments Act (FTPAct), of 28.04.1961, newly published 27.5.2009, Federal Law Gazette I, p. 1150, as last amended by the 13th Thirteenth Act amending the Foreign Trade and Payments Act and the Foreign Trade and Payments Regulation of 18.4.2009, Federal Gazette 2009 I of 23.4.2009; in force 24.4.2009.

[91] Außenwirtschaftsverordnung (AWV), Foreign Trade and Payments Regulation (FTP Regulation), of 18.12.1986, newly published 27.5.2009, Federal Law Gazette I, p. 1150, as last amended by the 13th Thirteenth Act amending the Foreign Trade and Payments Act and the Foreign Trade and Payments Regulation of 18 April 2009, Federal Gazette 2009 I no. 20, of 23.4.2009, in force 24.4.2009.

[92] Source of the German and English version: see Website of the Federal Ministry of Economics and Technology at http://www.bmwi.de/BMWi/Navigation/Service/gesetze,did=223394.html. Translation reviewed by KRB.

6.2 Foreign Trade and Payments Act

Foreign Trade and Payments Act as amended effective 24.4.2009, Section 7 - Protection of Security and External Interests

(1) Legal transactions and acts in foreign trade and payments may be restricted in order to

- guarantee the essential security interests of the Federal Republic of Germany,
- prevent a disturbance of the peaceful coexistence between nations, or
- prevent a major disruption of the foreign relations of the Federal Republic of Germany
- guarantee the public order and security of the Federal Republic of Germany within the meaning of Articles 46 and 58 (1) EC [now Articles 52 and 56 (1) FEU]

(2) According to para 1 above, the following may be restricted in particular

1.-4. […]

5. Legal transactions on the purchase of resident companies which

- produce or develop war weapons and other military equipment, or
- produce cryptographic systems admitted for the transmission of governmental classified information by the Federal Office for Information Security Technology with the company's approval,
- or legal transactions on the acquisition of shares in such companies, in order to guarantee the essential security interests of the Federal Republic of Germany; this applies in particular if the political and security interests of the Federal Republic of Germany or the military security precautions are jeopardized as a result of the purchase.

6. Legal transactions on the acquisition of resident companies or shares in such companies by a non-EU purchaser provided that as a result of the acquisition the public order and public security of the Federal Republic of Germany are

jeopardized pursuant to Para 1 no. 4; a real and sufficiently serious jeopardy is needed which affects a fundamental common interest. Non-EU purchasers from the Member States of the European Free Trade Association (Iceland, Liechtenstein, Norway, Switzerland) are treated as EU-purchasers.

Section 27 - Issue of Statutory Orders

(1) […]

(2) The Federal Ministry of Economics and Technology acting in agreement with the Foreign Office and the Federal Ministry of Defence shall have exclusive power to issue the statutory orders in the case of Section 7(2) no. 5. In the case of Section 7(2) no. 5 second indent the agreement of the Federal Ministry for Internal affairs is also required.

(3) The Federal Ministry for Economics and Technology shall have exclusive power to issue statutory orders in the case of Section 7(2) no. 6; however orders banning the acquisition or imposing restrictions require the consent of the federal government.

Section 30 – Authorisations

(1) Authorisations may be provided with collateral clauses. They are not transferable unless otherwise provided therein.

(2) The authorisation, the denial of an application for authorisation, the withdrawal and revocation of an authorisation shall be made in writing.

(3) Objections to and appeals against a decision shall have no suspending effect.

Section 31 - Legal Invalidity

(1) […]

(2) A legal transaction in connection with the acquisition of a resident company, which is subject to reporting under section 7 (1) and (2) no. 5 and to the faculty of the federal Government to prohibit the acquisition within a given period of time, is provisionally ineffective up to the expiry of this period. The legal

transaction will become effective after the expiry of said period unless the authority takes another decision prior to the expiration of the deadline.

(3) […]

6.3 Foreign Trade and Payments Regulation

Foreign Trade and Payments Regulation as amended effective 24.4.2009

Section 52: Restriction

under Section 7(1) and (2) no. 5 of the Foreign Trade and Payments Act

(1) The acquisition of a resident company, or the direct or indirect participation in such a company that

produces or develops goods specified in Part B of the Annex to section 1(1) of the War Weapons Control Act (War Weapons List),

produces or develops specially designed motors or gears for combat tanks or other armoured military tracked vehicles, or

produces cryptographic systems admitted for the transmission of governmental classified information by the Federal Office for Information Security Technology with the company's approval,

by a non-resident or a resident company in which a non-resident has at least 25 percent voting rights, shall be reported by the purchaser to the Federal Ministry of Economics and Technology.[93] This does not apply if the direct or indirect share in voting rights of the non-resident purchaser in the company concerned does not reach 25 per cent after the acquisition of the participation. When calculating the share in voting rights of the non-resident purchaser, the shares of other companies in the company to be acquired shall be added, provided the purchaser holds 25 per cent or more voting rights in the other company. The voting rights of third parties with whom the non-resident purchaser has concluded an agreement on the joint exercise of voting rights shall be allocated to the purchaser.

[93] The reporting requirements have been defined in Order 13/2004 of the Federal Ministry for Economics and Technology of 27.8.2004, Federal Bulletin 2004 p. 19565 of 1.9.2004.

(2) The Federal Ministry of Economics and Technology may prohibit the acquisition or issue orders within a period of one month after the reception of the completed documents related to the purchase, where necessary in order to safeguard the essential security interests of the Federal Republic of Germany. The documents to be communicated shall be determined by the Federal Ministry of Economics and Technology by means of an announcement in the Federal Gazette.

Section 53 - Restrictions
under Section 7(1) and (2) no. 6 of the Foreign Trade and Payments Act

(1) The Federal Ministry of Economics and Technology may, within a period of three months following the conclusion of the contract governed by the law of obligations on the acquisition of voting rights, examine the purchase of a resident company or a direct or indirect acquisition of shares of such a company by a non-EU resident in order to determine whether the purchase will jeopardize the public policy or public security of the Federal Republic of Germany; in cases involving a public offer, the period begins with the publication of the decision to make the offer or with the publication of the fact that control of the company has been attained. This shall not apply if the direct or indirect share of voting rights held by the non-EU purchaser in the company in question after the purchase is less than 25%. When the share of voting rights held by the non-EU purchaser is being calculated, any voting rights held by other companies in the company to be purchased shall be allocated to the non-Community purchaser where the non-Community purchaser holds 25% or more of the voting rights of the other company. The voting rights of third parties with which the non-Community purchaser has concluded an agreement on the joint exercise of voting rights shall also be accorded to the purchaser. Branches and permanent establishments belonging to the purchaser shall not be considered as Community-resident. The Federal Ministry of Economies and Technology may under the preconditions of sentences 1 and 2 also examine the purchase of a Community-resident company or a direct or indirect participation in such a company by a Community-resident company in which a non-Community resident holds at least 25% of the voting rights if there are indications that an

abusive arrangement or circumvention transaction has taken place in order to circumvent an examination pursuant to sentences 1 and 2. Non-Community purchases from Member States of the European Free Trade Association (Iceland, Liechtenstein, Norway, and Switzerland) shall be afforded the same treatment as Community-resident purchasers. The Federal Ministry of Economies and Technology shall notify the purchaser of its decision to examine an acquisition pursuant to the first sentence.

(2) If the Federal Ministry of Economies and Technology has informed the purchaser of its decision to examine an acquisition in accordance with the first sentence of Section 53 paragraph 1, the purchaser shall be required to communicate to the Federal Ministry of Economics and Technology all documents relating to the purchase pursuant to sentence 2. The documents to be communicated shall be determined by the Federal Ministry of Economics and Technology by means of an announcement in the Federal Gazette. The Federal Ministry of Economics and Technology shall inform the federal Government of the results of the examination. The Federal Ministry of Economics and Technology may, within a period of two months following receipt of the complete documents, prohibit or issue orders where necessary in order to safeguard the public policy or public security of the Federal Republic of Germany. Prior consent has to be obtained from the federal Government before a purchase is prohibited or orders are issued.

(3) At the written request of a purchaser, in which he outlines of the planned purchase, the purchaser and his field of business must be presented, the Federal Ministry of Economics and Technology shall issue a certificate stating that there is no objection to the acquisition (certificate of non-objection), if the purchase raises no concerns concerning the public policy or public security of the Federal Republic of Germany. The certificate of non-objection shall be deemed to have been issued if the Federal Ministry of Economics and Technology does not open an examination procedure pursuant to Section 53 paragraph 1 sentence 1 within one month of receipt of the application.

(4) In order to implement a prohibition the Federal Ministry of Economies and Technology may take the necessary measures. In particular it may:

prohibit or limit the exercise of voting rights in the purchased company where they belong to or are to be allocated to a non-Community purchaser, or appoint a trustee to reverse a purchase that has already taken place."

[…]

6.4 "Strategic defence assets" – Introductory Remark KRB

Introductory Remark KRB

Only Article 1(1) of the German War Weapons Control Act read together with Part B of the Annex to this Act is relevant for present purposes. Part B of this Annex is the 'war weapons list' which determines the scope of the abovementioned rules of the FTPAct and the FTP Regulation concerning the control of foreign investments (the defence-related regime).

This War Weapons List comprises products which are caught by the defence-related regime, i.e. Articles 7(1)1-3 and (2)5 FTP Act and 52 FTP Regulation and represent certainly "Strategic Defence Assets" within the meaning of the Eurocon Study.

In our view, the EU notion of "Strategic Defence Assets" within the meaning of the Eurocon study may also include military items which are not mentioned on the List below and not caught by the defence-related system but by the wider security regime, Article 7(1)4 (2)6 FTP Act and 53 FTP Regulation.

6.5 "Strategic defence assets" – War Weapons Control Act[94]

Article 1(1): For the purpose of this Act, weapons introduced for warfare (war weapons) comprise the items, substances and organisms listed in the Annex to this Act (War Weapons List).

War Weapons List[95]

Part A

[not applicable]

Part B

Other War Weapons

Projectiles

7. Guided projectiles

8. Unguided projectiles (missiles)

9. Other projectiles

10. Firing devices (launchers and launching equipment) for the weapons listed in items 7 to 9. including portable firing devices for guided projectiles to combat tanks and aircraft

11. Firing devices for weapons listed in item 8, including portable firing devices as well as rocket launchers

12. Aero-engines for the propulsion of the weapons specified in items 7 to 9

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[94] (Kriegswaffenkontrollgesetz) as last amended by Article 3 of the law of 11 October 2002, Federal Law Gazette I, p. 3970. See http://www.bafa.de/bafa/en/export_control/-legislation/export_control_cwc_p_war_weapons_control_act.pdf.

[95] (Kriegswaffenliste) as amended by the ninth regulation amending the War Weapons List of 26 February 1998, Federal Law Gazette I, p. 385.

Combat Aircraft and Helicopters

13. Combat aircraft having at least one of the following features:

    1. integrated weapon system equipped particularly with target acquisition, firing control and relevant interfaces for avionics,
    2. integrated electronic armaments
    3. integrated electronic combat system

14. Combat helicopters having at least on of the following features:

    1. integrated weapon system equipped particularly with target acquisition, firing control and relevant interfaces for avionics,
    2. integrated electronic armaments,
    3. integrated electronic combat system

15. Cells for the weapons listed in items 13 and 14

16. Jet, turboprop and rocket engines for the weapons under item 13

Vessels of War and Special Naval Equipment

17. Vessels of war, including those for military training

18. Submarines

19. Small vessels with a speed of more than 30 knots, equipped with offensive weapons

20. Mine sweeping boats, mine hunting boats, mine layers, mine breakers as well as other mine combat boats

21. Landing crafts, landing vessels

22. Tenders, ammunition transporters

23. Hulls for the weapons listed under items 17 to 22

Combat Vehicles

24. Combat tanks

25. Other armoured combat vehicles, including combat-supporting armoured vehicles

26. Any type of special vehicles, exclusively designed for the use of weapons listied under items 1 to 6

27. Carriages for the weapons listed under items 24 and 25

28. Turrets for combat tanks

Barrel Weapons

29.

a) Machine guns, except those with water cooling

b) Machine pistols, except those introduced as a model in a military armed force before 1 September 1939*

c) Fully automatic rifles, except those introduced as a model in a military armed force before 2 September 1945

d) Semiautomatic rifles except those introduced as a model in a military armed force before 2 September 1945, and rifles for hunting and sporting purposes **.

30. Machine guns, rifles, pistols for combat grenades

31. Cannons, howitzers, any kind of mortars

32. Automatic cannons

33. Armoured self-propelled guns for the weapons listed under items 31 and 32

34. Barrels for the weapons listed o under items 29, 31 and 32

35. Breech blocks for weapons listed under items 29, 31 and 32

36. Revolving breeches for automatic cannons

Light Anti-Tank Weapons, Military Flame Throwers, Mine-Laying and Mine-Throwing Systems

37. Recoilless, unguided, portable anti-tank weapons

38. Flame throwers

39. Mine laying and mine-throwing systems for land mines

Torpedoes, Mines, Bombs. Independent Ammunition

40. Torpedoes

41. Torpedoes without warheads (explosives)

42. Torpedo bodies (torpedoes without warhead – explosive – and without target detection device)

43. Mines of all types

44. Bombs of all types, including water bombs

45. Hand flame cartridges

46. Hand grenades

47. Infantry explosive devices, adhesive and hollow charges as well as mine-sweeping devices

48. Explosive charges for the weapons of item 43

Other Ammunition

49. Ammunition for the weapons listed under items 31 and 32

50. Ammunition for the weapons listed under item 29a, c and d, except cartridge ammunition having a soft core projectile with full casing, provided that the projectile does not contain any accessories, particularly a flare, incendiary or explosive charge, and where cartridge ammunition of the same calibre is used for hunting and sporting purposes

51. Ammunition for weapons of item 30

52. Ammunition for the weapons listed under items 37 and 39

53. Rifle grenades

54. Projectiles for the weapons listed under items 49 and 52.

55. Propelling charges for the weapons listed under items 49 and 52.

Other Essential Components

56. War heads for the weapons listed under items 7 to 9 and 40

57. Ignition charges for the weapons listed under items 7 to 9, 40, 43, 44, 46, 47, 49, 51 to 53 and 59, except propellant charge ignitors

58. Target detection heads for the weapons listed under items 7, 9, 40, 44, 49, 59 and 60

59. Submunition for the weapons listed under items 7 to 9, 44, 49 and 61

60. Submunition without ignition for the weapons listed under items 7 to 9, 44, 49 and 61

Dispensers

61. Dispensers for the systematic distribution of submunition

Laser weapons

62. Laser weapons specially designed for causing permanent loss of eyesight.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– Italy –

1st September 2010

Table of Contents

1 INTRODUCTION

Italy has a significantly large and highly developed defence industry. During the period 2004-2008 Italy has been the 7th largest producer of complex weapon systems in the world and the 4th largest in Europe. Italy's defence industry represents a key industrial sector for the national economic system in terms of sales, employment, technological impact as well as for its strategic relevance. The defence industry can be represented as a pyramid having at its apex a big international player, Finmeccanica, followed by two large specialized companies, Fincantieri and Iveco DV, and about a hundred small and medium enterprises.

The most important means of State control over defence assets is State ownership in combination with special rights rather than legislation regulating the review of foreign direct investment. The main reason is that the largest industrial activities in the defence sector have been originally undertaken by the State itself, and the privatisation process managed in the 1990s left the Finmeccanica majority stake in the Government hands.

Even after the large privatisation process experienced since the 1990s, Government own majority shareholdings in the major Italian defence firms. Indeed, it own one third of Finmeccanica shares, thus controlling important subsidiaries as Avio and Telespazio, and almost 100% of Fincantieri stocks. Consequently, only few companies, for example, Iveco DV and Piaggio Aero Industries, are potentially subject to foreign acquisitions. Currently, there are no plans to privatise Finmeccanica.

Moreover, a specific legislation establishes special powers for the Government as a shareholder in privatised companies, including the right of veto on ownership related decisions. Particularly, in the Finmeccanica case such special rights include specific prerogatives on changes of the ownership structure, in order to limit shareholdings by other investors, as well as stipulations about certain operations and about the appointment of the boards of directors. Furthermore, all companies partly privatised have introduced particular clauses in their statutes in order to allow minority shareholders, like the government, to appoint representatives in the board of directors.

As a result, the Court of Justice of the European Union (CJEU) has condemned Italy because of the violation of the related EU law[96].

Furthermore, there are legal instruments to monitor the processes related to potential transfers of property or of branches of the companies, including the *Registro delle Imprese (Registry of Companies)* managed by the Ministry of Defence where industries owners have to register, provide information and fulfil obligations. In addition, there are some indirect restrictions used to discourage potential unwelcome acquisitions of Italian firms by foreign companies. Finally, it has been created an inter-ministerial body provisionally named "*Comitato Strategico per l'interesse nazionale in economia*" (Strategic Committee for the national interest in the economic domain) dealing with foreign strategic investments in Italy, especially those made by Sovereign Wealth Funds.

All these instruments do not take into account the European dimension of the issue. However, the Letter of Intent (LOI) commitment and the Code of Practices approved to implement such commitment could represent a starting point in that sense.

Because of this particular situation, the Government has seen no need to propose a specific legislation for FDI control until now. This eventual legislation would also require a very challenging definition of "what" are the defence strategic assets and "who" decides the definition's scope. It seems to be that today there is no awareness of the issue at the adequate political and institutional levels.

Nevertheless, the experts and stakeholders interviewed for the purpose of this study widely agree that the national approach to foreign investments' control on strategic defence assets is not adequate. According to the majority of interviewees foreign investments should be encouraged, because of their positive impact on GDP, but the lack of specific regulation dealing with the control of foreign investment on strategic defence assets is perceived as a problem. This is especially true when it comes to issues related to security of supply and technology transfer.

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[96] European Court of Justice 'Case C-326/07: Commission of the European Communities V Italian Republic (Failure of a Member State to fulfil obligations – Articles 43 EC and 56 EC – Articles of association of privatised undertakings – Criteria for the exercise of certain special powers held by the state)', available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0326:EN:HTML>.

The necessity of a European intervention on the issue is widely acknowledged. It would be better to have a common mechanism at the EU level than the current group of different national legislation in order to prepare a clear and accessible context for the investors.

The different national legal frameworks hamper investments in Europe, particularly for Transnational Defence Companies (TDCs) which operate in several MSs and therefore have to comply with diverging rules about State control on investments in defence strategic assets. The fact that TDCs have to comply with such diverging rules can also have a negative effect on the security of supply of the MSs.

2 CONTEXT

2.1 The Italian defence industry

Italy's defence industry can be suitably described as a pyramid having at its apex a big international player, Finmeccanica, followed by two large specialized companies, Fincantieri and Iveco DV, and a hundred small and medium enterprises (SMEs). Finmeccanica operates through its subsidiaries in the aviations segment, in the helicopter industry, the space sector and in the defence electronics market.

The major means of State control over defence assets is State ownership in combination with special rights rather than legislation regulating the review of foreign direct investment. The main reason is that the largest industrial activities in the defence sector have been originally undertaken by the State itself, and the privatisation process of the 1990s left the majority of Finmeccanica's equity in the hands of the government.

Italy's defence industry represents a key industrial sector for the national economic system in terms of sales, employment, technological impact as well as for its strategic relevance. During the period 2004-2008[97] Italy was the 7th largest producer of complex weapon systems in the world, and the 4th largest in Europe. In 2008 Italy's

[97] Stockholm International Peace Research Institute (2009) *SIPRI Yearbook 2009, Armaments, disarmament and international security* (Oxford: Oxford University Press).

industrial revenues resulting from defence business amounted to € 8.4 billion, slightly below its 2007 total turnover which reached € 8.8.[98] In terms of employment, the national defence sector counts roughly 64,000 employees in Italy and 22,000 abroad.[99]

Italy's defence industry can be represented as a pyramid. At its apex we find a big international player, Finmeccanica, and two large specialized companies, Fincantieri and Iveco DV. All three operate as prime contractors in the higher market segments in terms of business volume and technological contents, providing complex weapon systems and systems integration. The second tier of this pyramid is composed by smaller firms, such as Elettronica and Avio, often specialized in the production of single applications or subsystems. Finally, a third tier includes nearly a hundred small and medium enterprises (SMEs), which generally provide larger companies with components and/or services.[100]

Finmeccanica is the main Italian industrial group in the defence sector. With its subsidiary companies, it is the 8th world biggest aerospace and defence group counting more than € 15 billion of revenues in 2008, out of which € 7 billion resulted from defence business, is by far Italy's largest group in the sector. Through its subsidiaries, it operates in the aviation segment (Alenia Aeronautica and Alenia Aermacchi) and in the helicopter industry (AgustaWestland). It is also present in the space sector through two joint ventures with the French company Thales (Thales Alenia Space e Telespazio). With regard to the specific defence sector, Finmeccanica is strongly involved in the defence systems segment (WASS, Oto Melara and the joint venture MBDA) as well as in the defence electronics market (Selex Sistemi Integrati, Selex Galileo, Selex Communications, Elsag Datamat). Notwithstanding its focus on defence, the group also operates in civilian sectors, such as energy (Ansaldo Energia) and rail transport (Ansaldo STS and AnsaldoBreda).

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[98] Figures consider revenues of Italy's major defence firms, namely Finmeccanica (included its subsidiaries), Iveco DV, Fincantieri, Avio and Elettronica.

[99] Federation of the Italian enterprise for Aerospace, Defence and Security (AIAD, Federazione Aziende Italiane per l'Aerospazio, la Difesa e la Sicurezza) (2009) *Relazione annuale 2009* [= Annual Report 2009] (Rome).

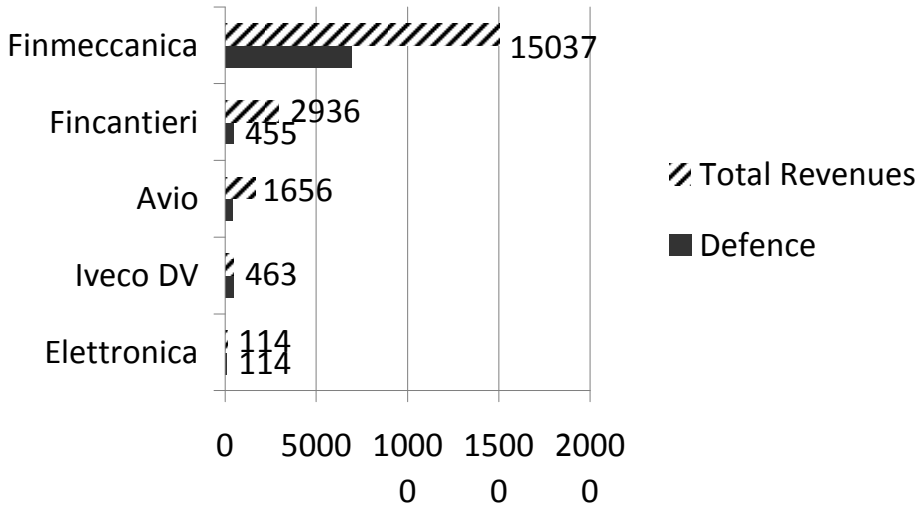
[100] Federation of the Italian enterprise for Aerospace, Defence and Security (AIAD, Federazione Aziende Italiane per l'Aerospazio, la Difesa e la Sicurezza) (2009) *Repertorio Aziende associate 2009* [= Associated Companies Index 2009] (Rome).

Fincantieri is one of the largest groups in the world in the design and construction of merchant, commercial and military ships. In 2008 the group had revenues of € 2.936 billion (€ 455 million in the defence sector). At the end of 2008, the company entered the American market through the acquisition of the Manitowoc Marine Group.

Iveco Defence Vehicles, a company belonging to the Iveco group, is specialized in the production of multi-role vehicles, tactical and logistic trucks and wheeled armoured vehicles. In 2008 the company's overall revenues amounted to € 463 millions. Its increasing competitiveness is proved by its remarkable export sales performance (roughly 70% of its total turnover).

The Avio Group, founded in 1908, is a world leader in the aerospace sector, with outstanding competencies in the aerospace propulsion segment. In 2008 the group had revenues of € 1.656 billion, € 429 million of which were generated in the military sector. As systems and motor producer, Avio is involved in several important international projects, such as the F-35 JSF multi-role fighter and the European aircraft Eurofighter Typhoon.

Figure 1: Revenues of Italian aerospace and defence companies[101]



[101] Briani, V. (2009) 'L'industria italiana della difesa [The Italian defence industry]'. *Osservatorio di Politica Internazionale [Observatory on International Politics]*, Vol. 3, No. 3 December.

Between 2004 and 2008 Italy was the 7th producer of complex weapon systems in the world, accounting for 4% of the global armament exports during the period.[102] Italy's exports volume increased steadily since 2000, exceeding € 3 billion in 2008. In terms of export authorizations, it has been registered a significant 28% increase compared to 2007.[103]

Domestically, Finmeccanica receives the majority contracts issued by the Ministry of Defence, obtaining about 70% of the Italian defence research, development, testing and engineering, and procurement spending.[104]

2.2 The scale of defence procurement

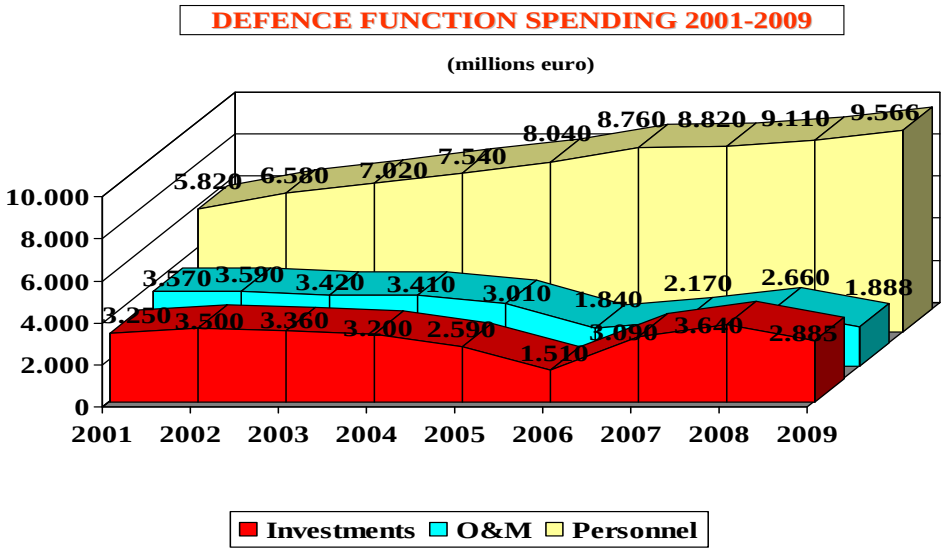
Regarding the demand side, as explained in details in the following figure, the defence spending has slightly increased since 2001. Yet, the percentage devoted to investment has decreased, while the personnel costs have radically increased.

[102] Stockholm International Peace Research Institute (2009) *SIPRI Yearbook 2009, Armaments, disarmament and international security* (Oxford: Oxford University Press), p. 330.

[103] Italian Presidency of the Council of Ministers (2008) 'Rapporto del Presidente del Consiglio dei Ministri sui lineamenti di politica del Governo in materia di esportazione' [= Report of the President of the Council of Ministers on the Government's policy guidelines on matter of exportation, importation and transit of armaments], available at <http://www.governo.it/Presidenza/UCPMA/Rapporto_2008/RAPPORTO_2008.pdf>.

[104] Bialos, J.P., Fisher C.E and Koehl S.L. (2009) *Fortresses & Icebergs*, Vol. II (Washington: Center for Transatlantic Relations), p. 413.

Figure 2: Italian defence spending 2001-2009[105]



Source: Based on Ministry of Defence data, Nota aggiuntiva allo stato di previsione per la Difesa, 2001-2009.

2.3 National defence industry and market policies

The major means of State control over defence assets in Italy is State ownership in combination with special rights rather than legislation that regulate the review of foreign direct investment. There are two main reasons for this development.

On the one hand, the main industrial activities in the defence sector have been originally undertaken by the State itself through the construction, for instance, of naval dockyards and ammunitions manufactory plants. Subsequently, the advent of large-size industry at the beginning of the 20th century increased the private participation in the sector. However, the private share declined after the Great Depression of 1929, being largely replaced by public industry intervention through the activities of the *Istituto per la Ricostruzione Industriale* (IRI, Institute for Industrial Reconstruction). After the Second World War, the public industry grew under the lead of both the IRI and the *Ente Partecipazione e Finanziamento Industrie Manifatturiere* (EFIM, Agency for the Participation and Funding of Manufacturing Industries), absorbing almost all the companies operating in the sector, with the

[105] Source: Gasparini, G., Marta, L. and Briani, V. (2009) 'Data on defence economics and industry', available at <http://www.iai.it/pdf/Economia_difesa/Tabelle-grafici-EN-2009.pdf>.

relevant exception of the FIAT Group. The Government sold EFIM in 1993 and IRI in 2002, while in 2000 IRI had privatized Finmeccanica (which had already acquired EFIM's defence assets). However, even after the privatization of Finmeccanica, the majority stake (nearly 33% of the share) as well as a golden share remain in the government's hands.[106] To sum up, since the public control over the industries operating in the sector has been predominant for decades, the inflow of foreign capital in the national defence segment was only a theoretical issue without any possible concrete implication.

On the other hand, the publicly-supported (and controlled) Italian defence sector has been believed not to be attractive for foreign investors. However, it was underestimated the efficient and competitive portion of the national industry.

This situation clearly became evident to decision-makers in 1993 when, dealing with the dismissal of the EFIM, the Government initially evaluated the possibility to sell also its subsidiaries operating in the defence sector. However, since these companies represented a strategic asset for the country, they were merged into Finmeccanica, enabling the remarkable growth of the group as well as the preservation of some segments of technological excellence (helicopters, naval weaponry, defence electronics). Therefore, only for few months in 1993 these companies were exposed to become private and, therefore, potentially under the control of foreign players.

The lack of specific regulation dealing with the control of foreign investments in strategic defence assets is mainly due to these two factors.

More recently, in the few circumstances the debate was opened, it has been fostered more by social concerns linked to employment issues than by conscious politico-institutional considerations aimed at protecting strategic defence assets (see Paragraph 5). Therefore, such debate addressed only indirectly the lack of a specific regulation on the matter.

According to some interlocutors, the dynamics emerged in the case of Avio, when the State intervened directly in the company's capital stock through Finmeccanica (see Paragraph 5), could be adopted again in the future if foreign actors would attempt to acquire a national company considered strategic by the government. Although such

[106] For further details please see sections 3 and 4 below.

dynamics are reasonably predictable, according to several interlocutors they would represent obvious market disturbances.

3 NATIONAL PRACTICES OF RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

Even after the significant privatisation effort of the 1990s, the Italian Government still owns majority share in the major Italian defence firms. Indeed, it owns one third of the equity of Finmeccanica, thereby controlling important subsidiaries such as Avio and Telespazio, and almost 100% of the equity of Fincantieri. Consequently, only a few companies, for example, Iveco DV and Piaggio Aero Industries, can potentially become subject of foreign acquisitions. Currently, there are no plans to privatise the publicly owned part of Finmeccanica.

Since 1993, and on the basis of the legal framework ruling the privatisation of state-owned companies and semi-public agencies such as ENI and IRI, Italy experienced the most important series of privatisations ever.[107] It culminated with the partial privatisation of large state-owned companies such as ENI, ENEL and Finmeccanica.

As a result, in December, 2009 the MEF through the Treasury Department held the following stocks in defence-related companies ensuring its control on that.[108]

30,18 % of Finmeccanica SpA [=plc];[109]

100% of Fintecna S.p.a, which controls 99,35% of Fincantieri shares.

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[107] Law 359/1992: "Conversione in legge, con modificazioni, del decreto-legge 11 luglio 1992, n. 333, recante misure urgenti per il risanamento della finanza pubblica."

[108] Although not directly related to the defence industry, it is worth mentioning the case of SOGIN S.p.a., whose shares are 100% held by MEF. Created in 1999, SOGIN is in charge of dismantling and controlling Italian nuclear power plants (which were shut down following the abrogative referendum in 1987), while assuring safety and security of the sites and operating proper procedures. This is an interesting example of total State control in a potential strategic sector achieved in relatively recent years.

[109] MEF (2009) 'Shareholdings', available at http://www.dt.tesoro.it/it/finanza_privatizzazioni/partecipazioni/

In turn, Finmeccanica holds stocks of other companies, including:

- Avio (aeromotors), whose shares belong 85% to the European investment fund Cinven and for the 15% to Finmeccanica.
- Elettronica SpA (electronic warfare) whose shares are held by Thales (33,33%), Finmeccanica (31,33%) and the Benigni family (35,34%).
- Thales Alenia Space Italia, whose shares are held by Thales (67%) and Finmeccanica (33%).
- Telespazio, whose shares are held by Finmeccanica (67%) and Thales (33%).
- Consortium Iveco-Oto Melara, where Fiat Gruppo Iveco and Oto Melara SpA (the latter controlled by Finmeccanica) hold respectively the 50% of stock.
- Orizzonte Sistemi Navali SpA whose shares are held by Fincantieri (51%), which is controlled by Fintecna SpA, and by Finmeccanica (49%).

As a result, the fact that Finmeccanica manages roughly the 80% of the Italian defence industrial and technological capabilities greatly contains the problem of the control of foreign investments on defence. In addition, the market share controlled by Fincantieri further reduces the importance of the issue on a specific regulation dealing with the control of foreign investments on defence assets, including strategic ones.

According to some interviewees, the state's control on Finmeccanica has facilitated the consolidation and merging process at national level, because the State had the opportunity to encourage and guarantee certain mergers and acquisition in the defence sector. Others argue that Finmeccanica dominant position could reduce the opportunities for further consolidation within international alliances. [110]

Regarding Fincantieri, its future privatisation, planned when the condition of both the financial market and the shipping sector will make it feasible, will anyway guarantee the State ownership of the shares' majority. According to the Italian Government

[110] Bialos, J.P., Fisher C.E and Koehl S.L. (2009) *Fortresses & Icebergs*, Vol. II (Washington: Center for Transatlantic Relations), p. 416.

Economic and Financial Program 2008-2011, the MEF will maintain at least 51% of Fincantieri stocks.[111]

Consequently, the private part of the Italian defence industry, potentially subject to foreign acquisition, is limited to few examples including:

Iveco Defence Vehicles;

- Piaggio Aero Industries, whose shares are divided into three equal parts held respectively by Mubadala Development Company, (the Abu Dhabi government's strategic investment fund), Tata Limited, and private shareholders (Ferrari and Di Mase families).
- Vitrociset, listed in the Milan Stock Exchange and entirely owned by private shareholders;
- Fabbrica di Armi Pietro Beretta SpA, within the Beretta Holding SpA owned by the Beretta family.

Elettronica, the part of the shares of Elettronica held by the Benigni family.

In addition, there is a number of privately SMEs which have a great capacity of innovation and participation to the security of supply.

Finmeccanica is a joint stock company listed at the Milan stock exchange market. Its capital is constituted exclusively by ordinary shares, all of them with the same rights, particularly with the right of vote in both general and extraordinary shareholders meetings.

Since the re-capitalization decided by the board of directors on 1st, August 2008, MEF is the only shareholder with more than 2% of the equity shares, namely 30,18%, a shareholding able to guarantee the *de facto* control of the company. According to the June 2009 data, shareholders include institutional investors, mainly banks, accounting for 49% of shares, and private investors (21%).[112]

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[111] MEF (2007) 'Documento di programmazione economico-finanziaria per gli anni 2008-2011' [=Report for the economic and financial programming for the years 2008-2011]. Rome, available at <http://www.tesoro.it/documenti/open.asp?idd=17881>.

[112] Up to August 2008, relevant shares included: MEF with 33.72%, Capital Research and Management Company with 2.11%, Barclays Global Investors UK Holdings Ltd. with 2.01% of ordinary stocks. Based on data of March 2008.

As confirmed by several interviewees, there are currently no plans to privatise Finmeccanica. The "White Book on Privatisations" prepared by MEF in 2001[113] mentions under "next operations and challenges for the future" the end of the state's shareholding in the major industries still under its control, particularly in the electricity and oil sectors, and gradually in the defence industry. Yet, ten years later this strategy has not been pursued.

3.2 Special rights

A specific legislation establishes special powers for the Government as a shareholder in privatised companies, including the right to veto decisions on ownership related issues. Particularly, in the Finmeccanica case such special rights include specific prerogatives on changes of the ownership structure, in order to limit shareholdings by other investors, as well as stipulations about certain operations and about the appointment of the boards of directors. Furthermore, all companies partly privatised have introduced particular clauses in their statutes in order to allow minority shareholders, like the government, to appoint representatives in the board of directors.

When the Government retains a shareholding in privatised companies, the Italian so-called "golden share" legislation[114] establishes special powers and in particular introduces a clause which attributes to the Minister of Finance, in agreement with the Minister of Economic Development the power

- to approve or oppose the acquisition of shareholdings and the conclusion of contracts by shareholders representing relevant proportion of voting rights (at least 5%) in a national company's ordinary shareholders meeting, or, as the case may be, even representing a lesser percentage if explicitly fixed by the Ministry of Finance;

[113] MEF (2001) 'Libro bianco sulle privatizzazioni' [= White book on privatizations]. Rome, available at http://www.dt.tesoro.it/export/sites/sitodt/modules/documenti_it/finanza_privatizzazioni/finanza_privatizzazioni/Libro_bianco_privatizzazioni_4603028-1-136.pdf

[114] Art. 2 of the Legislative-Decree n. 332 of 31 May 1994, as defined by the Legislative Decree of the President of the Council of Ministries 10 June 2004.

- to veto the adoption of all those decision aimed at dismissing or transferring the company, merging or breaking it down, moving its registered office abroad, modifying its holdings, changing its statute, in order to suppress or amend the special powers provided for Art. 2.

Regarding Finmeccanica, the government's special rights include specific prerogatives on changes of the ownership structure, in order to limit shareholdings by other investors, as well as stipulations about certain operations and about the appointment of at least of one member of the boards of directors and one auditor.

- First, the right of "preventive approval" has become a right of "opposition". The *Commissione Nazionale per le Società Quotate in Borsa* (CONSOB, National Committee for Quoted Companies) has to notify the MEF of the agreements finalized according to the norms of the "*Testo unico delle disposizioni in materia di intermediazione finanziaria*" (Single Act on provisions in the domain of financial brokering) in order to allow the State to exercise such right, regarding companies included in the stock market which are directly or indirectly under its control.
- Second, the State can put a veto only if the MEF considers the operation damaging to the State vital interests and it has to adequately motivate its decision. The evaluation on the fact that vital interests are involved should be done on a case by case basis as there are no specific rules to this specific purpose. The sectors potentially involved certainly include, not exclusively, those mentioned in the Decree 2004.[115] So far, from that point of view, there is not definition about what

[115] Legislative Decree of the President of the Council of Ministries, 10 June 2004 "Definition of the criteria for the exercise of special powers as defined in Art. 2 of the Legislative-Decree n. 332 of 31 May 1994, converted, with modification, by Law 474/1994": "[…] that among the companies directly or indirectly controlled by the State operating in the defence, transports, telecommunications, energy sectors and in other public services sectors, some are identified by means of decree issued by the President of the Council of Ministers […] Art 1. […] relevant and indisputable reasons of general interest, in particular concerning public order, public security, public health, and defence, to the adequate and proportional extent in terms of protection of that interest, also with appropriate calculation of temporal limit and provided the respect of the principles of communitarian and national law/regulations, in particular of the non-discriminatory principle. Art. 2 […] in relation to the occurrence of any of the following circumstances: a) severe and effective risk of shortages in the national supply of oil and energy products, as well as in the provision of related and consequential services; in general, in the supply of raw materials and goods essential to the community, as well as of a minimum level of telecommunications and transport services; b) severe and effective danger to the continuity of obligations exercise towards the community in the domain of public order, as well as to the achievement of societal goals of public

in Italy can be considered as "strategic" in the defence sector, although it seems that the MOD initiated at the end of 2009 an in-house study aimed at defining which are the key strategic activities that should be most protected.

- Finally, the State can appoint only one member of the board of directors, who has no right to vote. This limits the application of art 2449[116] of Legislative Decree No 6 of 17th January 2003, which confirmed the State right to appoint one or more members of the board of directors, or auditor, or members of the surveillance council.

Nevertheless, some corporate governance rules are maintained in order to protect the minority shareholders. These norms are neither included in the Finance Law nor in the new civil law norms.[117] Therefore, all the companies still under state's control or partly privatised have introduced in their statutes clauses which envisage specific voting systems, in order to allow the election of members of the directors' board by the minority shareholders. According to such clauses, executives were appointed in the boards of some companies on the basis of lists of candidates presented by minority shareholders, often institutional investors.

A part from the complexity of the legal framework, it has to be noticed that the recent modifications did not make substantial progresses towards the limitations of the MEF special rights. In fact, in June 2006 the European Commission referred Italy to the European Court of Justice regarding the so-called "golden share" legislation, which

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interest; c) severe and effective danger to the security and safety of essential public services sites and networks; d) Severe and effective danger to national defence, military security, public order and security; e) Health emergences.[…]".

[116] Art. 2449: *Companies with shares held by the State or by public agencies* – When the State or public agencies hold shares of a public limited company, the statute can confer them with the right to appoint one or more board directors or auditors or members of the surveillance council. According to the former comma, board directors, auditors or members of the surveillance council can be removed from post only by their appointers.

[117] In particular, companies with a cap on owned shares are obliged to set up statutory clauses for board directors to be elected by list voting. Art. 4, Law 474/94, establishes that 1/5 of the board directors must be attributed to voting lists presented by minority shareholders (who represent at least 1% of the share capital). The same mechanism is designed to appoint auditors, however in case of quoted companies, provisions overlap with those of the Testo unico della finanza (Single financial act). In fact, art. 48 of the Single financial act, second comma, provides that quoted companies' statutes (included those privatized) must comprise the necessary clauses aimed at assuring the election of at least one effective member of the board of statutory auditors by minority shareholders (nonetheless, if the board is composed of more than three members, those elected by the minority cannot be fewer than two).

envisages state's special rights on privatised companies. Consequently, in March 2009, the Court of Justice of the European Union condemned Italy because of the violation of the related European law.[118]

The judgement specifies that the decree of the Italian Prime Minister of 10th June 2004, regarding the exercise of state's special rights on implementation and acceleration of the selling of State and Government agencies shareholdings in privatised companies, is too generic and inaccurate.[119] The ECJ (now CJEU) held that the lack of specifications on the circumstances allowing the exercise of such rights damages investors, who do not know when such exercise will take place. Particularly, the Court condemns the "opposition" right to the acquisition of relevant stocks by investors representing more than 5% of right to vote, and to the finalization of agreements among them. The power to veto decision to dissolve, sell, merge or split a company, or to transfer its legal seat abroad, to change the scope of its activities, and finally to modify its statute regarding the special rights and the appointment of a member of directors' board without the right to vote is equally viewed with concern.[120]

Even stronger clauses have been incorporated in the Finmeccanica statute, including the state's special rights

- to veto acquisitions of shareholdings exceeding the 3% of the equities;
- to veto agreements among shareholders representing more than the 3% of the equities;

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[118] European Court of Justice 'Case C-326/07: Commission of the European Communities V Italian Republic (Failure of a Member State to fulfil obligations – Articles 43 EC and 56 EC – Articles of association of privatised undertakings – Criteria for the exercise of certain special powers held by the State)', available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0326:EN:HTML>.

[119] Legislative Decree of the President of the Council of Ministries, 10 June 2004 "Definition of the criteria for the exercise of special powers as defined in Art. 2 of the Legislative-Decree n. 332 of 31 May 1994, converted, with modification, by Law 474/1994".

[120] European Court of Justice 'Case C-326/07: Commission of the European Communities V Italian Republic (Failure of a Member State to fulfil obligations – Articles 43 EC and 56 EC – Articles of association of privatised undertakings – Criteria for the exercise of certain special powers held by the State)', available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0326:EN:HTML>.

- to veto, with adequate motivation, in case of real damages to the State's interests, or to decisions to dissolve, merge or split the company, or to transfer its legal seat abroad, or to change the scope of its activities;
- to appoint a member of the directors' board without the right to vote.

In addition, the election system of the board of directors envisages that two third of the seats are won by the list which gains most votes among shareholders, even if it does not have the absolute majority, thus guaranteeing the control of the company to this list.

Finally, regarding eventual MEF exercise of its rights, there are no pre-established criteria. Therefore, there is neither formal provision regarding an eventual European dimension, namely European interests in the sector like the formation of an European Defence Technological Industrial Base (EDTIB); nor it is considered the impact on other MSs, for instance regarding their security of supply (see paragraph 5).

3.3 Regulation of foreign acquisitions of defence assets

At present there is not a specific legislation directly and explicitly dealing with the control of foreign investment in strategic defence assets. The control on those assets is rather guaranteed through the previously outlined government's shareholding and special rights. In addition, there legal instruments to monitor the processes related to potential transfers of property or of branches of the companies, including the *Registro delle Imprese (Registry of Companies)* managed by the Ministry of Defence where industries owners have to register, provide information and fulfil other obligations. In addition, there are some indirect restrictions used to discourage potential unwelcome acquisitions of Italian firms by foreign companies.

In addition an inter-ministerial body provisionally named "*Comitato Strategico per l'interesse nazionale in economia*" (Strategic Committee for the national interest in the economic domain) has been created. It deals with foreign strategic investments in Italy, especially those made by Sovereign Wealth Funds. All these instruments do not take into account the European dimension of the issue. However, the Letter of Intent (LOI) commitment and the Code of Practices approved to implement such commitment could represent a starting point in that sense.

In the Italian context, the issue of a specific legislation directly aimed to control foreign investment in strategic defence assets needs to be addressed for several reasons:

- The first concerns those companies operating in the defence sector which are not controlled, either directly or indirectly, by the state.
- The second reason concerns the future, improbable but possible, complete privatisation of Finmeccanica and Fincantieri. Indeed, the Government could sell its shares in order to reduce the public debt and/or to increase the level of independence of the two groups. In particular, this would be done to free Finmeccanica and Fincantieri of the tight, potentially insidious, relationship with a State, which is at the same time customer, shareholder, R&D founder, and rule-setter both in the internal market and exports domains. If the Government will lose the control guaranteed by company shareholdings, another form of control on foreign investments would be necessary.
- The third reason is linked to the transfer of sensitive (strategic) assets from the defence sector to other sectors of the economy e.g. to the security sector. Such aspect might entail also the necessity to supervise and control some research, development and production activities in other market segments different from the military one as traditionally perceived. In regards to a potential foreign acquisition, a twofold need seems to emerge: to keep on maintaining certain (strategic) capabilities and to avoid that (sensitive) technologies and know-how might be indirectly exported.

In order to address such issue it is necessary an adequate monitoring capacity on the restructuring processes, for example on mergers and acquisitions, particularly on potential transfers of property or of branches of the companies.

At national level a series of legal instruments contribute to implement such monitoring capacity, even if they are not directly aimed to control foreign investments. They can be used by the Government to acquire information about potential transfers of property within companies operating in the defence sector, or to prevent, or discourage, possible unwelcome purchases by foreign companies.

Firstly, companies operating in Italy's defence sector have to register at the dedicated *Registro delle Imprese* (Register of Companies) at the Ministry of Defence, providing

some legal and financial information, such as the name of the company's owner or that of its legal representative; the legal headquarters; the type of activity exercised; the list of those owners and shareholders which own more than 1% of the company's total shares. Companies have to inform promptly the registry in case of variation of their legal and financial status after the registration.

According to the regulation disciplining the application to the *Registro delle Imprese*, companies' owners, legal representatives, shareholders, presidents, deputy presidents, chief executives, chairmen, general managers, counsellors and consultants have to prove to be compatible with provisions contained in the Law 185/90 in order to be included and maintained in the *Registro delle imprese*. Moreover, companies' owners, legal representatives and shareholders have not to be involved, in the past as well as in the present, in secret societies, and have not to be sentenced for illegal arms trade crimes.

In 2008 it has been decided to require also information concerning the property (in the case of stock companies only for shares above 1%). However, the decision in not yet operational, because of different legal views between the Ministry of Defence and the judges of the Council of state.

The Decree no. 125, 3 July 2009, jointly issued by the Ministers of Defence, of Foreign Affairs and of Economic Development, was published in the Official Journal no. 195, 24 August 2009. The Decree concerns revisions to the Regulation no. 96, 26 February 1991, which established norms on the registration of foreign firms operating in the armament sector (former Law 185/90) on the Register of Companies. Such changes are aimed at collecting information from the companies on their ownership and, in particular, "the list of the firms' owners, partners, and shareholders when holding no less than 1% of shares" (added in letter d-bis, art. 1 para. 2). The provision of such information is related to the commitments Italy made within the Letter of Intent (LOI) signed in July 2000. However, on the demand of the State Council, a request was added for a declaration "in substitution of certificates" concerning (art. 1 para. 3, letters b, c, d) and related to the condition which exclude the possibility to apply Law no. 55, 19 March 1990 about the investor of not

- "belonging or having belonged to secret associations, by art. 1, Law no. 17, 25 January 1982";

- being convicted for "crimes in illegal armaments trade".

In other terms, companies should provide the authorities with information proving their owners/shareholders' "honesty", along with what had already been required for "the owner or the legal representatives". However, the Secretary General of Defence/National Armaments Director (SGD/NAD) opposed the new constraint considering it impracticable in the envisaged terms, especially when confronted with foreign citizens or companies. The ensuing risk entails the non-registration or the suspension of those companies that do not make available the requested information. As a result, it was decided to interrupt the implementation of the Decree and to appeal to the State Council for a new recommendation.

Furthermore, companies applying for the registration have to receive a specific authorization from the Ministry of Defence and meet the security requirements established by the *Autorità Nazionale per la Sicurezza – Ufficio Centrale per la Sicurezza* (National Security Authority – Central Office for Security).

In addition, there are some indirect (informal) restrictions used to discourage potential unwelcome acquisitions of Italian firms by foreign companies:

- The legal representative of defence company registered in Italy has to be an Italian citizen (Law 185/90) and the company's personnel can deal with classified documents only if provided with security clearance.
- Only companies registered at the Business Registry are eligible to receive the authorization to import and export defence products, and such authorization is issued by the Ministry of Foreign Affairs (MAE) (Law 185/90).
- Defence research and development activities and, partially, those concerning acquisitions are funded according to a complex legal construct (Laws 808/85, 421/96, 388/00, 140/99) of the Ministry of Economic Development. After a preliminary investigation are examined and evaluated those projects which, once approved, force the company to keep the Ministry informed on its activity.
- The contracts for development and procurement are granted by the Ministry of Defence and oblige the company to not modify the program agreed without the approval of the Ministry itself. In joint intergovernmental programs the Ministry of Defence chooses directly the Italian companies to be involved.

The main problem of the current instrument is that information required has to be provided ex post, forcing the Government to recur only to moral suasion in order to oppose to an initiative already undertaken. In this case, an ex post intervention has various negative consequences, in particular because it is doomed to become public. According to several interviewees it is a mistake to underestimate the importance of such instruments, as it is clear that an investor cannot risk to antagonize its main customer and the authority which enables the company's operational capacities. Therefore, it is largely agreed that actors regarded as hostile could hardly alter the status quo of a defence company established under the current legislation. In any case, this aspect does not resolve either the problem of obtaining prompt and adequate information on potential agreements between companies nor the issue of limiting the possible unwelcome transfer of technologies and know-how.

Finally, it is particularly relevant the creation in 2008 of an inter-ministerial body provisionally named "*Comitato Strategico per l'interesse nazionale in economia*" (Strategic Committee for the national interest in the economic domain. The committee, created on the joint initiative of the MAE and the MEF, deals with issue of foreign strategic investments in Italy, especially those made by Sovereign Wealth Funds[121].

The "*Comitato strategico per lo sviluppo e la tutela all'estero degli interessi nazionali in economia*" (Strategic Committee for the development and the protection abroad of national interests in the economic domain) has been established by law through the Budget Law 2009, art. 83[122]. The Committee's regulation has been modified by the conversion law[123], putting the body mainly under the responsibility of the MAE. Furthermore, the law does not indicate the specific sectors of interest, and does not mention any collaboration with the companies operating in such domains.

On October 13th 2008 a decree issued by the MAE in collaboration with the MEF established that the MAE's Secretary General chairs the Committee, which is

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[121] Upon its establishment the Committee should have taken charge of the direct management of the relationship with Sovereign Wealth Funds (SWFs). The possibility of restricting the share of an Italian firm that SWFs can acquire to 5% was foreseen. However, this would have made the Italian market the most restrictive one in Europe as far as sovereign funds are concerned.

[122] Decree-law 112/2008

[123] Law 6 August 2008, No 133, art. 83, par. 25

composed of up to twelve highly-qualified experts, appointed by the two ministers involved. The "Unità per il sistema paese e le Autonomie Territoriali" ("Unit for the Country System and Autonomous Administrations"), belonging to the MAE's General Secretariat, acts as the Committee's technical Secretariat.[124]

The Committee is an advisory body, which today includes eight members and according to the Government guidelines has a role in analysis, support and coordination on complex economic phenomena linked to globalization:

- regarding sovereign funds at national and international level, the Committee has to identify the economic policy options to pursue within the EU and in the multilateral fora Italy takes part;
- regarding sustainable development in developing countries, the Committee has to define middle-term strategies coherent with the foreign policy's priorities established by the Government and with the international commitments undertaken by Italy;
- the Committee has also to deepen the analysis of economic and financial thematic areas related to globalization, if explicitly required by the government.

Indeed, according to Foreign Minister Frattini there are sectors in Italy where the intervention of sovereign funds is particularly welcome, such as infrastructure, transports and tourism. In contrast, in sectors such as defence the aim is to enhance industrial cooperation but not investments in corporate stock.[125]

According to several interlocutors a potential regulation of the defence sector, either national or European, should clearly separate the discipline of industrial investments and that of the financial ones (i.e. sovereign funds). The reason is that the former are considered to be related to an industrial strategy that can modify the structure of the offer, while the latter should be considered form the point of view of the nature and the stability of the new ownership of the involved company.

It has to be pointed out that neither the informal instruments mentioned above, nor the recent creation of the Strategic Committee take into account the European dimension.

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[124] See: http://www.sistemapaese.esteri.it/Unita_Sistema_Paese/Menu/Focus/Farnesina_e_imprese/

[125] Cifoni, L. (2008) ' I fondi sovrani non superino quota 5%' [SWD do not exceed 5% threshold]. *Il Messaggero*, 20th October, available at <http://www.openpolis.it/dichiarazione/375789>.

Indeed, there is no distinction between EU and non-EU objectives during the activities of control and monitoring, it does not reckon with evaluations concerning European interests in the sector such as potential impacts on the establishment of an EDTIB, and finally it does not consider the consequences on other EU Member states, for instance on their security of supply.

The only exception applies to the countries signatory of the Letter of Intent (LoI), the commitment agreed by Italy in Farnborough in July 2000, when it signed a Framework Agreement together with the Ministries of Defence of France, Germany, Spain, Sweden and UK, and ratified in June 2003 with Law 148. According to the LoI/FA, in the case foreign investors would acquire a national defence company supplying also other partners or operating in their territory, the Italian Government should inform and consult with the partners involved in order to evaluate the potential impact of the transfer. Obviously, such disposition assumes that the national authorities receive promptly all the required information.

Such target has been reached in 2005-06 with the subscription of the "*Codice di Comportamento*" (Code of Practice), finalized during the application-phase of the Framework Agreement by the large majority of the companies operating in the defence sector. At present the Code has been signed by most of the companies registered at the "Registro nazionale delle imprese" ("National register of companies") established by the Law 185/90[126]. It should be considered that only the companies registered in the National Register can subscribe the Code and consequently.

Such initiative could set the parameters for the application of the model to further domains and to circles larger than the only LoI-signatories, thus representing a starting point for a "European dimension" of FDI. However, such an approach presents a major limit: it would involve only defence companies, excluding de facto all those firms operating in the security sector, and would include only six countries out of the 27 EU Member States.

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[126] Italian Presidency of the Council of Ministers 'Legge 9 luglio 1990, n. 185, "Nuove norme sul controllo dell'esportazione, importazione e transito dei materiali di armamento" [=Law 185/90, New norms on the control of exportation, importation and transit of armaments] published on the Official Journal 14th July 1990, n. 163 (with amendments introduced by the law 148/2003), available at <http://www.governo.it/Presidenza/UCPMA/doc/legge185_90.pdf >

So far no case of industrial restructuring triggered the application of the LoI/FA rules. This could be partly explained because only Italian companies have so far subscribed the Code of Practice, while in the other five LoI/FA countries the Code remained frozen due to the pending definition of the Code of Conduct on Prioritisation of defence articles and services. It should be noted that the system would have been functioned, at the governments level, even on the basis of the Implementing Arrangement on Security of Supply signed in 2003. When industrial restructuring cases have occurred, the involved countries did not perceive the need to apply the system. Nevertheless, from the Italian side the importance of following the agreed upon process is clearly recognized, which is the reason why the Italian authorities and firms act in this sense in the LoI/FA community.

4 CASE STUDIES

4.1 Carlye and Cinven acquire AVIO in 2003 and 2006 respectively

In 2003 Fiat Group decided to sell Avio, a manufacturer of aircraft engines for commercial and military programs; aero-derivate turbines and electronic automation propulsion systems for naval use; maintenance, repair, and overhaul activities for civil and military aeronautical and launchers engines.

Immediately, proposals came from American and British investment funds, Carlyle Group and Doughty Hanson (together with the Italian partner Piaggio Aero Industries) respectively, as well as from the French State owned company Snecma (together with Finmeccanica), specialized in aeronautical and aerospace engines and from General Electric. The Italian Government preferred a solution that allowed Avio to remain under partial Italian control; it requested the intervention of Finmeccanica in the financial operation.[127]

[127] Fiat Avio: francese Snecma accelera sull'acquisto, [Fiat Avio: French Snecma speed up on the acquisition], *Il Sole 24 Ore*, 23 January 2003, <http://archivio-radiocor.ilsole24ore.com/articolo-265886/fiat-avio-francese-snecma-accelera/>

Because of disagreements between Snecma and Fiat on the price of Avio and between Snecma and Finmeccanica on risk values and business choices, Snecma withdrew its offer. Beside economic and financial reasons for the failed operation, the national media highlighted causes related to international politics, such as the different positions adopted by the Italian and French governments in the occasion of U.S. intervention in Iraq.

The withdrawal of the Franco-Italian proposal allowed Carlyle Group to advance its offer together with Finmeccanica, which was at that moment no longer engaged with Snecma. The new deal envisaged Carlyle as the principal financial shareholder with 70% of the equity and Finmeccanica as the industrial partner holding the remaining 30%. In April 2003 the two companies acquired Avio for € 1.5 billion. Finmeccanica, although a minority shareholder, was going to play a crucial role in defining the strategy and managerial decisions of the Avio Holding S.p.A. thanks to the fact that it was granted shares with multiples voting rights. Indeed, Finmeccanica benefited from veto rights on strategic decisions such as the expansion of activities and/or the prospect of alliances with other companies.

Concerning the final outcome, the State appears to have carefully assessed the political-strategic impact of the financial operation. In fact, Carlyle was a valuable partner, and the Italian Government was unwilling to entirely hand over a company operating in the defence sector to foreign investors.[128]

The issue was also debated in the Parliament, where a number of members expressed reasons for concerns regarding an Italian company operating in an advanced industrial sector and high-tech know-how being acquired by a foreign investment fund lacking expertise and experience in industrial management and production. Adding to this, the Parliamentarians opposed the expected negative consequences for employment.[129]

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[128] Finmeccanica: da cda ok quota minoranza Fiat Avio, [Finmeccanica: from CEO ok on minority share Fiat Avio], *Il Sole 24 Ore*, 8 April 2003, <http://archivio-radiocor.ilsole24ore.com/articolo-285632/fiat-avio-bersani-ds-serve-urgente/#ixzz0fcuyNZEz>; Finmeccanica Sacrifica Stm per Fiat Avio [Finmeccanica renounces to Stm for Fiat Avio], *La Repubblica*, 29 March 2003.

[129] Senate of the Republic, Interrogation, 11 March 2003, <http://www.senato.it/japp/bgt/showdoc/showText?tipodoc=Sindisp&leg=14&id=64032>; Chamber of Deputies of the Republic, Interrogation, 1 April 2003, <http://wai.camera.it/_dati/leg14/lavori/stenografici/sed290/pdfbt01.pdf>; Senate of the Republic, Interrogation , 9 April 2003,

In the process of the initial public offering of Avio in March 2006 the European investment fund Cinven, originally British, expressed an interest in the company. In August 2006 Cinven acquired the shares from Carlyle and Finmeccanica for € 2.57 billion and established Avio Investments. As part of the transaction, Finmeccanica gained € 430 million and agreed to reinvest € 150 million in the company, alongside Cinven, acquiring 15 % of shares.

At the national level, Finmeccanica's choices raised concerns about an eventual demerging, leaving former Italian shares to a second foreign investor and making Avio totally owned by non-Italian investors. Hence, some parliamentarians warned the Government about the industrial consequences and effects on employment of Finmeccanica's financial disengagement.[130] In this respect, the Government confirmed its strong interest in the strategic sector in which Avio operated and excluded to have received signals that Finmeccanica was about to cede its shares. Moreover, it committed to organize talks with the company to examine development lines for the future.[131]

In conclusion, the Government exerted control on foreign investment in defence strategic asset in three indirect ways. First, it asked the state-owned company Finmeccanica to intervene in the transaction in partnership with foreign investors from an allied country. Secondly, in the Articles of Association of the Avio Holding Finmeccanica was granted special rights such as veto right on strategic decisions. Finally, Finmeccanica became a minority shareholder in the transaction with Cinven to guarantee the Italian role in Avio. As a result, it was avoided a foreign control on this strategic asset, even if it accepted investments from both, a non-EU country (by the American investment fund Carlyle) and a EU country (by the British investment fund Cinven).

<http://www.senato.it/japp/bgt/showdoc/frame.jsp?tipodoc=Resaula&leg=14&id=00114286&part=doc_dc&parse=no>

[130] Senate of the Republic, Interrogation, 26 September 2006, <http://www.senato.it/service/PDF/PDFServer/BGT/219824.pdf>

[131] Senate of the Republic, Answer by the Government, 19 December 2006

4.2 Finmeccanica & Alcatel create Thales Alenia Space and Telespazio in 2004

In 2004, Finmeccanica and Alcatel became protagonists of the so-called "space alliance". They established a Franco-Italian niche of excellence in the space sector, which represents a major European operator in satellite systems and services.

Both companies created two new firms, establishing a cross-shareholding structure. On one hand, Alcatel Alenia Space, 67% controlled by Alcatel and 33% by Finmeccanica, gathered manufacturing activities of Alcatel Space and Alenia Spazio, specializing in the development, production and design of space systems, satellites and ground systems. On the other hand Telespazio, 67% controlled by Finmeccanica and 33% by Alcatel, drew together the operational activities and services of Telespazio and Alcatel Space, focusing on activities and satellite services like the monitoring and the exploitation of space systems, the network-supply, and earth observation. The two companies were involved European space programs such as Cosmo Skymed and Galileo, and later GMES.

According to Guarguaglini, the president and CEO of Finmeccanica, the agreement concluded with Alcatel was adjusted to ensure the protection of domestic investment and the respect by all the contracting parties of the golden share held by Italy. Indeed, corporate governance agreements safeguarded Finmeccanica as a minority shareholder of Alcatel Alenia Space. As a matter of fact, they protected the centres of technological excellence for research and development subjected to Italian rules.[132]

Nevertheless, during the completion of the alliance some concerns about the impact of cross-holdings emerged at the national level: a number of members of the Parliament interpreted the minority role of Alenia Spazio, compared to the one hold by Alcatel Space, as a risk, a "clearance sale of national technology estate in a strategic sector like the space industry".[133] In face of what they regard to be a risk, the Parliamentarians proposed the creation of a single company in which Finmeccanica

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[132] Chamber of Deputies, Public Hearing of Finmeccanica representatives in front of Commission V,

[133] Chamber of Deputies, Interrogation, 15 December 2004, <http://wai.camera.it/_dati/leg14/lavori/stenografici/sed560/pdfbt31.pdf>; Senate of the Republic, Interrogation , 9 December 2004, <http://www.senato.it/service/PDF/PDFServer/BGT/122179.pdf>

could have asserted its competence in services with a substantial financial commitment. At the same time, the Italian Government and the Italian Space Agency would have had to increase orders directed to the company to strengthen the Italian role within the alliance. Nonetheless, they recognized the importance to stipulate alliances between European companies in order to ensure stability and development of the Italian industry in this strategic and basically oligopolistic sector.[134]

Confronted with these problems, the Italian Government argued that its strategy did not only defend Italian interests by exercising the rights and obligations deriving from the golden share but also support the internationally-oriented strategy of Finmeccanica.[135]

In 2006, following Thales acquisition of Alcatel, the shares of the two joint ventures have been transferred to the new company. Thus, Alcatel Alenia Space was renamed Thales Alenia Space, while the allocation of shares of both companies remained unchanged in accordance with the conditions posed by Finmeccanica. Indeed, the Italian group retained a veto right, provided by corporate governance agreements with Alcatel, on a possible transfer of shares of the two joint ventures to a third company.

In conclusion, the Thales Alenia Space and Telespazio case can be classified as acceptance of investments from a EU country. Like in Avio, the control on foreign investment by the Italian Government is exerted through the presence of state-owned Finmeccanica in the two companies, and the special rights guaranteed by the corporate governance of Thales Alenia Space to Finmeccanica as minority shareholder. This control instrument is buttressed by a cross-shareholding structure between Finmeccanica and Thales via the two subsidiaries.

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[134] Ibid.

[135] Senate of the Republic, Answer by the Government, 22 April 2004, <http://documenti.camera.it/_dati/leg14/lavori/stenografici/sed455/s370r.htm>

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of relative openness of countries to FDI

Italian experts who were asked about their perceptions of the relative openness of the case study countries to foreign acquisition of defence assets gave on average the following assessment:

Table 5.1: Ranking of countries according to perceived openness:

Country	Rank 1=most open – 9=most closed	Comment
France	9	
Germany	5/6	
Italy	4	
The Netherlands	2/3	
Poland	4	
Spain	5	
Sweden	5/6	
United Kingdom	2	
United States	3/4	

5.2 On the need for EU level action

The necessity of a European intervention on the issue is widely acknowledged. It would be better to have a common mechanism at the EU level than the current group of different national legislation in order to prepare a clear and accessible context for the investors.

The different national legal frameworks hamper investments in Europe, particularly for Transnational Defence Companies (TDCs) which operate in several MSs and therefore have to comply with diverging rules about State control on investments in

defence strategic assets. The fact that TDCs have to comply with such diverging rules can also have a negative effect on the security of supply of the MSs.

Several Italian interviewees have expressed an open-minded attitude towards a EU level mechanism, but exclusively with guarantees and conditions to be defined in its implementation phase. Moreover, they supported the idea to distinguish within such a mechanism between investments from EU Member States (MSs) and not-MSs is considered to be useful to the creation of a European common defence market.

A common mechanism at EU level can create the conditions of homogeneity which encompasses the different rules of each MS and thus create the conditions for a level playing field for players, but also a positive impact on the establishment of an EDTIB. The level playing field concept requires removing all the obstacles for intra-EU transfers of defence products, technologies and investments.

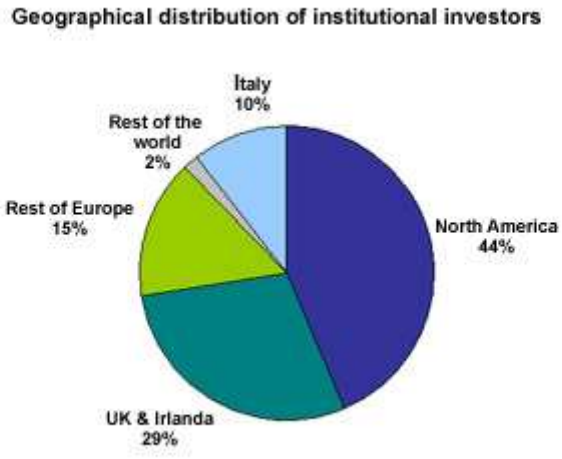
The current diverging European framework risks altering the functioning of an efficient European defence integrated market having different rules and procedures in the field of foreign investments controls, if there are any. One reason is that the different and national approaches allow only to protect the essential interests of security with the national but not the European dimension.

On the other hand, Italian experts have expressed reservation about a potential EU level mechanism in face of what they held in general of European legislation, namely that it is unclear regarding basic principles and often over-detailed. Thus, at the moment the lack of a strong institutional framework in the defence industrial area, with a management structure is somehow replaced by too complicated a legal framework.

6 ANNEX

6.1 Finmeccanica: Shareholding Structure[136]

Share Capital: Euro 2.543.861.738,00 represented by 578.150.395 ordinary shares – as of June 2009



[136] Source: Finmeccanica (2009) 'Shareholding Structure', available at http://www.finmeccanica.it/Holding/EN/Corporate/Investor_relations/Azionariato/index.sdo]

6.2 Finmeccanica SpA: Articles of Association[137]

Approved on 27 February 2009

[…]

5.1 bis - Under Article 3 of Decree-law No 332 of 31 May 1994, converted with amendments into Act No 474 of 30 July 1994, no one, except for the state, public bodies or entities controlled thereby and any other party authorised by law, may possess, on any basis, shares in the Company that constitute a shareholding of more than 3% of the share capital represented by shares with voting rights.

The maximum shareholding limit is also calculated in consideration of the total holding of the controlling undertaking, which may be a natural person, legal person or corporation, by direct or indirect subsidiaries and by the subsidiaries of a single controlling undertaking, by affiliated undertakings and by relatives within the second degree of consanguinity or affinity or spouses, provided that the spouses are not legally separated.

With also reference to parties other than companies, the term "control" is held to be within the meaning of Article 93 of Legislative Decree No 58 of 24 February 1998. The term "affiliation" is held to be within the meaning of Article 2359, paragraph 3 of the Italian Civil Code, and is also deemed to exist between parties who, directly or indirectly, through their subsidiaries, other than those which manage mutual funds, sign, with third parties or otherwise, agreements relating to the exercise of voting rights or the transfer of shares, belonging to third parties or otherwise, or other agreements or contracts with third parties or otherwise, as referred to in Article 122 of the aforesaid Legislative Decree No 58 of 24 February 1998, if such agreements or contracts concern at least 10% of the voting capital for listed companies or 20% of the voting capital for unlisted companies.

For the purposes of calculating the aforesaid shareholding limit (3%), consideration is also given to shares held through trust companies and/or intermediaries or by third parties in general.

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[137] Finmeccanica (2009) 'Articles of Association' approved on 27th February, available at <http://www.finmeccanica.com/EN/Common/files/Holding/Corporate/Investor_relations/Corporate_Governance/_ok_By_Laws_february_27.pdf >.

Voting rights relating to shares that exceed the aforesaid maximum limit may not be exercised and voting rights held by shareholders in excess of the shareholding limit shall be reduced proportionally, unless otherwise previously and jointly indicated by all the shareholders concerned. In case of non-compliance, meeting resolutions may be challenged under Article 2377 of the Italian Civil Code if the required majority would not have been reached had the votes exceeding the maximum limit not been included.

However, non-voting shares shall be included for the purposes of calculating the meeting quorum.

5.1 ter - Under Article 2, paragraph 1 of Decree-law No 332 of 31 May 1994, converted with amendments into Act No 474 of 30 July 1994, as replaced by Article 4, paragraph 227 of Act No 350 of 24 December 2003, the Italian Minister of the Economy and Finance, jointly with the Italian Minister of Economic Development, has the following special rights:

a) the right to oppose the acquisition, by parties subject to the shareholding limit, as referred to in Article 3 of Decree-law No 332 of 31 May 1994, converted with amendments into Act No 474 of 30 July 1994, of material shareholdings, this being understood to mean shareholdings that – as laid down by Decree of the Italian Minister of the Treasury, Budget and Economic Planning of 8 November 1999 – represent at least 3% of the share capital composed of shares with voting rights at Ordinary General Meetings. The objection shall be raised within 10 days from the notification, to be issued by directors when entry in the shareholders' register is requested, if the Minister considers that the operation could harm the vital interests of the state. During the period in which the right of opposition may be exercised, the voting right and any other rights not relating to equity pertaining to shares representing the material shareholding shall be suspended. If the right of opposition is exercised, in the form of a ruling duly justified by the actual harm caused by the operation to the vital interests of the state, the shareholder concerned may not exercise the voting rights or rights not relating to equity pertaining to the shares representing the material shareholding and shall transfer these shares within a period of one year. In case of non-compliance, the court, on request of the Italian Minister of the Economy and Finance, shall order the sale of the shares representing the material

shareholding in accordance with the procedures set out in Article 2359-ter of the Italian Civil Code.

The ruling by which the right of opposition is exercised may be challenged by the shareholder concerned within 60 days before the Regional Administrative Tribunal of Lazio;

b) the right to oppose the signing of pacts or agreements as set out in Article 122 of the Consolidated Law, Legislative Decree No 58 of 24 February 1998, in the event that – as laid down by Decree of the Italian Minister of the Treasury, Budget and Economic Planning of 8 November 1999 – such pacts or agreements represent at least 3% of the share capital composed of shares with voting rights at Ordinary General Meetings. So that the right of opposition may be exercised, CONSOB shall inform the Italian Minister of the Economy and Finance of any material agreements and contracts within the meaning of the present article of which it has been informed under said Article 122 of the Consolidated Law, Legislative Decree No 58/1998.

The right of opposition must be exercised within 10 days from the date of notification by CONSOB. During the period in which the right of opposition may be exercised, the voting right and any other rights not relating to equity of shareholders who signed the agreement shall be suspended. If an opposition ruling is issued, duly justified in view of the actual harm caused by said agreements or contracts to the vital interests of the state, said agreements or contracts shall be invalidated. If the behaviour at meetings of syndicated shareholders suggests that the obligations assumed under the agreements or contracts referred to in Article 122 of the Consolidated Law, as referred to in Legislative Decree No 58/1998, still apply, resolutions adopted with the vote of the shareholders concerned may be challenged. The ruling exercising the right of opposition may be challenged within 60 days by shareholders who signed the agreements or contracts before the Regional Administrative Tribunal of Lazio;

c) the right of veto, duly justified in view of the actual harm caused to the vital interests of the state, on resolutions to wind up the Company, transfer the business, proceed with mergers or demergers, relocate the Company's head office to a different country, alter the corporate objects or amend the Articles of Association, where such resolutions abolish or alter the powers referred to in the present article. The ruling by

which the right of veto is exercised may be challenged within 60 days by dissenting shareholders before the Regional Administrative Tribunal of Lazio;

d) the right to appoint a director without a voting right. Should the director thus appointed leave office, the Italian Minister of the Economy and Finance, jointly with the Italian Minister of Economic Development, shall appoint a replacement.

The right of opposition referred to in subparagraphs a) and b) hereinbefore may be exercised in the cases set out in Article 4, paragraph 228 of Act No 350 of 24 December 2003. The special rights referred to in subparagraphs a), b), c) and d) hereinbefore shall be exercised in accordance with the criteria laid down by the Prime Ministerial Decree of 10 June 2004, fully incorporated herein.

Directors appointed by decree of the Italian Minister of the Economy and Finance of 16.5.2003 shall remain in office, with the powers granted to them at the time of their appointment, until their term of office expires.

Such directors shall not be replaced if, prior to the expiry of said term, they should have cause to leave office. The appointment of the director without a voting right, as referred to in subparagraph d) of the present article, may take place only after the departure from office of all the aforesaid directors. The auditor appointed by Decree of the Italian Minister of the Economy and Finance of 16.5.2003 shall remain in office until the term of office expires. If, prior to the expiry of said term, said auditor should have cause to leave office, a replacement shall be appointed in accordance with the provisions of the Italian Civil Code. Should the director without a voting right be appointed, as referred to in subparagraph d) of this article, said director shall be guaranteed the same rights as those granted to other directors by law and/or by the Articles of Association. This shall include the attendance to meetings of the Board of Directors, bar the voting right.

Said director may not be delegated authority or given particular duties, on a supplementary or temporary basis or otherwise; under no circumstances may he or she chair meetings of the Board of Directors nor represent the Company legally, whether on an ad-hoc basis or otherwise, and his or her presence shall not be included for the purpose of calculating the quorum of meetings of the Board of Directors of the Company. […]”

[Disclaimer - These Articles of Association has been translated into English solely for the convenience of the international reader. In the event of conflict or inconsistency between the terms used in the Italian version of the Articles of Association and the English version, the Italian version shall prevail, as the Italian version constitutes the official document.]

6.3 Decree-law 112/2008

Decree-law 112/2008 "Urgent provisions for economic development, public budget stabilization, and tax equalization" published in the Official Journal no. 147, 25 June 2008 – Ordinary Supplement No 152/L[138]

Article 83

"25. Within the Presidency of the Council of Ministers, it is established the Comitato strategico per lo sviluppo e la tutela all'estero degli interessi nazionali in economia" (Strategic Committee for the development and the protection abroad of national interests in the economic domain) in charge of directing, consulting as well as coordinating information. This is also done by means of exchanging data with the principal national firms, especially those with State shareholdings, which operate in the sectors of energy, transports, defence, telecommunications, as well as in the sectors related to public services.

26. The Committee, with a view to advising the Government, is also responsible for analyzing complex economic phenomena related to globalization, as the impact of sovereign funds and sustainable development in developing countries. In addition, the Committee is in charge of supporting coordinated efforts to develop activities of Italian firms, as well as initiatives of national interest, abroad.

27. Composed of a maximum of ten members, the Committee includes high technical professionals with elevated specialization in the domain of interest, as well as competent representatives of the Ministries of foreign affairs, of economy and finances, of defence, of economic development, of infrastructures and transports.

28. The Committee's secretariat functions are guaranteed by the Presidency of the Council of Ministers, in accordance with the limits imposed by ordinary appropriated funds. The Committee and its secretariat are established by decree of the President of the Council of Ministers, together with the Ministry of Economy and Finances, with

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[138] Italian Parliament 'Decreto Legge 112/2008 "Disposizioni urgenti per lo sviluppo economico, la stabilizzazione della finanza pubblica e la perequazione tributaria"'['Decree-law 112/2008 "Urgent provisions for economic development, public budget stabilization, and tributary adjustment"'] published in the Official Journal 25th June 2008, No 147, available at <http://www.camera.it/_dati/leg16/lavori/stampati/pdf/16PDL0005301.pdf >.

whom general provisions on their functioning are also agreed. The Committee reports on its activities and results every six months. The participation in the Committee is free of charge."

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6.4 Conversion Law

Conversion Law with modifications of the Decree-law 25 June 2008, No 112, providing urgent provisions on economic development, simplification, competiveness, public budget stabilization, and tax equalization [139]

The Senate has substituted comma 25 with the following:

"25. Within the Presidency of the Council of Ministers, it is established the Comitato strategico per lo sviluppo e la tutela all'estero degli interessi nazionali in economia" (Strategic Committee for the development and the protection abroad of national interests in the economic domain) in charge of the analysis, support and coordination of complex economic phenomena related to globalization, as the impact of sovereign funds and sustainable development in developing countries. The composition of the Committee and its functioning are defined by decree of the Ministry of Foreign Affairs, together with the Ministry of Economy and Finances. Qualified representatives of the Ministries participate in the work, as well as high professionals and experienced technicians in the domain of interest. Secretariat functions are guaranteed by the structures of the Ministry of Foreign Affairs, in accordance with the limits imposed by ordinary appropriated funds. The participation in the Committee is free of charge".

Commas 26 and 28 are abolished.

Approved by Law 6 August 2008, no. 133

[139] Italian Parliament 'Conversione in legge, con modificazioni, del decreto-legge 25 giugno 2008, n. 112, recante disposizioni urgenti per lo sviluppo economico, la semplificazione, la competitivita`, la stabilizzazione della finanza pubblica e la perequazione tributaria' ['Conversion to law, with modifications, of the Decree-law 25 June 2008, no. 112, providing urgent provisions on economic development, simplification, competiveness, public budget stabilization, and tributary adjustment'], published in the Official Journal 21st August 2008, No 195, available at <http://www.camera.it/parlam/leggi/08133l.htm>.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– The Netherlands –

1st September 2010

Table of Contents

1 INTRODUCTION

This report describes the situation prevailing in the Netherlands with respect to foreign investment in strategic Dutch defence assets.

The Netherlands prides itself as being open to investors. This openness also applies to their defence and security industry. This industry comprises some 250 companies, 95 percent of which are active in both sectors. Many of them are heavily engaged in R&D, specialised in "niche" areas and producing high-tech equipment, often with spin-offs in civilian markets. However, the companies are mostly small or medium sized, their contribution to Dutch GDP has as yet remained relatively low (some 0.5%), while their export share with relation to their turnover is high (some 60%).

The industry's predominant economic interest is directed towards participation in the development, production and maintenance of defence equipment in cooperation with the larger producers in other EU and third countries (including the U.S.), and towards contribution to cross-border supply chains and long term international projects.

Neither the Dutch defence industry nor the Dutch authorities see the control of investments as it applies in certain adjacent countries as an obstacle to the access of Dutch operators or investors. Frontiers are open and should remain so; their market is global.

Accordingly, the Netherlands has no control of foreign investments, neither by regulation, public ownership nor by special rights.

The Dutch authorities would welcome consultations among the Member States in cases which may have an impact upon the defence industry or the security interests of the Netherlands. Industry representatives stressed that the defence equipment business has been "globalised" and that subjecting it to restrictions at the national or the EU level was inadequate. However, for so long as national controls exist, consultations should take place. Another opinion was to the effect that as a first step, consultation should be instituted, whereas at a second stage the adoption of common binding rules with relation to third countries was in the EU interest.

2 CONTEXT

2.1 The defence industry in the Netherlands

The defence-related industry in the Netherlands[140] ("the Industry") consists of around 250 companies that are mostly engaged in civilian and defence-related activities. Some 30 percent thereof are medium sized (workforce > 250) and small enterprises (25-250), with only few being large companies (> 500 employees). With their orientation towards niches and quality they operate at a high technological level. Whereas the value added to the Dutch economy is only some 0.5 percent, the Industry (predominantly its naval branch) reports significant spill-over effects into various civilian sectors.[141]

The three subsectors, "sea", "land" and "air", appear to be represented in a relatively balanced way, with the aerospace industry being pre-eminent.

The high technological level attained is primarily the result of the remarkable defence-driven R&D intensity maintained by the companies themselves (30% of their workforce is dedicated to R&D, also in the case of small companies). The Dutch defence-related "know-how infrastructure" also contributes. In science-based institutes, including the country's five large technological institutes and the technical universities, altogether some 800 persons are committed to research for defence-related purposes.

The Dutch Industry sees its chances in innovation and quality. Its special strengths are in the following areas ("priority technologies"):

- Command, control, communication, computers and intelligence ("C4I");
- Sensor systems;
- Integrated platforms;

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[140] Dutch Association of Defence Manufacturers, N. (2009) *Partners in Security - Almanach' (Partners in Veiligheid - Almanak)* (Den Haag: NIDV).

[141] See Ministerie van Economische Zaken and Dutch Association of Defence Manufacturers (NIDV) (2010) *Defence Industry Strategy - Final Edition' (Defensie Industrie Strategie - Eindreportage)* (Den Haag: NIDV).

- Electronic and mechatronic systems;
- New compounds and other advanced materials;
- Simulation, training and artificial surroundings.[142]

A major Industry strategy is directed towards "balancing foreign procurement", i.e. towards participating in international projects and supply chains that develop, produce and overhaul defence equipment. In the aircraft industry, for instance, around 60 domestic companies are included in supply chains with foreign original equipment manufacturers (OEMs).

The Industry has a strong export orientation (60%) and more than 70 percent of the companies have activities beyond the Dutch borders.[143]

2.2 The scale of defence procurement

The Dutch defence budget developed as follows:[144]

Table 2.1: Development of the defence budgets of the Netherlands:

	Total Defence budget
2005	7,690
2006	8,145
2007	8,388
2008	8,488
2009	8,472

[142] Ibid.

[143] The figure of 60% refers in particular to medium and small companies, see Ibid.

[144] Sources: EDA (2009) 'Defence Data of EDA participating Member States in 2008'. available at <http://www.eda.europa.eu/defencefacts/>. and Dutch Association of Defence Manufacturers, N. (2009) *Partners in Security - Almanach' (Partners in Veiligheid - Almanak)* (Den Haag: NIDV). with respect to 2009.

The purchasing strategy of the Ministry of Defence has shifted towards a more open procurement and follows the tendency to purchase commercial "off-the-shelf" products which increases competition with the civilian sectors.

Finally, the Dutch authorities have a very strict practice in observing the common rules on weapon exports.

2.3 National defence industrial/market policies

The national defence policy of the Netherlands is particularly directed at the following goals:

- Preserving the national Defence Technological Base (DTB);
- Contributing to the creation of a European DTB;
- Favouring the maintenance of a high level of innovation and competitiveness within the Industry.[145]

As far as it relates to the defence equipment market the national policy primarily aims at improving the capabilities of the personnel involved in foreign operations. To that effect, the Government pursues the following "defence priorities 2009":

- Increase the security of the personnel involved in foreign operations;
- Increase the interoperability of defence equipment;
- Replace and repair operational equipment;
- Reinforce Network Enabled Capabilities (NEC);
- Improve defence-related information chains and networks;
- Support information system projects (e.g. ERP software in project SPEER);
- Maintain and improve the use of certain helicopters (Apache);
- Continue to participate in the U.S. project developing the Joint Strike Fighter (JFS);

[145] Ministerie van Economische Zaken and Dutch Association of Defence Manufacturers (NIDV) (2010) *Defence Industry Strategy - Final Edition' (Defensie Industrie Strategie - Eindreportage)* (Den Haag: NIDV)..

- Contribute to increasing strategic air transport capacities, e.g. continue the participation in the NATO Initiative C-17 and develop, jointly with Germany, France and Belgium, the European Air Transport Command (EATC).[146]

3 NATIONAL PRACTICES WITH RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

Historically, after the Second World War, the Government owned certain defence-related companies. For instance, the predecessor of the company which is today Thales Nederland BV was nationalised as *N.V. Hollandsche Signaalapparaten (Signaal*" and Government owned until 1958 when Philips, the Netherlands-based electronics company, bought the majority of its shares.

However, today no company in the defence sector remains in public ownership.

The Dutch defence-related industry is critical vis-à-vis other Member States that are in a position to use public ownership as an instrument to restrict the free access to their markets. The preference for public ownership of defence companies, which prevails in some of the Member States has been and continues to be an issue for debate in the Netherlands. The defence-related industry advocates for the creation in Europe of a level playing field where public ownership is reduced or abandoned and cannot be used as a means to distort competition.

3.2 Special rights

State measures attaching particular rights to a share which exceed the rights conferred by this specific shareholding under normal company law have to comply *inter alia* with the rules on the free capital movement, Articles 63 et seq. TFEU.[147]

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[146] Ibid..

There are certain rights attached to shares of Thales Nederland BV, Hengeloo, and perhaps also to shares of EADS NV, Leiden. Below we examine whether special rights exist in relation to these companies. We restrict ourselves to an examination of special rights of the Dutch Government in Thales Nederland BV and EADS NV, since an analysis of the special right held by the French Government in Thales SA and EADS NV would be beyond the scope of this Dutch Country Report.

Thales Nederland

The Thales group with operations in 50 countries and 68,000 employees is a global technology leader for the aerospace, space, defence, security and transportation markets. Thales Nederland BV, Hengelo, makes part of this group.

It is common knowledge in the Netherlands that the Dutch Government holds a small share in Thales Nederland.[148] The rights attached to this share are exercised by the Ministry of Finance.

We have not been in the position to find documentary evidence regarding the existence and the nature of the right attached to the share. Thales Netherland as a BV is under no obligation to publish Articles of Association, and moreover, no consolidated version thereof is available at the competent Chamber of Commerce.[149]

According to the information provided by the representative of the Dutch Ministry of Economic Affairs in the Commissariat Military Production (Directorate General for Entrepreneurship and Innovation), the Dutch Government has a tiny participation in Thales Nederland BV which entitles the Government to have a seat in the (supervisory) board. This right is exercised by the Ministry of Finance.

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[147] See as to the ECJ case law on "golden shares" Cases C-98/01 *Commission v UK* ECR(2003) I-4641; C-463/00 *Commission v Spain* ECR(2003) I-4581; C-483/99 *Commission v France* ECR(2002) I-4781; C-112/05 *Commission v Germany* ECR(2007) I-8995; Opinion AG of 2 December 2009 Case C-171/08 *Commission v Portugal* ECR(2010) 0000.

[148] Thales is acc. to own information the largest Dutch defence company, with exports accounting for 75% of turnover, see at <http://www.thalesgroup.com/nl>.

[149] We have examined recent amendments to the company's Articles of Association with the assistance of the Chamber of Commerce in Enschede. They did not indicate the presence of the Government's share.

This participation is "historical" in the sense that it was instituted during the period when the company belonged to Philips (1958–1990).[150] We have been reassured that this Government share is not in any way directed against a change in the ownership of the BV and has never been exercised in this way.

In the absence of documentary evidence regarding the existence and the nature of the right attached to the share, we cannot exclude or confirm that the Dutch Government has special rights in Thales Nederland BV.

EADS NV

EADS is Europe's largest aerospace and defence group. The European Aeronautic Defence and Space Company EADS, Leiden, is a public limited company (NV) organised under the laws of the Netherlands. EADS NV is the Dutch holding and coordination company of the EADS group, having its shares listed in France, Germany and Spain. Along with its subsidiaries, it forms the EADS group, which has its headquarters in France and Germany.

As is well known, a Russian bank acquired some 5 percent of the shares of this holding company in 2006, but after a political debate refrained from increasing its participation.[151]

The Articles of Association published by EADS NV (dated 29 May 2009) do not provide for special rights for the Dutch Government nor for any other government. They are neutral in this respect.

EADS however publishes on its website certain information that requires publication under Dutch, French or German rules, see in particular the "registration document 2008". This document describes *inter alia* the shareholding structure and the shareholdings and voting rights, including a subchapter about "specific rights and undertakings".[152]

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[150] See Thales Nederland website at <http://www.thalesgroup.com/n>.

[151] ISDEFE and ISI (2009) *Study "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" EDA contract reference: 08-I&M-001* (Brussels: European Defence Agency).

[152] See EADS Registration document 2008, at http://www.eads.net/xml/-content/OF00000000400004/1/09/42508091.pdf, pp. 106 et seq.

The registration document does however not mention any special rights of the Dutch Government - which moreover is apparently not among the shareholders of EADS.

Accordingly, the Dutch Government possesses no special rights in EADS NV.

3.3 Regulation of foreign acquisitions of defence assets

The Netherlands have no rules or practices with respect to the State control of certain strategic assets. Investors from the Netherlands, from EU and EEA countries and from third countries are treated alike and all are welcome and free to acquire the control of strategic defence assets.

Nor is there in the Netherlands a definition of what could be "strategic defence assets" requiring protection from certain security risks.

On the occasion of a takeover of a Dutch defence company, the Dutch authorities could perhaps consider the risk of terrorism or of money laundering but not where the purchaser originates.

In case there is a need for review for security reasons such as terrorism, the Ministry of Defence and the Ministry for the Economy and the Dutch Foreign Office, along with the Dutch military information service would be in charge.

4 CASE STUDIES

4.1 Thales acquires Signaal in 1990

As mentioned, Thales Nederland is the largest defence company in the Netherlands (generating about 400 million euro worth of sales, 80% of which export in 2009).

The predecessor *N.V. Hollandsche Signaalapparaten ("Signaal"*), producing defence control systems, was Government owned until 1958 when Philips, the Netherlands-based electronics company, bought the majority of its shares. In 1990 Philips sold Signaal to Thomson-CSF, the French electronics and defence contractor. The acquisition has not been subject to a control procedure and has not been opposed. With the renaming of Thomson-CSF to Thales in 2000 the company became Thales

Nederland BV. Thales Netherland has a key role in naval systems within the Thales Group. Important for the Thales Group is also the continued good co-operation between Thales Nederland and the Netherlands Royal Navy.

4.2 Rheinmetall acquires Eurometaal in 2002

A second example of an acquisition of a Dutch defence-related industry can be found in the acquisition of the Dutch company Eurometaal (previously the "Artillerie Inrichtingen") by the German defence and security group Rheinmetall in 2002 becoming Rheinmetall Nederland BV. Again there was neither a control procedure nor opposition on the part of the Netherlands authorities. However, Eurometaal was closed not too long after the takeover whereas Rheinmetall continued to be active in the Netherlands.

The process leading to the closing down of Eurometaal was characteristic for the older type defence Industries, i.e. a drop in demand after the end of the Cold War, combined with an industrial climate that asks for larger and more consolidated markets. The same was true earlier for the Munitions Factory "De Kruithoorn" that closed in 1998. Important products were safeguarded in both cases, such as the "goalkeeper ammunition". Even if the munitions production is not continued in the Netherlands, critical know-how is safeguarded through TNO-Defence. Rheinmetall Nederland (they are a member of the relevant Dutch association NIDV) is active in the Boxer program, with industrial activity in a number of locations in the Netherlands.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

The Dutch industry proposes the following ranking of the countries concerned:

Table 5.1: Ranking of countries according to perceived openness:

Country	Rank 1= most open 9= most closed	Explain your ranking
France	6	"Clearly, French policy seems to favour French control. On the other hand, France is realistic, see the realities of EADS and Thales, both of them with significant control from outside France."
Germany	5	"A little bit like France, be it that the official policy is much more open. A complicating factor is the influence of the States inside the Federal Republic, leading to a practice that is not as far removed from the French position as Berlin likes to present."
Italy	4	"The Italian position is always a compromise between various policies. A US investment was originally at the basis of Selenia, othe companies have long-time Italian roots. In practice, one can always find a way out, with patience and flexibility."
The Netherlands	2	"There is no legislation requiring Dutch control. There is still no restricting policy in this respect."
Poland	-	"The situation in Poland is unknown to me."
Spain	4	"Spain has legislation in this respect. In practice Spanish companies are to some extent open to joint ventures (see Spanish participation in EADS). The Spanish naval sector on the other hand seems particularly closed."
Sweden	3	"Even is Sweden has legislation in this respect, they are realistic enough to seek co-operation. Also, the growing influence of companies like BAE Systems and of U.S. companies gives a pretty open picture."
United Kingdom	5	"Even if the UK claims an open policy and an open mind in these matters, practice looks more like the French approach than say the Dutch approach. One explanation is the UK history plus the fact that the UK considers its Defence industry as a Strategic asset (like France) and unlike the Netherlands."

Country	Rank 1= most open 9= most closed	Explain your ranking
United States	8	"Clearly, although foreign ownership of Defence companies is not forbidden (once Magnafox was a Philips subsidiary, today BAE Systemis large and active in the US, the management in those cases have to be largely American, with little control from the (European) owner."

5.2 On the need for EU level action

The competent Dutch authorities are reserved with respect to European initiatives that could have, or could be conceived as having, the effect of furthering the creation of a "fortress Europe" in trade with defence investments. Industry representatives stress that the defence equipment business has been "globalised" and that subjecting it to restrictions at the national level was inadequate. In the Dutch view, the European defence industry should in the future rather be made more attractive to investments *inter alia* from third countries.

However, they would welcome greater transparency in the legal treatment of defence investments as well as more consultations among the Member States in cases which may have an impact upon the defence industry or the security interests of the Netherlands. A legal framework for defence investments should be "EU wide or broader". It was also said that as a first step, consultations and greater transparency should be instituted, whereas at a second stage the adoption of common binding rules with relation to third countries was in the EU interest.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– Poland –

1st September 2010

Table of Contents

1 INTRODUCTION

The following report examines how the Polish Government controls FDI in defence companies.

An overwhelming majority of defence companies in Poland are state-owned. Most of them are grouped around either the Aviation-Radioelectronic Group (with the state-owned Agency for Industrial Development as the group leader) or the Munition-Rocket-Armour Group “Bumar”. Companies that belong to the first group are envisaged for privatisation. The second group is in turn to remain under state-control as a national holding. Although either groups are the main national defence assets they do not have a status of *strategic* assets which Polish law reserves for companies of the energy sector. State ownership of the defence companies – the “industrial defence potential” companies, or IDP companies – is hence the only, ultimate mechanism of State control. Consequently, Poland does not have a legal regime dedicated to the FDI control of defence assets be it state-owned or private ones.

The problem of FDI in defence companies is hence limited practically to the privatisation process of those companies that are selected by the state. The privatisation strategy of the IDP companies and their list is provided by the "Strategy of consolidation and support of the development of the Polish defense industry in the years 2007-2012" adopted by the Council of Ministers in August 2007. Thus far, however, only four companies from the list were sold to foreign investors. All of them represented the aviation industry. The legal basis for the privatisation of the IDP companies – as well as other enterprises - is provided in the bill “On privatization and commercialization of State enterprises” and relevant bills. It means that Polish regulations basically view the privatisation process of the defence companies in the same way as of other capital companies; i.e. it requires investors to comply with general law provisions.

Polish law and the practice of the privatization of the IDP companies does not differentiate between EU and non-EU companies. However, as Poland’s security and defence is bound with the EU and NATO one may say that as a matter of fact investors from NATO/EU are more welcome than from third countries.

The lack of a legal regime dedicated to FDI in defence companies does not mean, however, that the State does not secure its security interests in the privatisation process.

First, on the basis of general competences of the Minister of Defence – i.e. responsibility for the maintenance of the national defence system and the preparation of the Programme on Industrial Mobilization – he or she may negotiate special clauses attached to a privatization agreement with regard to the security-of-supply (SOS). SOS clauses are embedded in the privatization contract, and not in the privatized company's Article of Association. Privatization contracts are embraced with 'trade secret' clauses – they may be unveiled only with consent of the State Treasury Minister and the given investor.

Second, among special permissions required before the purchase of an IDP company (but not regular joint stock companies) are permissions with regard to the trade of sensitive goods, and access to classified information. Both types of certificates enable the State not only to prevent a takeover by an investor, but also to influence a company's business after the privatization.

Today, the lack of a systematic approach and relevant law regime is, however, considered as possibly insufficient to protect state's interests in the defence industry in the future. There seems to be a growing conviction among some governmental experts that the present legal regime needs to be strengthened and developed in a systematic way once State owned companies - like the national defence holding the Bumar Group – are e.g. partially privatized and listed on an stock-exchange.[153] These are just initial ideas which do not necessarily reflect a broader consensus. Consequently, it will take long time before they become part of a declared State policy. Clearly, the fact that the State effectively controls the overwhelming majority of the defence companies and seeks to privatize many of them is not conducive to such a reflection. For that reason it is also speculative whether Poland would welcome a EU level action pertaining to FDI control. The lack of a fully-ledged national approach implies the lack of thereof pertaining to the EU level.

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[153] Confidential interview in Ministry of National Defence, Warsaw, conducted on 11th February 2010. An expert from the Ministry of State Treasury suggested, however, that this may also be done on the basis of general law provisions regulating transactions on the stock exchange, confidential interview in Ministry of State Treasury, Warsaw, conducted on 22nd January 2010.

2 CONTEXT

2.1 The Polish defence industry

As in every other post-communist country the defence industry in Poland has not yet overcome its past. [154] It remains too big for the needs of Poland's armed forces, and - by and large - technologically backward to compete in the global market. It also is over-employed and has dispersed, ineffective and inefficient structures which only aggravate its malfunctioning. In addition to that, since the beginning of the 1990s the defence industry has been a victim of an incoherent industrial policy and the shrinking defence procurement what all together contributed to the decline of defence industrial base, and especially with regard to R&D.

This dire State of affairs began slightly improve at the beginning of 2000 as a direct result of two overlapping factors. First, the involvement of the Polish armed forces in foreign combat missions (Iraq and Afghanistan) has increased the scale of the national procurement which today makes PLN 5 billion (€ 1.250 billion). In this sense the growing military engagement of NATO and EU has become a vehicle for transformation for both the State owned and the private defence companies. Sales of Polish armaments have grown from PLN 400-900 million (€ 100-250 million) a few years ago to more than PLN 2.5 billion in 2006 (€ 625 million). Exports of arms, which in the early 2000s were worth no more than a few dozen million zlotys, reached PLN 1.4 billion (€ 350 million) in 2005-2006.[155]

The second factor results from successful economic reforms in Poland which allowed for an increase of the defence spending in real numbers. In 2002 Polish parliament adopted a bill on defence spending which commits every Government to spend 1,95% of GDP on national defence.

A fresh impulse for the continued restructuring came on 1 July 2006, when Poland joined the European Defence Agency's Intergovernmental Regime to Encourage Competition in the European Defence Equipment Market. In August 2007 a "Strategy

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[154] Behr T., Siwiecki A. (2004), 'Poland', In: Schmitt B. (eds), *EU enlargement and armaments. Defence industries and markets of the Visegrad countries,* Occasional Paper, no 54.

[155] 'Industry Without a Strategy' (2007), Altair Agency, http://www.altair.com.pl/start-296.

of consolidation and support of the development of the Polish defense industry in the years 2007-2012" (Strategy 2007-2012) was adopted.[156] The Strategy contains a detailed roadmap of the State policy towards industrial defence potential companies (IDP companies) owned by the State Treasury. It includes financial mechanisms, scale of R&D – PLZ 2,5 billion(€ 625 million) over 3-5consecutive years – patterns of the consolidation, privatization and restructuring of all State owned IDP companies. On the one hand, it aims at creation of a national holding around Bumar Group, and on the other it enumerates companies which might be sold to private investors. Since the incomes from the privatisation process are to be spend on the consolidation and the modernization of the defence industry, the ultimate success of the strategy is dependent on the successful privatisation of the selected IDP companies. Thus far, however, FDI in defence sector has been modest and limited to the best companies with a good industrial base, which constitute the minority of the IDP companies.[157]

Polish regulations define defence assets as *industrial defence potential* – IDP - which encompasses "material and non-material assets existing in Poland's industrial base, securing defence needs of the state, including needs of Poland's armed forces, with regard to armaments and military equipment." Industrial defence potential companies include (a) limited liability companies or joint-stock companies running business in the field of state's security and defence needs, (b) State controlled companies established by Minister of National Defence and companies established in result of the commercialization of those companies; (c) research and development units running business in the field of state's security and defence needs.[158] The notion of the "state's security and defence needs" remains vague as there is no definition of thereof. They reflect broader security and defence guidelines embedded in the National Security Strategy and defence planning directives.

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[156] Council of Ministers (2007), Strategy of consolidation and support of the development of the Polish defense industry in the years 2007-2012.

[157] Bialos, Jeffrey P. (2009), Fortresses and lcebergs -The Evolution of the Transatlantic Defense Market and the Implications for U.S. National Security Policy, Volume 11 Washington, D.C.: Center for transatlantic Relations, pp. 481-483.

[158] Ustawa z dnia 7 października 1999 r. o wspieraniu restrukturyzacji przemysłowego potencjału obronnego i modernizacji technicznej Sił Zbrojnych Rzeczypospolitej Polskiej, Dz. U. z 1999 r. Nr 83, poz. 932; z 2000 r. Nr 119, poz. 1250.

The present structure of the defence industry in Poland covers most defence sectors for the land, air and naval forces. The government-adopted "Strategy of consolidation and support of the development of the Polish defence industry in the years 2007-2012" divided the state-controlled companies of the industrial defence potential into four groupings:

- The Radioelectronic-Aviation capital group (holding) created around Agency of Industrial Development (ARP) - 100% controlled by the State Treasury.[159]
- The Munition-Rocket-Armour capital group (holding) around Bumar Ltd. - controlled by Minister of State Treasury (majority of shares) and ARP.
- defence companies remaining under the supervision of Minister of National Defence. There are joint-stock companies established in result of the commercialization of the state-controlled overhaul-and-production enterprises.
- research and development units.

The biggest defence company in Poland is the state-owned national holding, the Munition-Rocket-Armour Group BUMAR Ltd. The size of the turnover and the employment of the largest state-controlled defence firms are confidential data.

Since none of the private defence companies are listed in a stock-exchange Polish law does not commit them to unveil their turnover and other business data. The biggest private companies are in the aviation sector. There are former State companies sold to the leading world manufacturers: EADS, Agusta-Westland and Sikorsky.

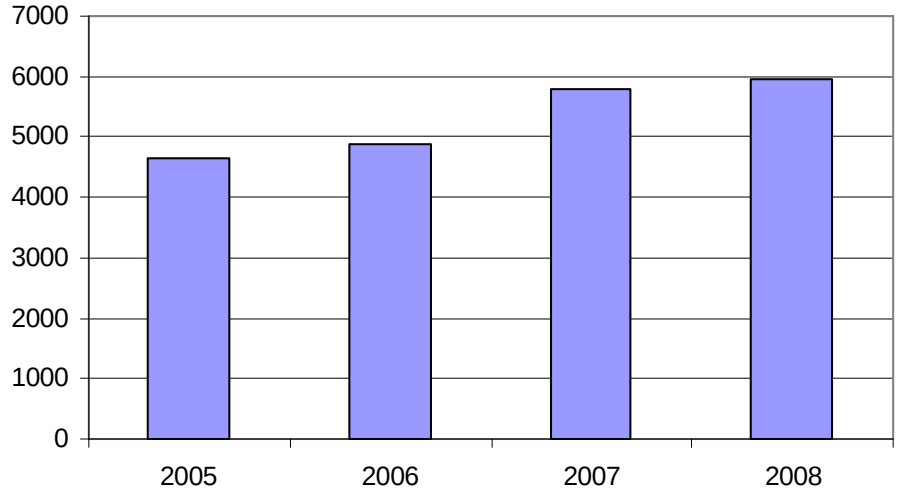
Polish root-grass defence companies are SME specialized in IT and system integration, e.g. WB Electronics, or special purpose vehicles, e.g. AMZ Kutno Ltd.

2.2 The scale of defence procurement

The defence budget of the Polish Government has considerably risen since 2005. While back then it presented € 4.6 billion it increased to almost € 6 billion in 2008. As a percentage of GDP, however, the Polish defence budget is well in line with that of the other EU countries; this figure fell from 1.9 to 1.7% .

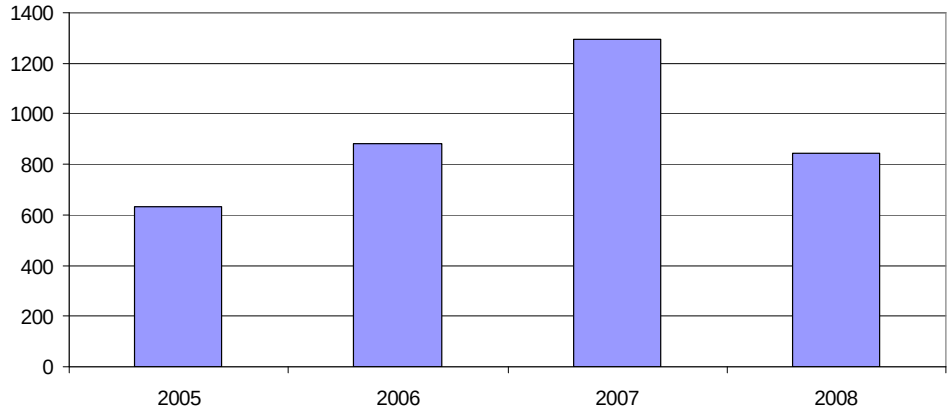
[159] http://www.arp.com.pl/ida/about_the_agency.aspx

Figure 2.1: Development of the Polish defence budget – 2005-2008 in million €[160]



The defence equipment budget has also increased over the past five years, albeit not as significantly as the overall defence budget. In 2005 the MoND spent € 633 million on new equipment. This figure had increased by more than € 200 million to reach € 844 million in 2008.

Figure 2.2: The Polish defence equipment budget – 2005-2008 in billion €[161]



[160] EDA (2010) 'European Defence Agency. Defence facts'. available at <http://www.eda.europa.eu/facts.aspx>.

[161] Ibid..

2.3 National defence industrial and market policies

The government-adopted "Strategy of consolidation and support of the development of the Polish defence industry in the years 2007-2012" envisages the following lines of action within the scope of structural transformation of defence industry entities:

1. Commercialisation of the State enterprises for which the founding body is the Minister of Defence, as well as of selected research and development units supervised by the Minister of Economy;
2. Reorganisation of selected research and development units;
3. Finding strategic investors for selected defence industry entities;
4. Gradual contribution to BUMAR Ltd of shares in selected companies established as a result of commercialisation of State enterprises, as well as inclusion of other entities which already function as commercial code companies;
5. Introduction of the internal organisational structure of BUMAR Group and transformation of the BUMAR Group Ltd. into a joint stock company,
6. Privatisation of selected entities in the years 2007-2012.

Whereas ***t****he exclusive role of ARP is to consolidate and restructure companies for the privatisation process, the main role of the Bumar Group* ***is*** to develop the national consolidated defence industrial base in order to secure demands of the Polish Armed Forces, and to establish a leading position for Group companies in the global marketplace. The Bumar Group consists of 21 trading and manufacturing companies[162] from the Polish defence industry, specializing in munitions, radars, rockets and armour. The Group was formed in 2002. Key objects of the Bumar Group include equipment of the Polish Armed Forces with special equipment and services; adaptation Group's manufacturing capacity to the needs of the Polish Armed Forces, the stimulation of the technological progress and the development of the R&D capacity.[163] In the coming years the Bumar Group is supposed to absorb the overhaul-and-production enterprises remaining under the supervision of Minister of National

[162] A list is available at http://www.bumar.com/about_us/Bumar_Group_companies

[163] http://www.bumar.com/about_us/Bumar_Group_background

Defence. Although the Bumar Group is not envisaged for the privatization (partial privatization is optional), some of the group's companies may be privatized in the future.

3 NATIONAL PRACTICES WITH RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

Poland – like other Central-East European countries – has never worked out a national legislation dedicated exclusively to control of foreign direct investment into defence industry.[164]

During the period of communism and state-controlled economy (1945-1989) the State was the only owner of the entire industrial base of the country, and the notion of private ownership of industry was never considered as an option. After 1989 in turn, the pace of the privatization process of the state's industrial assets had been much quicker than the adjustment of national law in the realm of the state's supervision of defence companies. A question of the national legislation on the special rights with regard to the defence industry had never been seriously addressed and remained a low priority issue.

3.1 Government ownership

Polish practices with respect to the State control of the defence assets are based on the state-ownership. Companies are hence divided between those that will remain under State ownership, and those that are envisaged for the privatization process.

- Directions of activities in the scope of structural transformations of the entities belonging to the Industrial Defense Potential are outlined in the before mentioned "Strategy of consolidation and support of the development of the Polish defense industry in the years 2007-2012"**.**

[164] EDA (2009), Study: Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices, p. 22.

- All State controlled firms are limited liability companies or joint-stock companies which are 100% held by the State Treasury. Not even a fraction of their shares is in the public turnover (e.g. listed on a stock-exchange) which secures full control of their business. State-owned IDP companies are supervised, however, by the different state's subjects which execute their rights from possessed shares: a state-controlled Agency for Industrial Development, a state-controlled Bumar Group Ltd. (holding), Minister of National Defence (MoND) and Minister of State Treasury. The division of supervision results from the "Strategy 2007-2012".
- MoND's supervision rights result from a bill "On privatization and commercialisation" which authorizes the Council of Ministers to create a register (a directive) of State enterprises and single-member state-owned company (where the only share holder is Minister of State Treasury) with a significant importance for the economy of the state. On that basis there are 12 companies (R&D, and overhaul-and-production) supervised by Minister of National Defence. Any change of the legal status of those companies (e.g. inclusion into other state-controlled subject, or privatisation) requires hence MoND's consent.

State ownership of the IDP companies and the commitment to the privatization process of chosen companies determine the nature and scale of special rights mechanisms pertaining to the defence companies.

3.2 Special rights

The defence industry is not subject to special right provisions allowing control over companies in which State Treasury is a share-holder.

In June 2005 a bill on "The special rights of State Treasury and their execution in capital companies of great importance for public order and public security" were adopted.[165] On the basis of that bill the Council of Ministers publishes a register of the so-called "strategic companies". According to article 8, par. 1 of the bill companies need to meet certain criteria to become subject of special provisions. Among the

[165] Ustawa z dnia 3 czerwca 2005 r. o szczególnych uprawnieniach Skarbu Państwa oraz ich wykonywaniu w spółkach kapitałowych o istotnym znaczeniu dla porządku publicznego lub bezpieczeństwa publicznego[1)] (Dz. U. z dnia 19 lipca 2005 r).

existing criteria none relate to companies of "industrial defence potential", hence there are no such companies on the list of "strategic companies". The bill on special right provisions of State Treasury is concerned mainly with companies of energy sector – extraction, transmission and transportation

Against this background, one cannot speak of special rights provisions with regard to defence companies in Poland but rather special mechanisms of securing state's interests in the privatisation process. Those mechanisms are rooted exclusively in the national practice (a political strategy) of the privatization process and the consolidation of the IDP companies, and not in the national legislation.

The policy is implemented through special mitigation clauses added to privatization contracts that – unlike Articles of Associations – cannot be altered by the company's shareholders; i.e. they would violate the privatization agreement. The investor is hence confronted with a necessity to take into account long-term obligations vis-a-vis state's defence and security needs while purchasing a company. Privatization contracts are embraced with a "trade secret" clause. Consequently, the exact content and nature of the mitigation clauses cannot be discussed here as it would require consent of both the Minister of State Treasury and the investor to unveil the contract or the clause.

However, with a great deal of accuracy one may say that the clauses are mainly concerned with the issue of security-of-supply (SOS) and include:

- The ban on transfer of production to a third country;
- Security-of-supply of spare parts for the equipment which production lines will be closed after the privatisation.
- The ban on sale of technical documentation;
- The readiness to assume tasks resulting from the national Programme on Industrial Mobilization.[166]

Such a practice does not result from any special rights embedded in bills regulating the privatization process or bills on state's policy with regard to IDP. It could be

[166] A programme adopted and reviewed every year by the Council of Ministers.

argued, however, that the practice is a derivative of provisions in the realm of national defence and support of national defence assets during the privatisation process.

There are two bills which open "a legal window" for mitigation clauses during privatization process. First, the bill "On the post of Minister of National Defence" which article 2, point 4 reads that the Minister "executes, within the competences entrusted upon him by the Council of Ministers, an overall supervision over the implementation of the defence tasks by the State administration, State institutions, local government, entrepreneurs (i.e. investors - emphasis added), and other subjects".[167] It is hence the Minister of National Defence who 'mingles' with the privatization process to secure some level of control over sold defence asset. He or she may insist on adding special clauses to the privatization agreement concerning SOS.

Second "window" is provided by the bill from October 7, 1999 on the „support of the restructuring of the industrial defence potential and technical modernization of the Armed Forces of RP."[168] Article 2 section 2 point 1 of that bill obliges the Council of Ministers to adopt a directive with a register of „companies, state-owned enterprises and research and development units, running business in the field of defence and security needs of the state, as well as companies that turn over with foreign countries goods, technologies and services of strategic impact for security of the State and for maintenance of international peace and security."[169] The register covers only those companies in the defence sector which are subject of the aforementioned bill on the „support of the restructuring of the industrial defence potential and technical modernization of the Armed Forces of RP", i.e. which are state-owned or were privatized. Those private defence companies that had never been owned by the State – and hence they were established by private persons – are not listed in the register.

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[167] Ustawa z dnia 14 grudnia 1995 r. o urzędzie Ministra Obrony Narodowej Dz.U. z 1996 r. Nr 10, poz. 6, Nr 102, poz. 474; z 1997 r. Nr 121, poz. 770, Nr 141, poz. 944, Nr 160, poz. 1083; z 1999 r. Nr 11, poz. 95; z 2001 r. Nr 123, poz. 1353, Nr 154, poz. 1800, z 2002 r. Nr 156, poz. 1301, z 2003 r. Nr 210, poz. 2036, z 2006 r. Nr 104, poz. 711, z 2007 r. Nr 107, poz. 732.

[168] Ustawa z dnia 7 października 1999 r. o wspieraniu restrukturyzacji przemysłowego potencjału obronnego i modernizacji technicznej Sił Zbrojnych Rzeczypospolitej Polskiej, Dziennik Ustaw z 1999 r. Nr 83, poz. 932; z 2000 r. Nr 119, poz. 1250.

[169] Ibid.

From the legal point of view the register only provides names of companies: in April, 15 2003 a directive was adopted that registered 69 companies' names – including those purchased by foreign investors – that meet the aforementioned criteria.[170] Seen politically, the list has a double purpose: it first allows the State to exercise the political supervision over companies in the field of its security interest since they are subject of the October 7, 1999 bill. Second, it is viewed by companies of IDP as a sort of 'state certificate' which helps them (especially the state-owned ones) to gain cooperation with foreign partners interested in providing goods and services for the armed forces and conduct business on the global market.

3.3 National regulation of foreign acquisitions of defence assets

The privatisation strategy of IDP companies set in the *Strategy 2007-2012* states that "investors' participation, especially the foreign ones, in the initial capital of companies of IDP ought to be differentiated and contingent upon state's defence and security needs – taking into account long-term needs of the Armed Forces in peace and war-time – as well as impact of these companies for the proper functioning of a new capital structure of the sector".[171]

Terms like "state's defence and security needs" or "long term needs of the Armed Forces" are not specify in the Strategy or any other public document. The "needs" result hence from the security perception and then are translated into programmes of transformation of armed forces, procurement plans and development of industrial defence potential. In practice the notions of "defence and security needs" shall not be seen within the context of FDI control, but as a guidance to privatization strategy. In other words, in those areas where Poland has a comparative advantage and/or can offer well developed, high-quality defence systems it will seek only cooperation or

[170] `Rozporządzenie Rady Ministrów z dnia 15 kwietnia 2003 r. w sprawie wykazu spółek, przedsiębiorstw państwowych i jednostek badawczo-rozwojowych, prowadzących działalność na potrzeby bezpieczeństwa i obronności państwa, a także spółek realizujących obrót z zagranicą towarami, technologiami i usługami o znaczeniu strategicznym dla bezpieczeństwa państwa oraz dla utrzymania międzynarodowego pokoju i bezpieczeństwa. Dziennik Ustaw z 17 maja 2003 Nr 86 poz. 790.

[171] `'Strategy 2007-2012', op. cit., Title IV, par.1.

partial privatization. In other areas, where the industry does not have such an advantage a full privatisation will be the ultimate goal.

The limited scale of FDI in defence sector, and the fact that it concerned only aviation companies – which Poland preferred to sell to foreign investors – and the lack of national regulation on FDI dedicated to defence companies narrows the actual number of case studies on national practices with regard to FDI to one, as all four aviation companies were privatized according to the same pattern.

Companies are sold to investors on the basis of the bill "On the commercialization and the privatization" from August, 30 1996[172] that deals with all state-owned companies. Privatization procedure is turn regulated by the bill "On the public offer and the requirements for the introduction of financial instruments into the organized system of turnover and public companies"[173] and other relevant bills.

Acting on behalf of the State Treasury a relevant institutions (ARP, Ministry of State Treasury) initiates the procedure of selling off shares of a company. The procedure has 4 stages:

1. preparation of negotiation process;
2. acceptance of offers and negotiations;
3. choice of purchaser (preliminary sale agreement - investor provides necessary permissions);
4. final settlements.

With regard to FDI, it is the 3rd stage that provides additional mechanisms for control. Investors interested in the purchase of an IDP (or any other) company need to obtain a number of permissions; e.g. permission for purchase or real estate (from Ministry of Internal Affairs and Administration), and a consent of the Office of Competition and Consumer Protection (antitrust watchdog). This procedure allows for a detailed

[172] Ustawa o komercjalizacji i prywatyzacji przedsiębiorstw, Dz. U. 1996 nr 118, poz. 561 (with subsequent changes).

[173] Ustawa z dnia 29 lipca 2005 r. o ofercie publicznej i warunkach wprowadzania instrumentów finansowych do zorganizowanego systemu obrotu oraz o spółkach publicznych, Dz.U. 2005 nr 184 poz. 1539.

screening of an investor and may be viewed as a control mechanism preventing to sell or accept a takeover of a company.[174]

By the same token, an investor purchasing a defence company needs certificates allowing the company to trade sensitive goods (the bill "On foreign turnover with goods, technologies, services of strategic importance for security of the state, and for maintenance of international peace and security" from 29 November 2009)[175], and allowing access to classified information (the bill "On protection of classified information", from 22 January 1999[176]).

Either certificate is necessary for every defence company to conduct its business. They are hence powerful instruments preventing an unwelcome investor to take over a company. Conversely, they may be used by the State to enforce from an investor to fulfil the obligations of the privatisation contract.

Poland's regulations and practice concerned with privatization of IDP companies do not differentiate between EU and non-EU countries. Since many of Poland's IDP companies are considered for privatisation, any EU-priority is seen to narrow the number of potential investors and to impinge on the bargaining position of the State Treasury.

There is, however, a tacit agreement that as a member of NATO and EU Poland naturally prefers to develop bonds with defence industry of other NATO and EU members. It first, corresponds with national security interests, and second it potentially offers the IDP companies access to the transatlantic defence market. The only obvious limitation with regard to FDI results from a list of countries embraced with international sanctions and embargos.

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[174] The Act on Special Powers of the Treasury and their Exercise in Companies of Special Importance for Public Order or Public Security from June 3, 2005 which was subject to EC infringement procedure was replaced on March 18, 2010 (in force from April 1, 2010) by The Act on Special Powers of the Treasury and their Exercise in Companies of Electricity, Oil and Gas sectors. The new bill has a narrower scope of application, and covers the energy related sectors and those companies which own the infrastructures considered as critical by the competent national authorities. It explicitly excluded defence companies to be covered by state's special powers. Any future steps aimed at expansion of the act would therefore require the full parliamentary procedure for amending the bill.

[175] Ustawa z dnia 29 listopada 2000 r. o obrocie z zagranicą towarami, technologiami i usługami o znaczeniu strategicznym dla bezpieczeństwa państwa, a także dla utrzymania międzynarodowego pokoju i bezpieczeństwa, Dz.U. z 2004 r. Nr 229, poz. 2315.

[176] Ustawa o ochronie informacji niejawnych, 22 stycznia 1999, Dz.U.2005.196.1631.

4 CASE STUDIES

Since the overwhelming majority of the IDP companies is state-owned, FDI in Poland's defence sector was concerned exclusively with the privatisation of the State enterprises. The process has begun in 2001 when the first company (PZL Warszawa Okęcie, an aviation company) was purchased by EADS. In addition to that none of Polish IDP companies – both state-controlled and private – are listed at a stock-exchange. It means that Poland has thus far never faced a problem of a private defence company being subject for a takeover (friendly or unfriendly) by a new investor yet.

The four privatized aviation companies were sold by ARP – acting on behalf of the State Treasury – to foreign investors.

4.1 Acquisitions by a company from another EU country

Agusta Westland acquires majority share of PZL Swidnik in 2009

In June 2008 ARP published a press announcement inviting investors to purchase 87.62% of the equity of PZL Swidnik, an aviation company specialized with helicopter production. PZL Swidnik had had a few years record of co-operation with Agusta Westland producing helicopters' fuselages, which stood for one third overall production worth PLN 150 million (company's overall income in 2008 was PLN 420 million, but consolidated revenue was only PLN 4.6 million). Total workforce was 4,000 staff.

Two investors entered the bid: Italian Agusta Westland (Finnmechanica holding) – revenue more than 15 billion Euro, total workforce over 73,000 staff[177] - and Czech Penta Investment – a private equity fund – revenue 1,9 billion of Euro, controlling 30 companies with total workforce 25,000 staff.

After a year of negotiations ARP choose Agusta Westland as it offered PLN 45 *per share* which made almost 340,000 million PLZ for 87,62 % of shares. In August 2009 ARP signed with Agusta Westland a preliminary contract and in January 2010 the

[177] Source: www.agustawestalnd.com

final agreemnt was signed. Since almost 7% of shares Agusta Westland bought from other subjects (e.g. city of Swidnik) it today possesses in effect almost 94% of shares. The rest was offered to PZL Swidnik staff as part of social packet. In the privatization agreement the investor accepted a SOS clause.

4.2 Acquisitions by a company from a non-EU country

United Technologies acquires majority of PZL Rzeszów

On 16 March, 2007 the US United Technologies Holdings S.A. (UTH), a United Technologies Corporation (UTC) company (58,700 billion revenue in 2008, 223,100 employees)[178] - parent company of Sikorsky Aircraft Corporation - bought from ARP 100% of the shares in PZL Mielec Ltd. for PLN 250 million. PZL Mielec was an aviation company specializing with production of airplanes. UTC was the only investor interested in PZL Mielec. It needs to be added, however, that in September 2006 the Mielec site had been selected as a strategic partner and assembly centre for the International Black Hawk programme.

In 2001 UTC bought also from ARP 85% shares in PZL Rzeszów – a company producing engines for airplanes.

4.3 Rejected attempted acquisition

There was only one reported attempted acquisition by a EU company that was rejected, although formal negotiations did not take place.

Finnish Patria was interested in purchasing WZM Siemianowice Sląskie[179] (overhaul-and-production company). In 2002 Patria won a tender for 690 armoured modular vehicles for the Polish Land Forces. As part of an offset agreement it was obliged to move production line to WZM where AMV were to be assembled. Patria sought to buy WZM but the Government was not interested in the transaction and WZM remained state-owned company, supervised by Ministry of National Defence.

[178] Source www.UTC.com

[179] Cf. www.wzms.pl

The reasons seem to have been purely economic ones: WZM was in a good economic shape, with a full portfolio of Government orders, and access to Patria's technologies. There was, hence, no need to seek privatization of the company.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

The historical legacy of the defence industry, the fact that the overwhelming majority of defence companies are state-owned, and the limited number of direct foreign investments determined the lack of a fully fledged, systemic FDI control regime of defence assets in Poland. It also needs to be taken into account that despite relatively huge defence industry and the numerous armed forces (100,000 troops) Poland is also not a LoI/FA country.

Against this background, when asked about a possible EU level action with this regard, interviewees did not have any clear opinions. On one hand, they would not rule out that such an action might be in Poland's interest in the future, on the other, however, their attitude was dependent of the exact content of possible EU regulations which is an open question. Clearly, it seems that from the Polish point of view a EU action with regard to FDI control is not a priority.

For all those reasons it seems therefore speculative whether Poland would welcome a EU level action pertaining to FDI control, or what it may expect from such an action. The lack of a fully fledged national approach implies the lack of thereof pertaining to the EU level.

For the similar reason, there is no detailed perception of other EU members' policies and regulations with regard to FDI. Existence of such opinions would suggest that Poland considers the problem as important these days and has developed an expertise on other countries' regulations in order to e.g. emulate them. As stated in the study, this is not the case however.

6 ANNEX

Ownership structure of the state-controlled IDP companies

„Aviation-Radioelectronic Group"

Agency for Industrial Development

(leading company)

Controlled companies

Company name	Defence sector
1. Stocznia Marynarki Wojennej S.A	Shipyard
2. SR „NAUTA" S.A.	Shipyard
3. SSR „Gryfia" S.A.	Shipyard
4. MSR S.A.	Shipyard
5. Kombinat „PZL – Hydral" S.A.	Aviation: power hydraulics, fuel supply control systems
6. ZR „RADMOR" S.A.	Communication systems

Munitions-Rocket-Armour Group „BUMAR" Ltd.

(holding's leader)

Controlled companies

Company name	Defence sector
1. WSK „PZL-WARSZAWA II" S.A.	Aviation
2. PCO S.A.	Optronics
3. CNPEP „RADWAR" S.A.	Radars
4. ZM „TARNÓW" S.A.	Guns and cannons
5. PSO „MASKPOL" S.A.	Personal protection equipment
6. ZM „DEZAMET" S.A.	ammunition
7. ZCh „NITRO-CHEM" S.A.	Explosives
8. ZM „BUMAR-ŁABĘDY" S.A.	Tanks
9. Fabryka Broni „ŁUCZNIK"	Guns
10. ZPS Sp. z o.o. w Pionkach	ammunition, explosives
11. ZM Kraśnik Sp. z o.o.	Missiles
12. ZPS „GAMRAT" Sp. z o.o.	Chemistry
13. FPS Sp. z o.o. w Bolechowie	Ammunition, warheads
14. URSUS Sp. z o.o.	Tractors
15. BZE „BELMA" S.A.	Electro-mechanics
16. PIT SA	Telecommunication
17. PPE „DOLAM" S.A.	electronics

Defence sector companies under the supervision of Minister of State Treasury

Controlled companies

Company name	Defence sector
I. Single-member companies (100% shares - MST):	
1. FŁT „KRAŚNIK" S.A.	Rolling bearings
2. ZTS „GAMRAT" S.A.	Chemistry, plastic
3. „STOMIL-POZNAŃ" S.A.	Tires
4. NITROERG S.A.	Explosives
II. Other companies from the IDP register:	
5. Huta Stalowa Wola S.A.	Mortars and artillery, optronics
6. WSK „PZL-KALISZ" S.A.	Aviation
7. GZE „UNIMOR" S.A.	Armour
8. „UNIMOR-RADIOCOM" Sp. z o.o.	Communication systems

Companies under supervision of Minister of National Defence

(commercialized overhaul-and-production companies, and R&D units)

Company name	Defence sector
1. Wojskowe Zakłady Mechaniczne S.A. 2. Wojskowe Centralne Biuro Konstrukcyjno-Technologiczne S.A. 3. Wojskowe Zakłady Elektroniczne S.A. 4. Wojskowe Zakłady Inżynieryjne S.A. 5. Wojskowe Zakłady Łączności Nr 1 S.A. 6. Wojskowe Zakłady Łączności Nr 2 S.A. 7. Wojskowe Zakłady Motoryzacyjne Nr 5 S.A. 8. Wojskowe Zakłady Uzbrojenia Nr 2 S.A. 9. Wojskowe Zakłady Lotnicze Nr 1 S.A. 10. Wojskowe Zakłady Lotnicze Nr 2 S.A. 11. Wojskowe Zakłady Lotnicze Nr 4 S.A. 12. Stocznia Marynarki Wojennej S.A. (0,4%)	1. Mechanics 2. Construction, technology 3. Electronics 4. Engineering 5. Communication 6. Communication 7. Automotive 8. Armour 9. Aviation 10. Aviation 11. Aviation 12. Shipyard

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Rozporządzenie Rady Ministrów z dnia 15 kwietnia 2003 r. w sprawie wykazu spółek, przedsiębiorstw państwowych i jednostek badawczo-rozwojowych, prowadzących działalność na potrzeby bezpieczeństwa i obronności państwa, a także spółek realizujących obrót z zagranicą towarami, technologiami i usługami o znaczeniu strategicznym dla bezpieczeństwa państwa oraz dla utrzymania międzynarodowego pokoju i bezpieczeństwa. Dziennik Ustaw z 17 maja 2003 Nr 86 poz. 790.

Ustawa z dnia 14 grudnia 1995 r. o urzędzie Ministra Obrony Narodowej Dz.U. z 1996 r. Nr 10, poz. 6, Nr 102, poz. 474; z 1997 r. Nr 121, poz. 770, Nr 141, poz. 944, Nr 160, poz. 1083; z 1999 r. Nr 11, poz. 95; z 2001 r. Nr 123, poz. 1353, Nr 154, poz. 1800, z 2002 r. Nr 156, poz. 1301, z 2003 r. Nr 210, poz. 2036, z 2006 r. Nr 104, poz. 711, z 2007 r. Nr 107, poz. 732

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– Spain –

1st September 2010

Table of Contents

1 INTRODUCTION

The following report analyzes the State control of strategic defence assets in Spain.

Spain has a considerable defence industrial base, despite the fact that it cannot be compared in terms of size and technological sophistication with the armaments industry of other major European countries, such as the UK, Germany or France. Although it does not possess the full spectrum of military capabilities production, it still has important competencies and an important military industry. Moreover, since the nineties, the country has put in place an active industrial policy in order to maintain and develop its national defence and technological industrial base.

In support of this effort Spain has implemented a set of regulations that control the foreign investments in strategic assets, including those of defence. The control is aimed more on safeguarding means to preserve and develop defence industrial capabilities and to retain them on Spanish soil rather than a control of foreign investments in order to safeguard security of supply. Industrial policy considerations seem to be the top priority of the Spanish government, more than considerations on the nationality of owners of defence enterprises.

While special rights are not used anymore for purposes of control, the Spanish Government still exerts controls over some of its defence enterprises by the means of State ownership, many of them due to their poor economic performance. The Government attempts to restructure those enterprises, Navantia being the most obvious example, in order to insert them in a competitive way within a trans-national merger. Knowing that the country doesn't dispose of a large amount of defence industrial competencies, the Spanish Government seems keen to maximise the benefits from consolidation, in terms of industrial capabilities and size of workforce implied in the loss of control of its national Defence Industrial and Technology Base (DITB). By consequence, foreign takeovers of national defence industries follow political negotiations between the Spanish Government and the foreign investor, often involving the latter's government.

2 CONTEXT

2.1 Main characteristics of the Spanish defence industry

The Spanish defence industry is composed of 547 companies listed at the registry of War Material Producers of the Directorate General of Armaments and Equipments (DGAM) of the Spanish Ministry of Defence (MoD). These enterprises employ more than 25.000 staffs working on arms production. The estimated "defence" turnover of the companies was € 4.6 billion in 2007.[180] 90% of Spanish defence companies are small and medium sized enterprises, accounting, however, only for 16% of the global turnover of the Spanish defence sector is realized by small and medium sized enterprises.[181]

The following seven defence companies present the main part of the Spanish DITB.

- Navantia is active in the naval sector and 100% owned by SEPI, a public company owned by the Minister of Finance for managing public assets. Navantia had a turnover of € 1.472 million for 2008 (defence turnover is not know) with a staff of 5,569.[182]
- Santa Barbara Sistemas is active in the land armaments and a subsidiary of the US American company General Dynamics. The turnover of Santa Barbara is not known.
- EADS – CASA's activity is mostly focused on military transportation. CASA was a public company owned by SEPI. When EADS was created, SEPI took a 5.48% share of the company, however, without holding any special rights. By investing in the Tiger Programme, Spain also obtained the localisation of a third pillar of the Eurocopter company, Eurocopter Espana.

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[180] For more details see Spanish Ministry of Defence, 'Arms Production Facts and Figures', <http://www.mde.es/en/Galerias/politica/armamento-material/ficheros/DGM_Industria_espanola_defensa.pdf>, accessed 12 December 2009.

[181] Michele Nones and Giovanni Gasparini, *Il Controllo Degli Investimenti Stranieri Nel Nascente Mercato Europeo Della Difesa E Sicurezza* (Rome: Istituto Affari Internazionali, 2008).

[182] For more information see Spanish Presidency of the Eu, 'Ficha De Empresa: Navantia', <http://www.sepi.es/default.aspx?cmd=0004&IdContent=15021&idLanguage=&paginacion=0&SearchText=Navantia&idContraste=>, accessed 21 March 2010.

- Indra's main activity is in the area of information Technology. Indra was privatised in 1996. Formerly controlled by SEPI, its main shareholder is currently Caja Madrid, with a 20% participation. Indra has a defence turnover of $ 944 millions.[183]
- Industria de Turbo-Propulsores S.A. (ITP), whose main activity is the development of military engines for airplane (as for the A400M for instance), is owned by Sener Aeronautics (53.125%) and Rolls Royce (46.875%). ITP had a turnover of € 483 millions for 2008, with 1622 employees.[184]
- The Sener Group, whose main activity is in aeronautics, is 100% owned by family Sendagorta.
- Tecnobit, whose main activity is in the field of defence electronics, is owned by the IT group OESIA. Tecnobit has 355 employees for a turnover of € 68.5 millions.[185]

Currently, the Spanish industry's capabilities cover a limited spectrum of national requirements for defence and many sophisticated weapons systems are procured from abroad.

2.2 The scale of defence procurement

The Spanish defence budget has increased in recent years, passing from € 10.5 billions in 2005, to € 11.5 billions in 2006, € 12.2 billions in 2007, and finally € 13.1 billions in 2008. Only 22.5% of this budget is devoted to equipment purchase and R&D, equivalent to almost € 3 billion.[186] This figure has, however, to be seen in a specific Spanish context.

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[183] Defence News.Com, 'Defense News Top 100 for 2008', <http://www.defensenews.com/static/features/top100/charts/country_2008.php?c=FEA&s=T1C>, accessed 21 March 2010.

[184] Grupo Itp, 'Grupo Itp Main Magnitude', <http://www.itp.es/index.php?option=com_content&task=view&id=15&Itemid=29>, accessed 21 March 2010.

[185] Interview with a representative of Tecnobit.

[186] See on this point NATO defence spending facts and figures. Nato, 'Nato Defence Expenditure 2008', <http://www.nato.int/issues/defence_expenditures/index.html>, accessed 30 January 2009.

While the national defence budget is limited, some special programmes, financed by the Ministry of Industry (MoI), have been used to fund defence procurement. Over the last twenty years the MoI has financed 22 "special programmes" in the area of defence, worth about € 23 billion.[187] Those programmes cover the totality of majors procurement programmes by the Spanish government.

The official reason for this utilisation of MoI funds is to preserve Spanish industrial base, it is clear that the Spanish Government avoids in this way a larger expansion of the national defence budget, which would be widely unpopular for historical reason. A similar phenomenon is present in others Europeans countries, such as Italy. The funds are granted to the Spanish defence industries and should be reimbursed by the Ministry of Defence, according to its budgetary means. In reality, the utilisation and the reimbursement of funds are quite intransparent.

2.3 National defence industrial and market policies

Since the end of the 1990s the Spanish Government has engaged the process of privatisation of defence industries with the goal to develop national industrial capabilities and to retain on Spanish soil qualified workforce and technological capabilities.

Until the end of the 1990s the Spanish defence industry was for the most part publicly owned. Subsequently, the Government started a privatisation process, mainly in an effort to qualify the country for the European Monetary Union. The Aznar Government (1996-2004) feared that opening the national defence market to European Union partners would result in a "colonization" of Spanish industrial companies. Between 1996 and 2003 the Aznar Government decided to privatise almost 50 Spanish companies controlled by SEPI (mainly civilian companies), with the aim of strengthening the national industrial sector and preparing it to compete with other European manufacturers. At this period CASA was merged within EADS, with the Government holding share-holding within EADS, while Indra and Santa Barbara were sold to foreign investors.

[187] Interview with an industrial stakeholder and with Spanish MoD officials.

The result has been an industrial policy of alliances with defence groups from other countries in order to preserve and develop some strategic companies. The idea was to prepare arms manufacturers for the creation of a common European defence market. Knowing that the technological level of Spanish industry was well below the UK, German or French one, the Aznar Government wanted to improve the competitiveness of the sector, via massive public financing (special funding from the Ministry of Industry), participation in transnational groups like EADS, or the preservation of national ownership for the non competitive industry.

The resulting industrial alliances were politically negotiated and the importance of gaining direct i.e. defence technology offsets were stressed during the political negotiations. Although, during the Aznar era, transatlantic alliances were privileged, the nationality of the owner was less a criteria than the technological benefit in terms of modernisation of the Spanish DTIB in order to be able to save some competencies for the future, when a European open defence market would be created.

The Spanish Government still retains a share in the equity of some defence companies such as the ship builder Navantia and CASA, albeit for different reasons. CASA is the national aeronautical company that has been one of the actors of the creation of EADS with the French companies Aérospatiale and Matra, and the German DASA. By consequence of this agreement, CASA became a part of EADS, and the Spanish government, via the holding SEPI, detains 5.48% of the European company. Navantia is still Government owned because of poor economic performance of the company. The Government is unwilling to privatize its assets in the present shape, as this would mean to lose control over a strategic asset without obtaining appropriate offsets. The shareholding in EADS, on the other hand, has a political character and is justified by the fact that other governments have been owners of the company.

The only case of public debate concerning the ownership of a defence company is linked to the purchase of Santa Barbara Sistemas by General Dynamics. In this case, the Spanish Government decided to open a call for tender for the privatisation of the company. Two offers were received: the one by General Dynamics and another by Krauss Maffei Wegmann from Germany, the producer of the Leopard tanks which were purchased by the Spanish MoD and assembled at Santa Barbara's facilities in Spain. General Dynamics was chosen by the government, essentially because of the

excellent relations between the Spanish conservative Government and the Bush administration, with Spain expecting great industrial development of Santa Barbara.

The industrial strategy of the Zapatero Government does not differ from that of the the Aznar government, and is a key element of the Spanish defence policy. The core idea is to develop Spanish industrial and technological capabilities in order to secure a larger share in the European defence equipment market. In order to do so, as previously said, special funds have been granted to the Spanish defence and technological industrial base, and a large programme of modernisation of armed forces has been put in place (Frigates F-100, aircraft carrier ship, Eurofighters, A400M and so on).

The key element of this strategy is the acknowledgment of the reduced size of Spanish DTIB. While others Europeans governments put in place legislation of foreign investments in order to safeguard national control of key industrial capabilities or the security of supply, Spanish officials acknowledged that Spain would have been in any case dependent for its arms supplies.[188] By consequence, Spain is trying to use its dependencies in order to obtain the best return on investment for its industrial base.

The agreement found with Lockheed Martin in order to obtain the Aegis systems for the aforementioned frigates and the consequent Spanish withdrawal from NATO's (German-Dutch) Future Fregates Consortium is an example of this industrial policy; the decision to purchase 27 A400M (more than the UK) in order to assure that the assembly line of the aircraft was in Spain yet another. By consequence, Spanish governments have been keen to obtain foreign investments in the defence sector as well as in other sectors of the economy, in exchange of an industrial development of the country, in an offset logic.

Given the fact that some circles of the Spanish governmental are sobered by the, in their eyes, poor results of this policy this strategy could soon be changed. On the one hand, the Santa Barbara purchase by General Dynamics did not bring the expected benefits. Santa Barbara is still a marginal company in the European land armaments sector. Once the production of the Leopard main battle tank and the Pizarro armoured fighting vehicle programmes will come to an end, the workload will be considerably

[188] Interview with Spanish MoD officials and with representatives of Spanish defence contractors. .

reduced, as no future programme is in sight. Similarly, some Spanish officials also seem to regret the participation in EADS, following the refusal of other shareholders to let Spain expand its participation, and the decision to move the direction of the A400M programme away from Spain after the delays and costs overruns of the programme.[189]

On the other hand, it is acknowledged that this industrial policy permitted CASA to enlarge the spectrum of activities, to obtain strong commercial support in its "CN" transport aircraft series, to participate in the Eurocopter consortium with the opening of a facility in Albacete, and to participate in the Airbus Tanker programme.

3 NATIONAL PRACTICES WITH RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

Government ownership in the Spanish defence industry is limited to about twenty firms. The Spanish Government controls strategic assets via the SEPI *(Sociedad Estatal de Participationes Industriales*). SEPI is a public law entity, directly dependent from the Ministry of Economy and Industry. SEPI was created by the Real Decreto Ley 5/1995. It was founded in order to reorganize and modernise the public sector. After the privatisation in the period from 1996 to 2003 in which more than 50 companies, held by SEPI in the civilian and defence sectors were privatised, the SEPI holds today shares in 21 companies, including Navantia and the Spanish participation within EADS.

In case of a privatisation of a SEPI held company, and in accordance with Spanish laws, a public tender is issued. The Spanish Government can decide whether to sell its assets via a public offer or via a Government to company or Government to Government negotiation.

[189] Interviews with officials from the Spanish MoD and from Spanish defence contractors.

After the privatisation wave of 1996-2003, there are no signals that the Spanish Government intends to sell its defence assets. Navantia, the main Spanish shipbuilders, has been many times pointed out as being a potential part of a European naval industry restructuring process. Still, the political climate for this restructuring seems inappropriate at present. Navantia is a brand new company regrouping the military assets of the former Izar. Despite a large amount of public orders, and some export successes, the company is still in debt, and new restructuring plans are often discussed and then postponed for political reasons. The Spanish Government seems conscious of the fact that a successful privatisation of Navantia is impossible at this moment.

In case of a privatisation of the company due to the creation of a European shipbuilder, the lack of financial wealth of Navantia would oblige the Government to accept a small shareholding part in a European company, following the model of EADS. However, the current fierce criticism of the EADS shareholding agreement and the perception of the lack of Spanish authority within the company make such a move politically sensitive. It is most likely, that the Spanish Government will try again, via SEPI, to restructure Navantia before accepting opening up the company to (foreign) investors.

3.2 Special rights

Since the abolition of golden share in 2004 there have been no cases of special rights in the Spanish defence industry. However, the Spanish Government has imposed "special arrangements" when privatizing defence companies.

The golden share was introduced with the Law 5/1995 of March 23rd 1995 on privatisation. It allowed the Spanish Government to use a golden share in the case of five companies considered as being strategic for the Spanish economy (Repsol, Iberia, Indra, Telefonica, Endesa). Since 1995, doubts have been raised by officials and lawyers on the golden share systems used for Indra, which were limited to a five year period. Given the global liberal investment policy at the end of the 1990s, with Spain acceding to the euro-zone, the Aznar Government decided to put in place a juridical instrument of control of foreign investments for strategic assets. The last of the aforementioned golden shares was abolished in 2006 by Law 12/2006, following a

ruling of the European Court of Justice (now Court of Justice of the European Union or CJEU).

Since the abolition of the golden share, no new special rights have been created, however, the Spanish Government has used arrangements with investors that buy shares in privatized companies as a means to safeguard its interests. These are no means of State control in the sense of this study but will be mentioned here for sake of comprehensiveness.

First, during the talks that issued in the creation of EADS, Spain demanded that a national representative should have seated permanently within the board of the company. This arrangements was agreed in the merger talks between DASA and CASA in 1999. Second, the *Junta* de *Inversiones Experiores*[190], can demand, and it did so in the case of Santa Barbara Sistemas that during a five year period the MoD can investigate the way in which privatisation agreements are respected, for example with regard to workload or maintaining technologies on the Spanish soil. Similarly, in the case of Santa Barbara Sistemas the Government demanded from the investor a limitation of access to Santa Barbara plants for personnel from General Dynamics in order to safeguard Leopard technology of the German firm Krauss Maffei. However, this special provision was imposed following demands by the German company Krauss Maffei Wegmann, a long-term partner of Santa Barbara Sistemas in the past.

3.3 Regulation of foreign acquisitions of defence assets

The Royal Decree 664 of 1999 almost completely liberalizes the regime of foreign investments in Spain.[191]

The only condition of the foreign investments is a declaration ex post to be addressed to the Minister of Industry, Tourism and Trade's register.

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[190] This *Junta* is an inter-ministerial body created by the decree 1794/1973. The Junta is composed by the General Director of foreign transactions of the Ministry of Industry and Trade, the General Director of foreign investments of the same Ministry, more a representative of different ministries (Foreign Affairs, Economy and Finance, Transports, Work and social security, Defence, Agriculture)

[191] Article 7.2 a makes an exception for investments coming from tax havens that must realize a prerequisite declaration to this register. For more information see Noticiasjuridicas.Com, 'Real Decreto 664/1999, De 23 De Abril Sobre Inversiones Exteriores.' <http://noticias.juridicas.com/base_datos/Fiscal/rd664-1999.html#a9>, accessed 21 March 2010.

The Council of Ministers can suspend the implementation of the liberalization regime if the Government considers that the investment might threaten public order, public security and public health (Articles 8 and 10). In this case of suspension of liberalization regime, foreign investments are propounded to a prerequisite authorisation of the Council of Minister (article 10.2). Article 11 of the Royal Decree specifies that all the activities related to the marketing or production of weapons, ammunitions, explosives or war materials are excluded from this regime and foreign investments into this sector require prior authorisation.

Article 9 of the decree 664/1999 specifies that an interdepartmental committee of the Minister of Industry, Tourism and Trade is responsible for the control of foreign investments in the defence equipment sector. It is called the « *Junta de Inversiones exteriores* », the General Direction of Trade and Investment. The *Junta* is composed of the General Director of Trade and Investment of the Ministry of Industry and Trade, and of representatives from every ministry that is be concerned with a concrete case.

The intention to acquire any share of a Spanish defence company must be notified to the General Direction of Trade and Investment. In case of defence companies, the Directorate General of Armament and equipment (*Dirección General de Armamento y Material*), and in particular the subordinated International Relations Division (*Subdirección General de Relaciones Internacionales*) is responsible for supervising requests for authorization and for assessing whether the purpose/activities of any enterprise affects or not to the national defence (Article 11.2 a). It adopts a resolution and presents it to the Minister of Industry, or to another Minister whose portfolio may be closer related to the nature of the concrete case. The Junta presents its advice to the Minister of Economy and Finances who should decide if it has to bring the question to the Council of Ministers. In practice the final decision is taken by the Council of Ministers.[192]

The current regulation is that the suspension of the liberalization regime can be only applied to enterprises engaged/performing activities directly related to national defence and to investors residing in a foreign country. Foreign investment is, in

[192] Interviews with officials from the Spanish government.

accordance with EU regulation not determined by the nationality of the investor, but by the investor's legal residence.[193] Consequently, foreign nationals can hold possessions in the Spanish defence industry through branch offices and establishments of non-residents *in* Spain. In other words, the legislation applies to any investment made by individuals or legal entities not resident, regardless of:

- the nationality of the investor (any legal person with its seat abroad, non-resident individuals, international institutions, foreign governments and public entities, subsidiaries of non-resident Spanish enterprises);
- the used means of payment;
- the internal or external source of funds (Art. 2.1 Decree 664/1999).

The Government has a maximum of six months to reach a decision after receiving the notification. The decision can be (a) to grant the investment permission; (b) to ban the investment; or (c) to impose conditions under which the investment is permitted. In reality, once the Council of Ministry is informed of the investment, political talks start between the Government and the potential investor. The Government tries to obtain guarantees on the industrial and technological development of Spanish facilities. In case this deadline is exceeded, the authorisation is considered as being granted. In other words, the decision of accepting or not the investment seems to be essentially political. In other words, it is the potential benefit for the industrial development of Spanish company and defence industry more generally rather than security of supply issues that are considered.

Although the 1999 decree makes no geographical discrimination, it is practice that European investments are considered in a different way from non-EU ones, and that during the Aznar Government USA investment were privileged. While during the Zapatero Government EU investors were viewed more favourable, Spain currently attempts to consciously seek its advantage on a case by case basis.[194]

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[193] Otherwise, the suspension would be against the EU principle of non-discrimination on grounds of nationality.

[194] Interview conducted by the author with an official from a Spanish defence contractor.

4 CASE STUDIES

4.1 Acquisitions by a company from a EU country

3i acquires a majority share of Tecnobit

Tecnobit has been for many years a leading defence electronic company in Spain with sales of about € 60 million in 2008 (€ 40 million in 2005). In November 1999, a few months after the publication of the Royal Decree regulating the control of foreign investments, 3i, a UK dominated venture capital firm bought a 75% share of Tecnobit, without asking for any authorisation.

The issue was unknown for several months. The Government did not interfere in terms of demanding the reversal of the transaction. In 2001, it rather prompted a Spanish bank, the Caja Castilla-La Manche to take a 34% share in the company in order to regain national control of Tecnobit. The Government also demanded that 3i asks for an ex post authorisation, which was then accorded. Today Tecnobit is held by OEASIA, a Spanish leasing company for Information Technology.

4.2 Acquisitions by a company from a non-EU country

General Dynamics acquires Santa Barbara Sistemas

General Dynamics, a US American defence company bought Santa Barbara Sistemas, the Spanish leading land armaments producer, in 2001. At this time, the Spanish Government presided by José Maria Aznar was conducting a large privatisation policy, aimed at strengthening the Spanish industrial base. Competitive companies were sold, in order to better insert them in international markets.

A tender for the privatisation of Santa Barbara was published by the public holding SEPI. Two companies expressed their interest for the Spanish company: Krauss Maffei Wegmann, a long-term industrial partner of Santa Barbara, and General Dynamics. Many observers expected a deal between Santa Barbara and KMW, the latter having sold a licence for the production of its Leopard tank, to Santa Barbara at the occasion of the purchasing of those tanks by the Spanish MoD.

However, the Spanish Government decided to sell the company to General Dynamics, after receiving larger offers of offsets by the American company. Some analysts feared that the General Dynamics offer to purchase Santa Barbara was linked to its interest in Leopard tanks technology. General Dynamics respected the procedure indicated in the Royal Decree of 1999, but the core decision was political, and Mr. Aznar himself had a leading role in the negotiation and the decision-making process. The public debate focused on a transatlantic cooperation versus European cooperation debate, indicating that the Aznar decision was aimed at strengthening the US-Spanish alliance.

A few years later, Spanish MoD officials interviewed for this study expressed disappointment with the industrial offsets received by Spain through the sale of Santa Barbara. The company did not develop a strong position in international markets.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

According to stakeholders interviewed for the purpose of this study, Spain is one the European countries most open to foreign direct investments (FDI). The quantity of FDI seems to confirm this analysis.[195] However, this statement has to be taken with a grain of salt. Although the larger part of national defence industry have been privatised, and although no special rights have been put in place, the question of openness of the country to FDI seems highly political. The Spanish government, right and the left have been aware of the relative importance of the DTIB in the European context.

Consequently an industrial policy has been put in place, in order to develop national industries and protect them from global competition. In the defence area this approach is exemplified by the need for negotiating with the Government industrial offsets or

[195] See on this point Nones and Gasparini, *Il Controllo Degli Investimenti Stranieri Nel Nascente Mercato Europeo Della Difesa E Sicurezza*.

guarantees for capabilities and employment on Spanish territory, while presenting an offer for a defence company. The fact that the Spanish legislation doesn't foresee any control for investments coming from a foreign owned, Spanish based company, also stresses the fact that more than national ownership, it is development of national capabilities that matters for the Spanish government.

Interviews with officials from the Spanish MoD, as well as with officials form defence contractors, made clear that the general Spanish perception on FDI is that other European countries protect their DTIB, so the Spanish Government should do the same. To sum up, they consider being protectionist, but no more than other countries.

5.2 On the need for EU level action

Knowing that for complex weapons systems, Spain will continue to depend on foreign manufacturers, considerations of industrial policy push the Spanish Government to use the creation of interdependencies via the purchase of foreign equipments in order to obtain the maximum benefits possible from foreign investments.

According to this philosophy, it seems unlikely that Spain will be an active sponsor of a European system for the control of foreign investments. This even more so, if the consequence of such a European dimension would imply the creation of a European armaments market in the Spanish defence industry that would then be fully exposed to the competitive pressures of its EU peers. In this context it should be born in mind that Spain, together with Hungary, was the only country initially refusing to join the European Defence Agency's Intergovernmental regime for defence procurement. Spain finally joined the regime in July 2007.

Interviews with Spanish officials from MoD and industrial contractor made clear that Spain doesn't see the need for such a mechanism at this point, especially if this would help establishing a common defence equipment market. At the present stage, if an interest is seen at all then by large, transnational companies like EADS. As to the form of such any EU level action, interlocutors stressed that such a mechanism should be limited to an exchange of information; it should be legally non-binding and coordinated by the European Commission.

6 ANNEX

6.1 Annex 1: Executive summary of Royal Decree 664/1999

Royal Decree 664/1999 of April the 23rd of 1999 on foreign investments

1. The freedom principle

In reference to Art. 1 of decree 664/1999: Financial relations between Spain and abroad are free.

The only condition of the foreign investments is a declaration after the event addressed to the Minister of Industry, Tourism and Trade's register.

Only the investments coming from tax havens must make a prerequisite declaration to this register.

2. Definition of the foreign investors

The definition of the foreign investment only takes into account the residency measure.

In this way, Spanish companies that capital is held by the majority by foreign capital are not considered as foreign investor.

3. Exceptions: some foreign investments are subject to a prerequisite authorisation and an operation of control

In reference to Art. 8 of the decree 664/1999, the council of minister can suspend the implementation of the liberalization regime established by the royal decree.

In reference to Art. 10 of the decree 664/1999, such an event can happen if the Government believes that the investment might threaten public order, public security and public health.

In this case of suspension of liberalization regime, foreign investments are propounded to a prerequisite authorisation of the Council of Minister.

4. List of controlled sectors

The Council of Minister disposes of a right of inspection on what it considers as being specific sectors. The controlled sectors are defined by 9 points.

The first 7 points do not deal with defence. It is a large list of different kinds of services such as gambling, private security, radio and television or air transport.

However, points 8 and 9 are specifically related to defence:

Making, marketing or retailing of weapon or civil use explosives.

Activities directly related with national defence.

The 11th article of the royal decree only deals with defence.

It stipulates that the Council of Minister can occur to its right of suspension of the liberalization regime in all the activities related to national defence:

the marketing or production of weapons, ammunitions, explosives or war materials.

However, the telecommunications that used to be considered as an activity related to the national defence are not anymore in this list.

Moreover, the second paragraph of the article 11 adds a specific case. In the case of a company having a stock market value deal with activities linked to the national defence, only the acquisitions of more than 5% (and that agree to belong to the Board of Director) of the capital made by non residency shall be authorized.

5. Who is in charge of controls?

In reference to the Art. 9 of the decree 664/1999, an interdepartmental committee of the Minister of Industry, Tourism and Trade is responsible for the control.

It is called the « *Junta de Inversiones exteriores* », the General Direction of Trade and Investment. It is composed by the general director of trade and investment, and by a representative of every minister that might be concerned according to different cases.

The suspension of the investment liberalization means that the foreign investors are propounded to a prerequisite authorization of the Council of Minister.

The demand of investment must be made to the General Direction of Trade and Investment. The resolution is adopted on the Minister of Industry, Tourism and trade proposal, or one of the specific ministers, which could be more appropriated to the nature of the case.

The administration has a maximum of six months after the demand's reception. In cases of non respect of this deadline, the authorisation is considered granted

6.2 Annex 2: On special rights

The law 5/1995 of March the 23rd of 1995 on privatisation allowed the Spanish Government to use a golden share on private companies. It was justified by the need to protect the security of supply of the strategic interests of Spain.

A ruling of the European Court of Justice (now CJEU) followed by the law 12/2006 put an end to this right.

Control of foreign investments is now under the same conditions as previously stated.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– Sweden –

1st September 2010

Table of Contents

1 INTRODUCTION

The following report examines how the Swedish Government controls strategic defence assets. It will provide the basis for assessing to what extent certain EU initiatives in this field would be useful.

During the cold war Sweden was non-allied and has strived to be autarkic as for the supply of all major weapons systems. Private Swedish companies have collaborated mainly with the U.S. in the development and production of arms that were not interoperable with NATO. Since the end of the cold war Sweden has adapted a defence policy based on cooperation, integration into the EU, partnership with NATO and close collaboration with the Nordic countries. This implied an opening up of the defence industry towards foreign investors with the explicit aim to foster collaborative security policy ties while ensuring security of supply and controlling proliferation.

State controls of strategic defence assets have to be seen against this background. Currently, the Government does not hold equity or special rights in any Swedish defence firm. However, legislation requires any legal entity – be it Swedish or foreign owned – to request a permit for the development, production, supply and export of military equipment. The permit is granted for security policy reasons, which mainly concern the security of supply of the Swedish armed forces, security of information and proliferation of sensitive technologies. By attaching conditions to the permit, the Government has an effective means of control. Thus it usually demands that all board members are Swedish citizens, provides for special oversight and reporting procedures and requires the notification of any changes of ownership structure.

Currently, no "European security interest" is considered when issuing a permit. Nevertheless, several interlocutors expressed the view that a EU level action with regard to the control of FDI from non-EU countries is required. The Swedish Government has consistently supported the creation of a level playing field and the creation of centres of excellence. It was argued that if these goals were pursued then the EU would be left vulnerable without a EU level control of FDI.

2 CONTEXT

As a long-time non-allied country Sweden has until the end of the cold gone at great length to remain autarkic. Collaboration with the United States on high technology equipment and tremendous domestic efforts ensured that Sweden developed and produced highly sophisticated weapons systems in all major categories from fighter jets such as the JAS 39 Grippen, over armoured vehicles, e.g. the Haegglund CV 90 to submarines. Despite its leaning towards the Western defence alliance Sweden pursued a deliberate policy of non-compatibility to decrease its vulnerability against Russian subversion and attack. As a consequence the Swedish defence industrial community has been rather small, held together by longstanding ties and shared values and understandings. Combined with the informal character of the Swedish culture in general and its openness towards the outside world, little need is felt to have a specific control on foreign ownership of defence companies.[196]

On the contrary, since the end of the cold war Sweden has shifted its defence policy putting an emphasis less on territorial defence of Sweden against invasion and more on expeditionary warfare. This policy shift implied also closer security policy ties and a general commitment to contribute to international peace missions. The Swedish armed forces are envisaged to be small, professional, and participating mainly in low intensity peacekeeping and humanitarian operations.[197] The country has assumed a more cooperative – as opposed to autonomous defence policy – expressed in its membership in the European Union and in Partnership for Peace with NATO, as well as in the Nordic Cooperation Council and in several bilateral collaborative efforts.[198]

The defence industry had to be seriously downsized and restructured and cooperation with defence companies from other countries was seen as a means to foster Sweden's military and security policy cooperation. Since the mid-1990s Swedish governments have supported their firms to actively seek out foreign partners and have not minded

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[196] (Interview Saab, 2010)

[197] Sicne the swift victory of Russian forces over Gerogia in August 2008 there has been debates over a re-orientation of the security policy towards territorial defence against a potential Russian threat. The construction of the Northstream Pipeline had contributed to that debate. For a summary and analysis see (Larsson, 2006), (Larsson, 2007)

[198] (Bialos and Fischer, 2009)

ceding managerial control to them. As a result a considerable part of the defence industry is owned and controlled by foreign firms from the UK, Germany, the Nordic countries and France. So far no hostile takeover bid has been made.

2.1 The Swedish defence industry

The Swedish defence industry has adapted to the government's strategy of cooperation. While during the cold war Swedish firms supplied sophisticated first-tier systems in all weapons categories, companies now need to participate in collaborative programmes with foreign companies and achieve significant foreign sales.

Throughout the cold war Swedish defence firms were held by private owners with the State only operating maintenance and support organization (FFV).[199] The only exception in recent history has been the formation of Celsius in the late 1980s. Following the collapse of Nobel Industries and interest by French defence firms to purchase the falling firms the Government concentrated its defence concerns (Bofors, Kockums, and FFV) in a single entity, Celsius. The latter was acquired in 1999 by Saab AB and thereby privatized. Subsequently, Saab sold parts of the Celsius business – notably Bofors and Kockums to foreign investors. As part of a parallel but different process related to earlier cooperation on fighter jets Saab invited BAE Systems of the UK as a major shareholder.

Today the leading Swedish defence firms in terms of revenue are Saab AB, Hägglunds, Bofors (Hägglunds and Bofors are today units in different parts of BAE Systems Global Combat Systems), Kockums, Nammo, and Volvo Aero, with BAE Systems of the UK being the single most important owner of Swedish defence firms. Volvo Aero has nowadays only a very limited part in the military area.

- Saab AB is by far the largest defence firm with annual sales of about € 2.1 billion and interests in aircraft – the Gripen – electronic warfare, missiles systems, C4I, radar and homeland security. Up until March 2010 BAE Systems of the UK owned 20.5% of the company's equity (corresponding to 20.3% of the voting rights). In March BAE disposed of 10.2% of the capital and expressed its intention

[199] (Interview Saab, 2010)

to shed the remainder in due course. The majority share 30% is now held by the Wallenberg family.[200]

- BAE Systems Hägglunds with sales of € 190 million mainly in tracked combat vehicles is owned 100% by BAE Systems;
- so is BAE Systems Bofors, an artillery and ordnance producer with revenues of € 129 million;
- Kockums builds surface ships and submarines (€ 116 million) as part of the German TKMS group;
- Nammo Group (€ 390 million in 2007) manufactures gun powder and ammunition and is owned by Nammo of Norway and Patria of Finland, each holding 50%;[201]
- Volvo Aero develops and manufactures mainly civilian engine components, aircraft engines and space propulsion systems. The company is a 100% subsidiary of Volvo Group.

2.2 The scale of defence procurement

Since 2000 Swedish defence budgets have slowly decreased in real terms by about € 1 billion. In 2008 Sweden has spent € 4.025 million on defence, which represents 1.23% of its GDP and 2% of the defence budget of all EU countries.[202] In 2009 the Swedish defence budget is expected to rise modestly to € 4.49 billion (EDD, 2010). However, this increase is not expected translate into a higher procurement budget, as the support of Sweden's participation in international operations remains a top priority.

The Swedish defence equipment procurement budget amounted to € 901 million in 2008, down from € 1.22 billion three years before. In addition the Swedish Government spend € 354 million on research and technology (R&T) in 2008.[203]

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[200] (Investor, 2010) For more information on the case of Saab also see under "Special rights" and "Case studies".

[201] (Nammo Group, 2008)

[202] All EU data are based on (EDA, 2009), if not otherwise noted. "EU" refers in the context of this study to the 26 "participating Members States" of the European Defence Agency (EDA), which are the all EU countries but Denmark.

[203] Ibid.)

Defence procurement is handled through a Government agency, the Swedish Defence Materiel Administration (Försvarets materielverk, FMV). It directly reports to the Ministry of Defence. While the agency is responsible for the supply of materiel and methods to the Swedish defence organisation it has also customers in the civil security market.[204]

2.3 National defence industrial and market policies

The international ownership structure and the strong export orientation of the Swedish defence industry reflect that fact that Sweden's defence budget cannot support the development and production of sophisticated weapons systems across the board. Ownership by foreign investors is generally welcomed and regarded as an advantage if contributing to collaborative efforts. It has provided Swedish not only with additional financial resources but also with access to foreign markets, to high technologies, marketing, distribution, and maintenance networks and allowed for capitalizing on synergies.[205]

Consequently, the procurement policy of the FMV emphasizes not only cost-effectiveness but also opportunities for international cooperation. Priority is given to upgrading existing systems and procuring off-the-shelf solutions in a competitive process. If these options are not possible, then the required equipment should be developed giving international cooperation "high priority".[206]

FMV will actively seek private and public partnerships for the procurement of new material and methods. Swedish public organizations are required to cooperate on their research, development, and procurement activities.

In addition other factors are also considered in procurement decisions, albeit a lesser weight is ascribed to them: ensuring the long-term viability of the defence industrial base; the reliability of technology transfer and the security of supply. As for the latter two aspects, mechanisms for the control of foreign direct investments in the defence sector are particularly important.

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[204] (FMV, 2010)

[205] (Interview Saab, 2010)

[206] (Interview FMV, 2010), (Regeringskansliet, 2010: 8-9).

3 NATIONAL PRACTICES OF STATE CONTROL OF STRATEGIC DEFENCE ASSETS

3.1 Government ownership

Currently, the Swedish Government does not own any equity of defence companies.

3.2 Special rights

Some Swedish defence firms have special rights provisions, albeit without giving the Government a special right. For example, Saab AB has issued shares with multiple voting rights: Series A shares entitle shareholders to 10 votes; Series B shares to 1 vote. In all other respects, the shares of Series A and Series B are equal to each other.[207]

Although the Swedish Government does not own any equity, the Wallenberg family does through its holding company Investor AB. The family can be expected to taken national security concerns into consideration when deciding on strategic issues.[208] As of March 2010, pending the approval by the relevant authorities, Investor owns 30% of the equity corresponding to 39.5% of the votes.[209]

The special rights are not anchored in law but rather in the Articles of Association. Special rights granted in the articles of association of a company and not anchored in a law or related to the Government are agreements among shareholders. They do not represent a limitation on the free movement of capital.

3.3 Regulation of foreign acquisitions of defence assets

The Military Equipment Act from 1992 is the legal basis for the control of FDI in defence assets by the Swedish government.[210] It is mainly a means for the control of

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[207] (Saab, 2006: Article 6) The articles of association of Saab AB are entailed in Annex 1.

[208] This general evaluation has been confirmed by all interviewees.

[209] (Investor, 2010).

[210] An English version of the Act is provided in Annex 2.

armaments exports and has been put in place at the beginning of the 1990s after a scandal in which a Swedish company had accidentally re-exported U.S. technology to the Soviet Union. In face of the embarrassment and the negative reaction from the U.S. Government the act was also to ensure compliance within Swedish firms.[211] The legislation has been adapted several times in the late 1990s, however, only for technical purposes.

The Act decrees that most activities with regard to the development, production, and export of weapons are forbidden in principle and an exemption has to be issued in each individual case. Any company – whether Swedish or foreign – that wishes to develop, manufacture or supply military equipment requires a permit.[212] "Military equipment" is defined by statute and generally refers to firearms and ammunition products of the defence industry. Other sectors are only included if their products – for example for medical or pharmaceutical purposes – are classified as military equipment (Section 3).

The permit is granted by the Swedish Agency for Non-proliferation and Export controls – formerly the National Inspectorate of Strategic Products – (ISP). The ISP is a governmental Agency operating under the Ministry of Trade, receiving input from the Ministry of Foreign Affairs. The agency is supported by the Export Control Council, a parliamentary cross-party advisory body called. Concerning technical assessments, ISP is advised by the Technical Scientific Council, whose members are highly qualified technical experts on armaments issues.[213]

Permits may be granted for security policy reasons only and if they do "not conflict with Sweden's foreign policy" (Section 1). Since the mid-1990s the security interest of Sweden has been considered to include close cooperation with the EU, with NATO (Sweden is a member of the Partnership for Peace) and with the other Nordic

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[211] (Interview Saab, 2010)

[212] (Swedish Ministry of Foreign Affairs, 2000: Section 3 and 4) The only exceptions are Swedish "government authorities which are public companies" (Swedish Ministry of Foreign Affairs, 2000: Article 3.). Other activities subject to control are the export of military equipment, all production of defence material in Sweden (Section 3); supply of military equipments in Sweden (Section 4); military training in Sweden (Section 10). Companies and persons domiciled in Sweden require a permit for the production under license of Swedish equipment overseas and in Sweden (Section 7) and for joint development of equipment with a foreign party overseas and in Sweden (Section 8).

[213] (ISP, 2009)

countries. Armaments cooperation and foreign participation in the Swedish defence industry are considered as a means to foster such a policy and, hence, as being in the Swedish interest.

Swedish security interests are safeguarded granting or cancelling permits or by imposing conditions that are attached to the permit. A permit is usually valid for ten years and specified in terms of products, sites and activities i.e. if a company with a permit wishes to extend its operations to a new site it would require a new permit (Section 9). A permit can be cancelled if an investor ("permit-holder") has disregarded the regulation of the Act or provisions issued under the act, or "if there are other special reasons" (Section 16). Such reasons concern the security and foreign policy interests of the country.[214]

To safeguard the latter, the Government can attach conditions to the permit, requiring board members and their deputies to be Swedish citizens and residents in Sweden; with regard "to supervisory and procedural regulations" (Section 14) but also with regard to ownership structures and reporting of changes in the ownership structure.[215]

Every company holding a permit is required to report once a year about its business and can in addition be required to inform the Government about changes in its equity and voting rights holding. Through this mechanism the Government has the possibility to control ownership right in companies concerned with military equipment.[216] In addition, if the foreign-owned defence company supplies the Swedish military forces through FMV, it must provide formal and informal insurances about security of supply, upgrading capabilities, and maintenance capabilities.[217]

Investors have a right to appeal against the decision of the ISP to cancel a permit and against the size of an annual fee that the Agency levies on each entity under the supervision of the ISP (Section 23a). The investor can lodge his appeal with a general administrative court. However, he has no right to challenge any other decision by the ISP, for example if a permit is not granted in the first place.

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[214] (Interview Saab, 2010)

[215] Ibid.)

[216] Ibid.)

[217] (Bialos and Fischer, 2009: 556), (Interview FMV, 2010), (Interview ISP, 2010), (Interview SOFF, 2010)

While permits and conditions are shaped in a way to serve Swedish security and defence policy, "European security interests" or the interests of other EU Member States are not taken into account. Similarly, although ISP has in regular contacts with representatives of export control organizations in the LoI/FA countries, from EU MS and from Nordic countries, where questions concerning the granting of permits could be asked, this has so far not been done.[218] The same practice prevails with regard to the Defence Material Administration FMV.[219]

In sum, with regard to the review and control of FDI in the defence industry Sweden relies on a law that requires a permit for any armaments related activity. The permit is provided by the Government on the suggestion of ISP and FMV for every case. Every investment and change of activity in the defence industry has to be notified to ISP, which then has the chance, in coordination with FMV to revoke a permit or to attach such strings to it, as to allow the Government to maintain its security policy interests. This approach towards the control of FDI has evolved against the background of the Swedish defence industrial restructuring. The privatization proceeded through a sale of the government's defence interests in Celsius to Saab AB, which in turn sold off part of the Celsius business to foreign investors. The Government decided each transaction on a case by case basis using the BAE investment into Saab AB in 1998 as a "blueprint".

4 CASE STUDIES

4.1 Acquisitions by a company from a EU country

BAE acquires 30% of Saab AB in 1998

In 1995, Saab AB and BAE Systems (then British Aerospace or BAe) created a 50/50 Joint Venture. The partnership had been actively sought by Saab who had informally sounded out the Swedish Government on this project. The intentions were fivefold, out of which the exploration of export opportunities of the JAS-39 Grippen has been

[218] (Interview Saab, 2010)

[219] (Interview FMV, 2010)

cited most often. BAE offered access and experience in numerous export markets that had formerly been closed for the Swedish defence industry but were now in reach due to a change in export policy. Additionally, the partnership also promised access to the larger UK defence market and would elevate the existing technological collaboration with BAE in the area of aircraft wings. Moreover, the transaction was considered as part of a wider restructuring of the European aerospace industry – joining the EU in that year Sweden saw a chance to demonstrate its commitment. Finally, BAE's commitment promised to increase Saab's financial strength.[220]

When Saab AB went public in 1998, the then main owner, the Wallenberg family contemplated several industrial partners for Saab: Dassault, Northrop, Boeing, and BAE Systems. With the latter Saab had established in 1995 already the *Saab-BAe Gripen AB*, to manufacture, market and support the Gripen in international markets. With BAE Systems Saab had the fewest overlap and most complementarities in terms of product range.[221] BAE acquired 35.1 percent of the capital and 35.0 percent of the voting rights in the company from Investor AB. In 2005 BAE Systems reduced its ownership in Saab AB to 20.5 percent of the capital and 20.3 percent of the votes; and to even lower levels in 2010.[222]

Back in 1998 the transaction was informally prepared through contacts of the company with FMV. As the permit to manufacture and supply military equipment had to be renewed for Saab, the FMV was tasked by the MOD to prepare this specific case in close cooperation with other Government agencies and to propose relevant actions to allow the transaction, imposing particular conditions. The conditions include, for example, that the Board of Directors has to be manned by Swedish citizens and resident in Sweden.[223] There was no wider public debate on this issue at any point in

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[220] Though the cooperation with BAE is generally seen as a success the hopes regarding exports did not materialize, as "BAE gave priority to the Eurofighter each and every time it came to a competition between the Typhoon and the Grippen, as in the case of Finland" (Interview Saab, 2010)

[221] The Grippen could fill the gap as an interim solution for a fighter jet as long as the Eurofighter would not be available, so the official reasoning by BAE Ibid.)

[222] (Investor, 2010); on the details see above under "Defence industry".

[223] The precise conditions were not revealed to the author during the interviews at ISP and Saab AB.

time.[224] In addition, a specific Memorandum of Understanding was signed between the UK and the Swedish governments to regulate the export activities.

4.2 Acquisitions by a company from a non-EU country

UDI acquires Bofors in 1999

After Saab AB had acquired Bofors in 1999 it sold part of the business – its artillery arm – to United Defence Industries (UDI), an U.S. American armaments company specialized in land armament.[225] While divesting the artillery arm of Bofors Saab AB retained the missile business.

This transaction too was a friendly takeover. It was regarded in Sweden more as an opportunity to safe know how, industrial facilities and jobs in an area where Sweden had traditionally been strong. Moreover, it facilitated the link to a strong financial and marketing partner.[226]

The transaction proceeded along the same lines as the aforementioned investment of British Aerospace. The same experts in the FMV and on the industrial side were involved and used "the blueprint" of the permit from the BAE case.[227]

The only concern back then was about the ability of Bofors to proceed with its export business to India. After being acquired by a U.S. company and India being subject of a U.S. embargo, the continued sale of defence material to India was in jeopardy. The problem was solved, however, by the formation of a separate legal entity that managed Borfors' exports.[228]

Other cases of foreign investment in the Swedish defence industry from EU or from third countries proceeded according to a similar scheme (notably the acquisition of the shipbuilder Kockums by HDW of Germany): The Swedish industry was actively

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[224] (Interview Saab, 2010)

[225] In 2004, BAE acquired Alvis, which had bought Swedish manufacture of amoured vehicles Hägglunds, and in 2005 United Defence Industries. Hence, Bofors and Hägglunds are now part of BAE Systems Land and Armaments.

[226] (Interview Saab, 2010)

[227] (Interview SOFF, 2010)

[228] Ibid.

seeking out foreign partners, consulting the relevant authorities informally. The Government then granted the permit on a case by case basis using its model it had develop and fine tuned in the former transactions.

All in all there have been very "few cases" of FDI in the Swedish defence industry, mainly associated to the privatization process at the end of the 1990s and the IPO of Saab AB. In recent years second and third tier firms mainly with dual-use production have been acquired in a number of smaller transactions below the € 100 million threshold. The Government is said to have become more relaxed with regard to conditions attached to the permits after the sale of the major defence companies i.e. 2000. This holds in particular for the current Government which rather champions liberal views on the defence market.[229]

So far no hostile takeover attempts have been made and no application of a foreign investor for a permit has been turned down. The fact that no permit has been denied so far is explained with reference to the closely knit informal network among defence officials and industry, which allows sorting out all possible issues in advance.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

Swedish representatives of industry and Government detect a great deal of difference regarding the openness of countries to foreign acquisitions in the defence industry. The following table provides a summary of the assessment by Swedish interview partners. They are combined with selected comments that reflect the assessment in the most succinct way to shed a light on the background of the assessment.

We wish to stress, however, that this ranking is by no means a representative picture of the opinion neither of the Swedish Government nor the Swedish defence industry.

[229] (Interview Saab, 2010)

Table 5.1: Ranking of countries according to perceived openness:

Country	Rank 1=most open – 9=most closed	Comment
France	9	"France strives ultimately for control of security of supply, very much like Sweden during the cold war."
Germany	5	"Germany is open to investment but they have a rigid review process."
Italy	8	"Their companies are very closely linked with the MoD."
The Netherlands	3	"The Netherlands don't have that much of a defence industry but are generally very open towards FDI."
Poland	7	"Poland seeks an alternative to the big European companies and to remain in control."
Spain	7	"Spain doesn't interact with the EU very much."
Sweden	1	"We are leading the liberal creed in the Nordic countries and are very open now; whether that is so sensible for defence remains to be seen."
United Kingdom	2	"Have been very open but have become more cautious."
United States	7	"The U.S. is generally open; but they control their defence assets tightly against foreign companies."

5.2 On the need for EU level action

There was agreement among all interlocutors that to this day there is by no means a common European approach, neither among the LoI/FA countries nor within the EU with regard to the review of FDI in the defence industry. The latter fact is by most of the interlocutors viewed as hindering "Europe to take a stronger stand" vis-à-vis the United States and other emerging powers such as China and India.[230] For the design of

[230] Ibid.)

a European approach the control mechanisms and practices of those countries should be examined.[231]

Moreover, experts from industry stressed that the LoI/FA countries share a common understanding that such a control is required, albeit for different reasons. This makes the LoI/FA a rather doubtful forum for such control action.

Especially industry representatives expressed the view that a EU level control mechanism for FDI in the defence industry from outside the EU should be in place, mainly for security as well as economic reasons. It is argued that the Swedish Government has championed the idea of a level playing field in which centres of excellence emerge. If that is to become true then control of third country investments is required. Otherwise, so the argument, the EU would be much more vulnerable than before, as the combination of different national mechanisms of control is considered to be ineffective, especially with regard to security of supply and the proliferation of sensitive technologies.[232] It should not be possible for someone from outside the EU to disrupt the technological base with it high-skill jobs.

Another argument for a EU level approach on this issues emerged with regard to a common approach on intellectual property rights. The Swedish Government has traditionally shared IPR with industry. Both had subsequently the chance to draw on the IPR. When Kockums, a Swedish naval company, was acquired by Germany's HDW German IPR regulations restricted the use of Kockums' IPR by the Swedish government. In the future the Swedish Government will hence make sure that the IPRs originally financed by Swedish tax payers will remain accessible for the government. A European agreement on this issue would be considered as helpful.[233]

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[231] Ibid.)

[232] Ibid.)

[233] Ibid.)

6 ANNEX

6.1 Articles of association for Saab AB[234]

§ 1

The name of the Company is SAAB AKTIEBOLAG. The Company is a public limited company (plc).

§ 2

The object of the Company's business is, directly or indirectly, to develop, manufacture, sell and maintain products to the aviation, engineering and electronic industries, and to provide technical services and consultancy in the electronics, telecommunications and computer fields. Operations are directed primarily at defense materiel. The company shall also own and manage real estate and chattels, buy and sell rights, and engage in financing activities as well as any other business compatible therewith.

§ 3

The registered office of the Company shall be located in Linköping, Sweden.

§ 4

The share capital shall comprise no less than seven hundred and fifty million (750,000,000) Swedish kronor and no more than three billion (3,000,000,000) Swedish kronor.

§ 5

The number of shares shall be not less than 46,875,000 and not more than 187,500,000.

§ 6

The shares shall be issuable in two series, designated Series A and Series B. Shares of either series may be issued in a number equivalent to the entire share capital.

[234] Adopted at the Annual General Meeting on April 5, 2006 (Saab, 2006).

When voting at a shareholders' meeting, one share of Series A shall entitle the shareholder to ten votes and one share of Series B shall entitle the shareholder to one vote. In all other respects, the shares of Series A and Series B are equal to each other.

A shareholder is entitled to demand that shares of Series A in his possession be converted into shares of Series B. An application to this effect shall be submitted in writing to the Company's Board of Directors, stating how many shares the owner wishes to convert and supplying all and any other information and documents that the Board of Directors may request. It is the duty of the Company's Board of Directors to report such application for registration purposes within one month of receipt of the application. Conversion shall take effect when registration has been completed.

§ 7

If the Company resolves to issue new shares of Series A and Series B through a cash issue or an issue by set-off, holders of shares of Series A and Series B shall have preferential right of subscription to new shares of the same share series in proportion to the number of shares already owned by the shareholder (primary preferential right). Shares which have not been acquired on the basis of primary preferential right shall be offered for subscription to all shareholders (subsidiary preferential right). If the shares thus offered are insufficient for subscription on the basis of subsidiary preferential right, the shares shall be allocated among the subscribers in proportion to the number of shares already held by them and, to the extent this cannot be done, through the drawing of lots.

If the Company resolves to issue through a cash issue or an issue by set-off shares either of Series A or Series B, but not both, all shareholders, regardless of whether their shares are of Series A or Series B, shall have preferential right of subscription to new shares in proportion to the number of shares already held by them.

If the Company resolves to issue, through a cash issue or an issue by set-off, warrants or convertible promissory notes, the shareholders shall, respectively, have preferential right of subscription to the warrants as if the issue concerned the shares that may be subscribed under the warrant, and preferential right of subscription to the convertible promissory notes as if the issue concerned the shares that the convertible promissory notes may be exchanged for.

The above shall not entail any limitation to the possibility of reaching a decision on a cash issue or an issue by set-off departing from the shareholders' preferential right.

If the share capital is increased through a bonus issue, new shares of each series shall be issued in proportion to the number of shares of the same series as already exist. In this connection, earlier shares of a specific series shall entitle the shareholder to new shares of the same series. This shall not entail any limitation to the possibility to issue shares of a new series through a bonus issue, following requisite amendments to the Articles of Association.

§ 8

In addition to the members who may in accordance with legal requirements be appointed by other than the Annual General Meeting, the Board of Directors of the Company shall comprise at least six (6) and at most twelve (12) regular members and at most four (4) deputies for such members.

§ 9

One or two Auditors with or without Deputy Auditors shall be appointed to examine the Company's Annual Report and accounts, as well as the administration of the Company's affairs by the Board of Directors and the Managing Director. Either one or two registered accounting firms may be appointed as auditor.

§ 10

The Company's accounting year shall be the calendar year.

§ 11

General Meeting of the Company's shareholders shall be held in Linköping or Stockholm.

§ 12

Notices convening a General Meeting shall be published in "Post- och Inrikes Tidningar", as well as in "Dagens Nyheter" and, "Svenska Dagbladet".

Shareholders wishing to attend a General Meeting shall be included in a printout or other representation of the shareholders' register reflecting the conditions five business days prior to the meeting and shall notify the Company no later than 12 noon on the day specified in the notice convening the meeting, stating the number of

assistants. This day may not be a Sunday, a public holiday, a Saturday, Midsummer's Eve, Christmas Eve or New Year's Eve, and may not fall earlier than the fifth weekday before the meeting.

§ 13

At the Annual General Meeting, the following items shall appear on the agenda:

1) Election of Chairman for the meeting

2) Approval of the voting list

3) Approval of the agenda

4) Election of one or two persons to verify the minutes of the meeting

5) Motion as to whether the meeting was duly convened

6) Presentation of the Annual Report and Auditors' Report, and of the Consolidated Annual Report and Consolidated Auditors' Report

7) Resolutions

a. on approval of the Income Statement and Balance Sheet and the Consolidated Income Statement and Consolidated Balance Sheet

b. on allocations in respect of profit or loss according to the approved Balance Sheet

c. on discharge of the Board of Directors and the Managing Director from liability for their administration of the Company's affairs

8) Stipulation of the number of regular and deputy Board Members and, where applicable, Auditor and Deputy Auditor, to be appointed by the Annual General Meeting

9) Stipulation of the Directors' and Auditors' fees

10) Election of regular Board Members and Deputy Board Members

11) Where applicable, election of Auditors and Deputy Auditors

12) Any other business which, in accordance with the Companies' Act or the Company's Articles of Association, requires consideration by the Annual General Meeting

§ 14

The Company's shares shall be registered in a CSD (Central Securities Depositary) register under the Financial Instruments Accounts Act (1998:1479).

6.2 The Military Equipment Act (1992:1300)

With amendments up to and including SFS 2000:1248 (Swedish Code of Statues)

(Unofficial translation from the Ministry of Foreign Affairs)

Introductory Provisions

Section 1

This Act covers weapons, ammunition and other matériel designed for military use which constitute military equipment in accordance with regulations issued by the Government.

Permits under this Act may only be granted for security policy and defense policy reasons and provided they do not conflict with Sweden's foreign policy.

Section 1a

The National Inspectorate of Strategic Products shall examine questions concerning permits, prohibitions and exemptions in individual cases under this act.

The National Inspectorate of Strategic Products shall submit a matter, with a statement, to the Government for consideration if the matter is of principle significance or is otherwise of special importance.

The Government may issue additional regulations regarding the submission of matters to the Government.

Definitions

Section 2

The following definitions apply in this Act:

manufacture: the production of matériel or parts thereof which constitute military equipment,

supply: sale, transfer, offer for sale, loan, gift or intermediation,

manufacturing right: any right to manufacture military equipment

Manufacture

Section 3

Military equipment may not be manufactured in Sweden unless a permit is granted.

The Government may issue regulations to this requirement for a permit with respect to:

1. Modification or conversion of firearms in cases referred to in Chapter 4 Section 1 of the Weapons Act (1996:67),

2. Manufacture of firearms on a one-off basis and of ammunition for the maker's personal use,

3. Manufacture for medical or pharmaceutical purposes or for research purposes of at most 100 grams per year of chemical products classified as military equipment.

The provision contained in the first paragraph does not apply to Government authorities which are public companies.

Supply

Section 4

Activities which involve the supply of military equipment, inventions concerning military equipment and methods for the production of such equipment may not be conducted in Sweden unless a permit is granted.

Swedish authorities, Swedish companies and persons who are resident or permanently domiciled in Sweden may not conduct such activities abroad either, without a permit.

The provisions contained in the first and second paragraphs do not apply to Government authorities which are not public companies.

Permits in accordance with the first or the second paragraph are not required for activities involving the supply of military equipment to Swedish central Government authorities or to manufacturers which have a permit to manufacture military equipment of the type supplied. Nor is a holder of a manufacturing permit required to have a permit as described in the first or the second paragraph if activities involve the supply of military equipment which is the property of the permit holder and which is located in Sweden or the supply of an invention or a method for the production of

military equipment to Swedish central Government authorities or to manufacturers which have permit to manufacture military equipment of the type supplied.

The Government may issue regulations concerning exceptions to the requirement for permits in accordance with the first and second paragraphs, for such trade in firearms as is regulated by the provisions contained in the Weapons Act (1996:67) or such handling of ammunition or other explosives which are regulated by the provisions contained in the Act concerning Inflammable and Explosive Goods (1988:868).

Section 5

Swedish authorities, Swedish companies and persons who are resident or permanently domiciled in Sweden may not supply to a person or entity abroad military equipment located abroad or an invention pertaining to military equipment or a production method for such equipment without a permit for the specific case in question.

Export

Section 6

Military equipment may not be dispatched abroad without a permit except as a consequence of this Act or other legislation. In the case of computer software, transmission abroad by means of telecommunications or by any similar method is equivalent to exportation.

The Government or an authority designated by the Government may issue regulations for the exportation of:

1. firearms and ammunition pertaining thereto for personal account, and also firearms and ammunition pertaining thereto, for use in hunting, competition or target practice abroad,
2. firearms for repair, overhaul or similar measures,
3. firearms brought into Sweden for measures covered by sub-section 2,
4. hunting and competition firearms and ammunition pertaining thereto which have been brought into the country in accordance with the provisions contained in Chapter 2, Section 13b, of the Weapons Act (1996:67)

Licensing Agreement, etc.

Section 7

An agreement involving the granting or transfer of manufacturing rights to a person or entity abroad may not be entered into in Sweden without a permit.

Swedish authorities, Swedish companies and persons who are resident or permanently domiciled in Sweden may not enter into such agreements abroad either, without a permit.

Section 8

An agreement with a person or entity abroad concerning the development, jointly or on behalf of that person or entity, of military equipment or of producing methods for such equipment, or concerning the joint manufacture of military equipment, may not be entered into in Sweden without a permit.

Swedish authorities, Swedish companies and persons who are resident or permanently domiciled in Sweden may not enter into such agreements abroad either, without a permit.

Changes in Agreements, etc.

Section 9

Agreements concerning a supplement to or modification of an agreement of a nature which requires a permit in accordance with Section 7 or 8 may not be entered into without a permit if such supplement or modification involves:

1. the equipment covered by the agreement, previously specified,

2. the granting or transfer of rights under the agreement to third parties

3. the right to supply military equipment to a recipient not previously specified,

4. the extension of the validity of the agreement, or

5. provisions regarding the protection of secret information.

Training with a Military Purpose

Section 10

Training with a military purpose of persons who are not Swedish citizens may not be conducted in Sweden without a permit.

Swedish authorities, Swedish companies and persons who are resident or permanently domiciled in Sweden ma not conduct such training abroad on a professional basis without a permit.

A permit is not required for training arranged by Government authorities which are not public companies, or which is arranged in connection with the sale of military equipment or for employees in companies which have a permit to manufacture military equipment.

Marketing, etc.

Section 11

A person or entity granted a permit in accordance with Section 3 or 4, and also Swedish Government authorities conducting corresponding activities, shall report to the National Inspectorate of Strategic Products in the form prescribed by the Government on:

1. the marketing of military equipment conducted abroad,

2. measures aimed at concluding an agreement which is subject to a permit in accordance with Section 7 or 8

The Government may issue more precise regulations regarding the obligation to report any exemptions from such an obligation. In particular cases, the National Inspectorate of Strategic Products may also allow exemptions from such an obligation to report.

Tendering, etc.

Section 12

A person or entity granted a permit in accordance with Section 3 or 4 as well as Swedish Government authorities conducting corresponding activities, shall notify the National Inspectorate of Strategic Products prior to submitting a tender, or, in a situation in which tendering procedures do not apply, prior to entering into an agreement concerning:

1. the supply of military equipment to a person or entity abroad,

2. the granting or transfer of manufacturing rights covered by Section 7, or

3. the manufacture or development of military equipment covered by Section 8.

The Government may issue more precise regulations concerning the deadline for notifications and any exemptions from the obligation to provide a notification. In particular cases, the National Inspectorate of Strategic Products may also grant exemptions from the obligation to provide a notification.

In particular cases, the Inspectorate of Strategic Products may prohibit submission of a tender or the establishment of an agreement as covered by the first paragraph.

Conditions, etc.

Section 13

A permit granted under Section 3 or 4 to a Swedish joint stock company may include a requirement that only a certain proportion of shares may be held, directly or indirectly by foreign legal entities. A permit may also include requirements under which the managing director of the company, members of the board and their deputies must be Swedish citizens and resident in Sweden

Conditions with respect to ownership may also be applied in permits granted to trading partnerships in accordance with Section 3 or 4.

Section 14

Permits granted in accordance with Sections 3-10 may be subject to other requirements than those referred to in Section 13, and may also include supervisory and procedural regulations.

Section 15

Permits granted in accordance with Sections 3 and 4 may be granted for a specified period of time or until further notice.

Cancellation

Section 16

Any permit granted in accordance with Sections 3-10 may be cancelled if the permit-holder has disregarded a regulation contained in this Act, or a regulation, requirement or provision issued under the Act or if there are other special reasons for such cancellation.

A permit to enter into an agreement granted under Section 7, 8 or 9 may not be cancelled if the agreement has already been entered into.

Cancellation takes effect immediately unless some other arrangement is decided.

Obligation to Provide Notification of Ownership in a Foreign Legal Entity

Section 17

A person or entity granted a permit under Section 3 or 4, as well as a Swedish Government authority conducting corresponding activities without requirement of permit, shall in accordance with regulations issued by the Government supply information to the National Inspectorate of Strategic Products concerning ownership in foreign legal entities involved in the development, manufacture, marketing or sale of military equipment

Supervision and Obligation to Provide Information

Section 18

A person or entity ranted a permit under section 3 or 4 shall be subject to supervision by the National Inspectorate of Strategic Products. The Government may issue regulations for such supervision.

Section 19

A person or entity granted a permit under Section 3 or 4 shall in accordance with the detailed regulations issued by the Government, submit to the National Inspectorate of Strategic Products, a solemn declaration on oath regarding the activity for which permission has been granted.

The Government may issue regulations specifying exemptions from the obligation to submit such a declaration.

The Government may issue regulations obliging:

1. a person or entity with a permit granted under Section 6 to provide information regarding military equipment which has been dispatched abroad,

2. a person or entity with a permit granted under section 7 or 8 to provide information regarding agreements which have been entered into.

Section 20

At the request of the National Inspectorate of Strategic Products, a person or entity with a permit granted under Section 3 or 4 shall submit information and documents required for inspection and give the Inspectorate access to the premises at which business operations are conducted. The Inspectorate is entitled to make use of the assistance of other Government authorities in fulfilling its function.

Section 21

If there is a change in the circumstances described in the application for a permit, the person or entity granted permission under this Act is obliged to notify such a change to the Inspectorate of Strategic Products in accordance with the regulations issued by the Government.

If the permit refers to the manufacture of chemical products, the holder of the permit shall notify the National Inspectorate of Strategic Products of changes in the activities planned for the current calendar year in accordance with the regulations issued by the Government.

Section 22

In order to cover public expenditure for the National Inspectorate of Strategic Products, a person or entity with a permit to manufacture military equipment granted under this Act or a person or entity that manufactures products coming under the supervision of the Inspectorate in accordance with the Section 12 of the Act on the Control of Dual-use items and Technical Assistance (2000:1064) is to pay an annual fee, if the invoiced value of the manufacturer's sales of products of this type exceeds SEK 2.500.000 during the year. The Inspectorate determines the fee for all manufacturers on the basis of their proportion of the invoiced value of sales of military equipment.

Audit Control

Section 23

If an auditor in the course of his scrutiny comments on a company's compliance with the provisions of this Act, and such comment has been presented in an audit report as described in Chapter 10 Section 5 of the Companies Act (1975:1385) or Section 6 of the Audit Act (19991079), he shall immediately dispatch a copy of the audit report to

the National Inspectorate of Strategic Products. An auditor for a Swedish Government authority has a corresponding obligation.

Appeal

Section 23a

An appeal may be lodged with a general administrative court against a decision by the National Inspectorate of Strategic Products to cancel a permit under Section 16 or to determine a fee under Section 22.

Review dispensation is required in the case of appeal to an administrative court of appeal.

Appeals may not be lodged against other administrative decisions

Provisions concerning Liability, etc.

Section 24

Provisions concerning unlawful exportation and attempted unlawful exportation are covered by the Act of Penalties for the Smuggling (2000:1248).

Section 25

A person or entity contravening any of the Sections 3-5 or 7-10 or a prohibition issued under Section 12 is sentenced to

1. a fine or imprisonment of not more than two years if the offence is intentional 2. a fine or imprisonment of not more than six months if the offence is the result of negligence.

A person or entity intentionally misleading the National Inspectorate of Strategic Products or the Government into granting a permit in accordance with any of the Sections 3-5 or 7-10 and thus causing a contract to be fulfilled or supply to be implemented will be sentenced to a fine or imprisonment of not more than two years. If the offence is the result of negligence, a fine or imprisonment of not more than six months will be imposed.

Sentence will not be passed in cases where the offence is minor.

Section 26

If an offence covered by Section 25 has been committed intentionally and is not to be considered a serious offence, the sentence shall be imprisonment of not less than six months and not more than 4 years.

In assessing whether the offence is of a serious nature, the court shall take into account whether the offence involved substantial pecuniary value, whether the offence was of considerable scope or duration or whether the offence was of a particularly serious nature in other respects.

Section 27

A sentence of a fine or imprisonment of not more than six months shall be imposed on a person or entity which intentionally or as a result of negligence:

1. fails to submit notification in accordance with Section 12 or to submit information in accordance with Section 17,

2. fails to provide notification under Section 21,

3. in cases not covered by Section 25 or 26 submits incorrect information in an application for a permit or in any other document which is relevant for consideration of a matter subject to this Act, or which is otherwise submitted to the supervisory authority,

4. disregards a condition or contravenes a supervisory or procedural regulation issued under this Act.

Sentence will not be passed in cases where the offence is minor.

Section 28

Sentence will not be passed under this Act if the offence is punishable under the Penal Code.

Section 29

Proceeds resulting from an offence covered by Section 25 or 26 shall be declared confiscated unless this is clearly unreasonable.

Section 30

Public prosecution for an act in contravention of Section 3 or 4 may only be instituted if permission is granted by the supervisory authority.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– United Kingdom –

1st September 2010

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1 INTRODUCTION

One of the most striking features of the United Kingdom's defence industrial base is the extent of foreign ownership. The UK Government has been broadly supportive of foreign ownership of UK defence industrial assets seeing it as a means of sustaining defence industrial capabilities in a consolidating market, providing an additional source of capital and sustaining competition in a consolidating industry. In contrast to some other European countries, the political saliency of the question of nationality of ownership has been surprisingly limited with the issue rarely subject of political comment.[235]

The UK Government privatised State owned defence industrial companies in the 1980s and sold its remaining stake in the QinetiQ defence research company in 2008. Special rights (special or "golden" shares) provisions were put in place as part of the Articles of Association. Certain rights including those related to foreign shareholding limits, disposals and the nationality of directors are related to the special share).

Domestic merger regulations contain provisions for the UK Government to intervene where mergers and joint ventures have a national security dimension. The UK Government has shown a preference for the use of behavioural undertakings relating to the future conduct of the merged business.

[235] Several Government and industry representatives interviewed for this study noted how the takeover of the confectionary company Cadbury by the US Kraft Foods had raised more public comment than most foreign acquisitions of UK defence companies.

2 CONTEXT

This section provides some background information on the UK defence industry, UK defence procurement and UK defence industrial policy.

2.1 The UK defence industry

The UK defence industry is large and has leading technological and industrial capabilities across a broad range of sectors from aerospace and defence electronics to nuclear submarine and propulsion system design and manufacture. In Europe, the UK defence industry together with that of France is the largest defence industry by turnover. The UK defence industry is also regularly in the top five defence exporters in the world.

The UK headquartered company BAE Systems is the largest company in Europe by defence revenues and the second largest in the world. Ten other UK companies feature in the *Defense News* Top 100 defence companies including Rolls-Royce, QinetiQ, VT Group and Cobham. The growth of UK companies in the last decade has been in last part a product of their successful record of acquisitions of defence companies in the United States.

One of the most striking features of the structure of the UK defence industrial base is the extent of foreign ownership of UK defence industrial assets. Foreign ownership has emerged as a consequence of joint ventures, acquisitions and the establishment of foreign owned industrial activities to meet off-set and other obligations associated with large defence programmes. The Defence Industrial Strategy White Paper estimated that 25 percent of the UK defence industry is foreign owned and important foreign owned participants in the UK defence industry include:

- **Finmeccanica UK** – Italian owned Finemeccainca is the second largest defence contractor in the UK following its buy-out of the AgustaWestland joint venture and its ownership of the SELEX companies and Vega Group.
- **Thales UK** – French-owned Thales (formerly Thomson-CSF) is the second largest defence contractor in the UK not least as the result of its acquisition of

Racal Electronics in 2000. Thomson-CSF established its position in the UK through a series of joint ventures during the 1990s which included equity stakes in Pilkington Optronics, Shorts Missile Systems and Thomson Marconi Sonar amongst others. In turn, it bought out its joint venture partners to take full ownership and control.

- **MBDA** – the creation of MBDA merges the UK-based guided weapons businesses of two BAE Systems joint ventures – Alenia Marconi Systems and MBD with those of Finmeccanica and EADS.
- **EADS** – EADS has established an important position in the UK defence communications sector through its acquisitions of Cogent Defence & Security Networks in 2001 and the acquisition of the BAE System share in the Astrium space joint venture in 2003.The latter established EADS as prime contractor for the UK's Skynet 5 military communications satellite programme.
- **Raytheon UK Ltd** – the U.S. owned company is prime contractor for a number of major UK programmes such as ASTOR (Airborne Stand-Off Radar), SIFF (Successor Identification Friend or Foe) and PGB (Precision Guided Bomb) and the company designs, develops and manufactures a wide range of advanced electronic products and systems in the UK. The U.S. company can trace its history in the UK back over forty years through the UK subsidiaries of the former Hughes and Texas Instruments companies.
- **Lockheed Martin UK Ltd** – the U.S. owned company is prime contractor for a number of UK programmes including the Royal Navy Merlin helicopter programme and the UK Cooperative Engagement Capability. Lockheed Martin has provided support to the Royal Navy for Fleet Ballistic Missiles since 1968 and is responsible for the integration of the Tomahawk SLCM into Royal Navy submarines.
- **General Dynamics UK** – the U.S. owned company is the prime contractor for the UK's Bowman digitization programme and in March 2004 the company launched an unsuccessful bid to acquire the UK land systems company Alvis.[236]

[236] The General Dynamics bid prompted a higher value counter-bid by BAE Systems which was accepted by Alvis. However, the General Dynamics transaction was subject to an Office of Fair

2.2 The scale of defence procurement

In 2008, the UK spent €10295 million on defence equipment and R&D, the largest expenditure of any EDA participating Member State. The UK defence market is comparatively open. According to figures in the UK defence Industrial Strategy White Paper, in 2004/05 some 5% of UK MOD spend with industry was directed at imports, a further 14% with foreign-owned UK-based companies and a significant further proportion (13%) to cooperative programmes run through European organisations such as NETMA and EUROPAAMS.[237]

2.3 National defence industrial and market policies

UK defence industrial policy was set out in the Defence Industrial Strategy White Paper published in 2005.[238] The acceptance of growing foreign ownership of the UK defence industry is a core part of the UK government's defence industrial strategy. This policy was first described in detail in the MOD's *Defence Industrial Policy* paper published in October 2002. The document was significant because it was the first time that the UK Government had explicitly and publicly stated its policy towards the defence industrial base – and foreign ownership. The paper stressed the UK government's view that the UK defence industry should be defined as *all* defence suppliers that create value, employment, technology or intellectual assets in the UK – irrespective of whether they were UK or foreign-owned. The UK's position was set out clearly (and was reiterated in the *Defence Industrial Strategy*):

> "One result of the defence industry's internationalization has been to blur the definition of what comprises the UK defence industry. An increasing number of companies with foreign parentage now have British boards and

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Trading investigation that suggested that the UK Government had some national security concerns but that it felt that those concerns could have been mitigated through behavioural undertakings had the transaction gone ahead.

[237] UK Ministry of Defence (2005) *Defence Industrial Strategy* (London: Ministry of Defence).

[238] The recent Green Paper noted that an update Defence Industrial Strategy is expected as part of the UK's Strategic Defence Review UK Ministry of Defence (2010a) 'Adaptability and partnership: Issues for the Strategic Defence Review'. available at <http://www.mod.uk/NR/rdonlyres/790C77EC-550B-4AE8-B227-14DA412FC9BA/0/defence_green_paper_cm7794.pdf>..

> workforces… Foreign-owned companies that set up in the UK can bring benefit in creating technology, employment and intellectual assets in this country… The UK defence industry should therefore be defined in terms of where the technology is created, where the skills and the intellectual property reside, where the jobs are created and sustained, and where the investment is made".[239]

By and large, the political reaction to this growth in foreign ownership has been muted. Recent foreign acquisitions have provoked little or no political reaction and only passing comment in the media. In contrast to some other European countries, the political saliency of the question of nationality of ownership has been surprisingly limited with the issue rarely subject of political comment.[240] Indeed, several Government and industry representatives interviewed for this study noted how the takeover of the confectionary company Cadbury by the US Kraft Foods had raised more public comment than most foreign acquisitions of UK defence companies.

3 NATIONAL PRACTICES WITH RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

In this section of this country study we turn to consider UK practice with respect to State control of strategic defence assets, looking in particular at three issues: first, Government ownership; second, special rights; and, third, regulation of foreign acquisitions of defence assets.

3.1 Government ownership

The UK Government does not retain ownership in any defence company. In the case of the UK, defence companies that were nationalised in the 1970s (British Aerospace,

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[239] UK Ministry of Defence (2002) *Defence Industrial Policy* (London: Ministry of Defence).

[240] During the 1980s, an intense political dispute that arose in the mid 1980s over the takeover of the helicopter manufacturer Westland which led to the resignation of two Cabinet Ministers and an intense political debate about the UK's attitude towards European cooperation. However, it ought to be stressed that the issue of foreign ownership was not at the centre of the "Westland Affair" but instead whether the foreign owner ought to be a U.S. or European consortium.

Rolls-Royce and some shipbuilders) were privatised in the 1980s. This was much earlier than other European countries and the UK has also gone further by also privatising the larger part of its Government defence research establishments. The UK government's remaining stake in the QinetiQ defence research company was sold in 2008.

Special rights

During the privatisation of state-owned companies, special rights (special or "golden" shares) provisions were put in place as part of their Articles of Association. These golden shares were retained by Government departments in privatised companies, such as British Gas, British Energy, British Airports Authority, as well as companies with defence businesses such as British Aerospace, Rolls-Royce and the Royal Dockyards. Overtime, and in response in part to European Court of Justice rulings on special shares, many of these shares in non-defence companies have been redeemed.

Defence companies subject to special shares provisions

Those special shares that remain in the defence industry include special shares in:

- Atomic Weapons Establishment
- BAE Systems
- BAE Systems (VSEL)
- Rolls Royce
- Devonport Royal Dockyard
- Rosyth Royal Dockyard
- QinetiQ

Purpose of the special share

The ownership of these special shares confer certain rights on the Government special share holder. It ought to be emphasized at the outset that these special rights and in no case do they confer direct power of day-to-day management control on the Government special shareholder. Instead, the purpose of the special rights is to protect

what the UK MOD regards as "vital defence industrial capabilities".[241] For instance, the MOD explains that it holds a special share in QinetiQ because: "This allows the Government to veto any transaction or shareholding that may result in unacceptable ownership, influence or control contrary to UK defence and security interests".[242] Significantly, many of the special shares relate to aspects of the UK's independent nuclear deterrent (e.g. AWE; BAE Systems (VSEL) and Rolls Royce).

Nature of Special Rights

Rights attached to the special share are set out in the Articles of Association of the company concerned. In the Annex we provide details of the special share provisions for BAE Systems, Rolls-Royce and QinetiQ and whilst they vary in some respects between companies, it can be seen that the speical shareholder has certain key rights, as follows:

Foreign shareholding limits – foreign shareholding limits were introduced as part of the privatisation of British Aerospace (now BAE Systems) and Rolls-Royce. These have been relaxed over time (see the case study below) but there is still a 15% limit on *individual* foreign shareholdings in BAE Systems and Rolls-Royce. Aggregate foreign shareholding has risen above 50% in both companies at certain points in their recent history.

Disposals – the special shareholder has certain rights with regard to consultation and veto powers over the sale of the company and some specific assets and in some cases has the option to purchase certain Strategic Assets in certain circumstances (for example, in the case of QinetiQ, see Annex 3)

Nationality of directors – in the case of BAE Systems and Rolls-Royce, a simple majority of the Board, including the Chief Executive and any Executive Chairman must be British.

Compliance system – in the case of QinetiQ and because of the sensitivity of the intellectual property and capabilities held by the company, and the importance of its advice and consultancy services for MOD remaining objective and impartial, the

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[241] UK Ministry of Defence (2005) *Defence Industrial Strategy* (London: Ministry of Defence).

[242] UK Ministry of Defence (2010b) 'MoD and QinetiQ'. London, available at <http://www.mod.uk/DefenceInternet/FactSheets/ModAndQinetiq.htm>.

special share confers certain rights with regard to the monitoring of the compliance system established as part of its privatisation (see Annex 3).

Illustrative case study: BAE SYSTEMS

The UK Government has two separate special shares in the company, the first relating to the whole of the business (the BAE Systems special share), and the second relating to the submarine business only (the VSEL special share).

When British Aerospace was partially privatised (51.5%) in 1981, the Company's Articles of Association contained a number of provisions in relation to ownership and control, which may be summarised as follows:

- Aggregate non-British ownership was limited to 15%;
- All Board members were to be British nationals;
- The Government could appoint a 'Government Director' to sit on the Board. (In practice, until the removal of this provision in 2002, this person was named from among the non-Executive Directors appointed by normal private sector practice and was never a representative of the Government.)

The company became fully privatised in 1985. In 1989 the limit on aggregate foreign ownership was raised to 29.5%, and in 1998 to 49.5%, but a new provision was introduced limiting share ownership by any one person or persons acting in concert to 15%. The provisions of the special share were last modified in 2002:

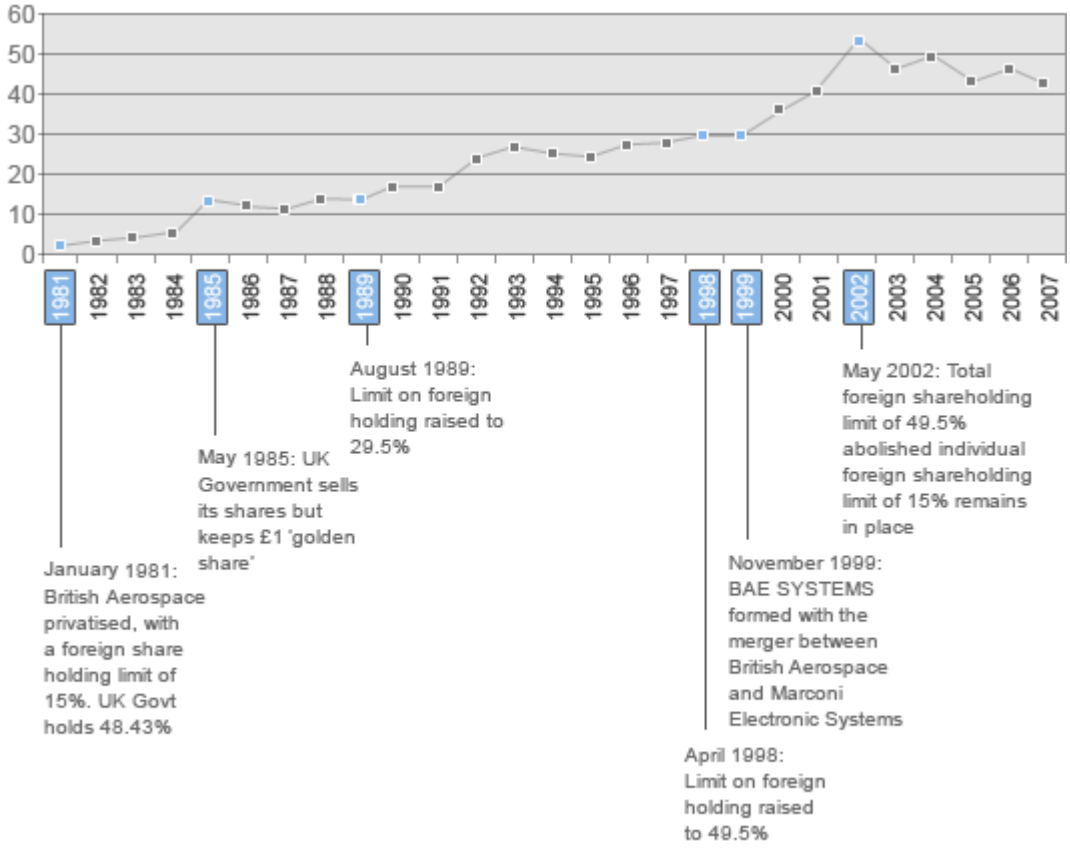
- the aggregate limit was abolished, leaving only the 15% cap on individual or concerted holdings;
- the nationality provisions in relation to Board membership were relaxed such that a majority of Board members, and the Chief Executive Officer and any Executive Chairman, must be British nationals. In March 2008, *The Sunday Times* newspaper reported that BAE Systems and Rolls-Royce had approached the Government in a bid to relax the terms of the special share to allow them the possibility to appoint a foreign Chief Executive.[243] No change in th rules resulted.

[243] Waples, J. and O'Connell, D. (2008) 'Roll-Royce and BAE Systems in secret plea to Downing Street'. *The Sunday Times, 16 March*..

- The position of Government Director was abolished.

Foreign ownership has since exceeded 50% for long periods, reaching a peak of 57% (see the Figure: Foreign shareholdings in BAE Systems).

Figure 3.1: Foreign shareholdings in BAE Systems[244]



- The ownership and Board nationality provisions may be relaxed at any time by an administrative decision of the Government. Thus, if the company was to be the subject of a foreign takeover or merger bid endorsed by the shareholders, the effect of the special share could be relaxed with the Government's consent. Similar considerations would apply to the appointment of a non-British Chief

[244] BAE Systems (2010b) 'Foreign shareholding: Individual foreign shareholding restrictions'. available at <http://bae-systems-investor-relations-2009.production.investis.com/shareholder-information/foreign-shareholding/timeline-of-key-events.aspx>.

Executive. Equally, the Government would be able to block a foreign takeover or merger.[245]

- The Government placed a special share in Vickers Shipbuilding and Engineering Ltd (VSEL) which was privatised in 1986. Acquired by GEC-Marconi in 1995 and consequently by BAE Systems in 1999, the line of business includes development and production of nuclear-powered submarines. The special share relates only to the wholly owned subsidiary in which the BAE Systems Submarine Solutions business is vested, and its provisions relate essentially to disposal of the whole or a material part of the business, together with nationality provisions requiring that Chairman, Chief Executive, Managing Director and a majority of directors are of British nationality.

3.3 National regulation of foreign acquisitions of defence assets

Merger policy in the UK is regulated under the Enterprise Act (2002) which came into force in June 2003, and the EC Mergers Regulation 04/139. The Enterprise Act (2002) allows the Secretary of State for Business Innovation and Skills to intervene on public interest grounds, including national security. In such cases, Government often seeks undertakings from acquiring companies on retaining defence capabilities in the UK. The potential acquisition of Centrica by the Russian company Gazprom Russia during the period 2006-2008 prompted political attention and a statement from the Government that there would be no change to the Enterprise Act (2002). A copy of the relevant sections of the Enterprise Act (2002) can be found in Annex 4.

Number of acquisitions subject to review on the grounds of national security

Since the commencement of the Enterprise Act's merger provisions on 20 June 2003, intervention notices relating to the public interest consideration "national security" have been issued in the following seven cases:

- 2004 - Acquisition of Alvis plc by General Dynamics Corporation.[246]

[245] But it is the Company's view that this power is secondary to other powers which the Government can exercise as customer and regulator.

- 2004 - Acquisition of full control of AgustaWestland N.V. by Finmeccanica S.p.A.
- 2004 - Acquisition of parts of the military communication and avionics businesses of BAE Systems plc by Finmeccanica S.p.A.
- 2005 - Acquisition of Insys Group Limited by Lockheed Martin UK Holdings Limited.
- 2007 - Release and variation of undertakings given by BAE SYSTEMS relating to its acquisition of the Marconi Electronic Systems business of the General Electric Company Plc (March 2000).
- 2007 - Acquisition of Smiths Aerospace Division by General Electric Company.
- 2009 - Acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik UK[247]

Reasons for review and definition of "defence assets" and "national security" used

The Enterprise Act (2002) gives the Government (through the Secretary of State for Business Innovation and Skills) the following powers to intervene in mergers with a national security dimension:

- The Enterprise Act provides for the Secretary of State to serve a "European intervention notice" to protect legitimate interests under Article 21(3) of the ECMR. National security is specified as a legitimate interest under the Enterprise Act. Chapter 2, 58 (2) of the Enterprise Act defines "national security" to include public security and "public security" has the same meaning as in Article 21(3) of the ECMR;
- The Enterprise Act provides for the Secretary of State to intervene in the consideration of a merger that s/he thinks might raise one or more public interest considerations ("merger public interest cases"). Public interest considerations are

[246] This transaction did not proceed since BAE Systems presented a higher value counter bid that was accepted by Alvis.

[247] BIS – Department for Business Innovation and Skills (2010) 'National Security Mergers'. available at <http://www.berr.gov.uk/Policies/business-law/competition-matters/mergers/mergers-with-a-public-interest/national-security-mergers>.

specified in the Enterprise Act as being national security, media plurality and stability of the UK financial system.

- The Act also provides for an exceptional category of mergers, which can be referred on public interest consideration grounds only ("special merger situation"). These are mergers involving a Government contractor (past or present) who holds confidential material related to defence – so triggering the consideration of national security – but who does not meet the normal qualifying thresholds relating to turnover or the share of supply.[248] The Enterprise Act 59(9) makes clear that "defence" has the same meaning as in section 2 of the Official Secrets Act 1989 (6) (see Annex 5 of this report); and "government contractor" includes any sub-contractor of a Government contractor, any sub-contractor of that sub-contractor and any other sub-contractor in a chain of sub-contractors which begins with the sub-contractor of the Government contractor.

Assessment of European interests in the review process

European interests are not formally taken into account in the review process. The Office of Fir Trading (OFT) issues an invitation to comment (ITC), allowing 10 days for 3rd parties to respond; Government departments (like MOD), other firms with an interest and any other individuals/entities all respond in this period; the ITC is referenced on the OFT's web-site, is communicated to the market via the Regulatory News Service (RNS), and is sent to companies nominated to the OFT by the target as competitors and customers.

Differentiation between EU and non-EU countries

The process does not differentiate between EU and non-EU countries. In law, the Enterprise Act (2002) does not make any distinction between EU and non-EU countries. Equally, in policy, the MOD does not distinguish between EU and third countries. For example, the Defence Technology Strategy sets out the critical areas where the UK judges a need to retain sovereign capabilities and as opposed to those

[248] The provisions of the Enterprise Act mean that, in normal circumstances, mergers can only be considered by the UK competition authorities if the turnover in the UK of the enterprise being taken over exceeds £70m or the merger creates or increases a 25% share in a market for goods or services in the UK or a substantial part of it.

where the UK can engage in international collaboration. No distinction is drawn between European and third country international collaboration.

Authorities responsible for the review process

The Enterprise Act (2002) gives the Government (through the Secretary of State for Business Innovation and Skills) the power to intervene in mergers with a national security dimension. The Secretary of State intervenes by serving an intervention notice on the Office of Fair Trade (OFT). The OFT is the UK's consumer and competition authority. Where a merger raises national security concerns, the OFT relies heavily on representations made by the Ministry of Defence. The MOD's Defence Equipment & Support organization (DES) has a mergers and acquisitions adviser within its Industry Group who is responsible for MOD advice on defence industry mergers and acquisitions. The Act allows the OFT to refer a transaction to the Competition Commission.

Intervention procedures

Under UK law, there is no general requirement to notify mergers to the UK competition authorities although guidance published by the Government recommends that: "If you consider the UK's essential security interests may be affected by the deal then you are advised to contact the Ministry of Defence".[249]

In *merger public interest cases*, the Secretary of State for Business Innovation and Skills intervenes by serving an intervention notice on the Office of Fair Trading (OFT).[250] The OFT then makes a report to the Secretary of State for Trade and Industry giving its advice on a number of matters. They include whether a relevant merger situation has been or will be created, whether a substantial lessening of competition has resulted or may be expected to result, whether any relevant customer benefits outweigh the substantial lessening of competition and any resulting adverse effect, whether the matter might appropriately be dealt with (disregarding any public interest consideration) by way of undertakings, and the importance of the market. The

[249] *The EC Merger Regulation Guidance Notes*, Competition Policy Directorate, Department of Trade and Industry, November 1998.

[250] The OFT is an organization independent of Government that is the principle body that investigates the competition aspects of mergers in the UK.

OFT makes recommendations on the public interest consideration and a summary of any representations about the case.

In the case of *merger special interest cases*, similar procedures to those in public interest cases apply. The Secretary of State must issue an intervention notice; the OFT makes a report as to whether a special merger has been or will be created, including any other relevant advice, recommendations on the public interest consideration and a summary of any representations about the case.

So far as the timetable for Enterprise Act public interest interventions is concerned, the minimum and maximum timescales are as follows:[251]

- OFT has a maximum of 40 working days to submit a report to the Department of Business Innovation and Skills (BIS) after BIS issues - publicly - its intervention notice
- Within this period, OFT issues an invitation to comment (ITC), allowing 10 days for 3rd parties to respond; Government departments (like MOD), other firms with an interest and any other individuals/entities all respond in this period; the ITC is referenced on the OFT's web-site, is communicated to the market via the Regulatory News Service (RNS), and is sent to companies nominated to the OFT by the target as competitors and customers.
- Following receipt of the OFT report, and internal BIS consideration, BIS issues a Press Release stating its intention to accept the undertakings supplied by the OFT in lieu of reference to the Competition Commission; BIS invites 3rd parties to provide comments on the undertakings, also published together with an unclassified version of the OFT report with the PR, within 15 working days; this period may be extended by a further recurrent 7 working days if comments are received and BIS decides to amend the undertakings and re-consult.
- The final stage of the process is a BIS PR reporting Ministerial acceptance of undertakings in lieu of reference

On receipt of the OFT report, for public interest cases, the Secretary of State for Business Innovation and Skills decides whether to:

[251] Interviews conducted with representatives of the Ministry of Defence, February 2010.

- clear a merger;
- refer the merger to the Competition Commission because it may be against the public interest.[252] A reference may be made on grounds of substantial lessening of competition and grounds of public interest, or on grounds of public interest alone. Where a case is referred on public interest grounds, the Secretary of State will also decide on remedies (if any) following receipt of the Competition Commission report;
- seek undertakings in lieu of reference. In public interest cases, the Secretary of State may accept undertakings by the company concerned in lieu of a reference to the Competition Commission following receipt of advice from the OFT. Again, it is the MOD, through the OFT, that proposes those undertakings.[253]

Right of appeal

The Enterprise Act public interest intervention process includes an appeal mechanism. Clause 120 allows aggrieved persons to apply to the Competition Appeal tribunal for a review of decisions. The mechanism was last used in relation to the Lloyds-HBOS merger in the banking sector. It has not been used for any defence merger under the Enterprise Act 2002.

Mitigation agreements

The UK government, through the MOD, has shown a strong preference for the use of behavioural undertakings to mitigate the effect of foreign acquisition in the defence sector. These mitigation agreements are not laid down in law (in the Enterprise Act) and several industry representatives with experience on the buy side and sell side of defence deals in the UK commented on the lack of transparency with respect to mitigation. Nevertheless, mitigation agreements are published by the OFT and it is

[252] The Competition Commission is an independent public body established by the Competition Act 1998. The Commission conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries. Every inquiry is undertaken in response to a reference made to it by another authority: usually by the Office of Fair Trading (OFT) but in certain circumstances the Secretary of State.

[253] By and large, undertakings in lieu of reference to the Competition Commission are likely to be preferred by the acquiring company not least because of the length of time a full Competition Commission enquiry takes – and the real prospect that the Competition Commission may find against the acquirer (on public interest grounds) and veto the transaction.

possible to analyse the content of these behavioural undertakings and draw some general observations.

One important theme that emerges from an analysis of the cases is the important role played by behavioural undertakings relating to the future conduct of the merged business. In each case, the Ministry of Defence (through its representations to the OFT) has raised concerns about the national security implications of the transactions and these concerns were resolved by means of behavioural undertakings by the acquiring company.

A review of the undertakings given by the companies shows that the UK Government uses a variety of mechanisms to control foreign-owned companies. This review is set out in Annex 6 which provides a detailed assessment. The key points are as follows:

1. **Maintenance of strategic capabilities** - The maintenance of strategic capabilities necessary for UK military programmes has been a key concern for the Ministry of Defence. In each case, the company has been asked to undertake that:

    - Military Programmes shall continue to be conducted by a company or companies incorporated within the UK under UK law and in relation to which a majority of the company Directors are UK nationals;

    - The Board of Directors of the UK company shall contain sufficient UK nationals who are security-cleared to enable security sensitive issues to be resolved at Board level should the need arise;

    - Prior notification by the parent company to the Ministry of Defence prior to disposing of any asset that is significant for the conduct of Military Programmes and in respect also for any proposal for the voluntary winding-up or dissolution of one of those assets.

    - Assurances of continuity of development and/or supply of all goods and services for Military Programmes in respect of which the contracts to which the UK company is a party

2. **Protection of classified information** - Another key concern has related to the protection of classified information and behavioural undertakings agreed to by the acquiring companies have included the following:

- All matters relating to security within the UK company, particularly within those carrying out activities in relation to Military Programmes, shall be maintained in line with UK National Security Regulations, including the security of work areas subject to special physical ring-fencing;
- The operational management of the UK company's Military Capability will be by UK security cleared personnel with security procedures meeting UK National Security Regulations and any other such requirements as deemed necessary from time to time by the UK security authorities;
- In addition, in cases where U.S. classified information is handled by the UK company in question, the behavioural undertakings have been included on these as well:
  - In its acquisition of Racal, Thomson-CSF undertook that: "With respect to Military Programmes or which the UK company offer elements of hardware and software sourced from USA, the company undertakes that all US Classified or unclassified information, technical data, software or equipment delivered with US Government approval to the UK company in support of programmes will not be released or disclosed to non UK or non US citizens, without the prior written approval of the US Government";
  - Of interest is that in the GE acquisition of Smiths Aerospace, the MOD insisted on the inclusion of an undertaking with respect to ITAR fearing that "[US ITAR] would have profound implications for UK security of supply if UK information and technology was combined with US information and technology without UK knowledge or approval".

3. **Compliance** - The undertakings also include specific requirements to ensure that the company complies with those undertakings.

Other means of regulation of the activities of foreign owned companies

The point was made by MOD officials and industry that there were other means available to the MOD to control foreign owned companies. MOD officials noted the UK's use of Security Deeds as an alternative to the use of the Enterprise Act in the case of small acquisitions where the cost of the review process under the Enterprise Act was deemed excessively burdensome on the parties concerned. The Enterprise

Act process is costly for both Government and the parties involved. The duration of the process is also seen as a problem since the Enterprise Act review process typically takes at least 2-3 months and often more during which there is an effective stop on the completion of the deal. Thus, it is deemed to be unsuitable for most small transactions and there is a feeling within the MOD that if the Enterprise Act were to be used for such transactions it might have the effect of deterring some acquiring companies from engaging in such transactions.

There is no published information on security deeds or any other forms of guarantee that the MOD might seek from companies buying firms in the UK's defence industrial base.[254] However, we have established that Security Deeds are a legal undertaking given by a party (the new owner) to the secretary of State for Defence. Security Deeds include similar behavioural undertakings to those used in lieu of reference to the Competition Commission under the Enterprise Act process. The number of Security Deeds agreed varies depending on the level of M&A activity and varies from 1-2 up to half a dozen a year. It ought to be emphasised that there are some small deals which have prompted full review because they were deemed by the MOD to be sensitive business with unique capabilities where the MOD wished to have statutory undertakings. For instance the acquisition of INSYS by Lockheed Martin and the acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik (see case study in section 4.1).

The previous sections have discussed the control of mergers and joint ventures. However, there are many foreign owned companies operating in the UK defence industry that have been established by means other than acquisition. For instance, Raytheon has not made any UK acquisitions per se – its presence in the UK industry is the product of a combination of off-set deals dating back to the 1960s, project management offices and foreign direct investment in facilities in support of specific programmes. Lockheed Martin is similar. The activities of these companies are regulated by other means:

- All Government contractors have to abide by the requirements of the Official Secrets Act 1911 to 1989 and UK National Security Regulations as defined in

[254] Correspondence with the Ministry of Defence, February 2010.

the UK Government's Manual of Protective Security impose certain restrictions on the use of and requirements for the protection of classified material by Government contractors;

- UK National Security Regulations require that a security officer is appointed by the company responsible for facilitating and overseeing compliance with UK National Security Regulations;
- There is a requirement that Military Programmes are conducted by a company or companies incorporated within the UK under UK law and in relation to which a majority of the company Directors are UK nationals.
- In addition, U.S. companies operating in the UK remain governed by certain U.S. legislation not least the Foreign Corrupt Practises Act.

4 CASE STUDIES

4.1 Acquisitions by a company from a EU country

The acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik

The acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik is an example of the acquisition of a UK defence asset by a EU company.

In May 2009, Atlas Elektronik UK (AEUK) a UK subsidiary of the German company Atlas Elektronik GmbH (Atlas Elektronik) announced its attention to acquire Underwater Systems Winfrith (UWS Winfrith), a division of QinetiQ plc. UWS Winfrith is a key supplier of research, advice, enabling technology, systems and support for a number of current and future maritime platforms for the UK's armed forces.

On 15 May 2009, the Secretary of State for Business Innovation and Skills issued a special intervention notice to the Office of Fair Trading (OFT) under section 59(2) of the Enterprise Act 2002. The OFT subsequently confirmed that the transaction would lead to a special merger situation since the UWS Winfrith was a relevant Government contractor under section 59(8) of the Enterprise Act.

Following receipt of the special intervention notice, the OFT consulted and invited comments on the national security public interest consideration identified in that notice. In response to the consultation, representations on national security issues were received from the MoD and a third party (which was not named in the OFT's report to the Secretary of State).

The MoD expressed concerns because UWS Winfrith possesses unique capabilities that could not be replicated in other onshore capabilities operating in similar and analogous sectors without significant MoD investment. The concern is that following the acquisition, Atlas Elektronik might choose to rationalise its defence activities with the potential consequence that these essential UK capabilities could either be run down, sold off or transferred abroad to be combined with Atlas Elektronik's other foreign based business activities. In addition, the move to ultimate control by a German parent company raises concerns for the MoD due to the potential for day-to-day management of programmes in support of the MoD being moved to Germany, and for application of German export control regulations to UWS Winfrith's output for the MoD. MoD consider that this would have profound implications for the UK's security of supply, as well as the timely delivery, of advice or systems, if UK information and technology were to be combined with foreign information and technology without UK knowledge or approval and/or MoD supply became subject to German export control.

MOD went on to express further detailed concerns regarding the impact on UK national security, maintenance of strategic UK capabilities, protection of technology and information, independence and impartiality of research outputs and advice.

In its report to the Secretary of State, the OFT noted that the MOD had proposed undertakings in lieu of reference to the Competition Commission to mitigate the national security issues raised by the transaction. The OFT noted that the MoD believed that it would be necessary to establish special security arrangements to ensure that the UK's national security interests were being adequately protected post merger. The aim of these arrangements would be to satisfy the MoD that sensitive information could not be passed to foreign nationals without the MoD's express approval and that the MoD would be informed before UK military capability was adversely affected, enabling it to take appropriate action.

In its report to the Secretary of State, the OFT attached draft undertakings intended to remedy, mitigate or prevent the particular effects adverse to the public interest identified by the MoD which may be expected to result from the creation of the special merger situation concerned. The OFT noted that AEUK and Atlas Elektronik have confirmed to the MoD that they are willing to sign the undertakings in the form attached in the appendix.

Consequently, on 28th September 2009 the Secretary of State cleared the acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik UK subject to those Statutory Undertakings.

4.2 Acquisitions by a company from a non-EU country

In January 2007, the U.S. company General Electric announced its intention to acquire the aerospace business of Smiths Group PLC for $4.8 billion. Smiths Aerospace was active in the supply of various types of aerospace systems and equipment. It had critically important capabilities within the UK in the areas of combat, weapon and communications system integration and research capabilities.

On 20 March 2007, the Secretary of State for Trade and Industry issued a European intervention notice to the Office of Fair Trading (OFT) under section 67(2) of the Enterprise Act 2002 citing Article 21 (4) of the ECMR to take appropriate measures to protect public security as a legitimate interest.

The Ministry of Defence (MOD) made the representations on national security issues to the OFT and in particular identified three main areas of concern arising from the proposed transaction: the transfer of ownership of Smiths Aerospace outside the UK, the maintenance of strategic UK capabilities and the protection of classified technology and information. Regarding the transfer of ownership of Smiths Aerospace, the MOD stated that GE may be able to influence Smiths Aerospace in ways that could prejudice national security unless the MOD obtains assurances over certain aspects of its behaviour. With regard to the maintenance of strategic UK capabilities, the MOD stated that Smiths Aerospace is a key supplier of sub-systems for a number of important current and future weapons platforms and that it was essential for the protection of the UK's national security that these capabilities were retained within the UK.

Interestingly, the MOD also expressed concern that the move to US control might create difficulties due to the US International Traffic in Arms Regulations (US ITAR) which would have profound implications for UK security of supply if UK information and technology was combined with US information and technology without UK knowledge or approval.

The MOD argued that it was necessary to obtain an assurance from GE that it will continue to make available to the UK the capabilities that Smith Aerospace possesses in these areas, and that, in the event of any proposed rationalisation by GE, such capabilities will be maintained within the UK and neither run down, nor transferred abroad, following the Transaction without prior consultation with the

MOD. In relation to the protection of classified technology and information the MOD notes that the above described capabilities are dependent, to different extents, on classified technology and information. The 'leakage' of such information or technology outside the UK could directly prejudice the UK armed forces' operational security and capability.

The MOD proposed undertakings in lieu of reference to the Competition Commission. In particular, legally binding undertakings from GE (combined with an appropriate compliance regime) were proposed to assure the UK Government that sensitive information and technology was adequately protected.

In its report to the Secretary of State, the OFT appended draft undertakings intended to remedy, mitigate or prevent the particular effects adverse to the public interest identified by the MOD. The OFT noted that GE and Smiths Aerospace had confirmed that they were willing to give the undertakings and the secretary of State subsequently authorized the transaction subject to those undertakings.

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of countries to FDI

UK representatives of industry and Government detect a great deal of difference regarding the openness of countries to foreign acquisitions in the defence industry. The following table provides a summary of the assessment by UK interview partners. They are combined with selected comments that reflect the assessment in the most succinct way to shed a light on the background of the assessment.

We wish to stress, however, that this ranking is by no means a representative picture of the opinion neither of the UK Government nor the UK defence industry.

Table 5.1: Ranking of countries according to perceived openness:

Country	Rank 1=most open – 9=most closed	Comment
France	9	"[France has] a very nationalistic defence industrial policy and defence acquisition strategy; continues national ownership of parts of its defence industrial base."
Germany	5	"Arguably recent legislation and decisions to block some deals suggest that Germany is less open than it was."
Italy	8	"Foreign investment is very difficult but not impossible; but rules are very unclear."
The Netherlands	4	
Poland	6	
Spain	7	"France, Italy and Spain retain extensive public ownership and have not generally embraced inward investment."
Sweden	1	"Sweden has shown itself to be open and welcoming to foreign acquisition."
United Kingdom	2	"Our policy is clear and open to foreign investment but the process is less transparent than it could be."

Country	Rank 1=most open – 9=most closed	Comment
United States	3	"Clarity of policy is important – the US has lots of regulations but they are clear and transparent and you know what the rules are when you invest".

The perception of "relative openness" has been the subject of comment by the UK government. The UK Defence Industrial Strategy says: "The principal continental European markets remain less open than the UK in terms of foreign access to domestic markets, rules on foreign inward investment into local companies and significant retained shareholdings by some governments". In addition, the UK has sought to address some of these matters through the LOI/Framework Agreement process and through the EDA.

In the view of UK industry, 'special shares' or comparable arrangements in other jurisdictions are not of themselves a determining factor in defence M&A activity. The question is one of governmental will: various means are available first to discourage and second, if required, to thwart an undesired merger or acquisition. It is also possible for acquirers to obtain regulatory approvals but then find that the business they have bought are starved of public R&D funds or procurement contracts.[255]

In Europe, in this view, the fundamental impediment to M&A activity derives from Government ownership and control of defence companies. One industry representative noted that it is observable that, in the six LoI nations, there has generally been much greater openness to inward acquisitions by the UK, Germany and Sweden – countries which do not have public ownership of defence industry. On the other hand, France, Italy and Spain retain extensive public ownership and have not generally embraced inward investment. Indeed, the vertical consolidations of private national companies into their state-controlled businesses in the late 1990s will remain in place unless and until the groups and their Government shareholders decide to deconsolidate. This seems most unlikely to occur in the near term: governments' instinct is generally limited to making perimeter adjustments between state-controlled

[255] Interview with a representative of BAE Systems, February 2010.

businesses. Foreign private capital is largely excluded from making substantive acquisitions in these markets: indeed, denationalising a company through sale to a foreign owner would be very politically challenging. It is probably also true to say that, even if offered the opportunity, private capital would be cautious about making acquisitions in these markets since these governments often appear to lack the political maturity to treat foreign enterprise on an even competitive footing with state-controlled champions. [256]

5.2 On the need for EU level action

In our interviews and meetings with representatives of UK Government and industry we found no support for EU level action and – in some cases – active antagonism and opposition to such an idea.

With respect to UK government, we have noted how the Defence Industrial Strategy commented on the lack of a "level playing field" in Europe and that UK Government had sought to use the LOI and EDA to address some of these issues. However, UK Ministry of Defence officials did not express any particular enthusiasm for a EU action with a Commission dimension. Officials expressed various reasons for their opposition, including a feeling that these issues were most appropriately dealt with by Member States through intergovernmental activity at the European or bilateral level, a feeling that this lay outside the Commission's competence and the view that the European commission is not best placed to make security assessments of foreign acquisitions and their link to national security.

Respondents from Government and industry stressed that there were a variety of controls open to Member States due to their position as monopsonistic buyers in the market for defence equipment. it is a major customer and major source of R&D investment for defence technology and can wield its power as budget holder; it has powers to grant or refuse security clearance to a company's physical sites for work involving classified information (such clearances and associated undertakings have been a necessary part of the UK Government's approval process for inward investments); and, depending on the precise circumstances of an acquisition or

[256] Interview with a representative of BAE Systems, February 2010.

merger, it has a potentially decisive influence over merger or other regulatory controls conducted under national jurisdiction by virtue of Articles 36 or 346 TFEU. These considerations apply in all EU Member States with indigenous industrial capability.

There were a number of specific comments and concerns made about the options presented to industry and the following presents some of the comments made:

- Some industry representatives commented that it was very difficult to add any kind of additional regulatory process that would not make the regulatory process more complex and slow down deals. If additional regulatory processes very to have this effect it be counter to the aim of promoting European consolidation since more complex and time consuming regulation would add time, cost and uncertainty in the minds of industry. Faced by additional time, cost and uncertainty industry might decide not to make acquisitions in Europe and prefer foreign direct investment in the United States or in the emerging Indian markets.
- There were strong concerns and anxieties voiced about the idea of any action that focused on third countries. Industry representatives noted that it was difficult to see how you could focus on a third country since this would likely result in major foreign policy tensions and would also be discriminatory.
- UK industry expressed a concern about any policy or legal development that might create or be perceived to create a “Fortress Europe”. In particular, there were clear and strongly voiced concerns about any development that discriminated against the U.S. since UK industry (and industry from other European countries including France and Italy) had made investments in the United States and would not wish EU level action to lead to U.S. counter actions that had the effect of blocking the possibility of further future investments in the United States.

6 ANNEX

6.1 Annex 1: BAE Systems special share[257]

The Special Share is held on behalf of the Secretary of State for Business, Enterprise and Regulatory Reform (the 'Special Shareholder'). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, the requirement that decisions of the directors at their meetings, in their committees or via resolution must be approved by a majority of British directors and the requirement that the chief executive and any executive chairman are British.

The holder of the Special Share is entitled to attend a general meeting, but the Special Share carries no right to vote or any other rights at any such meeting, other than to speak in relation to any business in respect of the Special Share. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, the Special Share shall be entitled to repayment of the £1 capital paid up on the Special Share in priority to any repayment of capital to any other members.

The holder of the Special Share has the right to require the Company to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

6.2 Restrictions on transfer of securities

The restrictions on the transfer of shares in the Company are as follows:

[257] BAE Systems (2010a) 'BAE Systems Annual Report 2008'. available at <http://www.annualreport08.baesystems.com/en/governance/statutory-regulatory-information/miscellaneous-information.aspx>.

- the Special Share may only be issued to, held by and transferred to the Special Shareholder or his successor or nominee;
- the directors shall not register any allotment or transfer of any shares to a foreign person, or foreign persons acting in concert, who at the time have more than a 15% voting interest in the Company, or who would, following such allotment or transfer, have such an interest;
- the directors shall not register any person as a holder of any shares unless they have received: (i) a declaration stating that upon registration, the share(s) will not be held by foreign persons or that upon registration the share(s) will be held by a foreign person or persons; (ii) such evidence (if any) as the directors may require of the authority of the signatory of the declaration; and (iii) such evidence or information (if any) as to the matters referred to in the declaration as the directors consider appropriate;
- the directors may, in their absolute discretion, refuse to register any transfer of shares which are not fully paid up (but not so as to prevent dealings in listed shares from taking place);
- the directors may also refuse to register any instrument of transfer of shares unless the instrument of transfer is in respect of only one class of share and it is lodged at the place where the register of members is kept, accompanied by a relevant certificate or such other evidence as the directors may reasonably require to show the right of the transferor to make the transfer;
- the directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly;
- where a shareholder has failed to provide the Company with certain information relating to their interest in shares, the directors can, in certain circumstances, refuse to register a transfer of such shares;
- certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws);
- restrictions may be imposed pursuant to the Listing Rules of the Financial Services Authority whereby certain of the Group's employees require the Company's approval to deal in shares; and

- awards of shares made under the Company's share incentive plan are subject to restrictions on the transfer of shares prior to vesting.

The Company is not aware of any arrangements between its shareholders that may result in restrictions on the transfer of shares and/or voting rights.

6.3 Annex 2: Rolls-Royce special share

Details of its special share were set out in the 2008 Annual Report and Accounts of Rolls-Royce[258] as follows.

Certain rights attach to the special rights non-voting share (Special Share) issued to HM Government (Special Shareholder). Subject to the provisions of the Companies Act 1985, the Special Share may be redeemed by the Treasury Solicitor at par at any time. The Special Share confers no rights to dividends but in the event of a winding-up it shall be repaid at its nominal value in priority to any other shares. Certain Articles (in particular those relating to the foreign shareholding limit, disposals and the nationality of directors) that relate to the rights attached to the Special Share may only be altered with the consent of the Special Shareholder. The Special Shareholder is not entitled to vote at any general meeting or any other meeting of any class of shareholders.

The Articles of Association also provide that no person may be appointed to the office of chairman (in an executive capacity) or to the office of chief executive, managing director or joint managing director of the Company, unless the individual is a British citizen. No person may be appointed to the office of director of the Company if, immediately following such appointment, the number of directors of the Company who are not British citizens would exceed one half of the total number of directors of the Company for the time being.

No disposal may be made to a non-Group member which, alone or when aggregated with, the same or a connected transaction, constitutes a disposal of the whole or a material part of either the nuclear business or the assets of the Group as a whole, without consent of the Special Shareholder.[259]

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[258] Rolls Royce (2008) 'Annual Report 2008: Corporate governance'. available at <http://www.rolls-royce.com/reports/2008/Download-Centre/RR_08_governance.pdf>.

[259] The Articles of Association of Rolls-Royce define “nuclear business” as the Group’s business providing and supporting submarine nuclear propulsion systems – i.e. the restrictions do not relate to the company’s civil nuclear business.

6.4 Annex 3: QinetiQ special share[260]

The Notes to the financial statement of QinetiQ's Annual Report and Accounts (2009) contain the folloing information on the QinetiQ special share.

Rights attaching to the Special Share

QinetiQ carries out activities which are important to UK defence and security interests. To protect these interests in the context of the ongoing commercial relationship between the MOD and QinetiQ, and to promote and reinforce the Compliance Principles, the MOD holds a Special Share in QinetiQ. The Special Share confers certain rights on the holder:

to require the Group to implement and maintain the Compliance System (as defined in the Articles of Association) so as to make at all times effective its and each member of QinetiQ Controlled Group's application of the Compliance Principles, in a manner acceptable to the Special Shareholder;

to refer matters to the Board or the Compliance Committee for its consideration in relation to the application of the Compliance Principles;

to veto any contract, transaction, arrangement or activity which the Special Shareholder considers:

may result in circumstances which constitute unacceptable ownership, influence or control over QinetiQ or any other member of the QinetiQ consolidated Group contrary to the defence or security interests of the United Kingdom; or

would not, or does not, ensure the effective application of the Compliance Principles to and/or by all members of the QinetiQ Controlled Group or would be or is otherwise contrary to the defence or security interests of the United Kingdom;

to require the Board to take any action (including but not limited to amending the Compliance Principles), or rectify any omission in the application of the Compliance

[260] QinetiQ Annual Report and Accounts 2009, notes to the financial statement http://annualreport2009.qinetiq.com/financial-statements/notes-financial-statements/share-capital.aspx

Principles, if the Special Shareholder is of the opinion that such steps are necessary to protect the defence or security interest of the United Kingdom;

to exercise any of the powers contained in the articles in relation to the Compliance Committee; and

to demand a poll at any of the QinetiQ's meetings (even though it may have no voting rights except those specifically set out in the Articles).

The Special Shareholder has an option to purchase defined Strategic Assets of the Group in certain circumstances. The Special Shareholder has, *inter alia*, the right to purchase any Strategic Assets which the Group wishes to sell. Strategic Assets are normally testing and research facilities (see note 36 for further details).

The Special Share may only be issued to, held by and transferred to H.M. Government (or as it directs). At any time the Special Shareholder may require QinetiQ to redeem the Special Share at par. If QinetiQ is wound up the Special Shareholder will be entitled to be repaid the capital paid up on the Special Share before other shareholders receive any payment. The Special Shareholder has no other right to share in the capital or profits of QinetiQ.

The Special Shareholder must give consent to a general meeting held on short notice.

The Special Share entitles the Special Shareholder to require certain persons who hold (together with any person acting in concert with them) a material interest in QinetiQ to dispose of some or all of their Ordinary Shares in certain prescribed circumstances on the grounds of national security or conflict of interest.

The Directors must register any transfer of the Special Share within seven days.

Note 36 is:

Freehold land and buildings and surplus properties

Under the terms of the Group's acquisition of part of the business and certain assets of DERA from the MOD on 1 July 2001, the MOD retained certain rights in respect of the freehold land and buildings transferred. These are:

i) Restrictions on transfer of title

The title deeds of those properties with strategic assets (see below) include a clause that prevents their transfer without the approval of MOD. The MOD also has the right to purchase any strategic assets in certain circumstances.

ii) Property clawback agreement

The MOD retains an interest in future profits on disposal following a 'trigger event'. A 'trigger event' includes the granting of planning permission for development and/or change of use, and the disposition of any of the acquired land and buildings. During the 12 years from 1 July 2001, following a 'trigger event', the MOD is entitled to clawback a proportion of the gain on each individual property transaction in excess of a 30% gain on a July 2001 professional valuation. The proportion of the excess gain due to the MOD is based on a sliding scale which reduces over time from 50% to 9% and at 31 March 2009 stands at 33% (2008: 37%). The July 2001 valuation was approximately 16% greater in aggregate than the consideration paid for the land and buildings on 1 July 2001.

Compliance Regime

The Compliance Committee monitors the effective application of the Compliance Regime required by the MOD to maintain the position of QinetiQ as a supplier of independent and impartial scientific/technical advice to the MOD and ensures that the required standards are met in trials involving human volunteers.

Strategic assets

Under the Principal Agreement with the MOD, the QinetiQ controlled Group is not permitted without the written consent of the MOD, to:

i) dispose of or destroy all or any part of a strategic asset; or

ii) voluntarily undertake any closure of, or cease to provide a strategic capability by means of, all or any part of a strategic asset.

The net book value of assets identified as being strategic assets as at 31 March 2009 was £2.7m (31 March 2008: £2.9m), the principal items being plant and machinery.

6.5 Annex 4: The Enterprise Act (2002)

CHAPTER 2 PUBLIC INTEREST CASES

Power to make references

42 Intervention by Secretary of State in certain public interest cases

(1) Subsection (2) applies where—

(a) the Secretary of State has reasonable grounds for suspecting that it is or may be the case that a relevant merger situation has been created or that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation;

(b) no reference under section 22 or 33 has been made in relation to the relevant merger situation concerned;

(c) no decision has been made not to make such a reference (other than a decision made by virtue of subsection (2)(b) of section 33 or a decision to accept undertakings under section 73 instead of making such a reference); and

(d) no reference is prevented from being made under section 22 or 33 by virtue of—

(i) section 22(3)(a) or (e) or (as the case may be) 33(3)(a) or (e); or

(ii) Community law or anything done under or in accordance with it.

(2) The Secretary of State may give a notice to the OFT (in this Part "an intervention notice") if he believes that it is or may be the case that one or more than one public interest consideration is relevant to a consideration of the relevant merger situation concerned.

(3) For the purposes of this Part a public interest consideration is a consideration which, at the time of the giving of the intervention notice concerned, is specified in section 58 or is not so specified but, in the opinion of the Secretary of State, ought to be so specified.

(4) No more than one intervention notice shall be given under subsection (2) in relation to the same relevant merger situation.

(5) For the purposes of deciding whether a relevant merger situation has been created or whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, sections 23 to 32 (read together with section 34) shall apply for the purposes of this Chapter as they do for the purposes of Chapter 1 but subject to subsection (6).

(6) In their application by virtue of subsection (5) sections 23 to 32 shall have effect as if—

(a) for paragraph (a) of section 23(9) there were substituted—

"(a) in relation to the giving of an intervention notice, the time when the notice is given;

(aa) in relation to the making of a report by the OFT under section 44, the time of the making of the report;

(ab) in the case of a reference which is treated as having been made under section 45(2) or (3) by virtue of section 49(1), such time as the Commission may determine; and";

(b) the references to the OFT in sections 25(1) to (3), (6) and (8) and 31 included references to the Secretary of State;

(c) the references to the OFT in section 25(4) and (5) were references to the Secretary of State;

(d) the reference in section 25(4) to section 73 were a reference to paragraph 3 of Schedule 7;

(e) after section 25(5) there were inserted—

"(5A) The Secretary of State may by notice to the persons carrying on the enterprises which have or may have ceased to be distinct enterprises extend the four month period mentioned in section 24(1)(a) or (2)(b) if, by virtue of section 46(5) or paragraph 3(6) of Schedule 7, he decides to delay a decision as to whether to make a reference under section 45.

(5B) An extension under subsection (5A) shall be for the period of the delay.";

(f) in section 25(10)(b) after the word "(4)" there were inserted ", (5A)";

(g) the reference in section 25(12) to one extension were a reference to one extension by the OFT and one extension by the Secretary of State;

(h) the powers to extend time-limits under section 25 as applied by subsection (5) above, and the power to request information under section 31(1) as so applied, were not exercisable by the OFT or the Secretary of State before the giving of an intervention notice but the existing time-limits in relation to possible references under section 22 or 33 were applicable for the purposes of the giving of that notice;

(i) the existing time-limits in relation to possible references under section 22 or 33 (except for extensions under section 25(4)) remained applicable on and after the giving of an intervention notice as if any extensions were made under section 25 as applied by subsection (5) above but subject to further alteration by the OFT or the Secretary of State under section 25 as so applied;

(j) in subsection (1) of section 31 for the words "section 22" there were substituted "section 45(2) or (3)" and, in the application of that subsection to the OFT, for the word "deciding" there were substituted "enabling the Secretary of State to decide";

(k) in the case of the giving of intervention notices, the references in sections 23 to 32 to the making of a reference or a reference were, so far as necessary, references to the giving of an intervention notice or an intervention notice; and

(l) the references to the OFT in section 32(2)(a) to (c) and (3) were construed in accordance with the above modifications.

(7) Where the Secretary of State has given an intervention notice mentioning a public interest consideration which, at that time, is not finalised, he shall, as soon as practicable, take such action as is within his power to ensure that it is finalised.

(8) For the purposes of this Part a public interest consideration is finalised if—

(a) it is specified in section 58 otherwise than by virtue of an order under subsection (3) of that section; or

(b) it is specified in that section by virtue of an order under subsection (3) of that section and the order providing for it to be so specified has been laid before, and approved by, Parliament in accordance with subsection (7) of section 124 and within the period mentioned in that subsection.

43 Intervention notices under section 42

(1) An intervention notice shall state—

(a) the relevant merger situation concerned;

(b) the public interest consideration or considerations which are, or may be, relevant to a consideration of the relevant merger situation concerned; and

(c) where any public interest consideration concerned is not finalised, the proposed timetable for finalising it.

(2) Where the Secretary of State believes that it is or may be the case that two or more public interest considerations are relevant to a consideration of the relevant merger situation concerned, he may decide not to mention in the intervention notice such of those considerations as he considers appropriate.

(3) An intervention notice shall come into force when it is given and shall cease to be in force when the matter to which it relates is finally determined under this Chapter.

(4) For the purposes of this Part, a matter to which an intervention notice relates is finally determined under this Chapter if—

(a) the time within which the OFT is to report to the Secretary of State under section 44 has expired and no such report has been made;

(b) the Secretary of State decides to accept an undertaking or group of undertakings under paragraph 3 of Schedule 7 instead of making a reference under section 45;

(c) the Secretary of State otherwise decides not to make a reference under that section;

(d) the Commission cancels such a reference under section 48(1) or 53(1);

(e) the time within which the Commission is to prepare a report under section 50 and give it to the Secretary of State has expired and no such report has been prepared and given to the Secretary of State;

(f) the time within which the Secretary of State is to make and publish a decision under section 54(2) has expired and no such decision has been made and published;

(g) the Secretary of State decides under section 54(2) to make no finding at all in the matter;

(h) the Secretary of State otherwise decides under section 54(2) not to make an adverse public interest finding;

(i) the Secretary of State decides under section 54(2) to make an adverse public interest finding but decides neither to accept an undertaking under paragraph 9 of Schedule 7 nor to make an order under paragraph 11 of that Schedule; or

(j) the Secretary of State decides under section 54(2) to make an adverse public interest finding and accepts an undertaking under paragraph 9 of Schedule 7 or makes an order under paragraph 11 of that Schedule.

(5) For the purposes of this Part the time when a matter to which an intervention notice relates is finally determined under this Chapter is—

(a) in a case falling within subsection (4)(a), (e) or (f), the expiry of the time concerned;

(b) in a case falling within subsection (4)(b), the acceptance of the undertaking or group of undertakings concerned;

(c) in a case falling within subsection (4)(c), (d), (g) or (h), the making of the decision concerned;

(d) in a case falling within subsection (4)(i), the making of the decision neither to accept an undertaking under paragraph 9 of Schedule 7 nor to make an order under paragraph 11 of that Schedule; and

(e) in a case falling within subsection (4)(j), the acceptance of the undertaking concerned or (as the case may be) the making of the order concerned.

44 Investigation and report by OFT

(1) Subsection (2) applies where the Secretary of State has given an intervention notice in relation to a relevant merger situation.

(2) The OFT shall, within such period as the Secretary of State may require, give a report to the Secretary of State in relation to the case.

(3) The report shall contain—

(a) advice from the OFT on the considerations relevant to the making of a reference under section 22 or 33 which are also relevant to the Secretary of State's decision as to whether to make a reference under section 45; and

(b) a summary of any representations about the case which have been received by the OFT and which relate to any public interest consideration mentioned in the intervention notice concerned and which is or may be relevant to the Secretary of State's decision as to whether to make a reference under section 45.

(4) The report shall, in particular, include decisions as to whether the OFT believes that it is, or may be, the case that—

(a) a relevant merger situation has been created or arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation;

(b) the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services;

(c) the market or markets concerned would not be of sufficient importance to justify the making of a reference to the Commission under section 22 or 33;

(d) in the case of arrangements which are in progress or in contemplation, the arrangements are not sufficiently far advanced, or not sufficiently likely to proceed, to justify the making of such a reference;

(e) any relevant customer benefits in relation to the creation of the relevant merger situation concerned outweigh the substantial lessening of competition and any adverse effects of the substantial lessening of competition; or

(f) it would be appropriate to deal with the matter (disregarding any public interest considerations mentioned in the intervention notice concerned) by way of undertakings under paragraph 3 of Schedule 7.

(5) If the OFT believes that it is or may be the case that it would be appropriate to deal with the matter (disregarding any public interest considerations mentioned in the intervention notice concerned) by way of

undertakings under paragraph 3 of Schedule 7, the report shall contain descriptions of the undertakings which the OFT believes are, or may be, appropriate.

(6) The report may, in particular, include advice and recommendations on any public interest consideration mentioned in the intervention notice concerned and which is or may be relevant to the Secretary of State's decision as to whether to make a reference under section 45.

(7) The OFT shall carry out such investigations as it considers appropriate for the purposes of producing a report under this section.

45 Power of Secretary of State to refer matter to Commission

(1) Subsections (2) to (5) apply where the Secretary of State—

(a) has given an intervention notice in relation to a relevant merger situation; and

(b) has received a report of the OFT under section 44 in relation to the matter.

(2) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) a relevant merger situation has been created;

(b) the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services;

(c) one or more than one public interest consideration mentioned in the intervention notice is relevant to a consideration of the relevant merger situation concerned; and

(d) taking account only of the substantial lessening of competition and the relevant public interest consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest.

(3) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) a relevant merger situation has been created;

(b) the creation of that situation has not resulted, and may be expected not to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services;

(c) one or more than one public interest consideration mentioned in the intervention notice is relevant to a consideration of the relevant merger situation concerned; and

(d) taking account only of the relevant public interest consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest.

(4) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation;

(b) the creation of that situation may be expected to result in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services;

(c) one or more than one public interest consideration mentioned in the intervention notice is relevant to a consideration of the relevant merger situation concerned; and

(d) taking account only of the substantial lessening of competition and the relevant public interest consideration or considerations concerned, the creation of the relevant merger situation may be expected to operate against the public interest.

(5) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation;

(b) the creation of that situation may be expected not to result in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services;

(c) one or more than one public interest consideration mentioned in the intervention notice is relevant to a consideration of the relevant merger situation concerned; and

(d) taking account only of the relevant public interest consideration or considerations concerned, the creation of the relevant merger situation may be expected to operate against the public interest.

(6) For the purposes of this Chapter any anti-competitive outcome shall be treated as being adverse to the public interest unless it is justified by one or more than one public interest consideration which is relevant.

(7) This section is subject to section 46.

46 References under section 45: supplementary

(1) No reference shall be made under section 45 if—

(a) the making of the reference is prevented by section 69(1), 74(1) or 96(3) or paragraph 4 of Schedule 7; or

(b) the European Commission is considering a request made, in relation to the matter concerned, by the United Kingdom (whether alone or with others) under article 22(3) of the European Merger Regulations, is proceeding with the matter in pursuance of such a request or has dealt with the matter in pursuance of such a request.

(2) The Secretary of State, in deciding whether to make a reference under section 45, shall accept the decisions of the OFT included in its report by virtue of subsection (4) of section 44 and any descriptions of undertakings as mentioned in subsection (5) of that section.

(3) Where the decision to make a reference under section 45 is made at any time on or after the end of the period of 24 weeks beginning with the giving of the intervention notice concerned, the Secretary of State shall, in deciding whether to make such a reference, disregard any public interest consideration which is mentioned in the intervention notice but which has not been finalised before the end of that period.

(4) Subject to subsection (5), where the decision to make a reference under section 45(2) or (4) is made at any time before the end of the period of 24 weeks beginning with the giving of the intervention notice

concerned, the Secretary of State shall, in deciding whether to make such a reference, disregard any public interest consideration which is mentioned in the intervention notice but which has not been finalised if its effect would be to prevent, or to help to prevent, an anti-competitive outcome from being adverse to the public interest.

(5) The Secretary of State may, if he believes that there is a realistic prospect of the public interest consideration mentioned in subsection (4) being finalised within the period of 24 weeks beginning with the giving of the intervention notice concerned, delay deciding whether to make the reference concerned until the public interest consideration is finalised or, if earlier, the period expires.

(6) A reference under section 45 shall, in particular, specify—

(a) the subsection of that section under which it is made;

(b) the date on which it is made; and

(c) the public interest consideration or considerations mentioned in the intervention notice concerned which the Secretary of State is not under a duty to disregard by virtue of subsection (3) above and which he believes are or may be relevant to a consideration of the relevant merger situation concerned.

Reports on references

47 Questions to be decided on references under section 45

(1) The Commission shall, on a reference under section 45(2) or (3), decide whether a relevant merger situation has been created.

(2) If the Commission decides that such a situation has been created, it shall, on a reference under section 45(2), decide the following additional questions—

(a) whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services; and

(b) whether, taking account only of any substantial lessening of competition and the admissible public interest consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest.

(3) If the Commission decides that a relevant merger situation has been created, it shall, on a reference under section 45(3), decide whether, taking account only of the admissible public interest consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest.

(4) The Commission shall, on a reference under section 45(4) or (5), decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

(5) If the Commission decides that such arrangements are in progress or in contemplation, it shall, on a reference under section 45(4), decide the following additional questions—

(a) whether the creation of that situation may be expected to result in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services; and

(b) whether, taking account only of any substantial lessening of competition and the admissible public interest consideration or considerations concerned, the creation of that situation may be expected to operate against the public interest.

(6) If the Commission decides that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, it shall, on a reference under section 45(5), decide whether, taking account only of the admissible public interest consideration or considerations concerned, the creation of that situation may be expected to operate against the public interest.

(7) The Commission shall, if it has decided on a reference under section 45 that the creation of a relevant merger situation operates or may be expected to operate against the public interest, decide the following additional questions—

(a) whether action should be taken by the Secretary of State under section 55 for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the relevant merger situation;

(b) whether the Commission should recommend the taking of other action by the Secretary of State or action by persons other than itself and the Secretary of State for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the relevant merger situation; and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

(8) Where the Commission has decided by virtue of subsection (2)(a) or (5)(a) that there is or will be a substantial lessening of competition within any market or markets in the United Kingdom for goods or services, it shall also decide separately the following questions (on the assumption that it is proceeding as mentioned in section 56(6))—

(a) whether action should be taken by it under section 41 for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted from, or may be expected to result from, the substantial lessening of competition;

(b) whether the Commission should recommend the taking of action by other persons for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted from, or may be expected to result from, the substantial lessening of competition; and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

(9) In deciding the questions mentioned in subsections (7) and (8) the Commission shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to—

(a) the adverse effects to the public interest; or

(b) (as the case may be) the substantial lessening of competition and any adverse effects resulting from it.

(10) In deciding the questions mentioned in subsections (7) and (8) in a case where it has decided by virtue of subsection (2)(a) or (5)(a) that there is or will be a substantial lessening of competition, the Commission

may, in particular, have regard to the effect of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned.

(11) In this section "admissible public interest consideration" means any public interest consideration which is specified in the reference under section 45 and which the Commission is not under a duty to disregard.

48 Cases where references or certain questions need not be decided

(1) The Commission shall cancel a reference under section 45(4) or (5) if it considers that the proposal to make arrangements of the kind mentioned in that reference has been abandoned.

(2) In relation to the question whether a relevant merger situation has been created or the question whether a relevant merger situation will be created, a reference under section 45 may be framed so as to require the Commission to exclude from consideration—

(a) subsection (1) of section 23;

(b) subsection (2) of that section; or

(c) one of those subsections if the Commission finds that the other is satisfied.

(3) In relation to the question whether any such result as is mentioned in section 23(2)(b) has arisen or the question whether any such result will arise, a reference under section 45 may be framed so as to require the Commission to confine its investigation to the supply of goods or services in a part of the United Kingdom specified in the reference.

49 Variation of references under section 45

(1) The Commission may, if it considers that doing so is justified by the facts (including events occurring on or after the making of the reference concerned), treat—

(a) a reference made under subsection (2) or (3) of section 45 as if it had been made under subsection (4) or (as the case may be) (5) of that section; or

(b) a reference made under subsection (4) or (5) of section 45 as if it had been made under subsection (2) or (as the case may be) (3) of that section;

and, in such cases, references in this Part to references under those enactments shall, so far as may be necessary, be construed accordingly.

(2) Where, by virtue of subsection (1), the Commission treats a reference made under subsection (2) or (3) of section 45 as if it had been made under subsection (4) or (as the case may be) (5) of that section, paragraphs 1, 2, 7 and 8 of Schedule 7 shall, in particular, apply as if the reference had been made under subsection (4) or (as the case may be) (5) of that section instead of under subsection (2) or (3) of that section.

(3) Where, by virtue of subsection (1), the Commission treats a reference made under subsection (4) or (5) of section 45 as if it had been made under subsection (2) or (as the case may be) (3) of that section, paragraphs 1, 2, 7 and 8 of Schedule 7 shall, in particular, apply as if the reference had been made under subsection (2) or (as the case may be) (3) of that section instead of under subsection (4) or (5) of that section.

(4) Subsection (5) applies in relation to any undertaking accepted under paragraph 1 of Schedule 7, or any order made under paragraph 2 of that Schedule, which is in force immediately before the Commission, by virtue of subsection (1), treats a reference as mentioned in subsection (1).

(5) The undertaking or order shall, so far as applicable, continue in force as if—

(a) in the case of an undertaking or order which relates to a reference under subsection (2) or (3) of section 45, accepted or made in relation to a reference made under subsection (4) or (as the case may be) (5) of that section; and

(b) in the case of an undertaking or order which relates to a reference made under subsection (4) or (5) of that section, accepted or made in relation to a reference made under subsection (2) or (as the case may be) (3) of that section;

and the undertaking or order concerned may be varied, superseded, released or revoked accordingly.

(6) The Secretary of State may at any time vary a reference under section 45.

(7) The Secretary of State shall consult the Commission before varying any such reference.

(8) Subsection (7) shall not apply if the Commission has requested the variation concerned.

(9) No variation by the Secretary of State under this section shall be capable of altering the public interest consideration or considerations specified in the reference or the period permitted by section 51 within which the report of the Commission under section 50 is to be prepared and given to the Secretary of State.

50 Investigations and reports on references under section 45

(1) The Commission shall prepare a report on a reference under section 45 and give it to the Secretary of State within the period permitted by section 51.

(2) The report shall, in particular, contain—

(a) the decisions of the Commission on the questions which it is required to answer by virtue of section 47;

(b) its reasons for its decisions; and

(c) such information as the Commission considers appropriate for facilitating a proper understanding of those questions and of its reasons for its decisions.

(3) The Commission shall carry out such investigations as it considers appropriate for the purpose of producing a report under this section.

51 Time-limits for investigations and reports by Commission

(1) The Commission shall prepare its report under section 50 and give it to the Secretary of State under that section within the period of 24 weeks beginning with the date of the reference concerned.

(2) Where article 9(6) of the European Merger Regulations applies in relation to the reference under section 45, the Commission shall prepare its report under section 50 and give it to the Secretary of State—

(a) within the period of 24 weeks beginning with the date of the reference; or

(b) if it is a shorter period, within such period as is necessary to ensure compliance with that article.

(3) The Commission may extend, by no more than 8 weeks, the period within which a report under section 50 is to be prepared and given to the Secretary of State if it considers that there are special reasons why the report cannot be prepared and given to the Secretary of State within that period.

(4) The Commission may extend the period within which a report under section 50 is to be prepared and given to the Secretary of State if it considers that a relevant person has failed (whether with or without a reasonable excuse) to comply with any requirement of a notice under section 109.

(5) In subsection (4) "relevant person" means—

(a) any person carrying on any of the enterprises concerned;

(b) any person who (whether alone or as a member of a group) owns or has control of any such person; or

(c) any officer, employee or agent of any person mentioned in paragraph (a) or (b).

(6) For the purposes of subsection (5) a person or group of persons able, directly or indirectly, to control or materially to influence the policy of a body of persons corporate or unincorporate, but without having a controlling interest in that body of persons, may be treated as having control of it.

(7) An extension under subsection (3) or (4) shall come into force when published under section 107.

(8) An extension under subsection (4) shall continue in force until—

(a) the person concerned provides the information or documents to the satisfaction of the Commission or (as the case may be) appears as a witness in accordance with the requirements of the Commission; or

(b) the Commission publishes its decision to cancel the extension.

(9) This section is subject to sections 52 and 53.

52 Section 51: supplementary

(1) No extension is possible under subsection (3) or (4) of section 51 where the period within which the report is to be prepared and given to the Secretary of State is determined by virtue of subsection (2)(b) of that section.

(2) Where the period within which the report is to be prepared and given to the Secretary of State is determined by virtue of subsection (2)(a) of section 51, no extension is possible under subsection (3) or (4) of that section which extends that period beyond such period as is necessary to ensure compliance with article 9(6) of the European Merger Regulations.

(3) A period extended under subsection (3) of section 51 may also be extended under subsection (4) of that section and a period extended under subsection (4) of that section may also be extended under subsection (3) of that section.

(4) No more than one extension is possible under section 51(3).

(5) Where a period within which a report under section 50 is to be prepared and given to the Secretary of State is extended or further extended under section 51(3) or (4), the period as extended or (as the case may be) further extended shall, subject to subsections (6) and (7), be calculated by taking the period being extended and adding to it the period of the extension (whether or not those periods overlap in time).

(6) Subsection (7) applies where—

(a) the period within which the report under section 50 is to be prepared and given to the Secretary of State is further extended;

(b) the further extension and at least one previous extension is made under section 51(4); and

(c) the same days or fractions of days are included in or comprise the further extension and are included in or comprise at least one such previous extension.

(7) In calculating the period of the further extension, any days or fractions of days of the kind mentioned in subsection (6)(c) shall be disregarded.

(8) The Secretary of State may by order amend section 51 so as to alter any one or more of the following periods—

(a) the period of 24 weeks mentioned in subsection (1) of that section or any period for the time being mentioned in that subsection in substitution for that period;

(b) the period of 24 weeks mentioned in subsection (2)(a) of that section or any period for the time being mentioned in that subsection in substitution for that period;

(c) the period of 8 weeks mentioned in subsection (3) of that section or any period for the time being mentioned in that subsection in substitution for that period.

(9) No alteration shall be made by virtue of subsection (8) which results in the period for the time being mentioned in subsection (1) or (2)(a) of section 51 exceeding 24 weeks or the period for the time being mentioned in subsection (3) of that section exceeding 8 weeks.

(10) An order under subsection (8) shall not affect any period of time within which the Commission is under a duty to prepare and give to the Secretary of State its report under section 50 in relation to a reference under section 45 if the Commission is already under that duty in relation to that reference when the order is made.

(11) Before making an order under subsection (8) the Secretary of State shall consult the Commission and such other persons as he considers appropriate.

(12) The Secretary of State may make regulations for the purposes of section 51(8).

(13) The regulations may, in particular—

(a) provide for the time at which information or documents are to be treated as provided (including the time at which they are to be treated as provided to the satisfaction of the Commission for the purposes of section 51(8));

(b) provide for the time at which a person is to be treated as appearing as a witness (including the time at which he is to be treated as appearing as a witness in accordance with the requirements of the Commission for the purposes of section 51(8));

(c) provide for the persons carrying on the enterprises which have or may have ceased to be, or may cease to be, distinct enterprises to be informed, in circumstances in which section 51(8) applies, of the fact that—

(i) the Commission is satisfied as to the provision of the information or documents required by it; or

(ii) the person concerned has appeared as a witness in accordance with the requirements of the Commission;

(d) provide for the persons carrying on the enterprises which have or may have ceased to be, or may cease to be, distinct enterprises to be informed, in circumstances in which section 51(8) applies, of the time at which the Commission is to be treated as satisfied as mentioned in paragraph (c)(i) above or the person concerned is to be treated as having appeared as mentioned in paragraph (c)(ii) above.

53 Restrictions on action where public interest considerations not finalised

(1) The Commission shall cancel a reference under section 45 if—

(a) the intervention notice concerned mentions a public interest consideration which was not finalised on the giving of that notice or public interest considerations which, at that time, were not finalised;

(b) no other public interest consideration is mentioned in the notice;

(c) at least 24 weeks has elapsed since the giving of the notice; and

(d) the public interest consideration mentioned in the notice has not been finalised within that period of 24 weeks or (as the case may be) none of the public interest considerations mentioned in the notice has been finalised within that period of 24 weeks.

(2) Where a reference to the Commission under section 45 specifies a public interest consideration which has not been finalised before the making of the reference, the Commission shall not give its report to the Secretary of State under section 50 in relation to that reference unless—

(a) the period of 24 weeks beginning with the giving of the intervention notice concerned has expired;

(b) the public interest consideration concerned has been finalised; or

(c) the report must be given to the Secretary of State to ensure compliance with article 9(6) of the European Merger Regulations.

(3) The Commission shall, in reporting on any of the questions mentioned in section 47(2)(b), (3), (5)(b), (6) and (7), disregard any public interest consideration which has not been finalised before the giving of the report.

(4) The Commission shall, in reporting on any of the questions mentioned in section 47(2)(b), (3), (5)(b), (6) and (7), disregard any public interest consideration which was not finalised on the giving of the intervention notice concerned and has not been finalised within the period of 24 weeks beginning with the giving of the notice concerned.

(5) Subsections (1) to (4) are without prejudice to the power of the Commission to carry out investigations in relation to any public interest consideration to which it might be able to have regard in its report.

Decisions of the Secretary of State

54 Decision of Secretary of State in public interest cases

(1) Subsection (2) applies where the Secretary of State has received a report of the Commission under section 50 in relation to a relevant merger situation.

(2) The Secretary of State shall decide whether to make an adverse public interest finding in relation to the relevant merger situation and whether to make no finding at all in the matter.

(3) For the purposes of this Part the Secretary of State makes an adverse public interest finding in relation to a relevant merger situation if, in relation to that situation, he decides—

(a) in connection with a reference to the Commission under subsection (2) of section 45, that it is the case as mentioned in paragraphs (a) to (d) of that subsection or subsection (3) of that section;

(b) in connection with a reference to the Commission under subsection (3) of that section, that it is the case as mentioned in paragraphs (a) to (d) of that subsection;

(c) in connection with a reference to the Commission under subsection (4) of that section, that it is the case as mentioned in paragraphs (a) to (d) of that subsection or subsection (5) of that section; and

(d) in connection with a reference to the Commission under subsection (5) of that section, that it is the case as mentioned in paragraphs (a) to (d) of that subsection.

(4) The Secretary of State may make no finding at all in the matter only if he decides that there is no public interest consideration which is relevant to a consideration of the relevant merger situation concerned.

(5) The Secretary of State shall make and publish his decision under subsection (2) within the period of 30 days beginning with the receipt of the report of the Commission under section 50.

(6) In making a decision under subsections (2) to (4), the Secretary of State shall disregard any public interest consideration not specified in the reference under section 45 and any public interest consideration disregarded by the Commission for the purposes of its report.

(7) In deciding whether to make an adverse public interest finding under subsection (2), the Secretary of State shall accept—

(a) in connection with a reference to the Commission under section 45(2) or (4), the decision of the report of the Commission under section 50 as to whether there is an anti-competitive outcome; and

(b) in connection with a reference to the Commission under section 45(3) or (5)—

(i) the decision of the report of the Commission under section 50 as to whether a relevant merger situation has been created or (as the case may be) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

(ii) the decision of the report of the OFT under section 44 as to the absence of a substantial lessening of competition.

(8) In determining for the purposes of subsection (5) the period of 30 days no account shall be taken of—

(a) Saturday, Sunday, Good Friday and Christmas Day; and

(b) any day which is a bank holiday in England and Wales.

55 Enforcement action by Secretary of State

(1) Subsection (2) applies where the Secretary of State has decided under subsection (2) of section 54 within the period required by subsection (5) of that section to make an adverse public interest finding in relation to a relevant merger situation and has published his decision within the period so required.

(2) The Secretary of State may take such action under paragraph 9 or 11 of Schedule 7 as he considers to be reasonable and practicable to remedy, mitigate or prevent any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the relevant merger situation concerned.

(3) In making a decision under subsection (2) the Secretary of State shall, in particular, have regard to the report of the Commission under section 50.

(4) In making a decision under subsection (2) in any case of a substantial lessening of competition, the Secretary of State may, in particular, have regard to the effect of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned.

Other

56 Competition cases where intervention on public interest grounds ceases

(1) Where the Secretary of State decides not to make a reference under section 45 on the ground that no public interest consideration to which he is able to have regard is relevant to a consideration of the relevant merger situation concerned, he shall by notice require the OFT to deal with the matter otherwise than under this Chapter.

(2) Where a notice is given to the OFT in the circumstances mentioned in subsection (1), the OFT shall decide whether to make a reference under section 22 or 33; and any time-limits in relation to the Secretary of State's decision whether to make a reference under section 45 (including any remaining powers of extension) shall apply in relation to the decision of the OFT whether to make a reference under section 22 or 33.

(3) Where the Commission cancels under section 53(1) a reference under section 45 and the report of the OFT under section 44 contains the decision that it is or may be the case that there is an anti-competitive outcome in relation to the relevant merger situation concerned, the Commission shall proceed under this Part as if a reference under section 22 or (as the case may be) 33 had been made to it by the OFT.

(4) In proceeding by virtue of subsection (3) to prepare and publish a report under section 38, the Commission shall proceed as if—

(a) the reference under section 22 or 33 had been made at the same time as the reference under section 45;

(b) the timetable for preparing and giving its report under section 50 (including any remaining powers of extension and as extended by an additional period of 20 days) were the timetable for preparing and publishing its report under section 38; and

(c) in relation to the question whether a relevant merger situation has been created or the question whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, the Commission were confined to the questions on the subject to be investigated by it under section 47.

(5) In determining the period of 20 days mentioned in subsection (4) no account shall be taken of—

(a) Saturday, Sunday, Good Friday and Christmas Day; and

(b) any day which is a bank holiday in England and Wales.

(6) Where the Secretary of State decides under section 54(2) to make no finding at all in the matter in connection with a reference under section 45(2) or (4), the Commission shall proceed under this Part as if a reference under section 22 or (as the case may be) 33 had been made to it instead of a reference under section 45 and as if its report to the Secretary of State under section 50 had been prepared and published by it under section 38 within the period permitted by section 39.

(7) In relation to proceedings by virtue of subsection (6), the reference in section 41(3) to decisions of the Commission as included in its report by virtue of section 35(3) or 36(2) shall be construed as a reference to decisions which were included in the report of the Commission by virtue of section 47(8).

(8) Where the Commission becomes under a duty to proceed as mentioned in subsection (3) or (6), references in this Part to references under sections 22 and 33 shall, so far as may be necessary, be construed accordingly; and, in particular, sections 77 to 81 shall apply as if a reference has been made to the Commission by the OFT under section 22 or (as the case may be) 33.

57 Duties of OFT and Commission to inform Secretary of State

(1) The OFT shall, in considering whether to make a reference under section 22 or 33, bring to the attention of the Secretary of State any case which it believes raises any consideration specified in section 58 unless it believes that the Secretary of State would consider any such consideration immaterial in the context of the particular case.

(2) The OFT and the Commission shall bring to the attention of the Secretary of State any representations about exercising his powers under section 58(3) which have been made to the OFT or (as the case may be) the Commission.

58 Specified considerations

(1) The interests of national security are specified in this section.

(2) In subsection (1) "national security" includes public security; and in this subsection "public security" has the same meaning as in article 21(3) of the European Merger Regulations.

(3) The Secretary of State may by order modify this section for the purpose of specifying in this section a new consideration or removing or amending any consideration which is for the time being specified in this section.

(4) An order under this section may, in particular—

(a) provide for a consideration to be specified in this section for a particular purpose or purposes or for all purposes;

(b) apply in relation to cases under consideration by the OFT, the Commission or the Secretary of State before the making of the order as well as cases under consideration on or after the making of the order.

CHAPTER 3 OTHER SPECIAL CASES

Special public interest cases

59 Intervention by Secretary of State in special public interest cases

(1) Subsection (2) applies where the Secretary of State has reasonable grounds for suspecting that it is or may be the case that a special merger situation has been created or arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation.

(2) The Secretary of State may give a notice to the OFT (in this Part "a special intervention notice") if he believes that it is or may be the case that one or more than one consideration specified in section 58 is relevant to a consideration of the special merger situation concerned.

(3) For the purposes of this Part a special merger situation has been created if—

(a) no relevant merger situation has been created because of section 23(1)(b) and (2)(b); but

(b) a relevant merger situation would have been created if those enactments were disregarded;

and the conditions mentioned in subsection (4) are satisfied.

(4) The conditions mentioned in this subsection are that, immediately before the enterprises concerned ceased to be distinct—

(a) at least one of the enterprises concerned was carried on in the United Kingdom or by or under the control of a body corporate incorporated in the United Kingdom; and

(b) a person carrying on one or more of the enterprises concerned was a relevant Government contractor.

(5) For the purposes of deciding whether a relevant merger situation has been created or whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, sections 23 to 32 (read together with section 34) shall apply for the purposes of this Chapter as they do for the purposes of Chapter 1 but subject to subsection (6).

(6) In their application by virtue of subsection (5) sections 23 to 32 shall have effect as if—

(a) for paragraph (a) of section 23(9) there were substituted—

"(a) in relation to the giving of a special intervention notice, the time when the notice is given;

(aa) in relation to the making of a report by the OFT under section 61, the time of the making of the report;

(ab) in the case of a reference which is treated as having been made under section 62(2) by virtue of section 64(2), such time as the Commission may determine; and";

(b) the references to the OFT in section 24(2)(a) and (b) included references to the Secretary of State;

(c) the references to the OFT in sections 25(1) to (3), (6) and (8) and 31 included references to the Secretary of State;

(d) the references to the OFT in section 25(4) and (5) were references to the Secretary of State;

(e) the reference in section 25(4) to section 73 were a reference to paragraph 3 of Schedule 7;

(f) the reference in section 25(12) to one extension were a reference to one extension by the OFT and one extension by the Secretary of State;

(g) the powers to extend time-limits under section 25 as applied by subsection (5) above, and the power to request information under section 31(1) as so applied, were not exercisable by the OFT or the Secretary of State before the giving of a special intervention notice;

(h) in subsection (1) of section 31 for the words "section 22" there were substituted "section 62(2)" and, in the application of that subsection to the OFT, for the word "deciding" there were substituted "enabling the Secretary of State to decide";

(i) in the case of the giving of special intervention notices, the references in sections 23 to 32 to the making of a reference or a reference were, so far as necessary, references to the giving of a special intervention notice or a special intervention notice; and

(j) the references to the OFT in section 32(2)(a) to (c) and (3) were construed in accordance with the above modifications.

(7) No more than one special intervention notice shall be given under subsection (2) in relation to the same special merger situation.

(8) In this section "relevant Government contractor" means—

(a) a Government contractor—

(i) who has been notified by or on behalf of the Secretary of State of information, documents or other articles relating to defence and of a confidential nature which the Government contractor or an employee of his may hold or receive in connection with being such a contractor; and

(ii) whose notification has not been revoked by or on behalf of the Secretary of State; or

(b) a former Government contractor who was so notified when he was a Government contractor and whose notification has not been revoked by or on behalf of the Secretary of State.

(9) In this section—

"defence" has the same meaning as in section 2 of the Official Secrets Act 1989 (c. 6); and

"government contractor" has the same meaning as in the Act of 1989 and includes any sub-contractor of a Government contractor, any sub-contractor of that sub-contractor and any other sub-contractor in a chain of sub-contractors which begins with the sub-contractor of the Government contractor.

60 Special intervention notices under section 59

(1) A special intervention notice shall state—

(a) the special merger situation concerned; and

(b) the consideration specified in section 58 or considerations so specified which are, or may be, relevant to the special merger situation concerned.

(2) Where the Secretary of State believes that it is or may be the case that two or more considerations specified in section 58 are relevant to a consideration of the special merger situation concerned, he may decide not to mention in the special intervention notice such of those considerations as he considers appropriate.

(3) A special intervention notice shall come into force when it is given and shall cease to be in force when the matter to which it relates is finally determined under this Chapter.

(4) For the purposes of this Part, a matter to which a special intervention notice relates is finally determined under this Chapter if—

(a) the time within which the OFT is to report to the Secretary of State under section 61 has expired and no such report has been made;

(b) the Secretary of State decides to accept an undertaking or group of undertakings under paragraph 3 of Schedule 7 instead of making a reference under section 62;

(c) the Secretary of State otherwise decides not to make a reference under that section;

(d) the Commission cancels such a reference under section 64(1);

(e) the time within which the Commission is to prepare a report under section 65 and give it to the Secretary of State has expired and no such report has been prepared and given to the Secretary of State;

(f) the time within which the Secretary of State is to make and publish a decision under section 66(2) has expired and no such decision has been made and published;

(g) the Secretary of State decides under subsection (2) of section 66 otherwise than as mentioned in subsection (5) of that section;

(h) the Secretary of State decides under subsection (2) of section 66 as mentioned in subsection (5) of that section but decides neither to accept an undertaking under paragraph 9 of Schedule 7 nor to make an order under paragraph 11 of that Schedule; or

(i) the Secretary of State decides under subsection (2) of section 66 as mentioned in subsection (5) of that section and accepts an undertaking under paragraph 9 of Schedule 7 or makes an order under paragraph 11 of that Schedule.

(5) For the purposes of this Part the time when a matter to which a special intervention notice relates is finally determined under this Chapter is—

(a) in a case falling within subsection (4)(a), (e) or (f), the expiry of the time concerned;

(b) in a case falling within subsection (4)(b), the acceptance of the undertaking or group of undertakings concerned;

(c) in a case falling within subsection (4)(c), (d) or (g), the making of the decision concerned;

(d) in a case falling within subsection (4)(h), the making of the decision neither to accept an undertaking under paragraph 9 of Schedule 7 nor to make an order under paragraph 11 of that Schedule; and

(e) in a case falling within subsection (4)(i), the acceptance of the undertaking concerned or (as the case may be) the making of the order concerned.

61 Initial investigation and report by OFT

(1) Subsection (2) applies where the Secretary of State has given a special intervention notice in relation to a special merger situation.

(2) The OFT shall, within such period as the Secretary of State may require, give a report to the Secretary of State in relation to the case.

(3) The report shall contain—

(a) advice from the OFT on the considerations relevant to the making of a reference under section 22 or 33 which are also relevant to the Secretary of State's decision as to whether to make a reference under section 62; and

(b) a summary of any representations about the case which have been received by the OFT and which relate to any consideration mentioned in the special intervention notice concerned and which is or may be relevant to the Secretary of State's decision as to whether to make a reference under section 62.

(4) The report shall include a decision as to whether the OFT believes (disregarding section 59(4)(b)) that it is, or may be, the case that a special merger situation has been created or (as the case may be) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation.

(5) The report may, in particular, include advice and recommendations on any consideration mentioned in the special intervention notice concerned and which is or may be relevant to the Secretary of State's decision as to whether to make a reference under section 62.

(6) The OFT shall carry out such investigations as it considers appropriate for the purposes of producing a report under this section.

62 Power of Secretary of State to refer the matter

(1) Subsection (2) applies where the Secretary of State—

(a) has given a special intervention notice in relation to a special merger situation; and

(b) has received a report of the OFT under section 61 in relation to the matter.

(2) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) a special merger situation has been created;

(b) one or more than one consideration mentioned in the special intervention notice is relevant to a consideration of the special merger situation concerned; and

(c) taking account only of the relevant consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest.

(3) The Secretary of State may make a reference to the Commission if he believes that it is or may be the case that—

(a) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation;

(b) one or more than one consideration mentioned in the special intervention notice is relevant to a consideration of the special merger situation concerned; and

(c) taking account only of the relevant consideration or considerations concerned, the creation of that situation may be expected to operate against the public interest.

(4) No reference shall be made under this section if the making of the reference is prevented by section 69(1) or paragraph 4 of Schedule 7.

(5) The Secretary of State, in deciding whether to make a reference under this section, shall accept the decision of the OFT included in its report under section 61 by virtue of subsection (4) of that section.

(6) A reference under this section shall, in particular, specify—

(a) the subsection of this section under which it is made;

(b) the date on which it is made; and

(c) the consideration or considerations mentioned in the special intervention notice which the Secretary of State believes are, or may be, relevant to a consideration of the special merger situation concerned.

63 Questions to be decided on references under section 62

(1) The Commission shall, on a reference under section 62(2), decide whether a special merger situation has been created.

(2) The Commission shall, on a reference under section 62(3), decide whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation.

(3) If the Commission decides that a special merger situation has been created or that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation, it shall, on a reference under section 62, decide whether, taking account only of the consideration or considerations mentioned in the reference, the creation of that situation operates or may be expected to operate against the public interest.

(4) The Commission shall, if it has decided on a reference under section 62 that the creation of a special merger situation operates or may be expected to operate against the public interest, decide the following additional questions—

(a) whether action should be taken by the Secretary of State under section 66 for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the special merger situation concerned;

(b) whether the Commission should recommend the taking of other action by the Secretary of State or action by persons other than itself and the Secretary of State for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the special merger situation concerned; and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

64 Cancellation and variation of references under section 62

(1) The Commission shall cancel a reference under section 62(3) if it considers that the proposal to make arrangements of the kind mentioned in that reference has been abandoned.

(2) The Commission may, if it considers that doing so is justified by the facts (including events occurring on or after the making of the reference concerned), treat a reference made under subsection (2) or (3) of section 62 as if it had been made under subsection (3) or (as the case may be) (2) of that section; and, in such cases, references in this Part to references under those enactments shall, so far as may be necessary, be construed accordingly.

(3) Where, by virtue of subsection (2), the Commission treats a reference made under subsection (2) or (3) of section 62 as if it had been made under subsection (3) or (as the case may be) (2) of that section, paragraphs 1, 2, 7 and 8 of Schedule 7 shall, in particular, apply as if the reference had been made under subsection (3) or (as the case may be) (2) of that section instead of under subsection (2) or (3) of that section.

(4) Subsection (5) applies in relation to any undertaking accepted under paragraph 1 of Schedule 7, or any order made under paragraph 2 of that Schedule, which is in force immediately before the Commission, by virtue of subsection (2), treats a reference made under subsection (2) or (3) of section 62 as if it had been made under subsection (3) or (as the case may be) (2) of that section.

(5) The undertaking or order shall, so far as applicable, continue in force as if—

(a) in the case of an undertaking or order which relates to a reference under subsection (2) of section 62, accepted or made in relation to a reference made under subsection (3) of that section; and

(b) in the case of an undertaking or order which relates to a reference made under subsection (3) of that section, accepted or made in relation to a reference made under subsection (2) of that section;

and the undertaking or order concerned may be varied, superseded, released or revoked accordingly.

(6) The Secretary of State may at any time vary a reference under section 62.

(7) The Secretary of State shall consult the Commission before varying any such reference.

(8) Subsection (7) shall not apply if the Commission has requested the variation concerned.

(9) No variation by the Secretary of State under this section shall be capable of altering the consideration or considerations specified in the reference or the period permitted by virtue of section 65 within which the report of the Commission under that section is to be prepared and given to the Secretary of State.

65 Investigations and reports on references under section 62

(1) The Commission shall prepare a report on a reference under section 62 and give it to the Secretary of State within the period permitted by virtue of this section.

(2) The report shall, in particular, contain—

(a) the decisions of the Commission on the questions which it is required to answer by virtue of section 63;

(b) its reasons for its decisions; and

(c) such information as the Commission considers appropriate for facilitating a proper understanding of those questions and of its reasons for its decisions.

(3) Sections 51 and 52 (but not section 53) shall apply for the purposes of a report under this section as they apply for the purposes of a report under section 50.

(4) The Commission shall carry out such investigations as it considers appropriate for the purpose of producing a report under this section.

66 Decision and enforcement action by Secretary of State

(1) Subsection (2) applies where the Secretary of State has received a report of the Commission under section 65 in relation to a special merger situation.

(2) The Secretary of State shall, in connection with a reference under section 62(2) or (3), decide the questions which the Commission is required to decide by virtue of section 63(1) to (3).

(3) The Secretary of State shall make and publish his decision under subsection (2) within the period of 30 days beginning with the receipt of the report of the Commission under section 65; and subsection (8) of section 54 shall apply for the purposes of this subsection as it applies for the purposes of subsection (5) of that section.

(4) In making his decisions under subsection (2), the Secretary of State shall accept the decisions of the report of the Commission under section 65 as to whether a special merger situation has been created or whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation.

(5) Subsection (6) applies where the Secretary of State has decided under subsection (2) that—

(a) a special merger situation has been created or arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a special merger situation;

(b) at least one consideration which is mentioned in the special intervention notice concerned is relevant to a consideration of the special merger situation concerned; and

(c) taking account only of the relevant consideration or considerations concerned, the creation of that situation operates or may be expected to operate against the public interest;

and has so decided, and published his decision, within the period required by subsection (3).

(6) The Secretary of State may take such action under paragraph 9 or 11 of Schedule 7 as he considers to be reasonable and practicable to remedy, mitigate or prevent any of the effects adverse to the public interest which have resulted from, or may be expected to result from, the creation of the special merger situation concerned.

(7) In making a decision under subsection (6), the Secretary of State shall, in particular, have regard to the report of the Commission under section 65.

6.6 Annex 5: Official Secrets Act 1989, Chapter 6

2 Defence

(1) A person who is or has been a Crown servant or Government contractor is guilty of an offence if without lawful authority he makes a damaging disclosure of any information, document or other article relating to defence which is or has been in his possession by virtue of his position as such.

(2) For the purposes of subsection (1) above a disclosure is damaging if—

(a) it damages the capability of, or of any part of, the armed forces of the Crown to carry out their tasks or leads to loss of life or injury to members of those forces or serious damage to the equipment or installations of those forces; or

(b) otherwise than as mentioned in paragraph (a) above, it endangers the interests of the United Kingdom abroad, seriously obstructs the promotion or protection by the United Kingdom of those interests or endangers the safety of British citizens abroad; or

(c) it is of information or of a document or article which is such that its unauthorised disclosure would be likely to have any of those effects.

(3) It is a defence for a person charged with an offence under this section to prove that at the time of the alleged offence he did not know, and had no reasonable cause to believe, that the information, document or article in question related to defence or that its disclosure would be damaging within the meaning of subsection (1) above.

(4) In this section "defence" means—

(a) the size, shape, organisation, logistics, order of battle, deployment, operations, State of readiness and training of the armed forces of the Crown;

(b) the weapons, stores or other equipment of those forces and the invention, development, production and operation of such equipment and research relating to it;

(c) defence policy and strategy and military planning and intelligence;

(d) plans and measures for the maintenance of essential supplies and services that are or would be needed in time of war.

6.7 Annex 6: Review of the content of behavioural undertakings

Based on an analysis of the mitigation undertakings published by the OFT, we can observe the following:

Maintenance of strategic capabilities

The maintenance of strategic capabilities necessary for UK military programmes has been a key concern for the Ministry of Defence. In each case, the company has been asked to undertake that:

Military Programmes shall continue to be conducted by a company or companies incorporated within the UK under UK law and in relation to which a majority of the company Directors are UK nationals;

The Board of Directors of the UK company shall contain sufficient UK nationals who are security-cleared to enable security sensitive issues to be resolved at Board level should the need arise;

The parent company shall inform the Ministry of Defence in writing and thereafter consult with the Ministry of Defence at least 3 months prior to disposing of any asset that is significant for the conduct of Military Programmes and in respect also for any proposal for the voluntary winding-up or dissolution of one of those assets.

The parent company shall inform the Ministry of Defence in writing and thereafter consult with the Ministry of Defence as soon as possible and in any event at least 2 months prior to running down or affecting adversely in any way the UK company's Military Capability;

The parent company shall inform in writing and thereafter consult with the Ministry of Defence as soon as possible after any proposal to dispose of, and in any event at least 3 months prior to disposal of, the whole or any part of its equity share holding of the UK company to any company or person whether by private sale or an offer to the public;

The company shall ensure:

- continuity of development and/or supply of all goods and services for Military Programmes in respect of which the contracts to which the UK company is a party and
- subject to the Ministry of Defence, acting reasonably, endeavouring to place contracts in the future, continuity of support (including re-supply and spares) for equipment in service with the Ministry of Defence for which the UK company owns the design rights.

In addition, and reflecting concerns that Thomson-CSF might subcontract work to its French operations, Thomson-CSF also agreed to the following:

"In accordance with existing contractual guidelines laid down by the Ministry of Defence and unless otherwise agreed by the Ministry of Defence, UK Military Programmes shall be designed, managed, manufactured and supported primarily in the UK and shall not be sub-contracted outside the UK without prior approval from the Ministry of Defence".

Protection of classified information

Another key concern has related to the protection of classified information and behavioural undertakings agreed to by the acquiring companies have included the following:

All matters relating to security within the UK company, particularly within those carrying out activities in relation to Military Programmes, shall be maintained in line with UK National Security Regulations, including the security of work areas subject to special physical ring-fencing;

The operational management of the UK company's Military Capability will be by UK security cleared personnel with security procedures meeting UK National Security Regulations and any other such requirements as deemed necessary from time to time by the UK security authorities;

Only approved personnel with appropriate security clearance will have access to information classified "Confidential" and above;

No information classified "Confidential" or above, or bearing a national or composite caveat, will be passed by the UK company to the Board of the foreign parent company or its Affiliates. Transfers by the UK company by whatever means of Classified

information to the foreign parent company and its Affiliates based overseas, to other foreign nationals or to locations outside the UK national jurisdiction shall only be conducted subject to the prior approval of the Ministry of Defence;

No information classified "Confidential" or above or bearing a national or composite caveat and no other Classified information which is owned by a third party or country shall in any circumstances be disclosed by the UK company to foreign or dual nationals without the prior written approval of the Ministry of Defence;

The existing security procedures to meet UK National Security Regulations will be maintained, and any others deemed necessary, from time to time, by security authorities to address the relevant issues arising from the new ownership shall also be adopted and maintained.

In addition, in cases where U.S. classified information is handled by the UK company in question, the behavioural undertakings have been included on these as well:

In its acquisition of Racal, Thomson-CSF undertook that: "With respect to Military Programmes or which the UK company offer elements of hardware and software sourced from USA, the company undertakes that all US Classified or unclassified information, technical data, software or equipment delivered with US Government approval to the UK company in support of programmes will not be released or disclosed to non UK or non US citizens, without the prior written approval of the US Government";

In its acquisition of Astrium, EADS undertook that: "No transfer or disclosure by whatever means of USProtected Material to EADS or its Subsidiaries based overseas, or locations based outside of the UK shall be made except with the prior approval of the US Government".

Compliance

The undertakings also include specific requirements to ensure that the company complies with those undertakings. In particular:

The company shall provide the Ministry of Defence with such information as it may from time to time reasonably require to ascertain that the company is fulfilling the obligations accepted by it pursuant to this Agreement. If the company is unable to

comply with any of these undertakings, it shall provide full reasons for the non-compliance within one month of becoming aware of the non-compliance;

A security officer will be appointed by the company responsible for facilitating and overseeing the compliance with UK National Security Regulations and the Security Undertakings set forth in this Agreement at each of the premises of the UK company (as required by UK National Security Regulations).

The company will appoint a "Compliance Officer", who shall be responsible for providing to the Ministry of Defence: an annual report within three months of the end of the year, as well as any other such information as the Ministry of Defence may from time to time require, to verify compliance with the Security Undertakings, including any measures taken or proposed by the company or by the UK company so as to ensure compliance with the Security Undertakings and to prevent any breach of them; and full particulars of any failure comply with the security undertakings immediately upon such failure becoming apparent.

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Study on State Control of Strategic Defence Assets (EUROCON)

Tender no ENTR/09/019

Country Report

– United States of America –

1st September 2010

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1 INTRODUCTION

The national practices of the United States are considered in this country report since they structure the opportunities for the European defence industry to make acquisitions in the United States. The existence of strong U.S. controls of strategic defence assets also means that the transatlantic situation is unbalanced and raises questions about the need for reciprocity. The practices of the United States may also provide a model for future developments at the EU level in the context of calls from some observers for a "European CFIUS".[261]

This country study observes that whilst the U.S. market for defence equipment remains in effect closed to foreign companies seeking to export to the United States, the U.S. market for corporate control has been open to European companies seeking to acquire U.S. defence assets. Whilst the successful acquisition strategies of UK companies has been the subject of particular comment this country study notes that companies from other European countries have also acquired defence companies in the United States. The country study is accompanied by a case of Finmeccanica's recent acquisition of the U.S. defence electronics company DRS.

When a foreign company seeks to acquire U.S. defence assets, the non-U.S. company is subject to two parallel national security review processes: the Committee on Foreign Investment in the United States and the Foreign Control and Influence (FOCI) review. These processes overlap, but they are based on different legislation, use different processes and are led by different Government agencies.

[261] CFIUS stands for Committee on Foreign Investment in the United States

2 CONTEXT

2.1 The U.S. defence industry

The United States has the largest defence industrial base in the world and leading capabilities across the full range of defence technologies. The U.S. defence industry is privately owned and most defence contractors are listed on the New York Stock Exchange.

Beginning in the early 1990s, and much earlier than in Europe, the United States defence industry engaged in a process of merger and acquisition driven consolidation. Some companies exited the defence sector by divesting their defence businesses. The outcome of this process was the emergence of a top-tier of large defence contractors comprising Lockheed Martin, Boeing, Northrop Grumman, General Dynamics and Raytheon who are considerably larger than their European counterparts (with the exception of BAE Systems). Eight of the ten largest defence contractors in the world by revenues are U.S. companies and there are also a significant number of "mid-tier" defence contractors who are themselves sizeable when compared to European companies. Overall, U.S. companies comprise 43 of the *Defense News Top 100* companies by revenues in 2008.[262]

2.2 The scale of defence procurement

The U.S. has the largest defence procurement budget in the world by some margin. In 2008, U.S. defence equipment procurement and R&D was €166.2 billion – more than four times that of European Member States combined.[263] The U.S. defence market is in effect closed to imports of non-U.S. defence equipment. This is enshrined in law as well as in *de facto* protectionist practices as evidenced by the recent dispute over the procurement of air tankers for the United States Air Force.

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[262] 'Defense News Top 100 for 2008' available at: http://www.defensenews.com/static/features/top100/charts/country_2008.php?c=FEA&s=T1C

[263] European Defence Agency (2009) *European - United States Defence Expenditure in 2008*, Brussels: European Defence Agency available at http://www.eda.europa.eu/defencefacts/

2.3 National defence industrial and market policies

Faced by these barriers, European companies seeking to access the U.S. defence market have sought to acquire U.S. defence companies. The United States has thorough and detailed processes for the review of proposed foreign acquisitions with a national security dimension and those processes form the focus of this country study. However, the existence of these processes should not be taken to mean that the U.S. is closed to foreign acquisitions. Companies from the United Kingdom, Israel, Italy and France amongst others have successfully acquired U.S. defence companies. Formally, U.S. policy is that: "Foreign investment can play an important role in maintaining the vitality of the U.S. industrial base. Therefore, it is the policy of the U.S. Government to allow foreign investment consistent with the national security interests of the United States".[264]

3 NATIONAL PRACTICES WITH RESPECT TO STATE CONTROL OF STRATEGIC DEFENCE ASSETS

When a non-U.S. corporation seeks to acquire a U.S. company that requires access to classified and/or export controlled information, the non-U.S. buyer is subject to two U.S. Government national security reviews: (1) the Committee on Foreign Investment in the United States, and (2) the Foreign Ownership, Control or Influence (FOCI) review. These review processes have been subject to some reform in the last five years in response to the political debate surrounding the (eventually) aborted takeover by Dubai Ports World of P&O as well as growing U.S. concerns about acquisitions by state-owned entities.

3.1 Government ownership

The United States has no strategic defence companies under total or partial Government ownership in the way understood by this study.

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[264] Para 2-300, *National Industrial Security Program Operating Manual*, DoD 5220.22-M, February 2006, Washington DC: Department of Defense.

3.2 Special rights

The United States has no companies that are subject to Special Rights provisions.

National regulation of foreign acquisitions of defence assets

Review under CIFU.S.

The main legislative dimension of U.S. controls of strategic defence assets is the 2007 Foreign Investment & National Security Act (FINSA) which revised the 1988 Exon-Florio Amendment to the *Defense Production Act*. The Committee on Foreign Investment in the United States is an inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person ("covered transactions"), in order to determine the effect of such transactions on the national security of the United States. CFIUS operates pursuant to section 721 of the *Defense Production Act* of 1950, as amended by the Foreign Investment and National Security Act of 2007 (section 721) and as implemented by Executive Order 11858, as amended, and regulations at 31 C.F.R. Part 800.

The 2007 FINSA was introduced following the attempted acquisition of the U.S. oil company Unocal by the China National Offshore Oil Company and – in particular – the highly controversial 2006 acquisition of P&O by Dubai Ports World (UAE). Legal analysts observe that, at one level, FINSA merely codifies many existing CFIUS practices that had been informally adopted over time. At the same time, it is also clear that FINSA makes the CFIUS process more public than before and subject to increased policy and political review by greatly expanding congressional oversight, requiring the consideration of additional factor in assessing the national security implications of a proposed transaction, and expanding the number of agencies potentially involved in CFIUS reviews and investigations.[265]

[265] Rubinoff, E.L. and Terhune, H.A. (2007) 'New CFIUS reform act presents challenges to foreign investment in the United States', *The Metropolitan Corporate Counsel*, September: p.29.

Number of acquisitions subject to review on the grounds of national security

The FINSA introduced new reporting arrangements including an annual report to Congress on the activities of CFIUS The public domain document contains very detailed statistical information on the types of transactions reviewed, sectors and nationality of companies. The public version contains no information on specific transactions notified to CFIUS since such public disclosure is prohibited in law.

In the three years 2006-2008, companies filed 404 notices of transactions that CFIUS determined to be covered transactions under section 721 of the *Defense Production Act*. 42 were withdrawn during the initial review stage. There were 36 second stage investigations during which 15 notices were withdrawn. There were two cases subject to Presidential decisions (see Table below). The increase in the number of second stage investigations in 2008 is significant since 2008 was the first year in which the FINSA reforms of the CFIUS reforms were operational and, as this country study will go on to note, FINSA introduced additional factors triggering second stage investigations.

The Annual Report also noted that there were 165 completed foreign M&As of U.S. companies in critical technology sectors announced in 2008. The United Kingdom had the largest number o transactions amongst European countries (49), followed by France (15) and Germany (9). Israel (13), Canada (12) and India (11) were the other major acquirers.

Table 3.1: CFIUS Covered transactions, withdrawals and Presidential decisions 2006-2008[266]

Year	Number of notices	Notices withdrawn during review	Number of investigations	Notices withdrawn during investigation	Presidential decisions
2006	111	14	7	5	2
2007	138	10	6	5	0

[266] Source: Committee of Foreign Investment in the United States (2009) *Annual Report to Congress*, November 2009, Public/Unclassified version, Washington DC: Committee of Foreign Investment in the United States.

2008	155	18	23	5	0
Total	404	42	36	15	2

Reasons for review and definition of "defence assets" and "national security" used

In the United States the notion of national security is broadly defined. CFIUS operates pursuant to section 721 of the *Defense Production Act* and it is explained that "national security" "is to be interpreted broadly and without limitation to particular industries".[267] The regulations do not define national security but explain that "Ultimately, under section 721 and the Constitution the judgment as to whether a transaction threatens national security rests within the President's discretion" and that "Generally speaking, transactions that involve products, services, and technologies that are important to U.S. national defence requirements will usually be deemed significant with respect to the national security".

Although this broad catch-all definition exists, the FINSA also included an expanded list of factors to be considered by CFIUS in determining whether a proposed transaction threatens U.S. national security. Those new factors include:

- The effect on U.S. critical infrastructure[268], including major energy assets[269];
- The effect on U.S. critical technologies[270]
- Whether the transaction is "a foreign government-controlled transaction"[271]

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[267] TITLE 31 - MONEY AND FINANCE: TREASURY SUBTITLE B - REGULATIONS RELATING TO MONEY AND FINANCE CHAPTER VIII - OFFICE OF INTERNATIONAL INVESTMENT, DEPARTMENT OF THE TREASURY, PART 800 - REGULATIONS PERTAINING TO MERGERS, ACQUISITIONS, AND TAKEOVERS BY FOREIGN PERSONS, subpart g - PROVISION AND HANDLING OF INFORMATION Appendix A to Part 800 - Preamble to Regulations on Mergers, Acquisitions, and Takeovers by Foreign Persons (Published November 21, 1991).

[268] Critical infrastructure is defined as those systems and asets "so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security"

[269] Transactions involving critical infrastructure were nonetheless also reviewed under the provisions of the 1988 Exon-Florio Amendment.

[270] FINSA defines the term "critical technologies" to include technologies or components "essential to national defense". These items are identified in the regulations implementing FINSA and comprise fourteen ritical technology sectors: advanced materials and process; chemicals; advanced manufacturing; information technology; telecommunications; microelectronics; seminconductor fabrication equipment; electronics (military-related); biotechnology; professional and scientific instruments; aerospace and surface transportation; energy; speace systems; and, marine systems.

- Adherence of the country in which the foreign person is located to non-proliferation control regimes, its cooperation in counter-terrorism efforts and the adequacy of its national export control laws and regulations;
- Long-term U.S. requirements for energy and other critical resources and material;
- Any other factors the President or CFIUS determines to be appropriate.

The CFIUS process does not legally differentiate between countries. However, it ought to be emphasised again – and as noted above – that State controlled enterprises ("foreign government-controlled transactions") are a factor specifically identified in FINSA as warranting particular scrutiny by CFIUS

Authorities responsible for the review process

The review is conducted by the inter-agency Committee on Foreign Investment in the United States (CFIUS). The composition of CFIUS was revised and expanded under the 2007 FINSA and is as follows[272]

Table 3.2: Composition of CFIUS

Members	Observers
Department of the Treasury (chair) Department of Justice Department of Homeland Security Department of Commerce Department of Defense Department of State Department of Energy Office of the U.S. Trade Representative Office of Science & Technology Policy	The following offices also observe and, as appropriate, participate in CFIUS's activities: Office of Management & Budget Council of Economic Advisors National Security Council National Economic Council Homeland Security Council

[271] A "foreign government-controlled transaction" is one that could result in the control of a U.S. business by a foeign Government or an entity acting on bhelaf of a foreign government.

[272] http://www.ustreas.gov/offices/international-affairs/cfius/members.shtml

The Director of National Intelligence and the Secretary of Labor are non-voting, *ex-officio* members of CFIUS with roles as defined by statute and regulation.

The FINSA established the role of "lead agency" which – with the support of the U.S. Treasury as Chair of CFIUS – undertakes to lead the review process and monitor any mitigation processes arising.

Intervention process

Formally, the CFIUS review process is voluntary and there is no legal requirement to file with CFIUS. In practice, it is effectively mandatory for foreign acquisitions involving U.S. companies that hold U.S. security clearances as well as companies engaged in U.S. "critical infrastructure". The regulations contemplate that persons considering transactions will exercise their own judgment and discretion in determining whether to give notice to the Committee with respect to a particular transaction but say that: "notice, while voluntary, would clearly be appropriate when, for example, a company is being acquired that provides products or key technologies essential to U.S. defense requirements".[273]

Notices to CFIUS are received, processed, and coordinated at the staff level by the Staff Chairperson of CFIUS, who is the Director of the Office of Investment Security in the Department of the Treasury. On notification of the transaction, CFIUS conducts a 30-day review. During this review, the Director of National Intelligence is required to conduct a thorough analysis of potential national security concerns. A "lead agency" is appointed by CFIUS with primary responsibility for the investigation. Any agency that is a member of CFIUS may also conduct its own enquiry with respect to the potential national security risk posed by a transaction but communication with the parties to the transaction must be through the lead agency.[274]

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[273] TITLE 31 - MONEY AND FINANCE: TREASURY SUBTITLE B - REGULATIONS RELATING TO MONEY AND FINANCE CHAPTER VIII - OFFICE OF INTERNATIONAL INVESTMENT, DEPARTMENT OF THE TREASURY, PART 800 - REGULATIONS PERTAINING TO MERGERS, ACQUISITIONS, AND TAKEOVERS BY FOREIGN PERSONS, subpart g - PROVISION AND HANDLING OF INFORMATION Appendix A to Part 800 - Preamble to Regulations on Mergers, Acquisitions, and Takeovers by Foreign Persons (Published November 21, 1991).

[274] Executive Order 11858, Foreign Investment in the United States.

Following completion of the 30-day review transacations will be subject to a subsequent 45-day investigation if the propose dtransaction falls under any of the following:

- threatens to impair U.S. national security and the threat has not been mitigated during the review;
- is a foreign government-controlled transaction;
- would result in foreign control of any critical infrastructure and could impair U.S. national security unless than impairment has been mitigated during the review; or
- the lead agency and CFIUS concur that an investigation should occur.

Right of appeal

There is no appeal process in the event of an acquisition being rejected.

Mitigation agreements

CFIUS or the lead agency acting behalf of CFIUS may seek to mitigate any national security risk posed by the transaction that is not adequately addressed by other provisions of law by entering into a mitigation agreement with the parties to the transaction or by imposing conditions on the parties.

- By law, the precise details of these mitigation agreements are confidential but it is common place for foreign acquisitions that complete the CFIUS process to be subject to approval conditions or mitigation agreements that may include Special Security Agreements; Proxy Boards; or partial divestments.
- For defence companies, these mitigation arrangements overlap with the FOCI process and will be considered in detail in the next section (on the FOCI process).

Review under FOCI

Formally, the CFIUS review and the industrial security FOCI review are carried out in two parallel but separate processes. By law, companies under foreign control and influence (FOCI) cannot hold facility security clearances unless measures are taken that effectively negate or mitigate FOCI. The FOCI review is conducted with different

time contraints and considerations.[275] FOCI is governed by the DOD's *National Industrial Security Policy Operating Manual* (NISPOM) and Directive-Type Memorandum (DTM) 09-019 *Policy Guidance for Foreign Ownership, Control or Infuence (FOCI)* issued by the Under Secretary of Defense (Intelligence) in 2009.

Reasons for review and definition of "defence assets" and "national security" used

The Foreign Ownership, Control or Influence (FOCI) review is intended to protect the security of classified and export controlled information and contractor performance on classified contracts. FOCI relates to all companies subject to a Facility Security Clearance to ensure "that foreign firms cannot undermine U.S. security and export controls to gain unauthorized access to critical technology, classified information and special classes of classified information"[276].

A company is determined to be under foreign ownership, control or influence (FOCI) when a foreign interest has the power, direct or indirect, whether or not exercised, to direct or decide matters affecting the management or operations of the company in a manner which may result in unauthorized access to classified information or may affect adversely the performance of classified contracts.[277]

The following factors relating to the company, the foreign interest, and the Government of the foreign interest are considered in the aggregate in determining if a company is under FOCI, its eligibility for a facility clearance and the protective measures required.[278]

- Record of economic and Government espionage against U.S. targets;
- Record of enforcement and/or engagement in unauthorized technology transfer;
- Type and sensitivity of the information requiring protection;
- Nature and extent of FOCI;
- Record of compliance with pertinent U.S. laws, regulations and contracts and

[275] National ISPOM 2-310 b.

[276] NISPOM, 2-300

[277] NISPOM, paragraph 2-300.

[278] NISPOM, Paragraph 2-301

- The nature of any bilateral and multilateral security and information exchange agreements that may pertain, and
- Ownership or control, in whole or in part, by a foreign government.

There is no differentiation between countries under the FOCI process.

Authorities responsible for the review process

The FOCI review is performed by the Department of Defense Defense Security Service (DSS) with support from the intelligence community.

Intervention process

A company is required to complete a Certificate Pertaining to Foreign Interests when applying for a Facility Clearance License or when significant changes occur to information previously submitted. When a contractor with an FCL enters into negotiations for a proposed merger, acquisition or takeover by a foreign interst, the contractor is obliged to notify the Department of Defense at the commencement of those negotiations.[279]

A review is conducted to establish the means of negating or mitigating the risk of foreign ownership or control. The FOCI is an on-going process for so long as the establishment holds an FCL and is under FOCI.

Right of appeal

There is no right to appeal

Mitigation agreements

NISPOM, paragraph 2-303 sets out the methods that can be applied to negate or mitigate the risk of foreign ownership or control. They are as follows:

- *Board Resolution* - The Board Resolution is used when the foreign entity does not own voting stock sufficient to elect a representative to the company's governing board.

[279] NISPOM, 2-302 b

- *Security Control Agreement* - The Security Control Agreement (SCA) is used when the cleared company is not effectively owned or controlled by a foreign entity and the foreign interest is entitled to representation on the company's governing board.

- *Special Security Agreement* - The Special Security Agreement (SSA) is used when a company is effectively owned or controlled by a foreign entity. The SSA has access limitations. Access to proscribed information by a company cleared under a SSA may require that the Government Contracting Activity complete a National Interest Determination to determine that the release of proscribed information to the company shall not harm the national security interest of the United States.[280]

The SCA and SSA are substantially identical arrangements that:

- Imposes substantial industrial security and export control measures within an institutionalized set of corporate practices and procedures

- Requires active involvement of senior management and certain Board members in security matters (who must be cleared, U.S. citizens) (Officer/Directors and Outside Directors);

- Provide for the establishment of a Government Security Committee (GSC) to oversee classified and export controlled matters (the GSC consists of cleared Officer/Directors and Outside Directors), and

- Preserve the foreign shareholder's right to be represented on the Board of Directors with a direct voice in the business management of the company while denying unauthorized access to classified information. (Inside Director(s)

The Proxy Agreement (PA) and Voting Trust Agreement (VTA) are used when a cleared company is owned or controlled by a foreign entity. The PA and VTA are substantially identical arrangements whereby the voting rights of the foreign owned stock are vested in cleared U.S. citizens approved by the Federal Government (DSS).

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[280] A National Interest Determination (NID) is a special authorisation for the release of proscribed information. NID approval is based on the view of the Government Contracting Authority that release of the proscribed information to the company shall not harm the national security interests of the United States.. A Government Contracting Authority in this case may be a Department of Defense Program Office, defence agency, etc.

Neither arrangement imposes any restrictions on the company's eligibility to have access to classified information or to compete for classified contracts.

Establishment of the PA or VTA involves the selection of three Proxy Holders or Trustees who must be directors of the cleared company's board. The Proxy Holders or Trustees exercise all prerogatives of ownership with complete freedom to act independently from the foreign stockholders, with the following exceptions:

- The Proxy Holders or Trustees must obtain approval from the foreign shareholder regarding the following matters:
- The sale or disposal of the corporation's assets or a substantial part.
- Pledges, mortgages or other encumbrances on the capital stock
- Corporate mergers, consolidations, or reorganization
- The dissolution of the corporation
- The filing of a bankruptcy petition

The Proxy Holder or Trustees assume full responsibility for the voting stock and for exercising all management prerogatives, except for the above matters. The company must be organized, structured and financed to be capable of operating as a viable business entity independent from the foreign shareholder.

Individuals serving as Proxy Holders or Trustees must be U.S. citizens, residing within the United States, completely "disinterested" individuals with no prior involvement with the cleared company, the corporate body with which it is affiliated or the foreign shareholder and they must be eligible for a personnel security clearance at the level of the facility clearance. Management positions requiring personnel security clearances must be filled by U.S. citizens residing in the U.S.

The difference between the Proxy Agreement and the Voting Trust Agreement is that under the Voting Trust Agreement the foreign owner transfers legal title in the company to the Trustees that are approved by DSS.[281]

[281] By title is meant here rights of ownership.

4 CASE STUDIES – ACQUISITION BY A EU COMPANY

4.1 Cobham acquires Sparta in 2008

In January2008, the UK company Cobham PLC ('Cobham') announced that it had reached an agreement to acquire SPARTA Inc. ('SPARTA') for up to US$416 million on a debt and cash free basis. This was the latest in a series of U.S. acquisitions made by Cobham as part of its strategy to establish itself as a mid-tier company in the large U.S. market. Cobham describes itself as international company engaged in the development, delivery and support of advanced aerospace and defence systems for land, sea and air platforms.

SPARTA was a US$300 million revenue business with System Engineering and Technical Assistance ('SETA') capabilities in Missile Defence and Intelligence. The acquisition, Cobham declared, would transform the UK company's position in the high growth US Intelligence market and presented further growth opportunities in the technical services, Intelligence, Electronic Signals Intelligence ('ELINT') and Signals Intelligence ('SIGINT') markets.

SPARTA and Cobham filed a joint voluntary notification to CFIUS concerning the merger and SPARTA – as a holder of Department of Defense facility clearances and performer of United States classified contracts – notified the Department of Defense's Defense Security Service when it entered into negotiations for the proposed merger with Cobham.

To mitigate FOCI, SPARTA and Cobham proposed to DSS that SPARTA be allowed to continue to perform its classified contracts pursuant to a Special Security Agreement ("SSA") that Cobham already maintained with regard to the performance of other United States classified contracts. Three senior 'Outside Directors' were nominated to the Board of Cobham North America, the SSA ('Special Security Agreement') company that now owns SPARTA. The Outside Directors are security cleared U.S. citizens. A Government Security Committee was established to oversee classified contracts and export matters. Six months later, in June 2008, the completion of the transaction was announced.

4.2 Finmeccanica acquires DRS in 2008

In May 2008, the Italian company Finmeccanica announced its intention to acquire the U.S. defence electronics firm DRS for U.S.$5.2 billion (€3.4 billion). DRS was a mid-tier U.S. defence contractor that described itself a leading supplier of integrated products, services and support to military forces, Government agencies and prime contractors worldwide. The company employed approximately 10,000 people and in FY2007 generated revenues of U.S.$2,821 million. DRS conducted a number of highly sensitive programmes for the U.S. government.

The financial media had also reported that both EADS and Thales had examined the possibility of acquiring DRS. EADS confirmed to the media that it had re-examined DRS as a potential acquisition after the U.S. company announced a merger with Finmeccanica but EADS "decided the electronics specialist was too sensitive a target for the European group". EADS explained that on criteria it used for U.S. acquisitions was that it would be "acceptable as owners" and in this acceptability area, there was a difference between sensitive and that which was "edge technology," which EADS viewed as effectively putting a company beyond its reach. EADS judged that DRS fell into that category. [282] Thales entered into negotiations with DRS and confirmed that it was interested in buying DRS before being out bid on price by Finmeccanica.[283]

The mitigation of potential FOCI concerns was a matter that was addressed by DRS and Finmeccanica from the outset. For instance, when the two companies announced their intention to pursue the deal, the press release that they issued stated that:

> "DRS will operate as a wholly-owned subsidiary, maintaining its current management and headquarters. As is customary in this type of transaction, DRS and Finmeccanica will comply with all national security requirements and will propose to the Defense Security Service (DSS) that the company operate under a Special Security Agreement (SSA), with its own board of

[282] Tran, P (2008) 'EADS: DRS was too hot to target for acquisition", *Defense News*, 14 July downloaded from http://www.defensenews.com/osd_story.php?sh=VSDF&i=3624401

[283] Jui Chakravorty Das (2008) "Thales keeps an eye out for deals", 16 December, *Reuters UK*, available at http://uk.reuters.com/article/idUKTRE4BF4Q220081216

directors comprised predominantly of U.S. citizens holding security clearances and a Government security committee".[284]

FOCI mitigation became a major issue during negotiations with the U.S. Government as it became clear that the sensitivity of some DRS technologies and business activities meant that the Defense Security Service would insist on a Proxy Board for certain of its activities. Mitigation through a Proxy Board would effectively seal off those parts of DRS covered by the Proxy from any management control or scrutiny by non-U.S. citizens. Finmeccanica made clear that it would not proceed with the acquisition should more than 40 percent of DRS by revenue be covered by the proxy Board.

Ultimately, Finmeccanica reached an agreement with the U.S. Government under which two companies were created. One is DRS, which is subject to a standard special security agreement. The other entity, 100 percent controlled by DRS, is DRS Defense Solutions, which is under a proxy agreement and contains around one-third of DRS activity, as calculated at the time of the division. The proxy agreement activity includes nuclear programmes and support programmes for the U.S. armed forces. DRS Defense Solutions has an all-American, three-man board, while DRS has a majority American board.[285]

5 ON THE EUROPEAN DIMENSION IN THE REVIEW OF FDI

5.1 Perceptions of the relative openness of the United States to FDI

We examined the question of perception of relative openness of the United States to acquisition by European companies. Certain key points arose.

284 'Finmeccanica to Acquire DRS for U.S.$5.2 billion (€3.4 billion)' News Release available at: http://drs-cs.com/MediaCenter/51208_2press.aspx

285 'Pierfrancesco Guarguaglini, CEO, Finmeccanica' interview in Defense News, published 1 June 2009 available at: http://www.defensenews.com/story.php?i=4116290

Some European companies from some European countries have had considerable success in making acquisitions in the United States. UK companies not least BAE Systems but also including Rolls-Royce, Ultra Electronics, QinetiQ and Cobham have all made acquisitions. However, as we can see from the case study, companies from other European countries have also made acquisitions, including Finmeccanica of Italy. French and German companies have also made acquisition of companies deemed to have "critical technologies".

Nevertheless, it was also said to us that the nature of U.S. FOCI mitigation requirements (especially Proxy Boards) can act as a deterrent to acquisition of U.S. defence assets by foreign companies. Indeed, we have noted that EADS was reported to have not bid for DRS in part because of concerns over the sensitivity of the technologies concerned and the fear that its acquisition would either be rejected or (more likely) would have Proxy Board mitigation arrangements imposed upon it. In addition, whatever the mitigation agreements, export of technologies remains covered by ITAR which presents a substantial barrier to technology transfer from the United States.

Although the CFIUS process rarely results in the President prohibiting a transaction, analysts regard this as deceptive. There is a strong deterrent effect to acquisition of U.S. defence assets by foreign companies. "A number of proposed transactions have been abandoned or significantly restructured after initial CFIUS scrutiny signaled that approval was unlikely". "[t]he fact that foreign corporations and governments are withdrawing their bids before CFIUS can make its recommendation indicates a strong unwillingness on the part of many foreign investors to subject themselves to this intense review process". [286]

5.2 On the need for EU level action

With respect to possible EU level action in this field, U.S. Treasury officials noted that the U.S. had taken the OECD initiative on national security controls and FDI very

[286] Farrar, B.J. (2008) Radosevic, S. (2003) 'Patterns of preservation, restructuring and survival: science and technology policy in Russia in post-Soviet era'. *Research Policy*, **Vol. 32**, **No. 6**, p.pp. 1105-24.

seriously. They suggested that any EU level initiative in this field would be judged against the OECD criteria of transparency and non-discrimination.

6 ANNEX: FOREIGN INVESTMENT AND NATIONAL SECURITY ACT OF 2007

PUBLIC LAW 110–49—JULY 26, 2007

110th Congress

An Act

To ensure national security while promoting foreign investment and the creation and maintenance of jobs, to reform the process by which such investments are examined for any effect they may have on national security, to establish the Committee on Foreign Investment in the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the ‘‘Foreign Investment

and National Security Act of 2007’’.

(b) TABLE OF CONTENTS.—The table of contents for this Act

is as follows:

SEC. 2. UNITED STATES SECURITY IMPROVEMENT AMENDMENTS;

CLARIFICATION OF REVIEW AND INVESTIGATION

PROCESS.

Section 721 of the Defense Production Act of 1950 (50 U.S.C.

App. 2170) is amended by striking subsections (a) and (b) and inserting the following:

‘‘(a) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

‘‘(1) COMMITTEE; CHAIRPERSON.—The terms ‘Committee’ and ‘chairperson’ mean the Committee on Foreign Investment in the United States and the chairperson thereof, respectively.

‘‘(2) CONTROL.—The term ‘control’ has the meaning given to such term in regulations which the Committee shall prescribe.

‘‘(3) COVERED TRANSACTION.—The term ‘covered transaction’ means any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.

‘‘(4) FOREIGN GOVERNMENT-CONTROLLED TRANSACTION.—

The term ‘foreign government-controlled transaction’ means any covered transaction that could result in the control of any person engaged in interstate commerce in the United States by a foreign Government or an entity controlled by or acting on behalf of a foreign government.

‘‘(5) CLARIFICATION.—The term ‘national security’ shall be construed so as to include those issues relating to ‘homeland security’, including its application to critical infrastructure.

‘‘(6) CRITICAL INFRASTRUCTURE.—The term ‘critical infrastructure’ means, subject to rules issued under this section, systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.

‘‘(7) CRITICAL TECHNOLOGIES.—The term ‘critical technologies’ means critical technology, critical components, or critical technology items essential to national defense, identified pursuant to this section, subject to regulations issued at the direction of the President, in accordance with subsection (h).

‘‘(8) LEAD AGENCY.—The term ‘lead agency’ means the agency, or agencies, designated as the lead agency or agencies pursuant to subsection (k)(5) for the review of a transaction.

‘‘(b) NATIONAL SECURITY REVIEWS AND INVESTIGATIONS.—

‘‘(1) NATIONAL SECURITY REVIEWS.—

‘‘(A) IN GENERAL.—Upon receiving written notification under subparagraph (C) of any covered transaction, or pursuant to a unilateral notification initiated under subparagraph (D) with respect to any covered transaction, the President, acting through the Committee—

‘‘(i) shall review the covered transaction to determine the effects of the transaction on the national security of the United States; and

‘‘(ii) shall consider the factors specified in subsection

(f) for such purpose, as appropriate.

‘‘(B) CONTROL BY FOREIGN GOVERNMENT.—If the Committee determines that the covered transaction is a foreign government-controlled transaction, the Committee shall conduct an investigation of the transaction under paragraph

(2).

‘‘(C) WRITTEN NOTICE.—

‘‘(i) IN GENERAL.—Any party or parties to any covered transaction may initiate a review of the transaction under this paragraph by submitting a written notice of the transaction to the Chairperson of the Committee.

‘‘(ii) WITHDRAWAL OF NOTICE.—No covered transaction for which a notice was submitted under clause (i) may be withdrawn from review, unless a written request for such withdrawal is submitted to the Committee by any party to the transaction and approved by the Committee.

‘‘(iii) CONTINUING DISCU.S.SIONS.—A request for withdrawal under clause (ii) shall not be construed to preclude any party to the covered transaction from continuing informal discussions with the Committee President or any member thereof regarding possible resubmission for review pursuant to this paragraph.

‘‘(D) UNILATERAL INITIATION OF REVIEW.—Subject to subparagraph (F), the President or the Committee may initiate a review under subparagraph (A) of—

‘‘(i) any covered transaction;

‘‘(ii) any covered transaction that has previously been reviewed or investigated under this section, if any party to the transaction submitted false or misleading material information to the Committee in connection with the review or investigation or omitted material information, including material documents, from information submitted to the Committee; or

‘‘(iii) any covered transaction that has previously been reviewed or investigated under this section, if—

‘‘(I) any party to the transaction or the entity resulting from consummation of the transaction intentionally materially breaches a mitigation agreement or condition described in subsection (l)(1)(A);

‘‘(II) such breach is certified to the Committee by the lead department or agency monitoring and enforcing such agreement or condition as an intentional material breach; and

‘‘(III) the Committee determines that there are no other remedies or enforcement tools available to address such breach.

‘‘(E) TIMING.—Any review under this paragraph shall be completed before the end of the 30-day period beginning on the date of the acceptance of written notice under subparagraph (C) by the chairperson, or beginning on the date of the initiation of the review in accordance with subparagraph (D), as applicable.

‘‘(F) LIMIT ON DELEGATION OF CERTAIN AUTHORITY.—

The authority of the Committee to initiate a review under subparagraph (D) may not be delegated to any person, other than the Deputy Secretary or an appropriate Under Secretary of the department or agency represented on the Committee.

‘‘(2) NATIONAL SECURITY INVESTIGATIONS.—

‘‘(A) IN GENERAL.—In each case described in subparagraph (B), the Committee shall immediately conduct an investigation of the effects of a covered transaction on the national security of the United States, and take any necessary actions in connection with the transaction to protect the national security of the United States.

‘‘(B) APPLICABILITY.—Subparagraph (A) shall apply in each case in which—

‘‘(i) a review of a covered transaction under paragraph (1) results in a determination that—

‘‘(I) the transaction threatens to impair the national security of the United States and that threat has not been mitigated during or prior to the review of a covered transaction under paragraph (1);

‘‘(II) the transaction is a foreign Government controlled transaction; or

‘‘(III) the transaction would result in control of any critical infrastructure of or within the United States by or on behalf of any foreign person, if the Committee determines that the transaction could impair national security, and that such impairment to national security has not been mitigated by assurances provided or renewed with the approval of the Committee, as described in subsection (l), during the review period under paragraph (1); or

‘‘(ii) the lead agency recommends, and the Committee concurs, that an investigation be undertaken.

‘‘(C) TIMING.—Any investigation under subparagraph (A) shall be completed before the end of the 45-day period beginning on the date on which the investigation commenced.

‘‘(D) EXCEPTION.—

‘‘(i) IN GENERAL.—Notwithstanding subparagraph (B)(i), an investigation of a foreign government-controlled transaction described in subclause (II) of subparagraph (B)(i) or a transaction involving critical infrastructure described in subclause (III) of

subparagraph (B)(i) shall not be required under this paragraph, if the Secretary of the Treasury and the head of the lead agency jointly determine, on the basis of the review of the transaction under paragraph (1), that the transaction will not impair the national security of the United States.

‘‘(ii) NONDELEGATION.—The authority of the Secretary or the head of an agency referred to in clause (i) may not be delegated to any person, other than the Deputy Secretary of the Treasury or the deputy head (or the equivalent thereof) of the lead agency, respectively.

‘‘(E) GUIDANCE ON CERTAIN TRANSACTIONS WITH

NATIONAL SECURITY IMPLICATIONS.—The Chairperson shall, not later than 180 days after the effective date of the Foreign Investment and National Security Act of 2007, publish in the Federal Register guidance on the types of transactions that the Committee has reviewed and that have presented national security considerations, including transactions that may constitute covered transactions that would result in control of critical infrastructure relating to United States national security by a foreign Government or an entity controlled by or acting on behalf of a foreign government.

‘‘(3) CERTIFICATIONS TO CONGRESS.—

‘‘(A) CERTIFIED NOTICE AT COMPLETION OF REVIEW.—

Upon completion of a review under subsection (b) that concludes action under this section, the chairperson and the head of the lead agency shall transmit a certified notice to the members of Congress specified in subparagraph (C)(iii).

‘‘(B) CERTIFIED REPORT AT COMPLETION OF INVESTIGATION.—

As soon as is practicable after completion of an investigation under subsection (b) that concludes action under this section, the chairperson and the head of the lead agency shall transmit to the members of Congress specified in subparagraph (C)(iii) a certified written report (consistent with the requirements of subsection (c)) on the results of the investigation, unless the matter under investigation has been sent to the President for decision.

‘‘(C) CERTIFICATION PROCEDURES.—

‘‘(i) IN GENERAL.—Each certified notice and report required under subparagraphs (A) and (B), respectively, shall be submitted to the members of Congress specified in clause (iii), and shall include—

‘‘(I) a description of the actions taken by the Committee with respect to the transaction; and

‘‘(II) identification of the determinative factors considered under subsection (f).

‘‘(ii) CONTENT OF CERTIFICATION.—Each certified notice and report required under subparagraphs (A) and (B), respectively, shall be signed by the chairperson and the head of the lead agency, and shall State that, in the determination of the Committee, there are no unresolved national security concerns with the transaction that is the subject of the notice or report.

‘‘(iii) MEMBERS OF CONGRESS.—Each certified notice and report required under subparagraphs (A) and (B), respectively, shall be transmitted—

‘‘(I) to the Majority Leader and the Minority Leader of the Senate;

‘‘(II) to the chair and ranking member of the Committee on Banking, Housing, and Urban Affairs of the Senate and of any committee of the Senate having oversight over the lead agency;

‘‘(III) to the Speaker and the Minority Leader of the House of Representatives;

‘‘(IV) to the chair and ranking member of the Committee on Financial Services of the House of Representatives and of any committee of the House of Representatives having oversight over the lead agency; and

‘‘(V) with respect to covered transactions involving critical infrastructure, to the members of the Senate from the State in which the principal place of business of the acquired United States person is located, and the member from the Congressional District in which such principal place of business is located.

‘‘(iv) SIGNATURES; LIMIT ON DELEGATION.—

‘‘(I) IN GENERAL.—Each certified notice and report required under subparagraphs (A) and (B), respectively, shall be signed by the chairperson and the head of the lead agency, which signature requirement may only be delegated in accordance with subclause (II).

‘‘(II) LIMITATION ON DELEGATION OF CERTIFICATIONS.—

The chairperson and the head of the lead agency may delegate the signature requirement under subclause (I)—

‘‘(aa) only to an appropriate employee of the Department of the Treasury (in the case of the Secretary of the Treasury) or to an appropriate employee of the lead agency (in

the case of the lead agency) who was appointed by the President, by and with the advice and consent of the Senate, with respect to any notice provided under paragraph (1) following the completion of a review under this section; or

‘‘(bb) only to a Deputy Secretary of the Treasury (in the case of the Secretary of the Treasury) or a person serving in the Deputy position or the equivalent thereof at the lead agency (in the case of the lead agency), with respect to any report provided under subparagraph

(B) following an investigation under this section.

‘‘(4) ANALYSIS BY DIRECTOR OF NATIONAL INTELLIGENCE.—

‘‘(A) IN GENERAL.—The Director of National Intelligence shall expeditiously carry out a thorough analysis of any threat to the national security of the United States posed by any covered transaction. The Director of National Intelligence shall also seek and incorporate the views of all affected or appropriate intelligence agencies with respect to the transaction.

‘‘(B) TIMING.—The analysis required under subparagraph (A) shall be provided by the Director of National Intelligence to the Committee not later than 20 days after the date on which notice of the transaction is accepted by the Committee under paragraph (1)(C), but such analysis may be supplemented or amended, as the Director considers necessary or appropriate, or upon a request for additional information by the Committee. The Director may begin the analysis at any time prior to acceptance of the notice, in accordance with otherwise applicable law.

‘‘(C) INTERACTION WITH INTELLIGENCE COMMUNITY.—

The Director of National Intelligence shall ensure that the intelligence community remains engaged in the collection, analysis, and dissemination to the Committee of any additional relevant information that may become available during the course of any investigation conducted under subsection (b) with respect to a transaction.

‘‘(D) INDEPENDENT ROLE OF DIRECTOR.—The Director of National Intelligence shall be a nonvoting, ex officio member of the Committee, and shall be provided with all notices received by the Committee under paragraph (1)(C) regarding covered transactions, but shall serve no policy role on the Committee, other than to provide analysis under subparagraphs (A) and (C) in connection with a covered transaction.

‘‘(5) SUBMISSION OF ADDITIONAL INFORMATION.—No provision

of this subsection shall be construed as prohibiting any party to a covered transaction from submitting additional information concerning the transaction, including any proposed restructuring of the transaction or any modifications to any agreements in connection with the transaction, while any review or investigation of the transaction is ongoing.

‘‘(6) NOTICE OF RESULTS TO PARTIES.—The Committee shall notify the parties to a covered transaction of the results of a review or investigation under this section, promptly upon completion of all action under this section.

‘‘(7) REGULATIONS.—Regulations prescribed under this section shall include standard procedures for—

‘‘(A) submitting any notice of a covered transaction to the Committee;

‘‘(B) submitting a request to withdraw a covered transaction from review;

‘‘(C) resubmitting a notice of a covered transaction that was previously withdrawn from review; and

‘‘(D) providing notice of the results of a review or investigation to the parties to the covered transaction, upon completion of all action under this section.’’.

SEC. 3. STATUTORY ESTABLISHMENT OF THE COMMITTEE ON FOREIGN

INVESTMENT IN THE UNITED STATES.

Section 721 of the Defense Production Act of 1950 (50 U.S.C.

App. 2170) is amended by striking subsection (k) and inserting the following:

‘‘(k) COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED

STATES.—

‘‘(1) ESTABLISHMENT.—The Committee on Foreign Investment in the United States, established pursuant to Executive Order No. 11858, shall be a multi agency committee to carry out this section and such other assignments as the President may designate.

‘‘(2) MEMBERSHIP.—The Committee shall be comprised of the following members or the designee of any such member:

‘‘(A) The Secretary of the Treasury.

‘‘(B) The Secretary of Homeland Security.

‘‘(C) The Secretary of Commerce.

‘‘(D) The Secretary of Defense.

‘‘(E) The Secretary of State.

‘‘(F) The Attorney General of the United States.

‘‘(G) The Secretary of Energy.

‘‘(H) The Secretary of Labor (nonvoting, ex officio).

‘‘(I) The Director of National Intelligence (nonvoting, ex officio).

‘‘(J) The heads of any other executive department, agency, or office, as the President determines appropriate, generally or on a case-by-case basis.

‘‘(3) CHAIRPERSON.—The Secretary of the Treasury shall serve as the chairperson of the Committee.

‘‘(4) ASSISTANT SECRETARY FOR THE DEPARTMENT OF THE

TREASURY.—There shall be established an additional position of Assistant Secretary of the Treasury, who shall be appointed by the President, by and with the advice and consent of the Senate. The Assistant Secretary appointed under this paragraph shall report directly to the Undersecretary of the Treasury for International Affairs. The duties of the Assistant Secretary shall include duties related to the Committee on Foreign Investment in the United States, as delegated by the Secretary of the Treasury under this section.

‘‘(5) DESIGNATION OF LEAD AGENCY.—The Secretary of the

Treasury shall designate, as appropriate, a member or members of the Committee to be the lead agency or agencies on behalf of the Committee—

‘‘(A) for each covered transaction, and for negotiating any mitigation agreements or other conditions necessary to protect national security; and

‘‘(B) for all matters related to the monitoring of the completed transaction, to ensure compliance with such agreements or conditions and with this section.

‘‘(6) OTHER MEMBERS.—The chairperson shall consult with the heads of such other Federal departments, agencies, and independent establishments in any review or investigation under subsection (a), as the chairperson determines to be appropriate, on the basis of the facts and circumstances of the covered transaction under review or investigation (or the designee of any such department or agency head).

‘‘(7) MEETINGS.—The Committee shall meet upon the direction of the President or upon the call of the chairperson, without regard to section 552b of title 5, United States Code (if otherwise applicable).’’.

SEC. 4. ADDITIONAL FACTORS FOR CONSIDERATION.

Section 721(f) of the Defense Production Act of 1950 (50 U.S.C.

App. 2170(f)) is amended—

(1) in the matter preceding paragraph (1), by striking ‘‘among other factors’’;

(2) in paragraph (4)—

(A) in subparagraph (A) by striking ‘‘or’’ at the end;

(B) by redesignating subparagraph (B) as subparagraph (C);

(C) by inserting after subparagraph (A) the following:

‘‘(B) identified by the Secretary of Defense as posing

a potential regional military threat to the interests of the

United States; or’’; and

(D) by striking ‘‘and’’ at the end;

(3) in paragraph (5), by striking the period at the end and inserting a semicolon; and

(4) by adding at the end the following:

‘‘(6) the potential national security-related effects on United

States critical infrastructure, including major energy assets;

‘‘(7) the potential national security-related effects on United States critical technologies;

‘‘(8) whether the covered transaction is a foreign government- controlled transaction, as determined under subsection

(b)(1)(B);

‘‘(9) as appropriate, and particularly with respect to transactions requiring an investigation under subsection (b)(1)(B), a review of the current assessment of—

‘‘(A) the adherence of the subject country to nonproliferation control regimes, including treaties and multilateral supply guidelines, which shall draw on, but not be limited to, the annual report on ‘Adherence to and Compliance with Arms Control, Nonproliferation and Disarmament Agreements and Commitments’ required by section 403 of the Arms Control and Disarmament Act;

‘‘(B) the relationship of such country with the United States, specifically on its record on cooperating in counterterrorism efforts, which shall draw on, but not be limited to, the report of the President to Congress under section 7120 of the Intelligence Reform and Terrorism Prevention Act of 2004; and

‘‘(C) the potential for transshipment or diversion of technologies with military applications, including an analysis of national export control laws and regulations;

‘‘(10) the long-term projection of United States requirements for sources of energy and other critical resources and material; and

‘‘(11) such other factors as the President or the Committee may determine to be appropriate, generally or in connection with a specific review or investigation.’’.

SEC. 5. MITIGATION, TRACKING, AND POSTCONSUMMATION MONITORING AND ENFORCEMENT.

Section 721 of the Defense Production Act of 1950 (50 U.S.C.

App. 2170) is amended by adding at the end the following:

‘‘(l) MITIGATION, TRACKING, AND POSTCONSUMMATION MONITORING

AND ENFORCEMENT.—

‘‘(1) MITIGATION.—

‘‘(A) IN GENERAL.—The Committee or a lead agency may, on behalf of the Committee, negotiate, enter into or impose, and enforce any agreement or condition with any party to the covered transaction in order to mitigate any threat to the national security of the United States that arises as a result of the covered transaction.

‘‘(B) RISK-BASED ANALYSIS REQUIRED.—Any agreement entered into or condition imposed under subparagraph (A) shall be based on a risk-based analysis, conducted by the Committee, of the threat to national security of the covered transaction.

‘‘(2) TRACKING AUTHORITY FOR WITHDRAWN NOTICES.—

‘‘(A) IN GENERAL.—If any written notice of a covered transaction that was submitted to the Committee under this section is withdrawn before any review or investigation by the Committee under subsection (b) is completed, the Committee shall establish, as appropriate—

‘‘(i) interim protections to address specific concerns with such transaction that have been raised in connection with any such review or investigation pending any resubmission of any written notice under this section with respect to such transaction and further action by the President under this section;

‘‘(ii) specific time frames for resubmitting any such written notice; and

‘‘(iii) a process for tracking any actions that may be taken by any party to the transaction, in connection with the transaction, before the notice referred to in clause (ii) is resubmitted.

‘‘(B) DESIGNATION OF AGENCY.—The lead agency, other than any entity of the intelligence community (as defined in the National Security Act of 1947), shall, on behalf of the Committee, ensure that the requirements of subparagraph (A) with respect to any covered transaction that is subject to such subparagraph are met.

‘‘(3) NEGOTIATION, MODIFICATION, MONITORING, AND

ENFORCEMENT.—

‘‘(A) DESIGNATION OF LEAD AGENCY.—The lead agency shall negotiate, modify, monitor, and enforce, on behalf of the Committee, any agreement entered into or condition imposed under paragraph (1) with respect to a covered transaction, based on the expertise with and knowledge of the issues related to such transaction on the part of the designated department or agency. Nothing in this paragraph shall prohibit other departments or agencies in assisting the lead agency in carrying out the purposes of this paragraph.

‘‘(B) REPORTING BY DESIGNATED AGENCY.—

‘‘(i) MODIFICATION REPORTS.—The lead agency in connection with any agreement entered into or condition imposed with respect to a covered transaction shall—

‘‘(I) provide periodic reports to the Committee on any material modification to any such agreement or condition imposed with respect to the transaction; and

‘‘(II) ensure that any material modification to any such agreement or condition is reported to the Director of National Intelligence, the Attorney General of the United States, and any other Federal department or agency that may have a material interest in such modification.

‘‘(ii) COMPLIANCE.—The Committee shall develop and agree upon methods for evaluating compliance with any agreement entered into or condition imposed with respect to a covered transaction that will allow the Committee to adequately assure compliance, without—

‘‘(I) unnecessarily diverting Committee resources from assessing any new covered transaction for which a written notice has been filed pursuant to subsection (b)(1)(C), and if necessary, reaching a mitigation agreement with or imposing a condition on a party to such covered transaction or any covered transaction for which a review has been reopened for any reason; or

‘‘(II) placing unnecessary burdens on a party to a covered transaction.’’.

SEC. 6. ACTION BY THE PRESIDENT.

Section 721 of the Defense Production Act of 1950 (50 U.S.C.

App. 2170) is amended by striking subsections (d) and (e) and inserting the following:

‘‘(d) ACTION BY THE PRESIDENT.—

‘‘(1) IN GENERAL.—Subject to paragraph (4), the President may take such action for such time as the President considers appropriate to suspend or prohibit any covered transaction that threatens to impair the national security of the United States.

‘‘(2) ANNOUNCEMENT BY THE PRESIDENT.—The President shall announce the decision on whether or not to take action pursuant to paragraph (1) not later than 15 days after the date on which an investigation described in subsection (b) is completed.

‘‘(3) ENFORCEMENT.—The President may direct the Attorney General of the United States to seek appropriate relief, including divestment relief, in the district courts of the United States, in order to implement and enforce this subsection.

‘‘(4) FINDINGS OF THE PRESIDENT.—The President may exercise the authority conferred by paragraph (1), only if the President finds that—

‘‘(A) there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security; and

‘‘(B) provisions of law, other than this section and the International Emergency Economic Powers Act, do not, in the judgment of the President, provide adequate and appropriate authority for the President to protect the national security in the matter before the President.

‘‘(5) FACTORS TO BE CONSIDERED.—For purposes of determining whether to take action under paragraph (1), the President shall consider, among other factors each of the factors described in subsection (f), as appropriate.

‘‘(e) ACTIONS AND FINDINGS NONREVIEWABLE.—The actions of the President under paragraph (1) of subsection (d) and the findings of the President under paragraph (4) of subsection (d) shall not be subject to judicial review.’’.

SEC. 7. INCREASED OVERSIGHT BY CONGRESS.

(a) REPORT ON ACTIONS.—Section 721(g) of the Defense Production Act of 1950 (50 U.S.C. App. 2170(g)) is amended to read as follows:

‘‘(g) ADDITIONAL INFORMATION TO CONGRESS; CONFIDENTIALITY.—

‘‘(1) BRIEFING REQUIREMENT ON REQUEST.—The Committee shall, upon request from any Member of Congress specified in subsection (b)(3)(C)(iii), promptly provide briefings on a covered transaction for which all action has concluded under this section, or on compliance with a mitigation agreement or condition imposed with respect to such transaction, on a classified basis, if deemed necessary by the sensitivity of the information. Briefings under this paragraph may be provided to the congressional staff of such a Member of Congress having appropriate security clearance.

‘‘(2) APPLICATION OF CONFIDENTIALITY PROVISIONS.—

‘‘(A) IN GENERAL.—The disclosure of information under this subsection shall be consistent with the requirements of subsection (c). Members of Congress and staff of either House of Congress or any committee of Congress, shall be subject to the same limitations on disclosure of information as are applicable under subsection (c).

‘‘(B) PROPRIETARY INFORMATION.—Proprietary information which can be associated with a particular party to a covered transaction shall be furnished in accordance with subparagraph (A) only to a committee of Congress, and only when the committee provides assurances of confidentiality, unless such party otherwise consents in writing to such disclosure.’’.

(b) ANNUAL REPORT.—Section 721 of the Defense Production Act of 1950 (50 U.S.C. App. 2170) is amended by adding at the end the following:

‘‘(m) ANNUAL REPORT TO CONGRESS.—

‘‘(1) IN GENERAL.—The chairperson shall transmit a report to the chairman and ranking member of the committee of jurisdiction in the Senate and the House of Representatives, before July 31 of each year on all of the reviews and investigations of covered transactions completed under subsection (b) during the 12-month period covered by the report.

‘‘(2) CONTENTS OF REPORT RELATING TO COVERED TRANSACTIONS.—

The annual report under paragraph (1) shall contain the following information, with respect to each covered transaction, for the reporting period:

‘‘(A) A list of all notices filed and all reviews or investigations completed during the period, with basic information on each party to the transaction, the nature of the

business activities or products of all pertinent persons, along with information about any withdrawal from the process, and any decision or action by the President under this section.

‘‘(B) Specific, cumulative, and, as appropriate, trend information on the numbers of filings, investigations, withdrawals, and decisions or actions by the President under this section.

‘‘(C) Cumulative and, as appropriate, trend information on the business sectors involved in the filings which have been made, and the countries from which the investments have originated.

‘‘(D) Information on whether companies that withdrew notices to the Committee in accordance with subsection (b)(1)(C)(ii) have later refiled such notices, or, alternatively, abandoned the transaction.

‘‘(E) The types of security arrangements and conditions the Committee has used to mitigate national security concerns about a transaction, including a discussion of the methods that the Committee and any lead agency are using to determine compliance with such arrangements or conditions.

‘‘(F) A detailed discussion of all perceived adverse effects of covered transactions on the national security or critical infrastructure of the United States that the Committee will take into account in its deliberations during the period before delivery of the next report, to the extent possible.

‘‘(3) CONTENTS OF REPORT RELATING TO CRITICAL TECHNOLOGIES.—

‘‘(A) IN GENERAL.—In order to assist Congress in its oversight responsibilities with respect to this section, the President and such agencies as the President shall designate shall include in the annual report submitted under paragraph (1)—

‘‘(i) an evaluation of whether there is credible evidence of a coordinated strategy by 1 or more countries or companies to acquire United States companies involved in research, development, or production of critical technologies for which the United States is a leading producer; and

‘‘(ii) an evaluation of whether there are industrial

espionage activities directed or directly assisted by foreign governments against private United States companies aimed at obtaining commercial secrets related to critical technologies.

‘‘(B) RELEASE OF UNCLASSIFIED STUDY.—All appropriate portions of the annual report under paragraph (1) may be classified. An unclassified version of the report, as appropriate, consistent with safeguarding national security and privacy, shall be made available to the public.’’.

(c) STUDY AND REPORT.—

(1) STUDY REQUIRED.—Before the end of the 120-day period beginning on the date of enactment of this Act and annually thereafter, the Secretary of the Treasury, in consultation with the Secretary of State and the Secretary of Commerce, shall conduct a study on foreign direct investments in the United States, especially investments in critical infrastructure and industries affecting national security, by—

(A) foreign governments, entities controlled by or acting on behalf of a foreign government, or persons of foreign countries which comply with any boycott of Israel; or

(B) foreign governments, entities controlled by or acting on behalf of a foreign government, or persons of foreign countries which do not ban organizations designated by the Secretary of State as foreign terrorist organizations.

(2) REPORT.—Before the end of the 30-day period beginning upon the date of completion of each study under paragraph (1), and thereafter in each annual report under section 721(m) of the Defense Production Act of 1950 (as added by this section), the Secretary of the Treasury shall submit a report to Congress, for transmittal to all appropriate committees of the Senate and the House of Representatives, containing the findings and conclusions of the Secretary with respect to the study described in paragraph (1), together with an analysis of the effects of such investment on the national security of the United States and on any efforts to address those effects.

(d) INVESTIGATION BY INSPECTOR GENERAL.—

(1) IN GENERAL.—The Inspector General of the Department of the Treasury shall conduct an independent investigation to determine all of the facts and circumstances

concerning each failure of the Department of the Treasury to make any report to the Congress that was required under section 721(k) of the Defense Production Act of 1950, as in effect on the day before the date of enactment of this Act.

(2) REPORT TO THE CONGRESS.—Before the end of the 270-day period beginning on the date of enactment of this Act, the Inspector General of the Department of the Treasury shall submit a report on the investigation under paragraph (1) containing the findings and conclusions of the Inspector General, to the chairman and ranking member of each committee of the Senate and the House of Representatives having jurisdiction over any aspect of the report, including, at a minimum, the Committee on Foreign Relations, the Committee on Banking, Housing, and Urban Affairs, and the Committee on Commerce, Science, and Transportation of the Senate, and the Committee on Foreign Affairs, the Committee on Financial Services, and the Committee on Energy and Commerce of the House of Representatives.

SEC. 8. CERTIFICATION OF NOTICES AND ASSURANCES.

Section 721 of the Defense Production Act of 1950 (50 U.S.C.

App. 2170) is amended by adding at the end the following:

‘‘(n) CERTIFICATION OF NOTICES AND ASSURANCES.—Each notice, and any followup information, submitted under this section and regulations prescribed under this section to the President or the Committee by a party to a covered transaction, and any information submitted by any such party in connection with any action for which a report is required pursuant to paragraph (3)(B) of subsection (l), with respect to the implementation of any mitigation agreement or condition described in paragraph (1)(A) of subsection (l), or any material change in circumstances, shall be accompanied by a written statement by the chief executive officer or the designee of the person required to submit such notice or information certifying that, to the best of the knowledge and belief of that person—

‘‘(1) the notice or information submitted fully complies with the requirements of this section or such regulation, agreement,

or condition; and

‘‘(2) the notice or information is accurate and complete in all material respects.’’.

SEC. 9. REGULATIONS.

Section 721(h) of the Defense Production Act of 1950 (50 U.S.C.

App. 2170(h)) is amended to read as follows:

‘‘(h) REGULATIONS.—

‘‘(1) IN GENERAL.—The President shall direct, subject to notice and comment, the issuance of regulations to carry out this section.

‘‘(2) EFFECTIVE DATE.—Regulations issued under this section shall become effective not later than 180 days after the effective date of the Foreign Investment and National Security Act of 2007.

‘‘(3) CONTENT.—Regulations issued under this subsection shall—

‘‘(A) provide for the imposition of civil penalties for any violation of this section, including any mitigation agreement entered into or conditions imposed pursuant to subsection (l);

‘‘(B) to the extent possible—

‘‘(i) minimize paperwork burdens; and

‘‘(ii) coordinate reporting requirements under this section with reporting requirements under any other provision of Federal law; and

‘‘(C) provide for an appropriate role for the Secretary of Labor with respect to mitigation agreements.’’.

SEC. 10. EFFECT ON OTHER LAW.

Section 721(i) of the Defense Production Act of 1950 (50 U.S.C.

App. 2170(i)) is amended to read as follows:

‘‘(i) EFFECT ON OTHER LAW.—No provision of this section shall be construed as altering or affecting any other authority, process, regulation, investigation, enforcement measure, or review provided by or established under any other provision of Federal law, including the International Emergency Economic Powers Act, or any other authority of the President or the Congress under the Constitution of the United States.’’.

SEC. 11. CLERICAL AMENDMENTS.

(a) TITLE 31.—Section 301(e) of title 31, United States Code, is amended by striking ‘‘8 Assistant’’ and inserting ‘‘9 Assistant’’.

(b) TITLE 5.—Section 5315 of title 5, United States Code, is amended in the item relating to ‘‘Assistant Secretaries of the Treasury’’, by striking ‘‘(8)’’ and inserting ‘‘(9)’’.

SEC. 12. EFFECTIVE DATE.

The amendments made by this Act shall apply after the end of the 90-day period beginning on the date of enactment of this Act.

Approved July 26, 2007.

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Appendix 2: Information on non-case study countries

1 INTRODUCTION

In an attempt to get coverage of practices across the whole of the European Union, the project team conducted a questionnaire survey of those EU Member States who are not the nine case study countries, conducted a limited desk research and contacted experts by telephone or email to gather additional information.

These "non-case study" countries examined in the survey are Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Portugal, Rumania, Slovak Republic and Slovenia.

As agreed with the Commission the questionnaire was sent out to the EDA Points of Contacts of National Armaments Directors (NAD PoCs). A list of contacts had by courtesy of the EDA been made available to the study team. The NAD PoCs had been requested to serve as an entry point for the survey and to forward the questionnaire to the expert on the issue of State control. In addition to the addressing the NAD PoCs the team asked representatives of National Defence Industry Associations (NDIAs) to fill in the questionnaire. Both questionnaires were followed up by email to ensure a higher response rate.

All in all about a third of the people contacted filled in and returned the questionnaire, a response rate that is well above the expectation we had based on similar surveys conducted in other projects. Despite the impressive response rate the additional information we could gather from the survey has been limited, as many responses have come mainly from countries with a small defence industry (Austria, Hungary) or almost no defence industry (Cyprus, Estonia, Ireland, Latvia), the main exceptions being Greece and Finland. The information on Romania and Greece has been complemented by desk research and partly on information obtained from experts via telephone and email.

2 STATE OWNERSHIP

Based on our survey we conclude that State ownership is used as a means of control in Belgium, Finland, Greece and Portugal but also in Eastern European countries: Estonia, Bulgaria, Hungary, Romania, the Slovak Republic and Slovenia. Austria, Cyprus, Ireland and Latvia reported that there is no State ownership in the defence industry (if it exists).

Country/name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
ESTONIA			
AS Erika Neli	Military and security maintenance and electronics	Owned by MOD[287]	1 (n.a)
BELGIUM[288]			
FN Herstal	Light weapons	Wallonia regional government	
BULRGARIA[289]			
Vazovski Machinotroitelmi Zavodi – VMZ Co.	Ammunition, antitank missiles, ordnance	100% Government owned	
Arsenal J. S. Co.	Small arms, ammunition, artillery	100% Government owned	
Kintex Co.	Trading agency for defence products. Also provides technical support to	100% Government owned	

[287] Shares will be transferred to the Ministry of Finance and might be dissolved entirely depending on a strategic review currently conducted. {Interview with Estonian MoD representative, 2009 #2319}

[288] ISDEFE and ISI (2009) Study "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" EDA contract reference: 08-I&M-001 (Brussels: European Defence Agency).

[289] Ibid.

	army		
Teraton Co.	Import-export agency for defence products	100% Government owned	

Country/name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
FINLAND			
Patria Oyj	Land armaments, aircraft and helicopter maintenance, command and control	State owns 73.2%[290]; remainder held by EADS	539 (2810)
Raskone Oy	Vehicle maintenance, mainly civil sector	State owns 85%[291]	n.a.
GREECE			
HDS (Hellenic Defense Systems) http://www.eas.gr	Weaponry & ammunition	n.a.	n.a. (2,000)
HAI (Hellenic Aerospace Industry) http://www.haicorp.com/	Military aerospace	n.a.	n.a. (5,000)
HVI (Hellenic Vehicle Industry) http://www.elvo.gr/	Military logistics vehicles & Armoured Fighting Vehicles	n.a. / 47.5% held by MYTILINEOS S.A.	40 (640)

[290] Patria Oyj (2010) 'Annual Report'. available at <http://www.patria.fi/Patria_WWW_EN_Sisalto/Patria_WWW_EN/Financials/Annual+Report/index.html>.and Nammo Group (2006) 'Sell out of Saab AB shares in Nammo'. available at <http://www.nammo.com/templates/page.aspx?id=338>.

[291] HELSINGIN SANOMAT INTERNATIONAL EDITION - BUSINESS & FINANCE (2009) 'Major political row brewing over ownership of state-owned companies. Government wants permission from Parliament to divest from three companies'. available at <http://www.hs.fi/english/article/Major+political+row+brewing+over+ownership+of+state-owned+companies/1135249222103>.

Name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
HUNGARY[292]			
FEG Army Arms Manufacturing Ltd.	Small arms	n.a.	n.a.
Mechanical Works Co. Special Division.		n.a.	n.a.
MFS 2000 Ammunition Manufacturing Ltd.	Ammunition	privatised	n.a.
MIKI Research and Innovation Co.	Electronics (computers)	n.a.	n.a.
MoD "Currus" Combat Vehicle Technical Co.	Land armaments	100% State owned	n.a.
MoD Arm. Com. Communication Ltd.	Communications	100% State owned	n.a.
MoD Arzenal Electromechanical Co.	Air defence	100% State owned	n.a.
MoD Electronics, Logistics and Property Management Co.	Electronics	100% State owned	n.a.
TKI Innovation Co.	Communications	n.a.	n.a.

[292] The following information, if not referenced otherwise, is taken from ISDEFE and ISI (2009) Study "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" EDA contract reference: 08-I&M-001 (Brussels: European Defence Agency).

Name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
PORTUGAL[293]			
EDISOFT - Empresa de Serviços e Desenvolvimento de Software, SA	C2, software development	*	n.a.
EID - Empresa de Investigação e Desenvolvimento de Electrónica, SA	Electronics, communications	*	n.a.
ENVC - Estaleiros Navais de Viana do Castelo, SA	Naval shipbuilding	*	n.a.
IDD – Indústria de Desmilitarização e Defesa, SA	Ammunitions and demilitarisation	*	n.a.
NAVALROCHA - Sociedade de Construções e Reparação Navais, SA	Naval shipbuilding	*	n.a.
OGMA – Indústria Aeronáutica de Portugal,S.A.	Aeronautics	*	n.a.
DEFAERLOC – Locação de Aeronaves Militares, SA	Aeronautics	*	n.a.
DEFLOC - Locação de Equipamentos de Defesa, SA	Logistics ("Defence equipment location")	*	n.a.
OGMA – IMOBILIÁRIA	Real estate (management)	*	n.a.
RIBEIRA D'ATALAIA	Civil construction		

[293] (*) All companies are held by *Empresa Portuguesa de Defesa*, which is fully owned by the State and reports to the Ministries of Finance and of Defence. The following information, if not referenced otherwise, is taken from ISDEFE and ISI (2009) Study "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" EDA contract reference: 08-I&M-001 (Brussels: European Defence Agency).

Name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
ROMANIA[294]			
Avioane Craiova SA	Aerospace	19.07%; remainder held by Aero Vodochody	4.7
SC Constructii Aeronautice SA	Aeronautical structures manufacture	Majority State owned	1.6
Eurocopter Romania	Helicopter	49%; remainder is held by EADS Eurocopter	n.a.
IAR SA Brasov	Aerospace	64.8%; remainder publicly held	55.3
IOR SA	Military optical equipment such as opto-electronics, lasers, metrology, thermo vision	Majority State owned	4.7
Romaero SA	Aerospace	27%; remainder held by Britain-Norman Group	n.a.
ROMARM SA with 16 subsidaries	Land armaments, air defence, ordnance	100%	58.8
SC Santierul Naval Mangalia SA	Maintenance, repair and overhaul for civil and military vessels	Majority State owned	1.0

[294] Information on Romania is based on data provided by the Romanian Ministry of Defence and taken from ISDEFE and ISI (2009) Study "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" EDA contract reference: 08-I&M-001 (Brussels: European Defence Agency).

Name of company	Sector of activity (e.g. land armaments, electronics)	Nature of ownership structure	Turnover (€ million) in 2008 (No. of employees)
SLOVAK REPUBLIC[295]			
Letecké opravovne Trenčín, a.s.	Aircraft maintenance	Slovak Republic - 100% shareholder	14.6
Vojenský opravárenský podnik Trenčín, a.s.	Repairing and production of military tracked and wheeled technics	Slovak Republic - 100% shareholder	21
Vojenský opravárenský podnik Nováky, a.s.	Revision, dismantling and destruction of ammunition	Slovak Republic - 100% shareholder	4.5
DMD GROUP, a.s.		100% Government ownership	2,2
KONŠTRUKTA-Defence, a.s.	R&D land and air defence weapons systems, ammunitions, electronic systems	100% Government ownership	7,0
ZTS-ŠPECIÁL, a.s.	Land armaments, cannons, barrels	100% Government ownership	9,2
ZVS holding, a.s.	Ammunition	50% Government ownership	20,4
SLOVENIA			
Fotona d.d. Ljubljana	Fire control systems	68%	
Gorenje Indop, d.o.o.	Light armoured vehicles	26.04%	

[295] A comparison with the EDA level playing field study shows that the information we obtained does only partly correspond to the information of the EDA report.

3 SPECIAL RIGHTS

Among non-case study countries only the Finish Government uses special rights. The golden share in Millog Oy, a firm providing maintenance and support functions, allows the government, for example to name a Director, to veto certain decisions and provides it a right to buy back shares in the company.

The following governments have reported that they do not hold special rights: Austria, Cyprus, Estonia, Greece, Ireland, Latvia, the Slovak Republic and Romania.

As for Romania the situation is not conclusive, since the publicly available information disagrees with the data provided by the MoD. A publication in the Romanian Journal of Economic Forecasting from 2008 stated that "Romania has limited, but not fully eliminated, the use of golden share to affect strategic decisions of firms", without specifying the sectors in which theses shares were held.[296] In 2009 it was reported that the government held special rights in the following eight defence companies:[297]

- Aerostar SA,
- Aerothermm Electronics,
- Avioane Cairova SA,
- Eurocopter Romania,
- IAR Brasov,
- Romaero SA,
- Romarm SA,
- SC AE Elctronics SA.

The Romanian MoD, however, stated in the survey in April 2010 that all special rights in defence companies had been abandoned by legislation adopted in 2006.

[296] (Fay, De Rosa and Calalin, 2008: 12).

[297] (Bialos and Fischer, 2009).

4 NATIONAL REGULATION OF INVESTMENT CONTROL: FINLAND

Only Finland has reported to have legislative means to control foreign investments in defence assets. A summary of the Finish law is provided in the following part of the Annex.

National legislation for investment control in Finland

The "Act on the monitoring of foreigners' corporate acquisitions in Finland" regulates the review of foreign investments in strategic defence assets in Finland.[298]

The Act contains provisions for the monitoring of specific "entities" that can touch upon "important national interests".

For the purposes of the Act, "important national interests" refers to "(1) securing national defence; (2) preventing such serious economic, social or environmental sectoral or geographic troubles as are likely to be permanent, and (3) safeguarding public order and the population's safety and health".[299]

The provisions differ slightly depending on whether the "entity" is a defence company or any other company. For sake of clarity we therefore distinguish between a wider security regime and a defence regime.

A monitored entity is any company with either

- Sales > € 170 million/year;
- Employees >1,000; or
- Balance sheet total > € 170 million (Section 3)

These limitations don't apply to the defence industry i.e. in respect of defence industry there are no limitations as for sales or employees. Thus any foreign acquisitions of defence companies (organisations or business undertakings that produce defence material referred to in the Act on the Export and Transit of Defence

[298] Ministry of Trade and Industry of the Republic of Finland (1992) 'Act on the monitoring of foreigners' corporate acquisitions in Finland (1612/1992; amendments up to 623/1999 included)'. available at <http://www.finlex.fi/en/laki/kaannokset/1992/>.

[299] Ibid., Section 2.

Material (242/1990) or provide for the purposes of military national defence vital ancillary services or goods such as maintenance, research, development services or spare parts) is subject to MoD´s confirmation (approval) if it exceeds certain threshold conditions.

The threshold for notifying an acquisition and obtaining an approval is an acquisition of 33 % of voting rights or if the investor becomes an owner of the monitored business undertaking. In case of defence industry also if the investor obtains dominant control in any other type of an organisation i.e. the act covers also acquisition of business unit or business unit other than a company.

The Ministry of Employment and the Economy (former Trade and Industry) handles the review for non-defence related cases and the Ministry of Defence for defence related cases. Both Ministries can only approve (confirm) an acquisition. If they consider that important national interests are in jeopardy, the case will be reviewed by the State Council who may decide not to approve (confirm) the acquisition.

No mitigation agreements are used. The decision could however include issues like abandoning part of the acquisition.

Predominately the Finish Government does not consult with other governments before approving such transactions.

Applicants can appeal a decision of the Council to Supreme Administrative Court. Section 13 of the Act stipulates that no appeal can be made against Ministry´s decision to elevate the case to the State Council. In all other cases, e.g. that the State Council denies the confirmation, an appeal can be made.

Since 2005 less than 10 transactions have taken place, out of which none was rejected.

The decisions are in practice only made available to the applicant. as the decisions are not published in any open media. Formally they decisions of the Government are public, unless provisions of the Act on Publicity stipulate otherwise. The Act on Publicity defines that these decisions have to be disclosed, if it is asked so. The Act contains exceptions to this principle, e.g. if the decision contains business or trade secrets or classified information. In these cases it may be kept confidential i.e. it will not be disclosed to any other than the applicant.

5 NATIONAL REGULATION OF INVESTMENT CONTROL: GREECE

We circulated our questionnaire to the Greek Ministry of Defence and the National Defence Industry Association. Only the latter responded stating that the Greek defence industry association reported that no specific investment control legislation for the defence sector exists.

However, since 2008 the Commission contests the Greek Law on investment in strategic companies (Law 3631/2008) which provides for an ex-ante authorisation system, according to which the acquisition of voting rights by shareholders other than the State is limited to 20%, unless prior approval has been granted by the Inter-ministerial Privatization Committee.

Since the study team did not succeed in obtaining any further information about the legislation we quote here the press release of the Commission of 27th November 2008, in which the Commission informs about the contestation of the Greek law.

"Free movement of capital: Commission contests Greek law on investment in strategic companies

The European Commission has sent Greece a formal request to eliminate the restrictions on investment in strategic companies introduced by Law 3631/2008. The infringement procedure was initiated by a letter of formal notice in May 2008. Having analysed the Greek government's reply, the Commission considers that the restrictions represent unjustified obstacles to EC Treaty rules on free movement of capital and freedom of establishment. The Commission's request takes the form of a 'reasoned opinion', the second stage of infringement procedures under Article 226 of the EC Treaty. If there is no satisfactory reply within two months, the Commission may decide to refer the case to the European Court of Justice.

The law in question establishes (i) an ex-ante authorisation system, according to which the acquisition of voting rights by shareholders other than the State is limited to 20%, unless prior approval has been granted by the Inter-ministerial Privatization Committee; and (ii) an ex-post approval system, according to which certain important

corporate decisions as well as certain decisions concerning specific management matters need, for their validity, the approval of the Minister of Economy and Finance.

The Commission considers that both authorisation systems are not suitable and proportionate measures. The criteria for granting the authorities' prior approval are imprecise, and no criteria exist for the ex-post approval by the Minister of Economy and Finance. This situation gives the administrative authorities a wide margin of discretion, which in the Commission's view restricts the rights of potential investors deriving from Article 56 of the EC Treaty on the free movement of capital.

In addition, the Commission considers that the law does not provide a clear definition of the scope of the measure, thus creating legal uncertainty as to which companies and sectors are currently subject to these mechanisms or might be covered by them in the future.

Consequently, it is considered that the schemes are not based on objective criteria known in advance to the undertakings concerned and subject to judicial review. Therefore, in the Commission's opinion, both the ex-ante authorisation regime and the ex-post approval system go beyond what is necessary to ensure the objective pursued by the Greek government, i.e. ensuring that there is a continuous and uninterrupted supply of services and that the networks function well."[300]

[300] European Commission, Free movement of capital: Commission contests Greek law on investment in strategic companies, Press release 27th November 2008, available online http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1784&format=HTML&aged=0&language=EN&guiLanguage=en

Appendix 3: Case studies illustrating the practice of the State control of strategic defence assets

1 INTRODUCTION

The European Commission asked for cases of actual practice which we present here. There are some limitations that need to be explained:

Acquisitions are rarely "rejected" but are more often withdrawn when it becomes apparent that they are likely to face significant opposition from the authorities. Equally, they may never be put forward in the first place if there is a perception that the Government is likely to be hostile. Hence, we could not find case studies of actually rejected transactions.

Some countries are more transparent than others when it comes to reporting transactions. For instance, under U.S. law, Government officials are expressly forbidden from discussing in public details of transactions that fall under CFIUS. In contrast, the United Kingdom Office of Fair Trading (OFT) publishes its reports to the Secretary of State for Business Innovation and Skills including the proposed mitigation arrangement. In turn, the agreed mitigation agreement signed by all parties is published.

There are relatively few cases in Europe and we were highly dependent upon those for which there is information in the public domain.

In the following we present selected case studies of foreign investments in strategic defence assets taken from the different Country Reports attached in the Annex. They illustrate the practice of the application of investment control legislation.

Irrespective of the country in which the target companies involved were located, we have grouped the case studies according to two criteria: location of the company initiating the transaction (another EU country or non-EU country) and reaction to the attempted transaction (acceptance (with and without conditions) or rejection).

Table 6.1: Four categories of case studies

	Accepted transactions	**Rejected transactions**
EU country	Diehl&Thales form Eurofuze (land) 3i / Tecnobit (electronic) Finmeccanica / PZL Swidnik (air, helicopter) Alcatel&Finmeccanica/Alenia Space&Telespazio BAE Systems / Saab	Patria / *WZM Siemianowice Sląskie*
Non-EU country	OEP / HDW (naval) Sikorsky Aircraft / PZL Mielec (air, helicopter) Carlye Group & Finmeccanica / Avio United Defence Industries / Bofors	

These case studies illustrate several points. First, the main investors from non-EU countries are U.S. firms. Investors from other countries have only very recently attempted to invest in strategic defence assets. In this context the activity of Sovereign Wealth Funds from countries such as Russia, China, and the Middle East has received much attention and at times been a subject for concern.

Second, the overwhelming number of illustrating cases concern accepted transactions. The number of rejected cases has been all in all very small as compared to the cases that have been accepted. This finding is in line with the sparse quantitative data we were able to gather.

In addition to the case studies that show the practice of the application of investment control legislation we also present two case studies of how the Italian Government currently safeguards its interests vis-à-vis foreign investors.

2 ACQUISITIONS BY A COMPANY FROM ANOTHER EU COUNTRY

2.1 Germany: Thales and Diehl create German joint venture in 2006

In 2006 Thales SA and Diehl Stiftung set out to create a joint control of the fuze businesses of the groups of Diehl and Thales. Thales is a French group active in defence, aerospace and civilian security technology. Its total worldwide turnover amounted to approximately €11 billion. Diehl Stiftung is a German group active in metals, controls, defence and aviation. Its total worldwide turnover amounted to approximately €2 billion.

The joint venture Microtec GmbH & co KG, Germany of which 49% are held by Thales and 51 by Diehl, brought together the fuze activities of the firms: TDA Armements SAS, Thales Munitronic BV, Forges de Zeebrugge, Junghans Feinwerktechnik GmbH & Co KG, all active in the fuze business. When the transaction was announced it became subject to two reviews.

The European Commission reviewed the case under the Merger Regulation as the thresholds of regulation 139/2004 on merger controls were met. It did not object to the transaction.

The German Government reviewed the case under Article 7(2)5 FTP Act read together with Article 52 of the German FTP Regulation - the defence-related regime - because the joint venture was concerned with the production of “war material” and thereby met the criteria given in the German legislation for a review.

The creation of the joint venture by Thales and Diehl implied the direct acquisition by Thales SA of 49 %, i.e. more than 25 %, of the German company Microtec and the indirect acquisition by Thales of the abovementioned companies now held by Microtec which Thales did not own before, among which the German company Junghans Feinwerktechnik in which Microtec holds 100%.

The German Government examined whether the acquisition threatened the essential security interests of Germany and did not raise objections to it either.

2.2 Poland: Agusta Westland acquires majority of PZL Swidnik in 2009

In June 2008 ARP published a press announcement inviting investors to purchase 87.62% of the equity of PZL Swidnik, an aviation company specialized with helicopter production. PZL Swidnik had had a few years record of co-operation with Agusta Westland producing helicopters' fuselages, which stood for one third overall production worth PLN 150 million (company's overall income in 2008 was PLN 420 million, but consolidated revenue was only PLN 4.6 million). Total workforce was 4,000 staff.

Two investors entered the bid: Italian Agusta Westland (Finnmechanica holding) – revenue more than 15 billion Euro, total workforce over 73,000 staff[301] - and Czech Penta Investment – a private equity fund – revenue 1,9 billion of Euro, controlling 30 companies with total workforce 25,000 staff.

After a year of negotiations ARP choose Agusta Westland as it offered PLN 45 *per share* which made almost 340,000 million PLZ for 87,62 % of shares. In August 2009 ARP signed with Agusta Westland a preliminary contract and in January 2010 the final agreemnt was signed. Since almost 7% of shares Agusta Westland bought from other subjects (e.g. city of Swidnik) it today possesses in effect almost 94% of shares. The rest was offered to PZL Swidnik staff as part of social packet. In the privatization agreement the investor accepted a SOS clause.

2.3 Spain: 3i acquires a majority share of Tecnobit

Tecnobit has been for many years a leading defence electronic company in Spain with sales of about € 60 million in 2008 (€ 40 million in 2005). In November 1999, a few months after the publication of the Royal Decree regulating the control of foreign investments, 3i, a UK dominated venture capital firm bought a 75% share of Tecnobit, without asking for any authorisation.

The issue was unknown for several months. The Government did not interfere in terms of demanding the reversal of the transaction. Rather, in 2001, in order to regularize the situation, the Caja Castilla-La Manche took a 34% share of the

[301] Agusta Westland (2010) 'Company information'. available at <www.agustawestalnd.com >.

company, and an authorisation ex post was demanded and accorded. Today Tecnobit is hold by OEASIA, the leasing Spanish company for Information Technology.

2.4 Sweden: BAE acquires 30% of Saab AB in 1998

In 1995, Saab AB and BAE Systems (then British Aerospace or BAe) created a 50/50 Joint Venture. The partnership had been actively sought by Saab who had informally sounded out the Swedish Government on this project. The intentions were fivefold, out of which the exploration of export opportunities of the JAS-39 Grippen has been cited most often. BAE offered access and experience in numerous export markets that had formerly been closed for the Swedish defence industry but were now in reach due to a change in export policy. Additionally, the partnership also promised access to the larger UK defence market and would elevate the existing technological collaboration with BAE in the area of aircraft wings. Moreover, the transaction was considered as part of a wider restructuring of the European aerospace industry – joining the EU in that year Sweden saw a chance to demonstrate its commitment. Finally, BAE's commitment promised to increase Saab's financial strength.[302]

When Saab AB went public in 1998, the then main owner, the Wallenberg family contemplated several industrial partners for Saab: Dassault, Northrop, Boeing, and BAE Systems, with which Saab had the fewest overlap and most complementarities in terms of product range.[303] BAE acquired 35.1 percent of the capital and 35.0 percent of the voting rights in the company from Investor AB. In 2005 BAE Systems reduced its ownership in Saab AB to 20.5 percent of the capital and 20.3 percent of the votes; and to even lower levels in 2010.[304]

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[302] Though the cooperation with BAE is generally seen as a success the hopes regarding exports did not materialize, as "BAE gave priority to the Eurofighter each and every time it came to a competition between the Typhoon and the Grippen, as in the case of Finland" Interview Saab (2010) *Interview conducted on 1st March with representatives of the Swedish defence industry in Stockholm*.

[303] The Grippen could fill the gap as an interim solution for a fighter jet as long as the Eurofighter would not be available, so the official reasoning by BAE Ibid.

[304] Investor (2010) 'Investor acquires 10.2 percent of Saab AB from BAE Systems'. available at <http://www.cisionwire.com/investor/investor-acquires-10-2-percent-of-saab-ab-from-bae-systems>.; on the details see above under "Defence industry".

Back in 1998 the transaction was informally prepared through contacts of the company with FMV. As the permit to manufacture and supply military equipment had to be renewed for Saab the FMV prepared this specific case in close cooperation with other departments of the Government and allowed the transaction, imposing particular conditions. The conditions include, for example, that the Board of Directors has to be manned by Swedish citizens and resident in Sweden.[305] There was no wider public debate on this issue at any point in time.[306] In addition, a specific Memorandum of Understanding was signed between the UK and the Swedish governments to regulate the export activities.

2.5 UK: Atlas Elektronik acquires QinetiQ's Under Water Systems in 2009

The acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik is an example of the acquisition of a UK defence asset by a EU company.

In May 2009, Atlas Elektronik UK (AEUK) a UK subsidiary of the German company Atlas Elektronik GmbH (Atlas Elektronik) announced its attention to acquire Underwater Systems Winfrith (UWS Winfrith), a division of QinetiQ plc. UWS Winfrith is a key supplier of research, advice, enabling technology, systems and support for a number of current and future maritime platforms for the UK's armed forces.

On 15 May 2009, the Secretary of State for Business Innovation and Skills issued a special intervention notice to the Office of Fair Trading (OFT) under section 59(2) of the Enterprise Act 2002. The OFT subsequently confirmed that the transaction would lead to a special merger situation since the UWS Winfrith was a relevant Government contractor under section 59(8) of the Enterprise Act.

Following receipt of the special intervention notice, the OFT consulted and invited comments on the national security public interest consideration identified in that notice. In response to the consultation, representations on national security issues

[305] The precise conditions were not revealed to the author during the interviews at ISP and Saab AB.

[306] Interview Saab (2010) *Interview conducted on 1st March with representatives of the Swedish defence industry in Stockholm*.

were received from the MoD and a third party (which was not named in the OFT's report to the Secretary of State).

The MoD expressed concerns because UWS Winfrith possesses unique capabilities that could not be replicated in other onshore capabilities operating in similar and analogous sectors without significant MoD investment. The concern is that following the acquisition, Atlas Elektronik might choose to rationalise its defence activities with the potential consequence that these essential UK capabilities could either be run down, sold off or transferred abroad to be combined with Atlas Elektronik's other foreign based business activities. In addition, the move to ultimate control by a German parent company raises concerns for the MoD due to the potential for day-to-day management of programmes in support of the MoD being moved to Germany, and for application of German export control regulations to UWS Winfrith's output for the MoD. MoD consider that this would have profound implications for the UK's security of supply, as well as the timely delivery, of advice or systems, if UK information and technology were to be combined with foreign information and technology without UK knowledge or approval and/or MoD supply became subject to German export control.

MOD went on to express further detailed concerns regarding the impact on UK national security, maintenance of strategic UK capabilities, protection of technology and information, independence and impartiality of research outputs and advice.

In its report to the Secretary of State, the OFT noted that the MOD had proposed undertakings in lieu of reference to the Competition Commission to mitigate the national security issues raised by the transaction. The OFT noted that the MoD believed that it would be necessary to establish special security arrangements to ensure that the UK's national security interests were being adequately protected post merger. The aim of these arrangements would be to satisfy the MoD that sensitive information could not be passed to foreign nationals without the MoD's express approval and that the MoD would be informed before UK military capability was adversely affected, enabling it to take appropriate action.

In its report to the Secretary of State, the OFT attached draft undertakings intended to remedy, mitigate or prevent the particular effects adverse to the public interest identified by the MoD which may be expected to result from the creation of the

special merger situation concerned. The OFT noted that AEUK and Atlas Elektronik have confirmed to the MoD that they are willing to sign the undertakings in the form attached in the appendix.

Consequently, on 28th September 2009 the Secretary of State cleared the acquisition of QinetiQ's Under Water Systems Division by Atlas Elektronik UK subject to those Statutory Undertakings.

2.6 U.S.: Finmeccanica acquires DRS in 2008

In May 2008, the Italian company Finmeccanica announced its intention to acquire the U.S. defence electronics firm DRS for U.S.$5.2 billion (€3.4 billion). DRS was a mid-tier U.S. defence contractor that described itself a leading supplier of integrated products, services and support to military forces, Government agencies and prime contractors worldwide. The company employed approximately 10,000 people and in FY2007 generated revenues of U.S. $2.821 million. DRS conducted a number of highly sensitive programmes for the U.S. government.

The financial media had also reported that both EADS and Thales had examined the possibility of acquiring DRS. EADS confirmed to the media that it had re-examined DRS as a potential acquisition after the U.S. company announced a merger with Finmeccanica but EADS “decided the electronics specialist was too sensitive a target for the European group”. EADS explained that on criteria it used for U.S. acquisitions was that it would be “acceptable as owners” and in this acceptability area, there was a difference between sensitive and that which was "edge technology," which EADS viewed as effectively putting a company beyond its reach. EADS judged that DRS fell into that category.[307] Thales entered into negotiations with DRS and confirmed that it was interested in buying DRS before being out bid on price by Finmeccanica.[308]

The mitigation of potential FOCI concerns was a matter that was addressed by DRS and Finmeccanica from the outset. For instance, when the two companies announced their intention to pursue the deal, the press release that they issued stated that: “DRS

[307] Tran, P. (2008) 'EADS: DRS was too hot to target for acquisition'. Defense News, 14 July, available at <http://www.defensenews.com/osd_story.php?sh=VSDF&i=3624401>.

[308] Das, J.C. (2008) 'hales keeps an eye out for deals'. Reuters UK, 16 December, available at <http://uk.reuters.com/article/idUKTRE4BF4Q220081216>.

will operate as a wholly-owned subsidiary, maintaining its current management and headquarters. As is customary in this type of transaction, DRS and Finmeccanica will comply with all national security requirements and will propose to the Defense Security Service (DSS) that the company operate under a Special Security Agreement (SSA), with its own board of directors comprised predominantly of U.S. citizens holding security clearances and a Government security committee".[309]

FOCI mitigation became a major issue during negotiations with the U.S. Government as it became clear that the sensitivity of some DRS technologies and business activities meant that the Defense Security Service would insist on a Proxy Board for certain of its activities. Mitigation through a Proxy Board would effectively seal off those parts of DRS covered by the Proxy from any management control or scrutiny by non-U.S. citizens. Finmeccanica made clear that it would not proceed with the acquisition should more than 40% of DRS by revenue be covered by the proxy Board.

Ultimately, Finmeccanica reached an agreement with the U.S. Government under which two companies were created. One is DRS, which is subject to a standard special security agreement. The other entity, 100% controlled by DRS, is DRS Defense Solutions, which is under a proxy agreement and contains around one-third of DRS activity, as calculated at the time of the division. The proxy agreement activity includes nuclear programmes and support programmes for the U.S. armed forces. DRS Defense Solutions has an all-American, three-man board, while DRS has a majority American board.[310]

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[309] DRS (2008) 'Finmeccanica to Acquire DRS for U.S.$5.2 billion (€3.4 billion)'. DRS, available at <http://drs-cs.com/MediaCenter/51208_2press.aspx>.

[310] Guarguaglini, P. (2009) 'Finmeccanica' interview in Defense News'. Defence News, 1 June, available at <http://www.defensenews.com/story.php?i=4116290>.

3 ACQUISITIONS BY A COMPANY FROM A NON-EU COUNTRY

3.1 Germany: OEP acquires control of HDW

The German company HDW has been in 2002 and in 2004 and now again is the target of a purchaser from a third country.

In 2002 One Equity Partners LLC (OEP) acquired 100% of Howaldtwerke Deutsche Werft GmbH (HDW). This was (and still is) a shipyard active in naval construction, repairs, upgrades and mid-life conversions. The company is known in particular for its construction of non nuclear submarines with air-independent fuel-cell drive.

The acquirer OEP is a U.S. finance investor which at the material time was affiliated to the J.P.Morgan Chase Corporation, USA. It was a friendly transaction.

The operation was completed prior to the entry into force of the German rules on the control of foreign acquisitions of defence assets.

A public political debate arose as to the necessity of a control of foreign investment in strategic defence assets. The public reaction was rather negative. In particular the fact was criticised that an important German company having developed a novel technology was going to be "sold out".[311] The German authorities feared the loss of military know-how and technology. This debate contributed to the adoption of Article 7(2)5 FTP Act on the control of certain defence assets which entered into force in July 2004.

In October 2004, OEP and ThyssenKrupp AG (TK), Munich agreed on the creation of an alliance of shipyards according to which TK would form a new group under the command of its affiliate ThyssenKrupp Marine Systems AG (TKMS), Hamburg. OEP agreed to contribute to TKMS 100% of the shares it held in HDW. TKMS had in 2008 a turnover of some 2 billion €.[312]

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[311] See e.g. Editorial (2002) 'Berlin tolerates the sell-out of HDW'. *Handelsblatt, 2 June*.

[312] Bundesministerium für Wirtschaft und Technologie (2009) *Report of the Federal Government on the maritime coordination policy* (Berlin: BMWI).

In return for this sale of HDW, OEP obtained 25% of the shares in TKMS[313] (controlling HDW) in 2005.

The EU Commission cleared the acquisition of control of HDW by TK by decision M.3596 of 10.12.2004 under the merger control regulation. The FTP Act was inapplicable to TK as a German purchaser but applicable to the acquisition by OEP of 25% in TKMS.

The German authorities examined the transactions under which OEP had initially full direct control of HDW and acquired subsequently a participation of 25% in HDW's parent company under the defence-related rules.

The transaction was subject to European merger control because the thresholds of Regulation 139/2004 were met and to a review under Article 7(2)5 FTP Act read together with Article 52 of the German FTP Regulation because it was within the scope the defence-related regime.

The Ministry of Economics and Technology entered into arrangements with OEP that were aimed at preventing any transfer to OEP of defence-related technology developed by HDW, as well as any use of such technology by OEP and others. Under these conditions the transaction was cleared.

3.2 Poland: United Technologies acquires majority of PZL Rzeszów

On 16 March, 2007 the U.S. United Technologies Holdings S.A. (UTH), a United Technologies Corporation (UTC) company (58,700 billion revenue in 2008, 223,100 employees) – parent company of Sikorsky Aircraft Corporation - bought from ARP 100% of the shares in PZL Mielec Ltd. for PLN 250 million. PZL Mielec was an aviation company specializing with production of airplanes. UTC was the only investor interested in PZL Mielec. It needs to be added, however, that in September 2006 the Mielec site had been selected as a strategic partner and assembly centre for the International Black Hawk programme.

[313] See European Commission (2004) *Commission decision COMP/M.3590 ThyssenKrupp/HDW* (Brussels: European Commission).

In 2001 UTC bought also from ARP 85% shares in PZL Rzeszów – a company producing engines for airplanes.

3.3 Spain: General Dynamics acquires Santa Barbara Sistemas

General Dynamics, a U.S. American defence company bought Santa Barbara Sistemas, the Spanish leading land armaments producer, in 2001. At this time, the Spanish Government presided by José Maria Aznar was conducting a large privatisation policy, aimed at strengthening the Spanish industrial base. Competitive companies were sold, in order to better insert them in international markets.

A tender for the privatisation of Santa Barbara was published by the public holding SEPI. Two companies expressed their interest for the Spanish company: Krauss Maffei Wegmann, a long-term industrial partner of Santa Barbara, and General Dynamics. Many observers expected a deal between Santa Barbara and KMW, the latter having sold a licence for the production of its Leopard tank, to Santa Barbara at the occasion of the purchasing of those tanks by the Spanish MoD.

However, the Spanish Government decided to sell the company to General Dynamics, after receiving larger offers of offsets by the American company. Some analysts feared that the General Dynamics offer to purchase Santa Barbara was linked to its interest in Leopard tanks technology. General Dynamics respected the procedure indicated in the Royal Decree of 1999, but the core decision was political, and Mr. Aznar himself had a leading role in the negotiation and the decision-making process. The public debate focused on a transatlantic cooperation versus European cooperation debate, indicating that the Aznar decision was aimed at strengthening the U.S.-Spanish alliance.

A few years later, Spanish MoD officials interviewed for this study expressed disappointment with the industrial offsets received by Spain through the sale of Santa Barbara. The company did not develop a strong position in international markets.

3.4 Sweden: UDI acquires Bofors in 1999

After Saab AB had acquired Bofors in 1999 it sold part of the business – its artillery arm – to United Defence Industries (UDI), an U.S. American armaments company

specialized in land armament.[314] While divesting the artillery arm of Bofors Saab AB retained the missile business.

This transaction too was a friendly takeover. It was regarded in Sweden more as an opportunity to safe know how, industrial facilities and jobs in an area where Sweden had traditionally been strong. Moreover, it facilitated the link to a strong financial and marketing partner.[315]

The transaction proceeded along the same lines as the aforementioned investment of British Aerospace. The same experts in the FMV and on the industrial side were involved and used "the blueprint" of the permit from the BAE case.[316]

The only concern back then was about the ability of Bofors to proceed with its export business to India. After being acquired by a U.S. company and India being subject of a U.S. embargo, the continued sale of defence material to India was in jeopardy. The problem was solved, however, by the formation of a separate legal entity that managed Borfors' exports.[317]

3.5 UK: General Electric acquires the aerospace business of Smiths in 2007

In January 2007, the U.S. company General Electric announced its intention to acquire the aerospace business of Smiths Group PLC for $4.8 billion. Smiths Aerospace was active in the supply of various types of aerospace systems and equipment. It had critically important capabilities within the UK in the areas of combat, weapon and communications system integration and research capabilities.

On 20 March 2007, the Secretary of State for Trade and Industry issued a European intervention notice to the Office of Fair Trading (OFT) under section 67(2) of the

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[314] In 2004, BAE acquired Alvis, which had bought Swedish manufacture of amoured vehicles Hägglunds, and in 2005 United Defence Industries. Hence, Bofors and Hägglunds are now part of BAE Systems Land and Armaments.

[315] Interview Saab (2010) *Interview conducted on 1st March with representatives of the Swedish defence industry in Stockholm*.

[316] Interview SOFF (2010) *Interview conducted on 2nd March with a representative of the Swedish defence industry in Stockholm*.

[317] Ibid.

Enterprise Act 2002 citing Article 21 (4) of the ECMR to take appropriate measures to protect public security as a legitimate interest.

The Ministry of Defence (MOD) made the representations on national security issues to the OFT and in particular identified three main areas of concern arising from the proposed transaction: the transfer of ownership of Smiths Aerospace outside the UK, the maintenance of strategic UK capabilities and the protection of classified technology and information. Regarding the transfer of ownership of Smiths Aerospace, the MOD stated that GE may be able to influence Smiths Aerospace in ways that could prejudice national security unless the MOD obtains assurances over certain aspects of its behaviour. With regard to the maintenance of strategic UK capabilities, the MOD stated that Smiths Aerospace is a key supplier of sub-systems for a number of important current and future weapons platforms and that it was essential for the protection of the UK's national security that these capabilities were retained within the UK.

Interestingly, the MOD also expressed concern that the move to U.S. control might create difficulties due to the U.S. International Traffic in Arms Regulations (U.S. ITAR) which would have profound implications for UK security of supply if UK information and technology was combined with U.S. information and technology without UK knowledge or approval.

The MOD argued that it was necessary to obtain an assurance from GE that it will continue to make available to the UK the capabilities that Smith Aerospace possesses in these areas, and that, in the event of any proposed rationalisation by GE, such capabilities will be maintained within the UK and neither run down, nor transferred abroad, following the Transaction without prior consultation with the

MOD. In relation to the protection of classified technology and information the MOD notes that the above described capabilities are dependent, to different extents, on classified technology and information. The 'leakage' of such information or technology outside the UK could directly prejudice the UK armed forces' operational security and capability.

The MOD proposed undertakings in lieu of reference to the Competition Commission. In particular, legally binding undertakings from GE (combined with an appropriate

compliance regime) were proposed to assure the UK Government that sensitive information and technology was adequately protected.

In its report to the Secretary of State, the OFT appended draft undertakings intended to remedy, mitigate or prevent the particular effects adverse to the public interest identified by the MOD. The OFT noted that GE and Smiths Aerospace had confirmed that they were willing to give the undertakings and the secretary of State subsequently authorized the transaction subject to those undertakings.

4 REJECTED ATTEMPTED ACQUISITION

Poland: Patria attempts to buy WZM Siemianowice Śląskie *in 2002*

There was only one reported attempted acquisition by a EU company that was rejected, although formal negotiations did not take place.

Finnish Patria was interested in purchasing *WZM Siemianowice Śląskie*[318] (overhaul-and-production company). In 2002 Patria won a tender for 690 Armoured Modular Vehicle for Polish Land Forces. As part of an offset agreement it was obliged to move production line to WZM where AMV were to be assembled. Patria sought to buy WZM but the Government was not interested in the transaction and WZM remained state-owned company, supervised by Ministry of National Defence.

The reasons seem to have been purely economic ones: WZM was in a good economic shape, with a full portfolio of Government orders, and access to Patria's technologies. There was, hence, no need to seek privatization of the company.

For the last twenty years there has been one attempted transaction targeting a French company that was rejected. It concerned a European single source in a very specific defence domain, which was intended to be taken over by one of its American competitor. The French authorities denied this transaction in order to sustain the security of supply in this sensitive technical area.

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[318] WZMS (2010) 'Company information'. available at <www.wzms.pl >.

Authorities in Finland, Germany, Sweden and Spain have not rejected any of the transactions they reviewed.

5 ACQUISITIONS CONTROLLED DESPITE THE LACK OF DIRECT CONTROL LEGISLATION

The following two cases are not an example of the application of investment control legislation but of other means of State control of strategic defence assets taken from Italy. The first refers to two transactions with regard to Avio, an Italian aeronautical company. Parts of its shares were first acquired by Carlyle Group from the U.S. and later by Cinven, a European investment fund. The second example represents the establishment of joint ventures between an Italian and a French firm. Both examples demonstrate how the Italian Government safeguards its interests via the (state-owned) company Finmeccanica and special rights that are agreed in the Articles of Association and not anchored in law.

5.1 Italy: Carlye and Cinven acquire AVIO in 2003 and 2006 respectively

In 2003 Fiat Group decided to sell Avio, a manufacturer of aircraft engines for commercial and military programs; aero-derivate turbines and electronic automation propulsion systems for naval use; maintenance, repair, and overhaul activities for civil and military aeronautical and launchers engines.

Immediately, proposals came from American and British investment funds, Carlyle Group and Doughty Hanson (together with the Italian partner Piaggio Aero Industries) respectively, as well as from the French State owned company Snecma (together with Finmeccanica), specialized in aeronautical and aerospace engines and from General Electric. The Italian Government preferred a solution that allowed Avio to remain

under partial Italian control; it requested the intervention of Finmeccanica in the financial operation.[319]

Because of disagreements between Snecma and Fiat on the price of Avio and between Snecma and Finmeccanica on risk values and business choices, Snecma withdrew its offer. Beside economic and financial reasons for the failed operation, the national media highlighted causes related to international politics, such as the different positions adopted by the Italian and French governments in the occasion of U.S. intervention in Iraq.

The withdrawal of the Franco-Italian proposal allowed Carlyle Group to advance its offer together with Finmeccanica, which was at that moment no longer engaged with Snecma. The new deal envisaged Carlyle as the principal financial shareholder with 70% of the equity and Finmeccanica as the industrial partner holding the remaining 30%. In April 2003 the two companies acquired Avio for € 1.5 billion. Finmeccanica, although a minority shareholder, was going to play a crucial role in defining the strategy and managerial decisions of the Avio Holding S.p.A. thanks to the fact that it was granted shares with multiples voting rights. Indeed, Finmeccanica benefited from veto rights on strategic decisions such as the expansion of activities and/or the prospect of alliances with other companies.

Concerning the final outcome, the State appears to have carefully assessed the political-strategic impact of the financial operation. In fact, Carlyle was a valuable partner, and the Italian Government was unwilling to entirely hand over a company operating in the defence sector to foreign investors.[320]

The issue was also debated in the Parliament, where a number of members expressed reasons for concerns regarding an Italian company operating in an advanced industrial sector and high-tech know-how being acquired by a foreign investment fund lacking

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[319] Editorial (2003a) 'Fiat Avio: francese Snecma accelera sull'acquisto, [Fiat Avio: French Snecma speed up on the acquisition]'. Il Sole 24 Ore, 23 January, available at <http://archivio-radiocor.ilsole24ore.com/articolo-265886/fiat-avio-francese-snecma-accelera/>.

[320] Editorial (2003b) ' Finmeccanica Sacrifica Stm per Fiat Avio [Finmeccanica renounces to Stm for Fiat Avio]'. La Repubblica, 29 March 2003, available at <http://ricerca.repubblica.it/repubblica/archivio/repubblica/2003/03/29/finmeccanica-sacrifica-stm-per-fiat-avio.html>, Editorial (2003c) 'Finmeccanica: da cda ok quota minoranza Fiat Avio, [Finmeccanica: from CEO ok on minority share Fiat Avio]'. Il Sole 24 Ore, 8 April, available at <http://archivio-radiocor.ilsole24ore.com/articolo-285632/fiat-avio-bersani-ds-serve-urgente/#ixzz0fcuyNZEz>.

expertise and experience in industrial management and production. Adding to this, the Parliamentarians opposed the expected negative consequences for employment.[321]

In the process of the initial public offering of Avio in March 2006 the European investment fund Cinven, originally British, expressed an interest in the company. In August 2006 Cinven acquired the shares from Carlyle and Finmeccanica for € 2.57 billion and established Avio Investments. As part of the transaction, Finmeccanica gained € 430 million and agreed to reinvest € 150 million in the company, alongside Cinven, acquiring 15 % of shares.

At the national level, Finmeccanica's choices raised concerns about an eventual demerging, leaving former Italian shares to a second foreign investor and making Avio totally owned by non-Italian investors. Hence, some parliamentarians warned the Government about the industrial consequences and effects on employment of Finmeccanica's financial disengagement.[322] In this respect, the Government confirmed its strong interest in the strategic sector in which Avio operated and excluded to have received signals that Finmeccanica was about to cede its shares. Moreover, it committed to organize talks with the company to examine development lines for the future.[323]

In conclusion, the Government exerted control on foreign investment in defence strategic asset in three indirect ways. First, it asked the state-owned company Finmeccanica to intervene in the transaction in partnership with foreign investors from an allied country. Secondly, in the Articles of Association of the Avio Holding Finmeccanica was granted special rights such as veto right on strategic decisions. Finally, Finmeccanica became a minority shareholder in the transaction with Cinven to guarantee the Italian role in Avio. As a result, it was avoided a foreign control on this strategic asset, even if it accepted investments from both, a non-EU country (by

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[321] Chamber of Deputies of the Republic (2003) 'Hearing, 1 April'. available at <http://wai.camera.it/_dati/leg14/lavori/stenografici/sed290/pdfbt01.pdf>, Senate of the Republic (2003a) 'Hearing, 9 April'. available at <http://www.senato.it/japp/bgt/showdoc/frame.jsp?tipodoc=Resaula&leg=14&id=00114286&part=doc_dc&parse=no>, Senate of the Republic (2003b) 'Hearing, 11 March'. available at <http://www.senato.it/japp/bgt/showdoc/showText?tipodoc=Sindisp&leg=14&id=64032>.

[322] Senate of the Republic (2006b) 'Hearing, 26 September'. available at <http://www.senato.it/service/PDF/PDFServer/BGT/219824.pdf>.

[323] Senate of the Republic (2006a) 'Answer by the Government, 19 December'.

the American investment fund Carlyle) and a EU country (by the British investment fund Cinven).

5.2 Italy: Finmeccanica & Alcatel create Thales Alenia Space and Telespazio in 2004

In 2004, Finmeccanica and Alcatel became protagonists of the so-called "space alliance". They established a Franco-Italian niche of excellence in the space sector, which represents a major European operator in satellite systems and services.

Both companies created two new firms, establishing a cross-shareholding structure. On one hand, Alcatel Alenia Space, 67% controlled by Alcatel and 33% by Finmeccanica, gathered manufacturing activities of Alcatel Space and Alenia Spazio, specializing in the development, production and design of space systems, satellites and ground systems. On the other hand Telespazio, 67% controlled by Finmeccanica and 33% by Alcatel, drew together the operational activities and services of Telespazio and Alcatel Space, focusing on activities and satellite services like the monitoring and the exploitation of space systems, the network-supply, and earth observation. The two companies were involved European space programs such as Cosmo Skymed and Galileo, and later GMES.

According to Guarguaglini, the president and CEO of Finmeccanica, the agreement concluded with Alcatel was adjusted to ensure the protection of domestic investment and the respect by all the contracting parties of the golden share held by Italy. Indeed, corporate governance agreements safeguarded Finmeccanica as a minority shareholder of Alcatel Alenia Space. As a matter of fact, they protected the centres of technological excellence for research and development subjected to Italian rules: in fact, even if the content of the above mentioned agreements are not public, it is known that the military activities of the agreement are "for national eyes only".[324]

[324] "The agreement has been shaped so as to secure national investments. In this respect, I would recall that the Italian State holds Finmeccanica's golden share, which implies the respect of certain rules, included in the agreement and accepted by the counterpart, concerning our most relevant research and development centres. It is always difficult to make foreign investors understand this, considering the difference of the Italian policy compared to that of other countries. Finmeccanica's statute comprises such an aspect, contrarily to other companies such as Fiat Avio, which can freely sell its own assets. When we acquired one third of Fiat Avio we imposed on Carlyle the Italian

Nevertheless, during the completion of the alliance some concerns about the impact of cross-holdings emerged at the national level: a number of members of the Parliament interpreted the minority role of Alenia Spazio, compared to the one hold by Alcatel Space, as a risk, a "clearance sale of national technology estate in a strategic sector like the space industry".[325] In face of what they regard to be a risk, the Parliamentarians proposed the creation of a single company in which Finmeccanica could have asserted its competence in services with a substantial financial commitment. At the same time, the Italian Government and the Italian Space Agency would have had to increase orders directed to the company to strengthen the Italian role within the alliance. Nonetheless, they recognized the importance to stipulate alliances between European companies in order to ensure stability and development of the Italian industry in this strategic and basically oligopolistic sector.[326]

Confronted with these problems, the Italian Government argued that its strategy did not only defend Italian interests by exercising the rights and obligations deriving from the golden share but also support the internationally-oriented strategy of Finmeccanica.[327]

In 2006, following Thales acquisition of Alcatel, the shares of the two joint ventures have been transferred to the new company. Thus, Alcatel Alenia Space was renamed Thales Alenia Space, while the allocation of shares of both companies remained unchanged in accordance with the conditions posed by Finmeccanica. Indeed, the Italian group retained a veto right, provided by corporate governance agreements with Alcatel, on a possible transfer of shares of the two joint ventures to a third company.

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rules, but our interlocutor couldn't understand why those were necessary. Confronted with the fact that the agreement with us could only be concluded respecting such conditions, the deal was eventually reached. Italy should maintain its capacity to secure certain technologies and industrial realities." Pier Francesco Guarguaglini, President and CEO of Finmeccanica, Chamber of Deputies (2005) 'Public Hearing of Finmeccanica representatives in front of Commission V, 8 February'. available at <http://documenti.camera.it/_dati/leg14/lavori/stencomm/05/indag/privatizzazione/2005/0208/pdf001.pdf>. Translation by the authors of this report.

[325] Chamber of Deputies (2004) 'Hearing, 15 December'. available at <http://wai.camera.it/_dati/leg14/lavori/stenografici/sed560/pdfbt31.pdf>, Senate of the Republic (2004b) 'Hearing, 9 December'. available at <http://www.senato.it/service/PDF/PDFServer/BGT/122179.pdf>.

[326] Senate of the Republic (2004b) 'Hearing, 9 December'. available at <http://www.senato.it/service/PDF/PDFServer/BGT/122179.pdf>.

[327] Senate of the Republic (2004a) 'Answer by the Government, 22 April'. available at <http://documenti.camera.it/_dati/leg14/lavori/stenografici/sed455/s370r.htm>.

In conclusion, the Thales Alenia Space and Telespazio case can be classified as acceptance of investments from a EU country. Like in Avio, the control on foreign investment by the Italian Government is exerted through the presence of state-owned Finmeccanica in the two companies, and the special rights guaranteed by the corporate governance of Thales Alenia Space to Finmeccanica as minority shareholder. This control instrument is buttressed by a cross-shareholding structure between Finmeccanica and Thales via the two subsidiaries.

Appendix 4: List of interviewed experts and consulted stakeholders

France – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of defence	DGA, strategy directorate, control of investment and economic intelligence	Director Deputy director Industrial affairs Head of industry supervision office Head of industrial strategy-partnership (former) and (new) Desk officer industrial affairs Desk officer industrial strategy Government commissioner
	Ministry of economy industry and employment	DGTPE, control of investment DGTPE, State participation agency,	DGTPE multicom 2 Desk officer of the State shareholding agency
NATIONAL INDUSTRY ASSOCIATION	GICAT		General manager (Land Manufacturers Association) Manager of economic studies Director International & Strategic Affairs Advisor to GICAT
KEY INDUSTRIAL COMPANIES	EADS		General secretary Senior VP director for EU and NATO

Category	**Organisation**	**Department/division**	**Position**
KEY INDUSTRIAL COMPANIES (cont.)	Thales	Department for Legal Affairs Corporate Department Defence France Strategy Department	Director Director Director
	Safran		Director European affairs
	DCNS		Secretary General
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	Relians consulting		Consultant public affairs
	Hogan and Hartson lawyer		Legal counsel
INVESTMENT BANK ANALYSTS	Fonds stratégique d'investissement (FSI)		Legal counsel for public affairs
	Banque Lazard		Advisor and former official of DGA

France – Consulted stakeholders

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Defence	DGA	Head of industry supervision office
NATIONAL INDUSTRY ASSOCIATION	GIFAS	European and international affairs	Director
KEY INDUSTRIAL COMPANIES	Thales	Corporate Department Defence France	Director
	MBDA		Legal for institutional affairs
	Defense conseil International (DCI)		Counsel for institutional affairs

Finland- Consulted stakeholders

Category	**Organisation**	**Department/division**	**Name or Position**
OFFICIALS FROM GOVERNMENT	Ministry of Defence of Finlan	Resource Policy Department	Senior Governmental Secretary

Germany – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Bundesministerium für Wirtschaft und Technologie Bundesministerium der Verteidigung	Division V B3 Foreign economic policy R II 1	Ministerial Director Head of Unit
NATIONAL INDUSTRY ASSOCIATION	Bundesverband der Deutschen Sicherheits- u.Verteidigungsindustrie BDSV :Federation of German Security & Defence Industries Bundesverband der Deutschen Luft- und Raumfahrtindustrie BDLI/German Aerospace Industries Associaton		Deputy Director Desk officer Defence and Space
KEY INDUSTRIAL COMPANIES	Thyssen Krupp Marine Systems Diehl Rheinmetall EADS Munich		Corporate Counsel

Germany – Consulted stakeholders

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Federal Ministry of Economics and Technology Federal Ministry of Defence Ministry of Foreign Affairs	Armaments Export Policy; Control of foreign investments Division Armament Economics and Industrial Affairs Export Control Division	Deputy Head of Unit Head of Division Legal Advisor
NATIONAL INDUSTRY ASSOCIATION	German Defence and Security Industry Association (BDSV)		Deputy Director
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	European Security Forum	Legal department	Author in the field of defence and procurement law Founding Member, Former MEP

Italy – Interviewed experts

Category	**Organisation**	**Department/division**	**Job title of individual**
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Defence	National Armaments Directorate	Vice Secretary of Defence and Vice National Armaments Director
		Cabinet of the Minister of Defence	Head of the Military Policy Office:
		Armed Forces Joint Staff	Chief of Staff
	Ministry of Foreign Affairs	Unità Sistema Paese della Segreteria Generale del MAE	Head
NATIONAL INDUSTRY ASSOCIATION	AIAD – Federazione Aziende Italiane per l'Aerospazio, la Difesa e la Sicurezza *(Federation of Italian Industries for Aerospace, Defence and Security)*		President
			Secretary General

Italy – Interviewed experts (cont.)

Category	Organisation	Department/division	Job title of individual
KEY INDUSTRIAL COMPANIES	Finmeccanica	Legal and Corporate Affairs Department	Director
	Finmeccanica		Deputy General Manager: **Alessandro Pansa**
	Fincantieri		CEO
	Iveco DVD		General Manager
	Avio		CEO Former CEO:
	Telespazio		CEO: prof.
	Elettronica		CEO

The Netherlands – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministerie van Economische Zaken	Department for Enterprise/Commissariat Military Production	Advisor International Affairs
		Directorate-General for Entrepreneurship and Innovation	Military Production
	Ministerie van Defensie	Directie juridische zaken	Desk officer
NATIONAL INDUSTRY ASSOCIATION	Stichting Nederlandse Industrie voor Defensie en Veiligheid NIDV Dutch Defence and Security Industries Association		Director of the Netherlands Defence Manufacturers Association.
KEY INDUSTRIAL COMPANIES	Stork Group		Director governmental Affairs
	Thales Nederland		Director governmental Affairs
	EADS NV		Director governmental Affairs
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	AeroSpace and Defence Industries Association of Europe ASD	Member of Economic and Legal Committee	Dutch delegate

The Netherlands – Consulted stakeholders

Category	Organisation	Department/division	Position
NATIONAL INDUSTRY ASSOCIATION	Netherlands Industries for Defence and Security		Advisor External Affairs

Poland - Interviewed experts

Category	Organisation	Department/division	Name or Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Economics	Dep. for Defence Issues Dep. for Offset Programmes	Director Director
	Ministry of Treasury	Department of Ownership Supervision and Privatisation V	Director
	Ministry of National Defence	Department for Armed Policy	Director
KEY INDUSTRIAL COMPANIES	BUMAR Holding Industrial Development Agency	Strategy and Management Office Department of Ownership Supervision	Director Director

Poland - Consulted stakeholders

Category	Organisation	Department/division	Name or Position
OFFICIALS FROM GOVERNMENT	Ministry of National Defence	Department for Armed Policy, Supervision Unit	Director

Spain – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Foreign Affairs	DG. Relaciones Económicas Internacionales y Asuntos Energéticos Cabinet of the Minister	Jefe de Área. Armas Convencionales Asesoría Parlamentaria Gabinete del Ministro Military Councel
NATIONAL INDUSTRY ASSOCIATION	ISDEFE		Legal Adviser
KEY INDUSTRIAL COMPANIES	SEPI Tecnobit		Director of participated companies (between them Navantia) Consultant Security and Defence Director of Business Development
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	Real Instituto Elcano		Investigador Principal Seguridad y Defensa
OTHERS	French Embassy		Defence Attaché

Spain – Consulted stakeholders

Spanish stakeholders contacted for the study, kindly accepted to exchange their views on the issue of the study, during a research mission conducted in Madrid. Since then, it has been impossible to obtain further returns, on the “stakeholder engagement” document, on options drafted by the study team, as well as on the perception of openness of case study countries to defence FDI

Sweden – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Foreign Affairs	Inspektionen för strategiska produkter (Swedish Agency for Non-Proliferation and Export Controls)	Head of Military Equipment, Deputy Director-General Legal Expert
	Swedish Defence Materiel Administration (*Försvarets materielverk*, FMV)		Head of Unit for Defence Industrial Analysis Strategic Analysis and International Relations Office
NATIONAL INDUSTRY ASSOCIATION	Swedish Organisation for Defence & Security Companies		Director General
KEY INDUSTRIAL COMPANIES	SAAB		Legal Council Strategy Advisor

Sweden – Consulted stakeholders

Category	Organisation	Department/division	Position
NATIONAL INDUSTRY ASSOCIATION	Swedish Organisation for Defence & Security Companies	Defence	Director General

United Kingdom – Interviewed experts

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Defence	Defence Equipment & Supply	Mergers & Acquisitions Adviser, Supplier Relations Team
	Ministry of Defence	Industrial Policy Secretariat	Official
	Ministry of Defence	DE&S International Relations Group	Assistant Head, Armamanets
	Department for Business Innovation & Skills	Aerospace, Marine & Defence	Deputy Director
NATIONAL INDUSTRY ASSOCIATION	ADS (UK Aerospace Defence & Security industries association)	Defence	Director, Defence & Homeland Security Assistant Secretary Defence Industry Council (DIC) Assistant Director – Overseas & Exports
KEY INDUSTRIAL COMPANIES	BAE Systems		Director, European Affairs Director of Government Affairs Counsel Programmes & Support
	Thales UK		VP Strategy & External Relations
	QinetiQ		
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	University of Birmingham	Law School	Professor Martin Trybus

United Kingdom – Consulted stakeholders

Category	Organisation	Department/division	Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Ministry of Defence Ministry of Defence	Defence Equipment & Supply Industrial Policy Secretariat	Mergers & Acquisitions Adviser, Supplier Relations Team Official
NATIONAL INDUSTRY ASSOCIATION	ADS (UK Aerospace Defence & Security industries association)	Defence	Director of Aerospace Defence & Homeland Security Assistant Director Overseas & Exports Commercial Policy Co-ordinator Assistant Secretary Defence Industry Council (DIC)
KEY INDUSTRIAL COMPANIES	BAE Systems	Public Affairs	

United States – Interviewed experts

Category	Organisation	Department/division	Name or Position
OFFICIALS FROM GOVERNMENT DEPARTMENTS	Department of Defense	Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (AT&L)	Lead officer for CFIUS reviews
	Department of the Treasury	International Affairs Bureau, Inward Investment Policy & Security	Senior Advisor, Inward Investment Policy Senior Policy Analyst
KEY INDUSTRIAL COMPANIES	Finmeccanica North America		President
	Lockheed Martin	Washington Operations	Director, Federal Acquisition Policy
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	Aspen Sutherland LLP		Partner (Jeff Bialos (Jeff Bialos was author of the DOD-sponsered study *Fortresses & Icebergs*)
	Covington & Burling LLP		Partner
	Center for Strategic & International Studies	Defense Industrial Initiatives Group	Executive Director – International
	Teal Group Corporation		
INVESTMENT BANK ANALYSTS & OTHERS	Charles River Associates	Aerospace, Defence & Security practice	Vice President

European organizations and EU institutions – Interviewed experts

Category	Organisation	Department/division	Position
GOVERNMENT REPRESENTATION	Permanent Representation of France at the EU		Counsel for Armament Deputy Counsel for Armaments Counsel for Competition State Aid
EUROPEAN AGENCY	EDA	Industry and market	Director
INDUSTRY ASSOCIATION	AeroSpace and Defence Industries Association of Europe		Secretary General

European organizations and EU institutions – Consulted stakeholders

Category	Organisation	Department/division	Position
INDUSTRY ASSOCIATION	AeroSpace and Defence Industries Association of Europe	Economic and Legal Committee (ELC)	12 Members of the ELC with representatives from SOFF, Finmeccanica, Thales, ASD, BAE Systems, EADS, Safrran, Alenia, Navantia, NIDV and SAAb
MEMBERS OF EUROPEAN PARLIAMENT	European Parliament	SEDE Subcommittee on Security and Defence	Member Member
EU institutions			Former European Commissioner Former official of DG MARKT, working on Transfer Directive
LEGAL EXPERTS & DEFENCE INDUSTRY ANALYSTS	European Security Forum	Legal department	Author in the field of defence and procurement law Founding Member, Former MEP

Appendix 5: Comment on the **"Level Playing Field for European Defence Industries"** *study commissioned by the EDA in comparison to the EUROCON study*

The 2008 European Defence Agency study entitled "Level Playing Field for European Defence Industries: the Role of Ownership and Public Aid Practices" has some limited overlap with the current study. However, there are considerable differences with regards to the objectives, methodology, and substance of the two studies.

The objective of the EDA study was to analyse the impact of public ownership and State aid polices of the participating Member States on a "level playing field" for the European defence industries. The emphasis was put on the impact of this ownership and these policies on competition and industry performance. Moreover, a particular concern was the interconnection between public ownership and public aid practices. In contrast, as outlined in Volume 1 of this Report, the three main objectives of the current study are (1) the examination of Member State regimes on the control of defence assets and their actual examination, (2) the identification of options for the introduction of a European dimension in the control of defence assets and to assess the advantages and disadvantages of each identified option, and (3) making recommendations on the best option available to the Commission.

The limited overlap is rooted in the fact that in some Member States public ownership is still a prevalent means of controlling defence assets. However, as outlined in Volume 1, the Member States have developed instruments other than State ownership, namely 'golden shares', mitigations, and regulation, to control their defence assets. While these alternative means of control potentially have an impact on a "level playing field" and therefore also feature in the EDA study, they are only related issues in the context of an analysis of State ownership and aids. In contrast, the second main element of the EDA study, State aids, is only a related issue in the current study.

The entirely different points of departure of the two Studies are already clear from their respective titles and reflect the different backgrounds of the institutions the Studies are conducted for. Both focus on issues for which the other institution claims competence. The EDA study looked at a "level playing field", an EDA term for a competitive "internal market" for armaments, and at State aids, both regimes of the TFEU, subject to Article 346 TFEU. In contrast, the current study looks at State control of strategic defence assets, an issue until now subject to exclusive Member State control, potentially to intergovernmental coordination, and possibly an important obstacle for the establishment of an internal market for defence goods and services.

The current study also differs from the 2008 study in its methodology and with regards to its second task of identifying options for the introduction of a European dimension of the control of defence assets. The latter is also a reflection of the wider range of competences of the Commission in the relevant areas.

Read together the two studies could provide a complete picture of important remaining obstacles for creation of a competitive European defence equipment market, covering the competences and tasks of both EDA and the European Commission.