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Multi-national Companies Under the Andean Pact— A Sweetener for Foreign Investors?

On May 26, 1969 the South American countries of Colombia, Chile, Perú, Ecuador and Bolivia signed the Agreement on Andean Subregional Integration (Cartagena Agreement) and thereby formed the Andean Subregional Common Market (ANCOM).[1] The hopes lying behind the Agreement went beyond the idea of establishing a free trade block, to the more ambitious undertaking of forging the economic development and integration of the Area.

Motivated by the desire to reserve the bulk of the anticipated trade liberalization and development benefits to nationals of the member countries, and to control the activities and roles of foreign investors in the Subregion, the Agreement called for the submission by the ANCOM governing body, the Commission, of a "common system for treatment of foreign capital."[2]

In response to this mandate the Commission issued its now famous Decision 24 entitled "Common Rules Governing the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties" (Investment Statute), in which are set forth a number of rules of foreign capital and technology which "will rank as the harshest restrictions . . . imposed by a group of Western countries in recent times."[3] The Investment Statute provoked a storm of controversy both within, and outside of, the Subregion, and caused many existing and potential foreign investors to take a

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[1]*See generally,* GARCIA AMADOR, LATIN AMERICAN ECONOMIC INTEGRATION, 2 LAW. OF THE AMERICAS, 445-449 (Oct. 1970); MCDERMONTT AND WIELAND, LATIN AMERICAN ECONOMIC INTEGRATION, 10 VA. J. INT'L. L. 139-179 (Dec. 1969).

[2]Art. 28.

[3]*See,* Schiesser, *Restrictions on Foreign Investment in the Andean Common Market,* in 5 THE INT'L LAW. 3 (1971), and Perenzin, *Regulation of the Andean Investment Code; Columbia,* in 4 LAWYER OF THE AMERICAS, L.J. 15 (1972).

fresh look at the business wisdom of continued or of new investments in the Area.

The year 1971 was an eventful one in the Subregion vis-à-vis the Investment Statute. Ecuador and Perú announced they would take advantage of the option in Article 44 of the Statute, of applying special rules to enterprises engaged in certain determined industries. Eyes next focused on Colombia. What degree of liberality would it superimpose on the Statute via its reglementation of same?

The answer came on November 5, 1971 when Colombia issued its regulations, a typically Colombian answer; a middle-of-the road approach—some giving and some taking.[4] On the heels of the Colombian government's announcement of the regulations, came the Republic's Supreme Court decision that Decree 1299 implementing the Investment Statute internally was unconstitutional, thus leaving the country, at least for a period, with no internal law on ANCOM foreign investment rules.[5]

No sooner had the confusion erupted as to the course Colombia would take in view of its Supreme Court decision, and the effect this would have in ANCOM, than the Commission issued Decision 46, relating to multinational enterprises.

It is our purpose here to analyze Decision 46 in terms of the meaning of the concepts and rules of the Decision, as an autonomous body of ANCOM "law," and as to its significance to foreign investors vis-à-vis the Investment Statute. It is important to note that Decision 46 did not become binding on member countries upon its issuance by the Commission. According to transitory article "a," the Decision shall be in full effect when all Member Countries have deposited with the Secretariat of the Junta the instruments (legal) by which it [the Decision] has been put into practice in their respective territories." Since such deposits have not yet been made, the Decision is by its own terms not yet ANCOM law.[6]

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[4]*See*, Perenzin, *Regulation of the Andean Investment Code: Colombia* in 4 LAW. OF THE AMERICAS, L.J. 15 (1972).

[5]In view of the Supreme Court decision, the Colombian government has apparently decided to issue regulations of Decree-Law 444 of 1967, which contains a number of rules on foreign investment, in a manner bringing 444 as close as possible to the spirit of the Investment Statute. Subsequently, the Government will submit the Agreement itself to Congress for approval, with the intention that with Congressional approval of the principal agreement all ANCOM decrees, rules, regulations and decisions will be implementable in Colombia by executive decree. The main fault found by the Supreme Court in Decree 1299, was the failure to submit it to Congress for approval.

[6]According to Article 28 of the Cartagena Agreement, upon which the authority of transitory Article "c" of Decision 46 rests, the Member Countries have undertaken to put the Decision into practice within six months from its issuance by the Commission, *i.e.*, during the month of June. It is highly unlikely that Colombia can meet this deadline, in view of the fact that either the Decision itself or the Cartagena Agreement must be approved by Congress.

The legal authorization for Decision 46, as in the case of Decision 24, is found in the Cartagena Agreement:

> The Commission, on the proposal of the Junta, may recommend the establishment of multi-national enterprises for the installation, expansion or complementation of determined industries. . . .[7]

The above quoted Article 24 suggests that Decision 46 is fundamentally of a different nature from that of Decision 24. Whereas the latter contains a number of sweeping restrictions and limitations on the role of foreign investments in the Subregion, the former appears to concern itself with encouraging the creation of multi-national enterprises. Rather than discouraging the Commission is now encouraging investments. Before examining the nature and scope of this encouragement, let us see precisely what is an ANCOM multi-national enterprise (AME).

Description of an AME

Decision 46 sets out five essential characteristics of an AME.

1. – National origin of the equity holders.
2. – Percentage of the equity held by certain investors.
3. – Control consequences resulting from the above ownership.
4. – Principal domicile and hence, according to Decision 46, the place of incorporation.
5. – Purposes of the AME.

Origin of Equity Ownership

To obtain a multi-national status the equity ownership of an enterprise must be held by nationals of at least two different Subregional member countries.[8] The term employed by Decision 24 is "Subregional Investor," defined as "a national investor of any member country other than the host country," with the host country being understood to be the place of principal domicile of the AME. Since a national investor is not defined in Decision 46, reference to Decision 24 becomes necessary. As to each member country a national investor is:

> The State, national individuals, non-profit legal entities and national enterprises as defined in this article. Also considered national investors are foreign natural persons who have had uninterrupted residence in the host country [in this context host country refers to the member country in which an investment is being made] for at least one year, and who waive the right to repatriate capital and remit profits before the competent national authority.[9]

A national enterprise to which reference is made in the above definition

[7]Art. 28.
[8]Decision 46, Art. 8 (d).
[9]Decision 24, Art. 1.

is one: "Constituted in the host country, and 80% of the capital of which is held by national investors . . . "[10] Although a foreign (non-Subregional) investor may, subject to limitations, have an ownership interest in an AME, this is not necessary. From this we get our first hint that Decision 46 may not be directed necessarily to foreign investors.

Percentage of Equity Held

With respect to Subregional Investors, those from each country who have in fact invested in the enterprise, must own at least 15 percent of the aggregate capital held by all Subregional Investors.[11] For example, if the total capital held by investors from Colombia, Perú and Ecuador amounts to $100,000, the investors from each of the three countries must hold at least $15,000 of the capital.

Foreign (non-Subregional) investors may hold up to a maximum of 40 percent of the capital.[12] This does not mean that 40 percent will be a fixed maximum since Decision 46 permits each member country to determine a lower ceiling.[13] No distinction is made as to whether the capital ownership carries with it the right to vote in the decision-making processes of the enterprise.

Control Consequences

Consistent with the rules of the Investment Statute, Decision 46 requires that the majority Subregional investment be reflected in the technical, financial, administrative and commercial management of the enterprise.[14] These are largely undefined concepts, as they are under the Investment Statute. As an adjunct to the above control requirements are the rules that (i) when both foreign and Subregional Investors exist, each shall separately designate their own members on the board of directors,[15] and at least one director must be named for the Subregional Investor or Investors from a given member country.[16]

Principal Domicile

The AME must have its principal domicile within the territory of one of the member countries.[17] This is also the place where the enterprise is to incorporate the form of business organization to be utilized. Although

[10] *Id.*
[11] Decision 46, Art. 11.
[12] *Id.* Art. 8.
[13] *Id.*
[14] *Id.*
[15] *Id.*, Art. 52.
[16] *Id.*
[17] *Id.*, Art. 8.

Decision 46 states that the enterprise must set up manufacturing, commercial or other establishments within the territory of each member country whose nationals own capital in it, this will be unnecessary if the "conditions and the nature of the enterprise do not justify it."[18]

Purposes[19]

The activities to be conducted by the enterprise must be of interest to the Subregion, and must conform to the conditions and modalities of the programs set forth below, and involve projects or products included in these programs:

a – Sectorial programs of industrial development;
b – Infrastructure projects aimed at resolving problems which obstruct the process of subregional integration;
c – Programs rationalizing the production of existing industries;
d – Joint programs for development of agriculture and cattle raising.

It should be borne in mind that in setting forth the above elements of an AME, Decision 46 is not describing what may be an already existing business enterprise. In fact, the AME is a creature of the Decision. Approval to organize such an enterprise must first be obtained.[20]

Underlying Objectives of Decision 46

As pointed out above, the Commission's purpose in issuing Decision 46 is to encourage the creation of AMEs. According to Article 7 it is believed that AMEs are capable of advancing the attainment of the various components of Subregional integration, *e.g.*, contribute to the economic integration process, to the balanced and harmonious development in the Subregion, to a more equitable distribution of the benefits of development and to strengthening the capability of management. In summary, the AME is organized not only as a means of accomplishing integration, but also as an implement for distributing throughout the Subregion the benefits accruing from the integration.

Foreign investors might ask themselves precisely what the above means in terms of investments by them in AMEs. There are no ringing suggestions in the Decision that foreign investments are therein contemplated as serving a key role in AMEs. On the other hand the Decision holds out a number of inducements to the organization of an AME. In view of these inducements it is important to examine whether participation in an AME is worthwhile for a foreign investor.

Before turning to an analysis of the inducements to investing in an

[18] *Id.*, Art. 13.
[19] *Id.*, Art. 18.
[20] *Id.*, Arts. 19 through 23.

AME, it will be useful to consider the general motives which normally lead to a business investment. Despite the recent clamor and debate over what a company's relationship to the community in which it functions should be, there is small doubt that the fundamental aims of the investor therein are to derive profits and to see his investment grow in value.

Occasionally both are not available with equal attractiveness but certainly both are desired. When transplanted to the area of investments in a foreign country, both of these motives, immediate return of profits and capital growth, take on an overriding additional consideration. Given the production of earnings, will the investor be permitted to remove them from the foreign country? Given the value growth of an investment, will the proceeds from the sale or liquidation thereof be repatriable?

Let us turn here to the question of whether Decision 46 offers anything new to the foreign investors vis-à-vis the above investment motives. As to both remittance of profits and repatriation of capital, Decision 46 simply refers back to the Investment Statute rules.[21] Hence profits are remittable up to 14 percent of the registered direct foreign investment. As to repatriation of capital, the Investment Statute permits the repatriation of the original direct investment and reinvestment plus the capital gain thereon.[22]

Since the limitation of the right to remit profits is unchanged, is there anything in Decision 46 which would enhance the possibility of greater capital appreciation, *which is not available to a foreign investor under the existing rules of the Investment Statute?*

Inducements to Form AMEs

The inducements held out by Decision 46 are divided into two categories: Those benefits which flow automatically from the attainment of AME status, and those which are available from a given member country only if its nationals hold 15 percent or more of the capital of the AME.

A – Automatic Benefits.

1 – *Free trade:* The products of AME may benefit from the advantages of the liberalization of trade program of ANCOM, *i.e.*, tariff reductions.[23]

2 – *Facilitation of capital transfers:* Member countries are required to adopt measures which will facilitate the transfer to the host country of capital destined for the operations of the AME or for its incorporation.[24]

B – Benefits Subject to the 15 percent Requirement.

1 – *Furnishing services or products to the State:* A qualified AME is to

[21] *Id.*, Art. 6.
[22] Decision 24, Arts. 7, 8, 9, and 10.
[23] Decision 46, Art. 28.
[24] *Id.*, Art. 29.

enjoy rights no less favorable than those given to a national enterprise of a given member country with regard to furnishing goods and services to the State.[25]

2—*No forced fade-out:* The equity holders of an AME are not required to sell any part of their ownership interests to nationals of the country in which it operates.[26]

3—*Internal taxes:* An AME is to enjoy the same tax treatment as the most favored enterprises engaged in the same economic activity.[27]

4—*Free reinvestment:* An AME needs no authorization to reinvest its profits.[28]

5—*Access to local credit:* An AME is to have the same access to local credit and financing treatment, which is now, or may in future be, given to most favored national enterprises engaged in the same economic activity.[29]

6—*Freedom to remit profits:* With prior authorization of the competent national authority, Subregional Investors are to have the right to transfer net profits to the country of origin of the capital invested.[30]

7—*Participation in reserved sectors of the economy:* With prior authorization of the competent national authority, an AME may engage in those sectors of the economy of a member country which have been reserved for national enterprises.[31]

The true test of the benefits for a foreign investor lies in the comparison of these benefits with those available to a mixed enterprise under the Investment Statute. Since a mixed enterprise is one in which foreign capital participates up to a maximum of 49 percent, it enjoys the clear advantage over the AME of allowing greater equity interest for the foreign investor.

Assuredly, the AME offers benefits over the Statute's "foreign enterprise" (one in which foreign capital participation exceeds 49 percent). But the question is whether the benefits of Decision 46 are of sufficient importance for a foreign investor to induce him to give up an additional 9 percent of his equity in a mixed enterprise.

Taken in the order of the above presentation, the benefits may be scored as follows as to whether they are "real" benefits:

A—Automatic Benefits.

1—*Free trade: No*

[25] *Id.*, Art. 30.
[26] *Id.*, Art. 31.
[27] *Id.*, Art. 32.
[28] *Id.*, Art. 33.
[29] *Id.*, Art. 34.
[30] *Id.*, Art. 35.
[31] *Id.*, Art. 36.

The benefits of the trade liberalization program are equally available to a mixed enterprise.

2—*Facilitation of capital transfers: No*

If we assume the capital will come from a non-member country, the facilitation of transfers of capital benefit the Subregional Investors.

B—Benefits Subject to the 15 percent Requirement.

1—*Furnishing products or services to the state: Possibly*

To the extent that the state of a given member country adopts a policy of acquiring its needs only from national enterprises, *i.e.*, enterprises over 80 percent of whose capital is held by national investors.

2—*No forced fade-out: No*

Foreign investors in a mixed enterprise are under no obligation to sell any part of their interests to local investors, in order to continue enjoying benefit flowing from its mixed nature.

3—*International taxes: Possibly*

To the extent that a given member country affords favorable tax treatment to certain economic sectors, this could be a real benefit.

4—*Free re-investment: No*

There are no limitations on re-investments by mixed enterprises under the Investment Statute.

5—*Access to local credit: Possibly*

Although there are no limitations in this connection in the Statute as to mixed enterprises neither does the Statute require that these be given treatment equal to that given to a most favored national enterprise. But again, the reality of the benefits depends on the existence of a credit policy favoring certain national enterprises.

6—*Freedom to remit profits: No*

The profit remittance benefit is available only to Subregional Investors. If a foreign investor has an interest in a Subregional Investor, this inducement would mean profits could be returned in full to the country in which the Subregional Investor is organized. However, further remittance by the foreign investor out of the Subregional Investor country to his home country or to any other non-ANCOM country would be limited by the Statute's 14 percent ceiling.

7—*Participation in reserved sectors of the economy: Possibly*

The problem here is the need of prior authorization from the country involved.

In addition to the above, there are some secondary advantages in using an AME, but these are for the most part non-economic in essence. For example, an AME may operate in any Subregional country without the requirement of first obtaining authorization from that country; hence time

and effort are saved. Also, since an AME may have investors from any of the member countries, the foreign investor has a wider choice in selecting his partners. Finally, since the law governing the organizational form selected for the AME will be that of the principal domicile of the AME, some freedom of choice is available, other factors being equal, in selecting a member country with less restrictive rules.

Conclusions

Decision 46 contains no major benefits of substance which automatically accrue to an AME, and which could result in greater appreciation of an investment. Significant possibilities are held out for the future, but their realization depends in great measure on steps and policies to be taken or adopted by individual member countries.

It is believed the Commission badly missed an excellent opportunity to counteract the pessimism generated by the Statute, by not eliminating or mitigating some of the harsher and, according to some potential investors, unacceptable rules of the Statute in return for participation in an AME.

Whereas Decision 24 gave rise to a storm of controversy, Decision 46 will probably be met with general indifference on the part of foreign investors.