

Global Investment Regulation and Sovereign Funds

*Efraim Chalamish**

Sovereign Wealth Funds (SWFs) have attracted significant attention over the past few years, as a result of their increasing role in the global economy and their controversial minority investments in distressed financial and infrastructure companies in Western economies. Although SWFs provide important benefits to home, host and global markets, they have been perceived by the Western mind as a growing threat to economic supremacy and national security. While the current legal scholarship provides an incomplete policy response, by either selectively referring to specific legal instruments within the international law framework or proposing an entirely new legal regime, this Article attempts to address this crucial lacuna by providing an original and comprehensive legal analysis of the SWF phenomenon and its interaction with the preexisting framework of international law.

The various abovementioned concerns have prompted various Western attempts to block SWF cross-border investments through legislative reforms or ad hoc protectionism of the executive branch. These governmental policies frequently violate international commitments in the international economic law arena and call for a closer look at the nature of such commitments and their respective implementation in the SWF environment.

* New York University Law School; S.J.D. (University of Michigan), LL.M. (Michigan), LL.B., LL.M., M.B.A. (Bar Ilan University). Efi.Chalamish@nyu.edu. The author would like to thank Robert Howse, Simon Chesterman, Richard Stewart, and Omer Kimhi for their helpful comments on earlier drafts. The author also thanks the participants at the Tel Aviv University Cegla Center, NYU Houser Global Forum, Society of International Economic Law Bi-Annual Conference in Barcelona, OECD Global Investment Forum in Paris, Asian Society of International Law (International Economic Law) Bi-Annual Conference in Tokyo, and American Society of International Law International Economic Law Seminar in University of California Los Angeles. All errors are mine.

The Article looks at recent practices in Western countries aimed at blocking SWF investments, especially in the context of iconic brands and national champions. It then reviews various relevant provisions in international legal instruments, which are applicable to these potential investments, and examines the question of their violation by capital-importing countries. A proposed innovative adaptation to this new reality is provided. I argue that the existing framework of international investment law can provide adequate solutions to investment protectionism against SWFs. Regarding regulation of SWFs' investments, since recent experience has underlined that SWFs function largely like any other commercial entities, there is a need to shift the discussion and terminology towards regulation of sovereign activity rather than sovereign funds. Finally, the Article explores the broad consequences of investment law and corporate governance reforms following the debate around SWF investments on maintaining healthy and productive cross-border economic relations in a globalized world.

INTRODUCTION

In terms of both number and size, sovereign wealth funds (SWFs) have seen a substantial increase worldwide between 1990 and 2010.¹ They have become important financial players in global markets and the subject of academic, policy and business debates. Despite various definitions and the misuse of the term in the public media, it was only in October 2008 that a definition was formally formulated as part of the Santiago Principles,² a set of soft rules designed by and for the SWF community and led by the International Monetary Fund (IMF).³ According to this definition, an SWF is a special purpose investment fund owned by the government, which includes foreign financial assets, for macroeconomic purposes.⁴ The new, narrow definition is

1 Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, 14 *LAW & BUS. REV. AM.* 179 (2008).

2 INT'L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, GENERALLY ACCEPTED PRINCIPLES AND PRACTICES "SANTIAGO PRINCIPLES" (2008), available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf> [hereinafter SANTIAGO PRINCIPLES].

3 Andrew Rozanov, *Definitional Challenges of Dealing with Sovereign Wealth Funds*, 1 *ASIAN J. INT'L L.* 249 (2011) (generally discussing definitional challenges).

4 SANTIAGO PRINCIPLES, *supra* note 2, at 27 app. I ("Defining Sovereign Wealth Funds").

aimed at excluding certain entities, such as currency reserve funds managed by central banks, which were included in some earlier definitions.⁵

Despite the narrow nature of the current definition, SWFs can have different legal structures, forms and purposes.⁶ Some SWFs have benefited from an increase in commodity prices before the global financial crisis of 2008 and hold a significant amount of foreign exchange reserves, and so serve as stabilization funds.⁷ Other funds are driven by the need to fund future pension liabilities.⁸ Some of these SWFs, in fact, served as white knights during the 2008 crisis and invested in several leading Western financial institutions that were facing a significant liquidity crisis.⁹ At the same time, some of these funds have provided a safe and stable source of capital in emerging markets since they have not been heavily influenced by the volatility of capital and commodity markets.¹⁰ Many countries have established their own new sovereign wealth funds¹¹ in order to stabilize the local market, protect the state against extreme volatility in foreign exchange and commodities markets, preserve the state's wealth for the next generation, and provide liquidity for global markets, especially when capital markets face credit constraints. The

5 Andrew Rozanov, *Who Holds the Wealth of Nations*, XV(4) CENT. BANKING J. (2005). This definition should be reexamined in light of current SWFs' tendency to invest locally.

6 Udaibir Das, Yinquiu Lu, Christian Mulder & Amadou Sy, *Setting Up a Sovereign Wealth Fund: Some Policy and Operational Considerations* 13-14 (IMF, Working Paper No. WP/09/179, 2009).

7 See, e.g., *The Heritage and Stabilization Fund*, MINISTRY OF FINANCE, THE REPUBLIC OF TRINIDAD AND TOBAGO, <http://www.finance.gov.tt/legislation.php?mid=20> (last visited Feb. 20, 2012).

8 See, e.g., *Chile's Sovereign Wealth Fund*, MINISTRY OF FINANCE, THE REPUBLIC OF CHILE, <http://www.hacienda.cl/english/sovereign-wealth-funds/economic-and-social-stabilization-fund.html> (last visited Apr. 11, 2012).

9 See, e.g., Rick Carew, Laura Santini & James T. Areddy, *Great Wall Street of China: Morgan Deal Underlines The New Capital Flow; Who's Playing Whom?*, WALL ST. J., Dec. 20, 2007, <http://online.wsj.com/article/SB119805649734239175.html> (reporting on the China Investment Corporation (CIC) five billion dollar investment in Morgan Stanley on December 19, 2007, which accounts for 9.9% of the company).

10 For a detailed description of SWFs' role in recent strategic financial investments, see DAVID MARCHICK, SOVEREIGN WEALTH FUNDS AND NATIONAL SECURITY, PAPER PRESENTED AT THE OECD CITY OF LONDON CONFERENCE ON SOVEREIGN WEALTH FUNDS IN THE GLOBAL INVESTMENT LANDSCAPE (Mar. 31, 2008), available at <http://www.oecd.org/dataoecd/38/12/40395077.pdf>.

11 Among the new SWFs we may mention the Heritage and Stabilization Fund (Trinidad and Tobago) and the Future Fund (Australia), both launched in 2006.

structure of a fund, as either a separate legal entity or a unit of the Central Bank or the Ministry of Finance, is designed to serve its purpose.¹²

Additionally, unlike traditional reserve funds, today one of the goals of SWFs is mid-to-long term financial planning and diversification of governments' investments. SWFs, thus, can provide the home government¹³ with higher returns on its investments, by, for example, purchasing majority or minority stakes in foreign companies. This important feature of all SWFs has contributed to global capital markets, stabilized financial markets during days of turmoil, and provided equity injection to troubled institutions.¹⁴

The private-public nature of a SWF, which involves public funds in private markets and corporations, raises a series of questions that came to light following the Dubai Port episode in 2006.¹⁵ In that case, a state-owned foreign buyer of U.S. ports had to spin off its U.S. operations as a result of public pressure and political reaction. This acquisition has exemplified the global concerns around SWFs' activity, especially the use of commercial investments for political goals and neglect of investment models based on risk-adjusted returns.¹⁶ These concerns have triggered a legal and economic debate over the need to address them through regulation and multinational cooperation,¹⁷ in addition to national legislation in home and host states that

12 Das, Lu, Mulder & Sy, *supra* note 6, at 13.

13 The country where the SWF is incorporated will be called here the "home country" and the country where the investment is made will be called the "host country." The governments will be called "home government" and "host government" respectively.

14 On the macroeconomic impact of SWFs on global markets, see generally Juergen Braunstein, *Sovereign Wealth Funds: The Emergence of State Owned Financial Power Brokers* (London Sch. Econ. & Pol. Sci., Working Paper, Jan. 14, 2009), available at <http://ssrn.com/abstract=1452797>.

15 See Matthew Byrne, *Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance*, 67 OHIO ST. L.J. 849, 876-80 (2006).

16 For a study on political bias of SWFs' investments, see Rolando Avendaño & Javier Santiso, *Are Sovereign Wealth Funds' Investments Politically Biased?: A Comparison with Mutual Funds* (OECD Dev. Ctr., Working Paper No. 283, 2010), available at http://www.oecd-ilibrary.org/development/are-sovereign-wealth-funds-investments-politically-biased_218475437211;jsessionid=15mnqb364dvy8.delta (comparing SWFs' and mutual funds' investments in order to examine whether SWFs' investments are politically biased).

17 Larry Summers, *Sovereign Funds Shake the Logic of Capitalism*, FIN. TIMES, July 30, 2007, www.ft.com/intl/cms/s/0/8c9dea94-3e30-11dc-8f6a-0000779fd2ac.html#axzz1n4YIteJt.

SWFs are subject to.¹⁸ In addition to the national security debate,¹⁹ SWFs' transparency standards and their significant impact on capital markets have raised corporate governance dilemmas, which will not be addressed in depth in this Article.²⁰ At the same time, host states' regulatory responses and the growing participation of state-owned entities in global markets call for a closer look at the ability of sovereign funds to bring claims against host states in order to enforce investment protection standards in international economic law and the future of such claims. This last aspect of SWF operations will be at the heart of this Article.

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- 18 An SWF, as a corporate entity, is governed by both national laws of the home state where the SWF is incorporated and the host state where the investment is made. Most of these laws are general laws that apply to both corporations and SWFs. For instance, national securities laws that enforce disclosure rules for both local and foreign corporate entities can be applied to SWFs' participation in public capital markets. In the United States SWFs have to report a five percent or greater acquisition of equity stake in a public company according to the Securities Exchange Act, 15 U.S.C. § 13(d) (1934). Additionally, antitrust, banking and corporate laws can be equally applied. However, due to the public feature of SWFs, and depending on the level of involvement of the home government, an SWF can be regulated by additional laws that deal with this public element. Such laws may include, for example, relationships between the central bank and the treasury, under which the SWF is managed in many home countries. A detailed comparison between these national laws is not within the scope of this Article, as they are extremely diverse.
- 19 The climax of these concerns was the purchase of P&O, a British port operator, by Dubai Port World, a UAE state-owned entity in 2006. The assets included a U.S. port facility. Serious political criticism in the United States forced Dubai Port World to sell the U.S. asset, which eventually was not part of the deal, *see* Byrne, *supra* note 15, at 876-80 (describing the Dubai Port world controversy).
- 20 *See generally* Anna Gelpern, *Sovereignty, Accountability, and the Wealth Fund Governance Conundrum*, 1 *ASIAN J. INT'L L.* 289 (2011). Several other factors have contributed to the growing concern in Western economies about the motives behind SWFs' investments in strategic industries in developed countries. Lack of proper transparency in these funds makes it difficult to evaluate their investment strategies and motives. Lack of clear governance rules, responsibility and accountability increases the role of a government in its SWF, which makes the case for a politically motivated function. For all these reasons, many SWFs have responded voluntarily to the global concerns about their actions and publicly shared their size, source of funding, investment allocation, and investment strategy. Similarly, they have adopted more concrete rules of governance and increased the level of accountability of their money managers. However, these responses have been sporadic and inconsistent.

The current legal scholarship provides an incomplete policy response, by either selectively referring to specific legal instruments within the international law framework or proposing an entirely new legal regime. This Article attempts to address this crucial lacuna by providing an original and comprehensive legal analysis of the SWF phenomenon and its interaction with the *preexisting* framework of international law. Fewer, consolidated and comprehensive legal instruments can provide a clear and consistent legal response, if indeed such a response is necessary. Also, it allows integrating the SWF phenomenon into the existing international economic law jurisprudence.

This Article has three parts. The first Part reviews the recent regulatory response to SWFs in host economies. The second Part examines several potential regulatory frameworks to deal with these protective measures. Finally, the third Part demonstrates that sovereign funds can bring investment claims against host states, and the international investment law framework is the best equipped to deal with SWFs and can provide, with some necessary adjustments, a comprehensive and appropriate response.

I. SWF – GLOBAL REGULATORY RESPONSE

The growing criticism against SWFs in Western economies and their being taken to represent the new state capitalism has brought several leading developed countries to introduce or improve existing legal instruments that enhance the ability of host countries to better control proposed investments by SWFs. SWFs' investments in strategic industries, such as financial institutions and technology, have been perceived as attempts by the SWFs' governments to increase their political influence on the developed world through strategic investments, which will be influenced by political or military motives. Several proposed investments by SWFs and other state-owned entities have also highlighted national security concerns due to the nature of these investments. While some scholars have proposed a minimalist approach that targets only governance concerns and market distortions,²¹ most policymakers have come up with ambitious proposals that address national security and other noncommercial risks. These protective measures can be divided into four categories.

The first is national regulation that blocks foreign investment by certain entities based on their identity as government-owned entities. The French

21 See, e.g., Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345 (2008).

government has recently announced its proposal to establish a governmental fund that will serve as a white knight when a foreign government-owned entity is bidding for a local champion.²² This practically means a *de facto* attempt to block hostile acquisitions by government-owned entities. The German government has criticized the French protectionist act, although it will be interesting to follow and see whether other European governments establish their own SWFs to deal with hostile takeovers.

The second category is national regulation that blocks foreign investment based on the type of industry of the invested company. Several Western countries have excluded certain industries from availability for acquisition by foreign entities. According to customary international law, countries are not obliged to accept foreign investment and thus have the right to control the proposed investments entering into their territories. The United States, for example, protects its nuclear energy and airline industries and prevents foreign control of companies in this space, which usually involves sensitive technology and defense elements.²³ These excluded industries appear as exceptions in various schedules to international investment agreements or as specific national laws that prevent foreign investors from investing in certain industries. Russia, for example, has recently adopted legislation that prevents foreign investors from investing in the gas and oil industries.²⁴

The third category is a screening mechanism of a proposed acquisition or investment that gives the executive branch the ability to evaluate a specific investment and decide upon its commercial goals and associated national security and risks. The Committee on Foreign Investments in the United States (CFIUS) is the American governmental committee that is used to screen proposed investments in sensitive industries. According to the CFIUS mechanism, several governmental departments review a proposed investment and then collectively decide whether to recommend approving that particular investment, blocking it, or taking protective measures to ensure that the purchaser is driven by commercial motives, such as separation between ownership and management in the invested company.²⁵ A similar screening

22 *Sarkozy Plans New French Wealth Fund*, FIN. TIMES, Oct. 23, 2008, <http://www.ft.com/intl/cms/s/0/e1f97c38-a10d-11dd-82fd-000077b07658.html#axzz1nEpnrOTw>.

23 See Federal Aviation Act, 49 U.S.C. § 101 (1958); Atomic Energy Act, 42 U.S.C. § 103(d) (1954).

24 Federal Law of the Russian Federation on Foreign Strategic Investments Law (FSIL), 2008, No. 57. 2008 (as amended) (Russ.).

25 For an overview of the historical background for foreign investment regulation in the United States, see EDWARD M. GRAHAM & DAVID MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT 33-73 (2006).

mechanism has been adopted or proposed recently in France,²⁶ Germany,²⁷ and China.²⁸ This mechanism can be used to screen investments that are proposed by commercial corporations and SWFs alike. While CFIUS and CFIUS-like models have been in existence for a long time, many of them have been adjusted as a result of the current wave of global investments by SWFs.²⁹ Thus, the United States has recently revised its CFIUS regulation to improve the transparency of the CFIUS procedure and increase the range of investments that are screened by the CFIUS committee. According to the revised regulation, an investment by a foreign government-controlled entity (such as an SWF) will have to be investigated by CFIUS for national security purposes,³⁰ while in the past such review was discretionary. Any investigation's report has to be shared with the Congress.³¹ This legislative act has served as a response to the growing criticism in the Congress and the public that the existing mechanism could not provide an adequate review of potentially hostile takeovers of U.S. companies by foreign SWFs.³²

Finally, a fourth category is adoption of an open market policy with certain checks and balances to ensure that once an investment has been made, it does not serve purely as a long investment arm of a foreign entity. Countries with a

26 Loi 2005-1739 du 30 décembre 2005 de Code Monétaire et Financier [Law 2005-1739 of 30 December 2005 on Financial Dealings with Foreign Countries], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANCAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Dec. 31, 2005, p. 20779 (Fr.).

27 *Germans Agree Sovereign Funds Law*, FIN. TIMES, Apr. 10, 2008, <http://www.ft.com/intl/cms/s/0/ae273848-0697-11dd-802c-0000779fd2ac.html#axzz1nEpnrOTw>. The new German law allows the government to block SWFs' acquisition of large stakes in German companies that could threaten Germany's interests. The new law supplements Section 7 of the German Foreign Trade and Payments Act of 27 May 2009, Federal Law Gazette I p. 1150 (Ger.) that restricts certain investments to protect essential security and external interests.

28 *China Is Creating a Law to Protect Its National Security. It Will Probably Never Use It*, WALL ST. J., Aug. 26, 2008, <http://blogs.wsj.com/deals/2008/08/26/china-is-creating-a-law-to-protect-its-national-security-it-will-probably-never-use-it/>.

29 See Mark Plotkin, *Foreign Direct Investment by Sovereign Wealth Funds: Using the Market and the Committee on Foreign Investment in the United States Together to Make the United States More Secure*, 118 YALE L.J. POCKET PT. 88 (2008), available at <http://www.yalelawjournal.org/images/pdfs/718.pdf> (discussing the application of CFIUS to cross-border investments by SWFs).

30 Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, § 121 Stat. 246 (2007).

31 *Id.*

32 The Dubai Port transaction epitomized this criticism, *id.* at 136-41.

strong tradition of open market policies can frequently limit foreign investors' activities once the investors are already operating in their host countries in order to mitigate the negative impact resulting from actions that are driven by political motives or goals related to national security. This allows the government to keep the market access policy with a stricter approach when necessary. Mitigation Measures in the United States can serve as a good example.³³

These various categories of protective measures that can be applied against investments by SWFs highlight the intense legislation and its complexity in this field, a fact that has encouraged several intergovernmental organizations to explore ways to offer additional and more cohesive rules that will balance this wave of protectionism in national legislation. The Organization for Economic Co-operation and Development (OECD), representing a club of the leading developed economies, has called for adoption of voluntary rules for its members that would prevent adoption of any protectionist measures and secure open market policies in the new SWFs era. These rules were scheduled to be released following endorsement by the G-7 Group.³⁴ And, indeed, the OECD group adopted the OECD Guidance on Sovereign Wealth Funds in October 2008.³⁵ This guidance, which presents investment policies relating to national security for the first time at the OECD, will be followed by a "peer review" mechanism of investment policies that will also involve non-OECD member states from capital-exporting economies. Evidently, it remains to be seen how OECD member states will implement these new rules on SWFs in light of the abovementioned existing national legislation, whether by revising this existing legislation or by changing the policy towards future rules that limit the market access of SWFs.

Clearly, the sovereign wealth fund and host state communities should and do consult with each other, but since they share different interests it is not surprising that they have created different appropriate forums. And, in fact, in addition to Western governments and the OECD, multinational organizations have simultaneously responded to the new state capitalism by proposing

33 COMM. ON FOREIGN INV. IN THE U.S., ANNUAL REPORT TO CONGRESS (2011), *available at* <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2011%20CFIUS%20Annual%20Report%20FINAL%20PUBLIC.pdf>.

34 For the statement of the G-7 Group, see DEP'T OF TREASURY, STATEMENT OF G-7 FINANCE MINISTERS AND CENTRAL BANKS GOVERNORS (2007), *available at* www.treasury.gov/press-center/press-releases/Pages/hp625.aspx.

35 See *OECD Guidance on Sovereign Wealth Funds*, OECD, http://www.oecd.org/document/19/0,3343,en_2649_34887_41807059_1_1_1_1,00.html (last visited Apr. 11, 2012).

rules that will govern SWFs. The IMF, in cooperation with the World Bank, in November 2008 came up with proposed rules, the Santiago Principles,³⁶ which will be adopted by SWFs voluntarily.³⁷ The purpose of these rules is to create a level playing field for SWFs and increase their transparency and accountability. Adoption of these rules by the SWF community will help host states to build trust, be more comfortable with any proposed investment, and build long-term relationships between the funds and host states.³⁸

Although several SWFs have already implemented various internal and external changes in their operations based on the Santiago Principles to respond to the global concerns around their motives and governance, a recent study conducted by the International Working Group of SWFs shows that many of these changes have a limited scope and are not applicable to many other SWFs.³⁹ In fact, the partial implementation of the Santiago Principles exemplifies the challenge of standardization in this area due to the diversity of goals, structures, and societies.⁴⁰ Consequently, there is still a strong need to follow closely the global reaction to SWFs' investments, on the side of both the host governments and the multinational organizations.

The national regulatory measures discussed above are an attempt to balance open market policies with a genuine response to national security and other noncommercial threats. These threats seem limited, as recent qualitative and quantitative analysis shows that SWFs function more like commercial entities in the respective capital markets of the host states with respect to both profit-maximization motives and shareholding voting patterns.⁴¹ Industry leaders have been using this new data to support their argument that any attempt to regulate SWFs independently or introduce discriminatory measures following recent volatility in the markets can lead to unintended consequences and also

36 SANTIAGO PRINCIPLES, *supra* note 2.

37 The principles were negotiated by the International Working Group. For more information on this group, see IWG: INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, <http://www.iwg-swf.org/> (last visited Apr. 8, 2012).

38 On the significance of this project, see Anna Gelpern, *A Sovereign Wealth Turn* 6 (Rutgers Sch. of Law-Newark, Research Papers Series, Paper No. 25, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1272395.

39 INT'L F. OF SOVEREIGN WEALTH FUNDS (IFSWF), IFSWF MEMBERS' EXPERIENCES IN THE APPLICATION OF THE SANTIAGO PRINCIPLES (2011), available at <http://www.ifswf.org/pst/stp070711.pdf>.

40 *Id.* at 45.

41 See, e.g., Alexander Dyck & Adair Morse, *Sovereign Wealth Fund Portfolios* (Chicago Booth Research Paper No. 11-15, MFI Working Paper No. 2011-003, Rotman Sch. of Mgmt. Working Paper No. 1792850, 2011), available at <http://ssrn.com/abstract=1792850>.

diminish the positive effect of sovereign investments in global markets.⁴² Therefore, the host states themselves are in the best position to examine whether their national laws deal with SWFs effectively and provide the appropriate legal framework.

Additionally, the IMF, as an institution with extensive technical financial expertise and a global membership that strengthens its legitimacy, is the appropriate forum to facilitate discussions among its members and SWFs on acceptable voluntary standards for SWFs across the board. General national legislation, which applies unbiased transparency and corporate governance requirements to SWFs,⁴³ along with the supplementary rules of the Santiago Principles, can provide an adequate response to the global concerns about the real motives of SWFs and the role of sovereign governments in their governance structure and decision-making.

As a matter of fact, following the adoption of the Santiago Principles, a consensus against the adoption of a separate binding legal regime for SWFs developed, for several reasons. First, the soft-law approach proved to be rather successful. The International Working Group managed to bring together all the constituencies within a short timeframe and got them to adopt voluntary principles that cover almost all the potentially controversial activities of SWFs, even beyond transparency, governance, and accountability. These rules are currently in the process of being implemented,⁴⁴ but have already succeeded in significantly reducing anti-SWF sentiment in recipient countries,

42 David Murray, SWFs: Myths and Realities, Global Sovereign Funds Roundtable, Keynote Address at the Global Sovereign Funds Roundtable, London (May 5, 2011), available at <http://www.ifswf.org/pst/london11.pdf>. On the impact of SWFs' investments on financial markets and their withdrawal, see generally JAMES JACKSON, FOREIGN OWNERSHIP OF U.S. FINANCIAL ASSETS: IMPLICATIONS OF A WITHDRAWAL (U.S. Cong. Res. Serv., Report No. RL34319, 2008); Veljko Fotak, Bernardo Bortolotti & William L. Megginson, *The Financial Impact of Sovereign Wealth Fund Investments in Listed Companies* (Working Paper, revised draft, Sep. 18, 2008), available at www.gresi-cetai.hec.ca/cref/sem/documents/081107.pdf.

43 For several examples of general application of some of these laws and procedures, see *supra* note 18.

44 The Kuwait Declaration of April 2009 established an International Forum of SWFs that will meet, exchange views on issues of common interest and facilitate understanding of the SANTIAGO PRINCIPLES, *supra* note 2, and SWFs' activities, see "Kuwait Declaration": *Establishment of the International Forum of Sovereign Wealth Funds*, IWG: INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, <http://www.iwg-swf.org/mis/kuwaitdec.htm> (last visited Apr. 8, 2012).

especially due to their direct participation in the regulative process and the genuine response from the various funds.⁴⁵

Second, the Western economies' moves to regulate SWFs multilaterally shifted in 2008 when the global financial crisis deepened. The constant and deep-rooted need for capital in light of the credit crunch and the financial crisis resulted in a dramatic transformation of sentiment against SWFs into a global campaign to increase the participation of the funds as long-term investors in global markets. As companies have desperately turned to their national governments for financial support, SWFs have suddenly become the solution and not the source of the problem. Thus, any kind of multilateral regulation that would complicate their participation in the markets has been seen as potentially very costly.

Finally, the financial crisis of 2008 led to a consolidation of multilateral efforts to regulate financial institutions and capital markets. Thus, the G20 was chosen to bring together leading developed and developing economies to regulate a wide variety of financial subjects, such as banks' equity requirements, executive pay, regulation of derivatives, and participation of governments in the banking system.⁴⁶ A separate process, which is aimed at adopting binding rules on SWFs, seems counterproductive in this context. Since regulation of SWFs was not part of the G20 Group's discussion on the fallout from the crisis, multilateral legislative processes aimed at SWFs were postponed to a future phase, if at all.

Meanwhile, SWFs will find themselves facing protective measures that are driven either by genuine national security interests or classical protectionism. As mentioned before, host countries have responded to the new SWF phenomenon and revised their rules to provide for a better review process. Such review will also provide investors with better transparency and predictability during the investment process. Any violation of the due process principle can be identified and proved. Under these circumstances, I argue, the existing legislation with some necessary adjustments can serve as a sufficient solution on the host state level. The fact that the need to propose a special legal regime for SWFs has come up, in the context of a few cases

45 Sven Behrendt, *Sovereign Wealth Funds and the Santiago Principles: Where Do They Stand?* (Carnegie Endowment for Int'l Peace, Carnegie Middle E. Ctr., Paper No. 22, 2010), available at http://carnegieendowment.org/files/santiago_principles.pdf (assessing the impact of the Santiago Principles on the funds' operations).

46 For a review of the G20 financial agenda, see *What Is G-20?*, G-20, <http://www.g20.org/en/g20/what-is-the-g-20> (last visited May 2, 2012).

of national security concerns in developed economies, makes the case for a minimalist approach towards regulating SWFs.

It is important to note that several scholars have criticized the global attempts to single out SWFs and to force them to adopt unnecessary governance or transparency rules, limit their ability to vote their shares, or impose investment restrictions on the funds. Professors Richard Epstein and Amanda Rose, for example, show that SWFs do not create a distinct problem in their markets since their impact can be offset by other investors both in equity trading and boards of directors' decision-making.⁴⁷ They explain that the current regulatory framework is sufficient to mitigate any potential harm, and that the unintended consequences, such as switching investments to less democratic regimes or retaliatory actions by the home government, are significant.⁴⁸ Effective national laws that ensure transparency and commercial motivation during an investment screening process, which covers sovereign wealth funds and non-sovereign investors alike, can provide the appropriate response to most fundamental and immediate concerns. On the other hand, when the protective measures are driven by classical protectionism and discrimination, SWFs can find themselves lacking the appropriate remedies, as national courts are all too frequently biased. Global protectionism in trade and investment increases in times of economic recession,⁴⁹ and so our discussion below is extremely timely.

II. INTERNATIONAL ECONOMIC LAW: INVESTMENT AND TRADE AGREEMENTS

The preceding overview of regulation of protective measures against SWFs and SWFs' activities has focused on national legislation and self-regulation by multinational organizations. The remaining question is which preexisting international legal instruments cover SWFs and if they provide a sufficient framework within international economic law on this subject matter. No such comprehensive framework on investment exists and existing instruments provide a limited solution through a patchy network of trade and investment agreements. This conclusion, however, should not be surprising to the international economic lawyer, who is familiar with the several attempts

47 Richard Epstein & Amanda Rose, *The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow*, 76 U. CHI. L. REV. 111, 123-28 (2009).

48 *Id.*

49 See, e.g., *The Return of Economic Nationalization*, THE ECONOMIST, Feb. 7, 2009, <http://www.economist.com/node/13061443>; Karl Sauvart, *FDI Protectionism Is on the Rise* (World Bank Policy Research, Working Paper No. 5052, 2009).

to regulate investment comprehensively on the multinational level. These attempts have failed, while there are limited investment rules within the World Trade Organization (WTO) as part of the Agreement on Trade Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS).⁵⁰

International legal instruments that may be available to SWFs mostly cover protective measures against SWFs and not SWFs' actual activities. The reason for this is that almost all these instruments deal with governmental behavior with respect to trade and investment, while avoiding regulating multinational corporations directly. Regulation of multinational corporations has been subject to a continuous debate in the international legal community and is currently primarily made up of soft-law instruments, such as the OECD Guidelines for Multinational Enterprises.⁵¹ Clearly, international economic law instruments can constrain policy responses to SWFs' activities abroad. At the same time, governments can effectively use the same international disciplines as a policy response to limit SWFs' activities and further protectionist goals, therefore acting against the spirit and original purpose of these disciplines that support free trade and investment. This tension will serve as a driving force in my analysis of SWFs and their place in international economic law.

In any case, regulation of protective measures against foreign investments is very limited. The OECD, for example, published the OECD Code of Liberalization of Capital Movements⁵² and OECD Declaration on International Investment and Multinational Enterprises of 1976, which was revised in 2000,⁵³ in order to liberalize capital movements and prevent protectionist sentiment against foreign investment among OECD members. The effectiveness of these soft-law instruments has proven to be questionable.⁵⁴ Moreover,

50 General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183 [hereinafter GATS]; Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 186 [hereinafter TRIMs Agreement]. Some of these provisions will be discussed later in this Part.

51 OECD, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2008), *available at* <http://www.oecd.org/dataoecd/56/36/1922428.pdf>.

52 OECD, OECD CODE OF LIBERALIZATION OF CAPITAL MOVEMENTS (2011), *available at* http://www.oecd.org/document/63/0,3343,en_2649_34887_1826559_1_1_1_1,00.html.

53 OECD, OECD Declaration on International Investment and Multinational Enterprises of 1976 (rev. 2000), *available at* http://www.oecd.org/document/24/0,3343,en_2649_34887_1875736_1_1_1_1,00.html.

54 *See, e.g.*, OECD WATCH, 10 YEARS ON (2010), *available at* <http://oecdwatch.org>.

these instruments do not provide multinational corporations with hard-law enforcement mechanisms. In the absence of a multilateral agreement on investment, despite several attempts to conclude such an agreement in the OECD in 1998⁵⁵ and in the WTO as part of the Doha Round that started in 2001, such regulation can be found in bilateral and regional investment agreements (or trade agreements with an investment chapter). It can also be found in the GATS, one of the WTO agreements that deals with trade and investment in services. It remains to be explained how these agreements can be applied to the protective measures discussed above.

The limited effectiveness of the various soft-law instruments and the lack of SWFs-focused legislation force SWFs to use the existing trade and investment law framework to deal with host states' intervention for protectionist reasons. While some of this intervention may be justified for national security reasons as previously discussed, host states often ignore the fact that sovereign funds function as commercial entities, like institutional investors, and adopt unnecessary protectionist measures against them. My following review will examine how sovereign investors can use trade and investment law to press direct and indirect claims against sovereign states in situations of protectionism against state capitalism. These claims and related remedies are crucial in order to keep borders open to sovereign investment and compensate SWFs for their losses in their investment process.

A. Trade Law

In spite of several attempts to conclude comprehensive investment rules within the WTO framework, there is no WTO treaty on investment *per se*.⁵⁶

org/publications-en/Publication_3550.

55 See Efraim Chalamish, *The Future of Bilateral Investment Treaties — A de facto Multilateral Agreement?*, 34 *BROOK. J. INT'L L.* 304, 304-05 (2009).

56 For an overview and analysis of the various attempts to conclude investment rules within the WTO framework, see Kevin Kennedy, *A WTO Agreement on Investment: A Solution in Search of a Problem?*, 24 *U. PA. J. INT'L ECON. L.* 77 (2003); Jürgen Kurtz, *A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment*, 23 *U. PA. J. INT'L ECON. L.* 713 (2002); Pierre Sauve, *Multilateral Rules on Investment: Is Forward Movement Possible?* 9 *J. INT'L ECON. L.* 325 (2006). Although the Doha Ministerial Declaration, World Trade Organization, Ministerial Declaration of 14 November 2001, WT/MIN(01)/DEC/1, 41 *I.L.M.* 746 (2002) [hereinafter Doha Declaration], explicitly included trade and investment in its agenda during the Doha Round of trade negotiations, the WTO General Council eventually decided on August 1, 2004 to withdraw investment negotiations due

Nevertheless, several WTO arrangements include investment provisions aimed at preventing discriminatory measures against foreign investment where the link to trade distortion is dominant.⁵⁷

One such arrangement that can potentially be applicable to SWFs is the GATS.⁵⁸ This agreement is designed to provide a free trade platform for trade in services and prevent discriminatory measures against foreign investment in services, as the role of services in the global economy is growing dramatically.⁵⁹ In fact, when we look at SWFs' investments in services since 1975, forty-four percent of the transactions were in the services sector.⁶⁰ Although the GATS covers mainly trade in services, it covers investment in services indirectly, as one of the ways to build a "commercial presence," also known as "mode 3," in the recipient country is by acquiring a local supplier.⁶¹

The "commercial presence" mode applies to foreign direct investment in services where the foreign investor holds more than fifty percent of the equity interest or exercises control over the invested enterprise.⁶² By applying the anti-discriminatory standards to acquisition of a local distribution company

to substantial North-South disagreements, *see* DOHA WORK PROGRAMME, DECISION ADOPTED BY THE GENERAL COUNCIL ON AUGUST 1, 2004 (2004), *available at* http://www.wto.org/english/tratop_e/dda_e/ddadraft_31jul04_e.pdf.

57 In addition to the GATS, *supra* note 50, which will be discussed later in this Article, we might also mention the TRIMs Agreement, *supra* note 50.

58 GATS, *supra* note 50.

59 For an overview of the GATS and its goals, see Marion Panizzon & Nicole Pohl, *Testing Regulatory Autonomy, Disciplining Trade Relief and Regulating Variable Peripheries: Can a Cosmopolitan GATS Do It All?*, in *GATS AND THE REGULATION OF INTERNATIONAL TRADE IN SERVICES 3* (Marion Panizzon, Nicole Pohl & Pierre Sauve eds., 2008).

60 WILLIAM MIRACKY ET AL., *ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMY* 38-42 (2008), *available at* http://www.monitor.com/Portals/0/MonitorContent/imported/MonitorUnitedStates/Articles/PDFs/Monitor_SWF_report_final.pdf (tracking SWFs' investment in services since 1975).

61 GATS, *supra* note 50, art. XXVIII(d) ("[C]ommercial presence' means any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service").

62 For the purposes of Mode 3, an ownership of a "commercial presence" is defined as (i) "owned" by persons of Member if more than fifty percent of the equity interest in it is beneficially owned by persons of that Member; (ii) "controlled" by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions; (iii) "affiliated" with

in the services sector, the GATS serves an important role in facilitating the freedom of capital inflows in the services sector. Thus, when an SWF of one WTO member invests in a services company of another WTO member, any attempt to block such investment by using protective measures can involve WTO procedures based on the WTO member's violations of its obligations in the GATS, assuming the proposed investment is included in the sectors covered by it.⁶³ These obligations can be general by nature, such as the Most-Favored-Nation standard, or based on the WTO member's own commitments and limitations in the national schedules to the GATS. The latter includes both Market Access⁶⁴ and National Treatment obligations,⁶⁵ where a member state is committed to open or close certain industries and not to discriminate between a local company and a foreign company with respect to selected industries.

The negotiators of the GATS understood the rising role of governments in global trade and the disruptive effect of their economic operations, and thus included sovereign governments' trade in the agreement.⁶⁶ The "government" is defined broadly for the purposes of the GATS, and may be inclusive of government firms, government agencies, or government-controlled funds.⁶⁷ This broad application is of great significance to our discussion due to the diversity of SWFs' structures and forms. While some funds are corporate entities owned by sovereign governments, others are fund managers who function as agents.

The GATS also includes several supplemental agreements, which are aimed at promoting the flow of trade in specific sectors. Thus, the GATS includes an Annex on Financial Services with sector-specific commitments.⁶⁸ This Annex is of special importance in the context of sovereign investments in foreign jurisdictions. Since SWFs have been active in capital market investments in Western markets, it is necessary to examine the home and host governments' commitments in the financial sector in order to assess the impact of any proposed restrictive regulation on potential violation of the GATS.

another person when it controls, or is controlled by, that other person; or when it and the other person are both controlled by the same person.

63 For a detailed description of the covered services, see *Sector by Sector Information*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/tratop_e/serv_e/serv_sectors_e.htm (last visited Feb. 20, 2012).

64 GATS, *supra* note 50, art. XVI.

65 *Id.* art. XVII.

66 *Id.* art. XIII (Government Procurement); *see also id.* art. XVII (State Trading Enterprises).

67 *Id.* art. XXVIII.

68 *Annex on Financial Services*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/tratop_e/serv_e/10-anfin_e.htm (last visited May 2, 2012).

Several obstacles to applying the GATS to investments by SWFs and other state-owned entities and monitoring protective measures against them should be discussed. First, the abovementioned GATS rules apply only when the foreign entity has control over the acquired company,⁶⁹ so a passive minority investment by a SWF will not be sufficient. Since the majority of investments by SWFs in recent years were a non-controlling minority investment in Western corporations as part of their passive, long-term investment strategy, or portfolio investment in equity markets, it is questionable whether these investments actually provide the SWFs with the required control for the purposes of the GATS.⁷⁰ As Nuno Fernandes and Arturo Bris show with respect to portfolio investments, on average, an SWF takes 0.74% of the shares outstanding in a company (average position of \$46,300,000).⁷¹ Indeed, their level of control only reaches fifty percent in less than one percent of their investments.⁷² In fact, several studies that have examined the level of political control of SWFs on their minority passive investments show a low level of influence on the acquired companies, a fact that supports the argument that these investments should not be covered by the GATS.⁷³

Moreover, more generally, despite the ability of the WTO to deal with disputes related to investment in services through the GATS' "commercial presence," the nature of the forum and the available remedies make the WTO a limited space for foreign investors who are trying to access new markets or who confront discriminatory practices against them in the services sector. The WTO is an intergovernmental forum where states bring international economic claims against each other.⁷⁴ While foreign investors have to collaborate with their respective governments in order to succeed in a WTO case, as they do

69 See GATS, *supra* note 50, art. XXVIII (definitions of "commercial presence" and "judicial person").

70 See Paul Rose, *Sovereign Wealth Funds: Active or Passive Investors?*, 118 YALE L.J. POCKET PT. 104 (2008) (discussing the passivity element of SWFs' investments).

71 NUNO FERNANDES & ARTURO BRIS, *NEW LIFE FOR SOVEREIGN WEALTH FUNDS: VALUABLE CONTRIBUTORS TO LONG TERM SHAREHOLDER VALUE 2* (2009), available at http://www.imd.org/research/challenges/upload/TC015_New_life_for_sovereign_wealth_funds.pdf.

72 *Id.*

73 Rolando Avendaño & Javier Santiso, *Are Sovereign Wealth Funds' Investments Politically Biased?: A Comparison with Mutual Funds* (OECD Dev. Ctr., Working Paper No. 283, 2010), available at <http://www.oecd.org/dataoecd/43/0/44301172.pdf>.

74 On the bilateral nature of WTO commitments, see Joost Pauwelyn, *The Nature of WTO Obligations* (Jean Monnet, Working Paper No. 1, 2002).

through *amicus brief* or collaboration behind the scenes,⁷⁵ eventually they are not a direct litigant in the procedure. Thus, in a WTO procedure based on the GATS a foreign investor cannot bring a direct claim against a host government.⁷⁶

Furthermore, the ultimate remedy in a WTO case is removal of the illegal measure.⁷⁷ This remedy can be effective when a foreign investor faces a legal barrier when trying to access a service industry in another jurisdiction. It cannot be effective when the investor, who is already based in a host country, faces an illegal or discriminatory measure. In this case, the investor may be more interested in receiving compensation for the damages incurred and the ability to continue and conduct business in the host state.⁷⁸ The perception that the GATS provides limited rules on the pre-establishment right of national treatment of foreign investors may also, in fact, reduce the use of the WTO by an SWF to claim market access based on the GATS.⁷⁹

Clearly, the GATS is missing two important components in this context: the ability to bring direct claims against the host state and compensation, both of which are available to foreign investors in other multilateral legal systems, such as the international investment law regime through its vast bilateral and regional investment agreements.⁸⁰ These agreements, as discussed later in this Article, provide foreign investors, potentially including sovereign funds, with the ability to sue host states directly for violation of international commitments and ask for the appropriate compensation.

Finally, the GATS includes general and specific exceptions that can frequently be applied to investments by SWFs, as well as to other investors. General exceptions,⁸¹ which cannot be negotiated and thus do not have to be scheduled, include, for example, prudential measures in the financial sector

75 See generally GREGORY SHAFFER, *DEFENDING INTERESTS: PUBLIC-PRIVATE PARTNERSHIPS IN WTO LITIGATION* (2003).

76 Integration of the “Singapore Issues” and new rules on investment in the WTO would have helped foreign investors in these situations.

77 See Petors C. Mavroidis, *Remedies in the WTO Legal System: Between a Rock and a Hard Place*, 11 EUR. J. INT’L L. 763, 777-90 (2000) (analyzing the WTO remedies regime).

78 Martin Molinuevo, *Foreign Investment in Services and the DSU*, in *GATS AND THE REGULATION OF INTERNATIONAL TRADE IN SERVICES*, *supra* note 59, at 296, 311-19.

79 *Id.* at 297.

80 For an historical perspective of investors’ rights in international investment law, see Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT’L L. & POL’Y 157 (2009).

81 GATS, *supra* note 50, art. XIV.

taken in accordance with the Annex on Financial Services.⁸² Prudential “carve out” can justify financial stabilization measures that support local banks and limit foreign ownership of the financial sector in response to a financial crisis.⁸³ Moreover, since SWFs frequently raise security concerns the Security Exceptions of the GATS can be used to justify governmental measures against state-controlled entities.⁸⁴

Additionally, with respect to the specific exceptions, WTO members list in their national schedules specific trade liberalization commitments and limitations to these commitments with respect to GATS’ Market Access and National Treatment obligations.⁸⁵ While the Market Access provision prescribes what would be considered a violation of the principle, states should list any discriminatory measure affecting the National Treatment obligation.⁸⁶ According to Article XVIII, WTO Members can also list additional commitments with respect to measures affecting trade in the form of undertakings (not limitations).⁸⁷ A review of the various GATS’ schedules that include these specific and additional commitments shows that many governments, which are leading capital importers from the SWF community, have already excluded state-linked investments from certain industries.⁸⁸

Any SWF’s potential investment will have to be examined according to general exceptions and specific commitments and limitations to these

82 See *Annex on Financial Services*, *supra* note 68, para. 2(a).

83 See Bart De Meester, *The Global Financial Crisis and Government Support for Banks: What Role for the GATS?*, 13 J. INT’L ECON. L. 27 (2010) (addressing the use of GATS’ exceptions generally, and its carve out specifically, to justify bail out of banks post global financial crisis).

84 GATS, *supra* note 50, art. XIV bis (Security Exceptions).

85 These specific commitments are set according to WTO, GUIDELINES FOR THE SCHEDULING OF SPECIFIC COMMITMENTS UNDER THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS) (2001).

86 Unlike Article XVI of the GATS, Article XVII does not contain an exhaustive listing of the types of measures which would constitute limitations on national treatment.

87 Such commitments can include, but are not limited to, undertakings with respect to qualifications, technical standards, licensing requirements or procedures, and other domestic regulations that are consistent with Article VI, *see* WTO, *supra* note 85, at 7.

88 Spain, for example, includes in its schedule of specific commitments (“Investment in Spain by foreign government and foreign public entities (which tends to imply, besides economic, also noneconomic interests to entity’s part), directly or through companies or other entities controlled directly or indirectly by foreign governments, need prior authorization by the government”).

commitments. Any interpretation of general exceptions in light of a specific SWF's investment will take into account international economic law jurisprudence, which includes international legal instruments that the WTO Member States are party to.⁸⁹

The potential use of the GATS to address global concerns about protectionist measures against SWFs will need to address all these obstacles. The limited application to SWFs due to the nature of their entity and investment, along with the wide range of listed exceptions to the GATS, makes the GATS a very partial solution. Several scholars have offered to use the WTO as the preferred forum to deal with protective measures against SWFs by WTO members due to the trade-distortion effects of these measures and the ability to strike political concessions within the WTO by extending its political agenda, which will include lifting barriers to market access in the SWF context.⁹⁰ Arvind Subramanian and Aaditya Mattoo distinguish between SWFs' transactions that involve majority ownership or corporate control, on the one hand, and minority portfolio investments, on the other hand. While the IMF can use its expertise to regulate portfolio aspects of SWFs' activities, the WTO, they argue, can be an appropriate forum to deal with SWFs' investments involving an effective control.⁹¹ If, indeed, the WTO follows this line, additional rules on SWFs may be required since the existing rules do not provide sufficient coverage, as previously discussed.

B. Investment Law

Bilateral Investment Agreements (BITs) and regional trade agreements with investment provisions traditionally include anti-discriminatory provisions which apply investor protection standards to foreign investors in the host state.⁹² These standards include the Most-Favored-Nation (MFN), National Treatment, and Fair and Equitable Treatment principles with respect to any

89 See, e.g., UNITED NATIONS, DRAFT ARTICLES ON RESPONSIBILITY OF STATES FOR INTERNATIONALLY WRONGFUL ACTS, WITH COMMENTARIES (2001), available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf.

90 Arvind Subramanian & Aaditya Mattoo, *Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization* (Ctr. for Global Dev., Working Paper No. 142, 2008).

91 *Id.* at 17-18.

92 For an overview of investment protection standards in investment and trade agreements, see Peter Muchlinski, *The Framework of Investment Protection: The Content of BITs*, in THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 37 (Karl P. Sauvant & Lisa E. Sachs eds., 2009).

specific investment, among other commitments.⁹³ An administrative action by a government that blocks a potential investment by a SWF can be a violation of one of these standards if they also include market-access elements. For example, if several foreign investors bid for a minority stake in a U.S. company and the U.S. government has adopted certain rules that disadvantage a Singaporean SWF for political reasons, this SWF can claim a violation of the MFN provision in the United States-Singapore Free Trade Agreement (FTA). This provision promises Singaporean investors equal treatment to other foreign investors, while a Singaporean SWF in this context suffers a disadvantage in comparison to other third parties.⁹⁴

BITs offer foreign investors a unique dispute settlement mechanism to enforce the rights given to them by the investment treaties. This unique element of investment treaties provides an investor with the possibility of bringing a direct claim against the host state in an international arbitration forum, such as the International Center for Settlement of Investment Disputes (ICSID) or the International Chamber of Commerce (ICC). A discriminatory act against an SWF can be followed by a direct claim by the SWF against the host state based on the applicable investment treaty between the host state and the home state of the SWF. Assuming successful passage through any jurisdictional challenges, an arbitration forum will have to decide whether the legislative or executive act can be considered a discriminatory measure that violates an investor protection standard.

This proposed application of international investment treaties to SWFs should be understood in the larger context of the rising role of state-owned entities in foreign markets and the use of international legal instruments to protect their legal interests in host countries. The rise in SWFs' activity globally, nationalization of strategic industries in many states, and commodities export growth — all have led to various commercial disputes in recent years between home states-linked companies and host governments. Due to the sensitive political nature of these disputes, international contractual arbitration has become a viable option. Thus, for example, the Abu Dhabi Investment Authority (ADIA), a state-owned entity, initiated an international arbitration against Citigroup in December 2009, claiming that the bank misrepresented during its equity sale to ADIA in the course of the financial crisis of 2008.⁹⁵

93 Efraim Chalamish, *Do Treaties Matter? On Effectiveness and International Economic Law*, 32 MICH. J. INT'L L. 325, 329 (2010).

94 Free Trade Agreement, U.S.-Sing., May 6, 2003, 42 I.L.M. 1026, available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/singapore-fta/final-text>.

95 Stephen Foley, *Abu Dhabi Says It Was Duped by Citigroup over Investment Deal*,

This legal action was followed by a lawsuit in New York in September 2010 by Norway's Central Bank against Citigroup for alleged misstatements over the bank's financial condition before the financial crisis.⁹⁶ It is important to note that treaty-based claims will be useful to SWFs especially when there is no contract between the parties or when the SWFs' claims involve protectionism or discrimination, as is often the case. An SWF may also want to use the procedural advantage of the investment treaty regime.⁹⁷

Treaty-based claims can introduce several structural and substantive challenges to the use of existing international investment agreements to regulate actions against SWFs. First, investment agreements usually cover in their "investor" definition investments by a natural person or a legal entity without referring specifically to state-owned entities or SWFs.⁹⁸ One can argue that SWFs as public entities do not qualify as private separate legal entities and thus cannot bring an investment treaty claim. If this is the case, BITs will not be the appropriate legal instruments to deal with actions with respect to SWFs. A review of BITs' practice shows that the investment treaty regime has not served as a platform for international commercial disputes between governments. We should take a closer look here at the characteristics of SWFs to examine the public or private nature of the funds for definitional and jurisdictional purposes.

Generally, while SWFs share common practices,⁹⁹ they can be divided into

THE INDEPENDENT, Dec. 17, 2009, <http://www.independent.co.uk/news/business/news/abu-dhabi-says-it-was-duped-by-citigroup-over-investment-deal-1843009.html>.

96 Andrew Ward, *Norway's Central Bank Sues Citigroup*, FIN. TIMES, Sept. 24, 2010, <http://www.ft.com/intl/cms/s/0/7b35e5b0-c800-11df-ae3a-00144feab49a.html#axzz1nEpnrOTw>.

97 One of these advantages is the ability to enforce in multiple jurisdictions based on The Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. XII, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3, available at http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf (entered into force on 7 June, 1959 and also known as the "New York Convention").

98 See, for example, the "investor" definition in the Agreement Between the Government of Canada and the Government of the Republic of South Africa for the Promotion and Protection of Investments, Can.-S. Afr. art. I, Nov. 27, 1995, available at http://www.unctad.org/sections/dite/iia/docs/bits/canada_southafrica.pdf (never entered into force).

99 Cornelia Hammer, Peter Kunzel & Iva Petrova, *Sovereign Wealth Funds: Current Institutional and Operational Practices* (IMF, Working Paper No. WP/08/254, 2008) (providing several common practices, such as not engaging in macroeconomic policies).

several subgroups.¹⁰⁰ The most significant difference between different types of SWFs is between a legally separate entity and one which is not. Funds which are not legally separate are usually owned by the Ministry of Finance or the Central Bank, their governing body is based on government officials, their asset allocation has a low-risk model, and they tend not to disclose their financials.¹⁰¹ Since forty-eight percent of SWFs (almost half) are currently structured as a pool of assets and not as a separate legal entity, the case for rising state capitalism and recognition of SWFs as government affiliates is getting more support.¹⁰²

Various BITs have different definitions for “investor,” an important jurisdictional requirement in any investment treaty. A closer case-by-case review approach is necessary by the arbitral tribunal to examine whether the structure of a particular SWF allows it, like a “person,” to use a BIT to avoid discrimination and to sue the respective host state in case such discrimination has occurred. The fact that several governments have recently added a specific reference to SWFs in their new investment treaties or have proposed to do so supports the view that their older treaties had limited jurisdictional coverage with respect to SWFs. For instance, Saudi Arabia, a rising capital-exporter through its oil-driven SWF and other state-linked entities, is interested in protecting its SWF’s investments abroad and has added a clear reference to its SWF and state-linked entities in its recent BITs.¹⁰³ Also, the U.S. Government’s Subcommittee on Investment of the Advisory Committee on International Economic Policy (ACIEP), which is currently reviewing the 2004 BIT model, has raised the possibility of dealing with the issue of SWFs explicitly in a new BIT model in the future.¹⁰⁴ The inclusion of

100 For example, while SWFs with a pension liability component have to meet their future liabilities and thus have special restrictive funding and withdrawing rules, fiscal stabilization funds will not have such rules as a result of their different goal.

101 Hammer, Kunzel & Petrova, *supra* note 99, at 12.

102 This is not the only distinction. SWFs have different practices as a result of their diverse nature, original intent, and legal personality. These practices include different policy objectives, funding and withdrawal rules, institutional frameworks and accountability arrangements, investment policies, and risk management frameworks. SWFs will look into previous practices and the SANTIAGO PRINCIPLES, *supra* note 2, to evaluate their own current practices.

103 *See, e.g.*, Agreement Between the Government of the People’s Republic of China and the Kingdom of Saudi Arabia on the Reciprocal Promotion and Protection of Investments, China-Saudi Arabia, art. 1(2)(b)(3), IC-BT 462 (1996).

104 *See Report of the Subcommittee on Investment of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty,*

specific SWFs-related provisions in a few BITs can be a pragmatic solution while a multilateral liberalized investment policy in the SWFs era is hard to achieve.

The Washington Convention has a similar requirement in the case of an ICSID claim,¹⁰⁵ but international investment arbitration case law shows that the jurisdictional requirements are quite similar; taking into account the fact that the ICSID allows disputes between host states and nationals of home states and not disputes between the governments themselves.¹⁰⁶ A similar discussion took place in the trade context, since governments can bring claims in the WTO as a result of use of illegal subsidies only if the subsidies are given to a private commercial entity by a sovereign government. The conclusions of this analysis can be very helpful for the debate on investment agreements and SWFs.

It is important to note, however, that, from an investment law perspective, ownership by the government and state funding do not by themselves exclude investors' protection as long as the state-owned entity serves a commercial function.¹⁰⁷ Investment arbitral tribunals have looked not only at the formal legal nature of the entity at stake and its relations with the home government, but also at its functionality.¹⁰⁸

Second, most BITs' protection covers investments in their post-establishment phase. In other words, they do not secure market access pre-establishment, but once an investment has already been made, investment agreements provide investor protection standards. Since most of the distinctive concerns around SWFs' investments in a host state arise when they try to

U.S. DEPARTMENT OF STATE, <http://www.state.gov/e/eeb/rls/othr/2009/131118.htm> (last visited Nov. 13, 2011). One of the concerns of the Subcommittee was anti-competitive practices by foreign governments that subsidize their sovereign funds in order to invest in the U.S. market.

105 International Center for Settlement of Investment Disputes (ICSID), Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, art. 25(2) (2006) [hereinafter ICSID Convention] (clarifying the "investor" jurisdictional requirement).

106 See U.N. CONFERENCE ON TRADE & DEV. (UNCTAD), INVESTOR-STATE DISPUTE SETTLEMENT AND IMPACT ON INVESTMENT RULEMAKING 12-15 (2007), available at http://www.unctad.org/en/docs/iteiia20073_en.pdf. Yet, a review of the history of the ICSID Convention, *supra* note 105, reveals that the drafters did not intend to exclude state-owned entities, see CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY (2d ed. 2009).

107 See, e.g., *CSOB v. Slovakia*, 5 ICSID Rep. 335, paras. 16-27 (1999) (Decision on Jurisdiction) (allowing claims by a state-owned entity).

108 *Id.*

access the host economy, the applicability of many BITs to SWFs pre-establishment is questionable. According to customary international law, governments have the right to decide which investments can enter their states' borders, and therefore international legal instruments cannot force them to do so. Yet, these funds will still be able to use post-establishment provisions with respect to existing investments in recipient countries. Nevertheless, it is important to note that the notion of investment encouragement and market liberalization is gradually becoming an integral part of the global investment discussion, and we may expect to see in the near future more BITs that expand investors' rights beyond the customary international law standards and apply their jurisdiction to investments pre-establishment, such as the North America Free Trade Agreement (NAFTA). Another way to apply investor protection pre-establishment if the rights are not explicitly included in the applicable treaty is to combine various treaties. An example would be a combination of a BIT between two European countries without a pre-establishment mechanism with a European treaty that forces liberalization of capital movements and facilitates an open market for foreign investment.¹⁰⁹

Finally, the unique element of investment arbitration based on a treaty claim is the enforcement mechanism and the ability of the investor to initiate a direct procedure against the host state. This investment arbitration procedure is especially effective when the claimant is looking for direct or indirect damages as a result of discriminatory measures, or any other damage to the value of the original investment. It will be very difficult to show damages if the only protective action taken by the government is preventing the SWF from entering the host country and the respective treaty protects such entry, unless the SWF as a bidder has already experienced significant expenses to prepare its bid, such as due diligence, financial analysis, or legal costs.¹¹⁰

Moreover, investors who are trying to enforce arbitral awards against a sovereign state may confront various judicial and political challenges, as the recent Argentinean 2001 financial crisis exemplified.¹¹¹ In fact, the impact of

109 For an analysis of the new E.U. investment policy post-Lisbon and its impact on existing BITs in Europe, see COUNCIL OF THE EUROPEAN UNION, CONCLUSIONS ON A COMPREHENSIVE EUROPEAN INTERNATIONAL INVESTMENT POLICY (2010), available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/117328.pdf.

110 Although it is hard to identify a clear precedent in investment arbitration cases on this matter, investment tribunals tend to reimburse investors for their pre-investment expenditures only if there is a final agreement to receive the investment, see *Mihaly Int'l Corp. v. Sri Lanka*, ICSID Case No. ARB/00/2, 308 ICSID Rep. 7 (2002).

111 On the challenges of enforcement of investor rights, see generally Susan Frank,

these challenges on the legitimacy of investor-state arbitration has fostered a serious debate among scholars and practitioners on ways to improve the enforcement mechanism.¹¹² Regarding an already-established investment by an SWF, the fund can find itself facing extra scrutiny, which, in extreme cases, can lead to the risk of divestiture. Thus, for example, the CFIUS committee in the United States can force divestiture if the SWF's investment turns out to be a political action that leads to a significant threat to national security interests. While under these circumstances the element of damages can be proven easily, it will be challenging to show an unlawful discriminatory act. Investment in a critical infrastructure will frequently get scrutinized with the risks of conditions and divestiture regardless whether the investor is an SWF or a traditional foreign commercial entity.

SWFs can also be the source of discrimination and not only its victims, as it is not always the case that SWFs are treated less favorably than other foreign private investors. In these cases, as exemplified here, international investment law can be used by other financial actors when they are discriminated *vis-à-vis* foreign SWFs. The tax regime is a case in point. In the United States, for example, unlike several other developed economies,¹¹³ SWFs are granted more favorable treatment as part of a preferred tax regime with respect to sovereigns' investments in equity markets.¹¹⁴ Section 892 of the tax code grants sovereign wealth funds an unconditional tax exemption when a foreign sovereign holds passive portfolio investments in the United States.¹¹⁵ The origin of this tax preference was the broad application of sovereign immunity in the U.S. legal system and the regulator's approach towards noncommercial activity of foreign governments in the United States.¹¹⁶ This tax policy has

The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future, 12 U.C. DAVIS J. INT'L L. & POL'Y 47 (2005).

112 *Id.*; see also Susan Frank, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005).

113 Jon Taylor, *Tax Treatment of Income of Foreign Governments and International Organizations*, in *ESSAYS IN INTERNATIONAL TAXATION* 151, 154 (1976).

114 See Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 5 (2008) (discussing the historical background of taxation of sovereigns by the U.S. government and revisiting its tax policy).

115 See I.R.C. § 892(a)(1) (2006).

116 The War Revenue Act, 40 STAT. 300, 337 § 1211 (1917) included the original provision exempting income of foreign governments, adding to the Revenue Act, 39 STAT. 756 § 30 (1916). For more on immunity from taxation of sovereign-

been criticized recently in several academic papers, news articles and forums.¹¹⁷ Those who oppose tax preference in this context claim that, while the U.S. equity markets and foreign investment policy do call for more sovereign investments in the United States in order to provide liquidity to capital markets, any subsidies given to foreign governments are unnecessary and, in fact, incentivize alleged noncommercial motives of their sovereign funds.¹¹⁸

Currently, the unconditional tax exemption for passive portfolio investments in the United States does not apply to other financial institutions, such as foreign private equity and pension funds. Thus, this tax discrimination can lead other foreign financial players to consider bringing Most-Favored-Nation claims against the U.S. government in investor-state arbitral forums.¹¹⁹

The use of international investment law by SWFs is in its early stage. As we have seen with the first investment arbitration cases in the 1990s, it takes business executives some time to become aware of the possible use of investment law and to fully understand its costs and benefits.¹²⁰ We have come a long way since the first arbitral cases, creating practical know-how and judicial jurisprudence. This important evolution in international investment law will be very useful to SWFs in the future. The Singaporean SWF has

owned entities, see Wm. W. Bishop, Jr., *Immunity from Taxation of Foreign State-Owned Property*, 46 AM. J. INT'L L. 239, 240 (1952).

117 See, e.g., Victor Fleischer, *Should We Tax Sovereign Wealth Funds?*, 118 YALE L.J. POCKET PT. 93 (2008), available at <http://yalelawjournal.org/images/pdfs/719.pdf> (calling on the U.S. government to grant foreign investors equal tax treatment regardless of their sovereign status); see also U.S. *Should Use as Political Lever Its Tax Break on Sovereign Funds*, WALL ST. J., Mar. 14, 2008, <http://online.wsj.com/article/SB120544570178634819.html>. But see Desai A. Mihir & Dharmapala Dhammika, *Taxing the Bandit Kings*, 118 YALE L.J. POCKET PT. 98 (2008), available at <http://yalelawjournal.org/images/pdfs/720.pdf>.

118 See Robert M. Kimmitt, *Public Footprints in Private Markets*, 87(1) FOREIGN AFFAIRS 119 (2008).

119 Most tax policy-related investment arbitration cases so far have involved windfall levy on certain industries as indirect expropriation, see, e.g., Fernando Cabrera Diaz, *Investor Challenges Ecuadorian Windfall Tax as Breach of Oil Participation Contract*, INVESTMENT TREATY NEWS (Mar. 2, 2007), http://www.iisd.org/pdf/2007/itn_mar2_2007.pdf. Yet, tax differentiation can be a basis for a national treatment or MFN claim in the future.

120 A recent study showed that seventy percent of the surveyed transnational corporations reported that international investment agreements played a role in making an investment decision, see U.N. CONFERENCE ON TRADE & DEV. (UNCTAD), *THE ROLE OF INTERNATIONAL INVESTMENT AGREEMENTS IN ATTRACTING FOREIGN DIRECT INVESTMENT TO DEVELOPING COUNTRIES*, at xi, 51 (2009), available at http://www.unctad.org/en/docs/diaeia20095_en.pdf.

recently contemplated filing a case against the government of Indonesia as a response to protective measures against it in the telecom industry.¹²¹ Additional cases may follow.

One of the reasons for the limited use of investment claims by SWFs can be the need to achieve a preliminary settlement since these funds tend to invest on a repetitive basis and seek to build positive long-term relationships with their host governments. Moreover, several recent disputes that are connected to the results of the 2008 financial crisis have not yet matured.¹²² Additionally, the recent debates on the questionable legitimacy and effectiveness of the international investment law regime have encouraged claimants to explore other ways of solving their commercial disputes.¹²³ Claimants are also concerned about the difficulties in applying substantive standards to state-owned entities such as SWFs. Thus, for example, applying the National Treatment standard requires a comparison between the foreign investor and a comparable local competitor, which is frequently hard to find for deep-pocketed investors such as state-subsidized SWFs. However, growing trade and investment protectionism, along with a dramatic rise in big developing economies with large SWFs such as China, may change this trend.¹²⁴ The rising shift from traditional portfolio investments to Foreign Direct Investment may support this new trend.

Furthermore, the majority of BITs also include a state-to-state dispute settlement mechanism, which allows signatory states to resolve any disputes related to either interpretation or implementation of the treaty by an arbitral tribunal.¹²⁵ Home and host states can use this mechanism to decide on the application of existing treaties to state-owned entities and sovereign wealth

121 Temasek Holdings, Singapore's state-owned investment company, was required by the Indonesian antitrust authorities to sell its stake in either of the country's two biggest mobile-phone operators within a year. Temasek considered international arbitration procedures after exhausting local procedures in Indonesia.

122 Norway's Central Bank, for example, has decided only recently to sue Citigroup based on a claim arising out of the 2008 financial crisis, as it has been exploring several other possibilities since the emergence of the dispute, Ward, *supra* note 96.

123 *See generally* THE BACKLASH AGAINST INVESTMENT ARBITRATION (Waibel Kaushal et al. eds., 2010); Efraim Chalamish, *Do Treaties Matter? On Effectiveness and International Economic Law*, 32 MICH. J. INT'L L. 325 (2010).

124 *See, e.g.*, UNCTAD, OECD & WTO, REPORT ON G-20 TRADE AND INVESTMENT MEASURES (2010), available at http://www.unctad.org/en/docs/wto_oecd_unctad2010d1_en.pdf.

125 *See, e.g.*, United States Model Bilateral Investment Treaty, art. 37 (2004) (State-State Dispute Settlement).

funds' investments. Since many of these funds invest on a repetitive basis, such a process can pave the way to the systematic integration of SWFs' investments into the existing framework of international investment law. Several investor-state arbitration decisions, which interpret the jurisdictional scope of BITs and the ICSID Convention with respect to SWFs, may also lead to a similar effect.

In sum, the potential use of investment treaties to regulate SWFs' activities is real but involves several limitations. Although the basic rationale behind an investment treaty, namely to liberalize investment policies and protect foreign investors from discriminatory measures, can be applied to SWFs as well, the unique character of the funds along with textual and jurisdictional challenges in the treaties could limit such application. In the vast majority of cases where the SWFs debate is taking place, protectionist measures that block foreign acquisitions by SWFs at their point of entry, the limits on the identity of the buyer and the current limited role of market access in BITs will serve as obstacles to the use of BITs. Nevertheless, international investment law offers an effective regulatory response, taking into account other alternative regulatory frameworks and emerging trends in international investment law.

III. SWFs AS CLAIMANTS IN INTERNATIONAL INVESTMENT LAW — A SYSTEMATIC INTEGRATION

Our overview of existing international trade and investment legal instruments proposes the applicability of these instruments to discriminatory measures against SWFs. But the application of trade and investment agreements involves several structural and substantive obstacles. Although both the WTO and investment tribunals can serve a similar goal in this context, securing market access for SWFs in a global financial environment, they present different forums, influenced by different rationales. Those who want to see the WTO dealing with any violation of the rules against SWFs emphasize the trade-distortion effect of SWF activity.¹²⁶ They also focus on the need to include private players, such as SWFs, in the WTO forum to increase its credibility and extend its agenda in order to increase the political capital of the Member States that want to liberalize capital inflows.¹²⁷

126 Arvind Subramanian & Aaditya Mattoo, *Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization* (Ctr. for Global Dev., Working Paper No. 142, 2008) (emphasizing the trade-distortion effect of currency manipulation and sovereign funds' investments).

127 *Id.*

Indeed, the WTO suffers from a constant decline in its credibility and its ability to conclude core trade arrangements.¹²⁸ Many important players, especially in the private sector, feel they have not been part of the trade debate. The Doha Round is about to come to its end without concessions on important agenda items.¹²⁹ However, adding WTO rules on SWFs or using the Dispute Settlement Body (DSB) to decide on protectionist measures by a WTO member against another member state will complicate the work of the trade organization and hurt its ability to deal with its existing agenda more effectively. The “Singapore Issues,” which were added to the trade discussions in Doha,¹³⁰ did include investment regulation in the WTO. It was part of an institutional attempt to have a serious debate on all trade-linked items, including investment, and to provide developed countries with the opportunity to reduce agriculture subsidies in exchange for liberalization of capital in the developing world. Extending the trade agenda and including investment in the WTO was, in fact, one of the failures of Cancun’s trade summit and caused the Member States to withdraw from negotiating on trade-related investment items.¹³¹ As a matter of fact, the WTO has very limited institutional expertise in this field and not all investment regulation is trade-related. For the same reason, the inclusion of any additional SWFs rules in the WTO or the application of existing rules to SWFs will diminish the organization’s ability to conclude additional agreements on its core agenda.

The failure to negotiate investment rules in the WTO has empowered the existing BITs network as the main regulatory framework for foreign investment, encouraged countries to negotiate new bilateral or regional investment agreements, and increased the number of investment arbitration claims.¹³² Elsewhere I have made the case that the BITs network can serve as

128 See, e.g., *Geopolitical Worries Move Up the Agenda*, FIN. TIMES, Jan. 28, 2011, <http://www.ft.com/cms/s/0/f4758388-2b04-11e0-a2f3-00144feab49a.html#axzz1CV55NzhA>.

129 For the state of the Doha Round, see *The Doha Round*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/tratop_e/dda_e/dda_e.htm (last visited Jan. 3, 2010).

130 “Singapore Issues” was the term given to the non-core trade areas that were originally included in the Doha Declaration, but were eventually left off the negotiation table, see Doha Declaration, *supra* note 56, paras. 20-22 (2001).

131 The WTO General Council concluded on August 1, 2004 that “investment issues will not form part of the Work Programme set out in that Declaration and therefore no work towards negotiations on any of these issues will take place within the WTO during the Doha Round,” see WORLD TRADE ORGANIZATION, DOHA WORK PROGRAMME (2004).

132 The ICSID alone registered 147 new investment arbitration claims between 2005

a *de facto* multilateral investment agreement.¹³³ Its signing mechanism based on a pre-negotiated model, the MFN provision that creates a standardization of investor protection standards for all nations, and the developing investment jurisprudence — all of these strengthen the multilateral aspect of the BITs network, support a harmonized investment liberalization policy, and increase its credibility to include additional investment-related items.¹³⁴ Thus, the BITs network can be a natural forum for discussing SWFs and, as shown above, for applying protection standards to protective measures against them in investment arbitration tribunals.

Several additional factors support my analysis. First, the investment arbitration is a unique procedure that brings together a private investor and a public entity. This special private-public forum provides the tribunal and the parties with the opportunity to discuss the link between the private and the public in international economic law.¹³⁵ Thus, the forum can discuss an SWF, a private entity with public features, more effectively. Second, although the main component of the BIT is investment protection, the liberalization of capital is becoming a growing element in BITs' language and investment arbitrators' decisions. Applying investment agreements to SWFs and adding financial features to the necessity exception, which would limit the use of the "necessity" exception against SWFs in non-emergency situations, will empower the liberalization element of the treaties through protection of market access in an environment where many cross-border investments are made by SWFs.¹³⁶ Indeed, vague "necessity exceptions" may effectively allow countries to discriminate against SWFs, but multilateral soft-law instruments¹³⁷ and arbitration jurisprudence have limited their ability to do so.¹³⁸

and 2010. For a recent comprehensive analysis of ICSID claims, see 2010-2 ICSID CASELOAD — STATISTICS, *available at* <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English12>.

133 Chalamish, *supra* note 55.

134 Among these additional provisions I propose to include human rights-related provisions in these treaties, *id.* at 345-53.

135 *See generally* GUS VAN HARTEN, INTERNATIONAL INVESTMENT ARBITRATION AS PUBLIC LAW (2007).

136 On the Japanese BITs and investment liberalization provisions, see *Japan Grows Positive on Bilateral Investment Treaties*, JAPAN ECON. REV., Feb. 15, 2004.

137 *See, e.g.*, OECD, GUIDELINES FOR RECIPIENT COUNTRY INVESTMENT POLICIES RELATING TO NATIONAL SECURITY (2008), *available at* <http://www.oecd.org/dataoecd/59/27/41807723.pdf>.

138 For a discussion on recent international arbitration awards which apply the "necessity exception," see generally José Alvarez & Tegan Brink, *Revisiting the*

Finally, as several authors have suggested, investment treaties offer a unique opportunity to include investors' obligations in the new global economic order and provide arbitrators with the ability to enforce human rights standards when applying investor protection standards to SWFs as claimants in investor-state arbitration.¹³⁹ It will allow us to use investment agreements to promote the development agenda within international economic law and to encourage private commercial entities to play a role in public policy that supports economic development through private-public partnerships in the host states. Similarly, SWFs play a very important role in developing economies, whether these are their home states or other developing economies where they invest.¹⁴⁰ In their home states, these funds increase economic diversification and build national champions.¹⁴¹

When it comes to international investments, they have a similar function to bilateral and regional development finance institutions.¹⁴² These institutions usually use public-private partnerships to support development initiatives. The growing size of SWFs and the financial impact of their investments in developing economies can have a similar effect to financial aid. Nevertheless, it is important to remember that unlike direct financial aid, SWFs have other primary investment goals and their investments should be driven by returns and long-term performance. Thus, strengthening the sustainable development of the host state should be a side effect of well-calculated investments by SWFs, while gradually increasing their role in developing countries and their capital markets.¹⁴³ A classical new example will be the International

Necessity Defense (N.Y.U. Pub. L. & Legal Theory Working Papers, Working Paper No. 261, 2011), available at http://lsr.nellco.org/nyu_plltwp/261.

139 See, e.g., Ryan Suda, *The Effect on Bilateral Investment Treaties on Human Rights Enforcement and Realization*, in *TRANSNATIONAL CORPORATIONS AND HUMAN RIGHTS: SYMPOSIUM 1* (Oliver de Schutter ed., 2005).

140 See Javier Santiso, *Sovereign Development Funds*, 58 *OECD POLICY INSIGHTS* (2008), available at <http://www.oecd.org/dataoecd/17/57/40040692.pdf> (discussing SWFs as economic development vehicles).

141 Javier Santiso, *Sovereign Development Funds: Key Financial Actors of the Shifting Wealth of Nations* 10-13 (OECD Emerging Markets Network Working Paper, 2008), available at <http://ssrn.com/abstract=1300288>.

142 *Id.*

143 See, for example, Qatar Investment Authority's new investment in PME Infrastructure Management Limited Fund, which will invest in African transportation, communication and energy sectors, *South Africa and Qatar to Hold Bilateral Consultations*, SWF INSTITUTE (Feb. 3, 2009), <http://www.swfinstitute.org/other-swf-news/south-africa-and-qatar-to-hold-bilateral-consultations/>.

Finance Corporation (IFC), which established in April 2010 an Africa, Latin America, and Caribbean Fund, which provides an opportunity for sovereign and pension fund investors to co-invest for the first time with IFC in growth equity investments in developing countries.¹⁴⁴

As Javier Santiso points out, this development dimension is missing in the current debate on the real financial impact of SWFs and their investment policies.¹⁴⁵ The development analysis will have a significant impact on this debate in the coming years as the level of SWFs' investments in developing countries rises. The weakening Western currencies, such as the U.S. dollar and the Euro, the negative experiences some SWFs have recently had in investing in U.S. financial institutions, and growing opportunities in the developing world due to its high growth rate — all these factors will encourage SWFs to consider investments in developing economies more seriously.¹⁴⁶

While in developed countries SWFs act as rational investors, looking for good returns and diversified portfolios,¹⁴⁷ in developing countries they add the additional element of development, providing capital for infrastructure and employing local workers. This unique know-how of well-run SWFs in emerging markets calls for a deeper involvement in the international finance space. Indeed, Santiso calls for the establishment of a South-South peer review and learning institution like the *Emerging Markets Network of the OECD*, which will provide SWFs the opportunity to share their knowledge and capacity-building with new SWFs in the developing world and their governments.¹⁴⁸ It will create a platform where SWFs, regional and bilateral development finance institutions, and international donors can all share their views and resources in order to maximize the development effect.¹⁴⁹ Indeed, similar cooperation has already started with several agreements between

144 See Press Release, IFC, Azeris, Dutch, Koreans, Saudis Invest in the IFC African, Latin American, and Caribbean Fund (Apr. 12, 2010), available at http://www1.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/ifc+news/ifc+asset+management+company+press+releases/amcpr_azeri.

145 Santiso, *supra* note 140, at 14-17.

146 For an analysis of the developing country's perspective, see STEPHANY GRIFFITH-JONES & JOSE OCAMPO, *SOVEREIGN WEALTH FUNDS: A DEVELOPING COUNTRY PERSPECTIVE* (2010).

147 Christopher Balding, *A portfolio Analysis of Sovereign Wealth Funds* (HSBC School of Business, Working Papers Series, 2008), available at <http://ssrn.com/abstract=1141531>.

148 Santiso, *supra* note 140, at 18-19.

149 *Id.*

Western and developing SWFs¹⁵⁰ and ad hoc advice given by well-established SWFs to governments in the process of starting their own new SWFs.¹⁵¹

To sum, a growing development element in SWFs' activity makes the case as well for a better integration of SWFs into the BITs network and its new development agenda. SWFs and other state-owned entities can bring direct claims against their host states in international arbitral tribunals, where arbitrators will balance their substantive rights with the public good.

CONCLUSION

This Article has dealt with one of the most exciting and emerging topics in international economic law. SWFs, legal entities that combine both private and public elements, present a challenge for the international community, namely, how to enjoy the benefits of SWFs' investments without being exposed to the negative impact which can result from political motives, non-transparent investments, and lack of a clear governance structure.

Legal fields frequently shape realities, but at the same time they are influenced by changing realities. For example, the U.S. Sarbanes-Oxley (SOX) regulation of 2002¹⁵² came as a response to the lack of trust and transparency in Corporate America following the collapse of WorldCom and Enron. Thus, a consequent public debate had to find ways to increase supervision and compliance in public companies with reasonable costs and without losing potential investors. The revolutionary SOX regulation was the result of that debate. Clearly, times of crisis tend to foster pro-government regulation, where the real impact becomes clearer after the fact. The financial crisis of 2008 has triggered a large amount of such proposed regulation, and the question is whether the SWF dilemma should and would bring a similar reaction by national and multinational regulators.

150 For example, the Vietnamese State Capital Investment Corporation (SCIC) and Qatar Investment Authority signed an agreement in 2008 to create a one billion dollar investment fund to invest in Vietnamese companies, *see* Press Release, State Capital Investment Corporation Signs MoU with the Qatar Investment Authority (April 2, 2008), *available at* http://www.scic.vn/english/index.php?option=com_content&view=article&id=66&Itemid=9.

151 The United States-based Alaska Permanent Fund helped the Democratic Republic of Sao Tome and Principe with knowledge transfer when they wanted to establish their own SWF, *see* Steve Cowper, *A Word to the Wise: Managing Alaska's Oil Wealth*, in *SOVEREIGN WEALTH MANAGEMENT* 219 (Jennifer Johnson-Calari & Malan Rietveld eds., 2008).

152 Sarbanes-Oxley Act of 2002, P.L. 107-204, 116 Stat. 745.

This Article demonstrates that despite the recent confusion and inconsistencies in regard to the legal framework of SWFs, which can lead to under- or overregulation, a thorough analysis and application of the existing legal framework is, in fact, possible and can provide satisfactory policy responses. While the IMF is the most appropriate forum for discussing SWF activity and can do it as part of its growing role in reshaping global financial regulation following the banking crisis of 2008, the investment agreements regime can provide an opportunity to regulate host countries' activity against SWFs in a more cohesive way. The BITs network integrates both the liberalization of capital and the promotion of the global development agenda. SWFs, which have been playing an important role in market access and international cooperation, should be part of this network. As private-public entities, SWFs can find their legal remedies in investment arbitration tribunals that bring together private and public views. This unique discussion on private-public partnership in public international law will continue to challenge the existing perception of sovereign immunity in the future. Any attempt to create a new forum to regulate SWFs or the adoption of any new legal instruments instead of applying existing tools with the appropriate adjustments can result in unnecessary complications and waste of resources.

The SWFs discussion originally focused on the unique characteristics of these funds and the tension between the need to adopt a new legal regime and using existing legal tools to address the various concerns. Since recent experience has underlined that SWFs function largely like any other commercial entities, there is a need to shift the discussion and terminology towards regulation of sovereign activity and not sovereign funds. In other words, addressing the nature of a particular investment activity may ease this tension and help reduce the risk of overregulation in the SWFs space. Thus, effective national laws that address national security concerns could be sufficient.

The urgent need for foreign investment and liquidity in Western financial markets following the 2008 financial crisis has suspended the energetic legal debate around SWFs' offshore activities. The soft-law rules adopted by the International Working Group, which have managed to return the trust in SWFs in the global markets, along with capital-importing economies' desire to avoid regulation that limits SWFs' ability to invest in the West, have contributed to this shift. Additionally, the growing role of the G-20 as the global forum for multinational financial regulation and its focus on other financial instruments has reduced the debate on SWFs as a standalone phenomenon. However, as the financial crisis deepens and with investment and trade protectionism on the rise, the discussion on the appropriate policy responses will be back on the agenda and will raise the question how sovereign funds can bring

claims against sovereign governments for discriminatory measures. More specifically, this Article provides an initial framework for dealing with the jurisdictional and substantive challenges that SWFs face as claimants in international investment disputes. Although my research has attempted to provide the legal framework for such discussion, additional studies are required to examine the full empirical impact of SWFs on various aspects of the market moving forward in order to support or reject any policy or legal proposals in the future.

