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# Sovereign Wealth Funds: Investors in search of an identity in the twenty-first century

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## ABSTRACT

Sovereign Wealth Funds (SWFs), as they have come to be known, are a hybrid type of foreign investor. They invest beyond their own borders with an aim to maximize returns as a foreign investor is expected to. At the same time, they are closely associated with governments, by ownership, source of funding, and/or investment objectives. Even as within this group, individual SWFs take various forms and may have divergent investment priorities and risk approaches. There is not even a universal definition of SWFs. As a result, they are often not viewed as typical foreign investors. The association of a SWF with a foreign government has raised various issues such as national security, trade protectionism and nationalism in the recipient countries. At the same time, due to the government ownership of some SWFs, they may fall into the group of business entities known as state-owned enterprises (SOEs). Given that SOEs are highly influential in some states, some recipient states have sought to subject SOEs to greater disciplines, such as in ensuring competition law and transparency principles apply to them, in order to level the playing field for other enterprises. Such disciplines have begun to appear in trade and investment treaties, and are coupled with the usual broad definitions of “investor” in such treaties. It is perhaps too early to state that there is a trend of greater legal and cross-border scrutiny over SOEs, and along with them, SWFs, in treaties. The Trans-Pacific Partnership Agreement that is under negotiation is an example of a potentially game-changing treaty which could affect SWFs qua SOEs. The challenge for SWFs is to carve a distinct identity in the twenty-first century, as more treaties that impose binding requirements arise. This article examines some recent developments, how SWFs may need to forge a unique identity and challenges of recipient states in balancing investment openness and the above concerns.

*Keywords:* Sovereign Wealth Funds, state-owned enterprises, free trade agreements, Trans-Pacific partnership

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## I. INTRODUCTION

The history of Sovereign Wealth Funds (SWFs) is generally described as having begun with the first SWF being formed by Kuwait in the 1950s.<sup>1</sup> The term “SWF” did not exist then and did not, in fact, exist till recently.<sup>2</sup> While there has not been a universal definition of SWFs, there have been various efforts to define them as a group. The European Union, for example, explains SWFs as follows:

Sovereign Wealth Funds (SWFs) are generally defined as state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets. Their origin dates back to the 1950s, when some major commodity exporting countries, particularly oil-rich countries, were looking for a way to invest funds originated by foreign exchange assets.<sup>3</sup>

In the United States, some common definitions refer to the risk tolerance and source of the funds.<sup>4</sup> The International Monetary Fund defines SWFs by their objectives and activities, which fall into five categories.<sup>5</sup> The non-binding Santiago Principles, established in 2008 by an International Working Group through facilitation of the International Monetary Fund, uses the following definition:

[S]pecial purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.<sup>6</sup>

Notably, this definition expressly excludes (to the extent it can do so clearly) “state-owned enterprises in the traditional sense.”<sup>7</sup>

Departing from the above formulations, one author has chosen to define SWFs as “funds established, owned and operated by local or central governments, which investment strategies include the acquisition of equity interest in companies listed in international markets operating in sectors considered strategic by their countries of incorporation.”<sup>8</sup> This latter definition seeks to

<sup>1</sup>See Martin A. Weiss, *SOVEREIGN WEALTH FUNDS: BACKGROUND AND POLICY ISSUES FOR CONGRESS 4* (2008), available at <http://fpc.state.gov/documents/organization/110750.pdf>.

<sup>2</sup>*Id.*

<sup>3</sup>A *Common European Approach to Sovereign Wealth Funds*, Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, at 8, COM (2008) 115 provisional, available at [http://ec.europa.eu/internal\\_market/finances/docs/sovereign\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf).

<sup>4</sup>The US Treasury Department has used the following definition: “a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities (the Central Bank and reserve-related functions of the Finance Ministry).” See Weiss, *supra* note 1, at 4; Robert M. Kimmitt, *In Praise of Foreign Investment*, *INTERNATIONAL ECONOMY* 62 (Spring 2008), [http://www.international-economy.com/TIE\\_Spo8\\_Kimmitt.pdf](http://www.international-economy.com/TIE_Spo8_Kimmitt.pdf) (last visited Oct. 12, 2014). See also Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance through Private Global Investment*, 41 *Geo. J. Int'l L.* 425, 437–38 (2010).

<sup>5</sup>

SWFs are a heterogeneous group and may serve various purposes. Five types of SWFs can be distinguished based on their main objective: (i) *stabilization funds*, where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings; (ii) *savings funds* for future generations, which aim to convert nonrenewable assets into a more diversified portfolio of assets and mitigate the effects of Dutch disease; (iii) *reserve investment corporations*, whose assets are often still counted as reserve assets, and are established to increase the return on reserves; (iv) *development funds*, which typically help fund socio-economic projects or promote industrial policies that might raise a country’s potential output growth; and (v) *contingent pension reserve funds*, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government’s balance sheet.

SOVEREIGN WEALTH FUNDS — A WORK AGENDA, *INTERNATIONAL MONETARY FUND* 5 (2009), available at <http://www.imf.org/external/np/pp/eng/2008/022908.pdf>.

<sup>6</sup>INT’L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, *GENERALLY ACCEPTED PRINCIPLES AND PRACTICES (GAPP)* 3 (2008) [hereinafter *SANTIAGO PRINCIPLES*], available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

<sup>7</sup>See *id.* This exclusion was highlighted by David Murray in a keynote speech: SWFs: Myths and Realities 16 (May 5, 2011) (transcript available at <http://www.ifswf.org/pst/london11.pdf>).

<sup>8</sup>Fabio Bassan, *The Differences between SOEs and SWFs*, in *THE LAW OF SOVEREIGN WEALTH FUNDS* 32 (Edward Elgar ed., 2011).

include aspects not adequately captured in others, including the manner of state involvement and the sectors that are of interest to the funds. Other typologies exist as well.<sup>9</sup>

While the above definitions are certainly useful building blocks toward understanding SWFs and their global activities, it is submitted that ultimately, one must look at how national laws and treaty instruments define and treat SWFs as these create pragmatic legal outcomes which both affect SWF conduct, governance by their home states, and treatment by their host states. One example of a divergence in how SWFs are *treated* (rather than merely defined) is in the area of taxation, where national laws are not uniform in their approach. This relates to the issue of whether such a state recognizes state immunity (in this context, from taxes) in the case of a SWF. This perpetuates the ambiguity arising from the public-yet-private nature of such funds.<sup>10</sup>

## II. PRIVATE, PUBLIC, QUASI-PRIVATE OR NONE OF THE ABOVE?

Even with this collective moniker and such explanations, SWFs have been suffering an identity crisis of sorts. There are three main reasons contributing to this ambiguity of character. First, the government ownership and investment roles together produce a hybrid type of entity that is neither a pure state organ nor a pure private enterprise. Such entities wield tremendous – and to some, alarming – economic power, as the 2008-2009 financial crisis and their “rescues” of private entities have shown.<sup>11</sup> Secondly, while the funds for investment by SWF entities are state-owned, SWFs are not necessarily similar to state-owned enterprises, which, though owned in full or in part by a state, may or may not have investment functions. Rather, state-owned enterprises (SOEs) generally have main functions other than investment, such as trading in or supplying of goods and/or services.

Indeed, even SWFs themselves are not all alike; they may differ for example in structure, level of government ownership and risk approaches.<sup>12</sup> Thirdly, SWFs have been viewed both with enthusiasm (for the funds they can contribute to badly-needed sectors of an economy) and suspicion (over concerns ranging from threats to national security, threats to competition and fears of leakage of sensitive data or information). As a result they have often raised questions as to whether they are a friend or a foe. SWFs’ activities have been described as “state capitalism,”<sup>13</sup> in that they participate in traditionally private capitalist endeavors, such as investment for returns. Others have suggested the possibility of SWFs as development tools.<sup>14</sup> The heterogeneity within the group further complicates attitudes towards them.<sup>15</sup> SWFs have also

<sup>9</sup>See *id.* at 20 (citing C. Chao, *The Rise of Global Sovereign Wealth Funds*, 10 MODERN BANKERS (2006); Adam D. Dixon & Ashby H. B. Monk, *Rethinking the Sovereign in Sovereign Wealth Funds*, 37 TRANSACTIONS INST. BRIT. GEOGRAPHERS 104, 108–14 (2012).

<sup>10</sup>For other aspects on divergence in state immunity treatment vis-à-vis SWFs, see Gaukrodger, D. (2010), “Foreign State Immunity and Foreign Government Controlled Investors”, *OECD Working Papers on International Investment*, 2010/02, OECD Publishing. <http://dx.doi.org/10.1787/5km91poksqs7-en>; Bassan, *supra* note 8, at 89–115.

<sup>11</sup>See, e.g., the hearings before the US Senate Foreign Relations Committee during this period. *Sovereign Wealth Funds: Foreign Policy Consequences in an Era of New Money*, 110th Cong. (2008) available at <http://fdsys/pkg/chrg-110shrg48061/html/chrg-110shrg48061.htm>; <http://www.gpo.gov/fdsys/pkg/CHRG-110shrg48061/html/CHRG-110shrg48061.htm>. Norway’s SWFs value (currently estimated to exceed US\$800billion) are expected to reach US\$1trillion by 2020, while the United Arab Emirates’ Abu Dhabi funds are reported to stand at over US\$700billion. Matthew Price, *Norway: Is world’s largest sovereign wealth fund too big?*, BBC News (Sept. 12, 2013, 20:08), <http://www.bbc.com/news/world-europe-24049876>. For an overview of SWF fund sizes, see the data at the website of the Sovereign Wealth Institute, at <http://www.swfinstitute.org/fund-rankings/>. Several SWFs have arisen in Asia and the Middle East in recent decades.

<sup>12</sup>As Peter Mandelsohn, the then EU Trade Commissioner, summed it up: “[I]t is important not to talk about the sovereign funds as if they were an amorphous block. They do not have a single brain or governing mind.” OECD Conference: Putting Sovereign Wealth in Perspective (Mar. 28, 2008) (transcript available at [http://europa.eu/rapid/press-release\\_SPEECH-08-155\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-08-155_en.htm)). On SOEs in Asia, see generally *Corporate governance of state-owned enterprises in Asia*, OECD, <http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprisesinasia.htm> (last visited Feb. 17, 2014).

<sup>13</sup>See, e.g., Lauge N. Skovgaard Poulsen, *Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States*, in PROSPECTS IN INTERNATIONAL INVESTMENT LAW AND POLICY – WORLD TRADE FORUM 73 (2013); Gerard Lyons, *State Capitalism: the Rise of Sovereign Wealth Funds*, 14 LAW & BUS. REV. AM. 179 (2008).

<sup>14</sup>See, e.g., Rumu Sarkar, *Sovereign Wealth Funds as a Development Tool for ASEAN Nations: From Social Wealth to Social Responsibility*, 41 GEO. J. INT’L L. 621 (2010).

<sup>15</sup>For other colorful characterizations of SWFs, see, e.g., Locknie Hsu, New York State Bar Association International Conference: Trojan Horses or White Knights (Oct. 2009); Mihir A. Desai and Dhammika Dharmapala, *Taxing the Bandit Kings*, 118 YALE L.J. 98 (2008); Edwin M. Truman, *Sovereign Wealth Funds: Threat or Salvation?*, Sept. 2010, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS, <http://www.iie.com/publications/briefs/truman4983.pdf>; Backer, *supra* note 4.

been discussed in the context of overlaps with state-owned enterprises and state-influenced enterprises (SIEs).<sup>16</sup>

Whether SWFs take the form of a central bank that invests abroad, or a corporate entity formed to invest state funds, the source of funding ultimately springs from government. In this regard it is hard for them to escape linkage – even if indirect – with a government. On the other hand, SWFs are often corporate entities which embrace private-investor approaches to risk and returns. In this regard they operate not purely as a government “arm” or regulatory organ, as they may exist primarily to make investment returns.

The various views, which are still in the process of formation,<sup>17</sup> reflect a degree of suspicion and distrust toward SWFs. Indeed, when speaking in support of a multilateral code of conduct for SWFs in 2008, Peter Mandelsohn, the then EU Trade Commissioner, warned against paranoia, “demonizing” them and “stoking fears,” and that “the challenge for Europe and the United States is to respond to the growth of these funds in a reasoned and reasonable way.”<sup>18</sup> At the same time, the ambivalence over whether to treat SWFs as private, public, quasi-public or unique entities, continues to occupy law-makers.<sup>19</sup>

### III. PROTECTIONISM AND SECURITY CONCERNS

Chief among the concerns surrounding SWFs and their economic clout is whether they are being used in a manner that threatens trade competition and national security in the recipient state. Such concerns over SWFs have been highly apparent.<sup>20</sup> While there have been a number of expressions of deep concern as to their motives and effects on the recipient economy, there have also been spirited defences that seek to debunk certain “myths” about SWFs.<sup>21</sup>

One explanation of a perceived disconnect between the US investment review authorities and SWFs as foreign investors, which may foster suspicion and such concerns, is as follows:

SWFs and the United States speak different languages when it comes to state-backed investments, a miscommunication that adds to the difficulties of any review. Foreign entities need to understand that the U.S. economy has no tradition of government ownership and that such ownership has long been suspect. At the same time, Americans must remember that government ownership in the economy is often prevalent elsewhere and that in some places there are still relatively few alternatives to such ownership.

Often overlooked is the fact that the performance of SWFs in the United States is watched closely back at home. This internal pressure comes from the rising profile of SWFs and the increasing importance that many states attach to them. Although governments have not been particularly successful private market participants in the past—due to misaligned

*Footnote continued*

Others have described SWF investment activity as “a reversal of neo-colonialism.” Yvonne Lee, *A Reversal of Neo-Colonialism: The Pitfalls and Prospects of Sovereign Wealth Funds*, 40 *Geo. J. Int'l L.* (2009) 1103; see also Patrick Schuette, *Tamed Tigers: Sovereign Wealth Funds as Passive Investors*, *Ill. Bus. L.J.* (Nov. 3, 2008), <http://www.law.illinois.edu/bljournal/post/2008/11/03/Tamed-Tigers-Sovereign-Wealth-Funds-as-Passive-Investors.aspx>. The status of a SWF entity vis-à-vis new “rules” may not always be immediately clear. See, e.g., *Temasek says it is not a sovereign wealth fund*, *The Straits Times*, Mar. 22, 2008, at 77; and see Bryan Lee, *Guidelines for wealth funds apply to Temasek, says Ministry*, *The Straits Times*, Apr. 1, 2008, <http://news.asiaone.com/print/News/The%2BStraits%2BTimes/Story/A1Story20080401-57250.html>; see also *Sovereign Wealth Funds in East Asia*, *World Bank* n.12 (June 20, 2008), <https://openknowledge.worldbank.org/bitstream/handle/10986/12639/705770ESWOP1110NAL00310July020080v2.txt?sequence=2> (last visited Jan. 15, 2014); see also Chia Yan Min, *Temasek's a 'one-of-a-kind sovereign wealth fund'*, *ASIAONE*, Dec. 8, 2013, <http://business.asiaone.com/news/temaseks-one-kind-sovereign-wealth-fund> (more recent statements by Temasek Chairman, Mr. Lim Boon Heng). For a discussion of the possible reasons as to the ambiguity surrounding SWFs, see Saadia M. Pekkanen & Kellee S. Tsai, *The Politics of Ambiguity in Asia's SWFs*, 13 *Bus. & Pol.* 1 (2011).

<sup>16</sup>With respect to SIEs, see, e.g., Daniel M. Shapiro & Steven Gliberman, *The International Activities and Impacts of State-owned Enterprises*, in *Sovereign Investing* 105 (Sauvant, Sachs, Yongbloed eds., 2012).

<sup>17</sup>See Clare O' Brien, Tania Matte & Naveen Thomas, *Sovereign Wealth Funds: Evolving Perceptions and Strategies*, *BLOOMBERG BNA*, Dec. 24, 2012, [http://www.shearman.com/~media/Files/NewsInsights/Publications/2013/01/Sovereign%20Wealth%20Funds%20Evolving%20Perceptions%20and%20\\_\\_\\_/Files/View%20full%20article%20Sovereign%20Wealth%20Funds%20Evolvin\\_\\_\\_/FileAttachment/SovereignWealthFundsEvolvingPerceptionsandStrate\\_\\_\\_pdf](http://www.shearman.com/~media/Files/NewsInsights/Publications/2013/01/Sovereign%20Wealth%20Funds%20Evolving%20Perceptions%20and%20___/Files/View%20full%20article%20Sovereign%20Wealth%20Funds%20Evolvin___/FileAttachment/SovereignWealthFundsEvolvingPerceptionsandStrate___pdf).

<sup>18</sup>Mandelsohn, *supra* note 12.

<sup>19</sup>See Bassan, *supra* note 8, at 17.

<sup>20</sup>By now, the *Dubai Ports World* story has become well known. See, e.g., David E. Sanger, *Under Pressure, Dubai Group Drops Port Deal*, *N.Y. Times*, Mar. 10, 2006, [http://www.nytimes.com/2006/03/10/politics/10ports.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2006/03/10/politics/10ports.html?pagewanted=all&_r=0); and JAMES K. JACKSON, *CONG. RESEARCH SERV.*, RL33388, *THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS)* 1, 6 (2014), available at <http://www.fas.org/sgp/crs/natsec/RL33388.pdf>.

<sup>21</sup>See, e.g., Murray, *supra* note 7.

incentive structures and less sensitivity to market stimuli—internal pressures for economic success can work to change this trend. These pressures are critical components of SWF investment behavior and key protectors against nefarious conduct.<sup>22</sup>

As a result of such concerns, a number of national laws have been strengthened in recent years to allow states greater power to scrutinize investments made by foreign-state-owned enterprises, particularly on grounds of national security. While academic views have varied, there has been a suggestion to subject SWFs to targeted limitations.<sup>23</sup>

#### IV. NATIONAL LAWS

In response to national security concerns and rising SWF activity, some developed countries have enacted or amended legislation to reflect these developments. As such, laws have been examined in detail elsewhere, these (and some updates) are raised just briefly here to provide the broader background of legal developments that SWFs continue to face.<sup>24</sup> In 2008, for instance, the US enacted the Foreign Investments and National Security Act 2007 (FINSAs) and its implementing regulations in 2008.<sup>25</sup> The implementing authority is the Committee on Foreign Investment in the United States (CFIUS).<sup>26</sup>

Canada administers an investment screening system under the Investment Canada Act, whose key criterion for admission is whether the investment is “of net benefit” to the Canadian economy. National security was not an explicit factor in evaluating investments until the law was amended in 2009. Recent amendments – discussed further below – have added a term (“state-owned enterprise”) to buttress the evaluation process for SWF investments.

<sup>22</sup>Michael E. 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.* 88, 91 (2008).

<sup>23</sup>See, e.g., Edwin M. Truman, *Do the Rules Need to be Changed for State-controlled Entities? The Case of Sovereign Wealth Funds*, in *SOVEREIGN INVESTING* 409 (Sauvant, Sachs, Yongbloed eds., 2012).

<sup>24</sup>For a discussion of such laws, see works by this author: *Multi-Sourced Norms Affecting Sovereign Wealth Funds: A Comparative View of National Laws, Cross-Border Treaties and ‘Codes’*, 10 *J. WORLD INV. & TRADE* 793 (2009); *A Decade of Security-related Developments in Trade and Investment*, 11 *J. WORLD INV. & TRADE* 697 (2010); and *Sovereign Wealth Funds, Recent US Legislative Changes, and Treaty Obligations*, 43 *J. WORLD TRADE* 451 (2009). See also chapters 7, 10, 12, 14, 15 and 16 dealing with issues in national security and SWFs in *SOVEREIGN INVESTING*, *supra* note 16. See also Senate Committee hearing statements, such as *Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the U.S.: Assessing the Economic and National Security Implications*, SENATE.GOV (Nov. 14, 2007, 2:00 PM), [http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing\\_ID=4c63b142-fd5c-4b82-aff9-75e254271056](http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=4c63b142-fd5c-4b82-aff9-75e254271056); and *US Senate Committee Hearing on Sovereign Wealth Funds*, SWF INSTITUTE, Apr. 28, 2008, <http://www.swfinstitute.org/other-swf-news/us-senate-committee-hearing-on-sovereign-wealth-funds/>. See also Bassan, *supra* note 8, at 55–67.

<sup>25</sup>Foreign Investment and National Security Act of 2007 (FINSAs 2007), H.R. 556, Pub. L. No. 110-49 (2007), available at <http://www.gpo.gov/fdsys/pkg/PLAW-110publ49/html/PLAW-110publ49.htm>; see also generally the information at *CFIUS Reform: The Foreign Investment & National Security Act of 2007 (FINSAs)*, TREASURY.GOV, <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/Summary-FINSAs.pdf> (last visited Oct. 16, 2014). Investment screening legislation in the US was not new - in 1975, President Gerald Ford had by Executive Order already introduced an inter-agency body, the Committee on Foreign Investment in the United States (CFIUS) to oversee foreign investments. This Committee had no enforcement powers. In the late 1980s, the US enacted legislation to strengthen the investment screening regime, in the form of the Exon-Florio Amendment to the Defense Production Act of 1950; this Amendment formed part of the Omnibus Foreign Trade and Competitiveness Act of 1988, Public Law 100-148. The Amendment essentially established a statutory basis for the CFIUS and a review procedure to screen foreign mergers, acquisitions and takeovers of US companies; the President could block such transactions if they threatened US “national security.” In July 2007, President George W. Bush signed into law amendments to the Exon-Florio Amendment, in the form of the Foreign Investment and National Security Act of 2007 (FINSAs 2007). Its preamble states that it aims: “[t]o ensure national security while promoting foreign investment and the creation and maintenance of jobs, to reform the process by which such investments are examined for any effect they may have on national security, to establish the Committee on Foreign Investment in the United States, and for other purposes.” For a recent overview of CFIUS and its activities, see THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS), *supra* note 20.

<sup>26</sup>For SWFs investing in banking entities, the US Federal Reserve also scrutinizes such investments. See Scott G. Alvarez, General Counsel, *Sovereign Wealth Funds*, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (Apr. 24, 2008), <http://www.federalreserve.gov/newsevents/testimony/alvarez20080424a.htm>. The Securities Exchange Commission also scrutinizes certain transactions of SWFs. See Ethiopis Tafara, Director, Office of International Affairs, *Testimony Concerning The Regulatory Framework for Sovereign Investments*, U.S. SECURITIES AND EXCHANGE COMMISSION (Apr. 24, 2008), <http://www.sec.gov/news/testimony/2008/tso32408et.htm>.



Australia administers an investment screening process under her Foreign Acquisitions and Takeovers Act (FATA).<sup>27</sup> Under current foreign investment policy, all foreign governments and their related entities<sup>3</sup> should notify the government and get prior approval before making a direct investment in Australia, regardless of the value of the investment, and they also need to notify the government and get prior approval to start a new business or to acquire an interest in land, including any interest in a prospecting, exploration, mining or production tenement (except when buying land for diplomatic or consular requirements).<sup>28</sup>

In 2008, the European Union outlined a policy for a common approach to SWFs, and national rules fall for scrutiny under general EU law. Member states remain able to regulate at the national level matters such as taxation and governance of SWF investments.<sup>29</sup> In its merger laws and regulations, the terms “state-owned undertakings” and “state-owned companies” are used.<sup>30</sup>

## V. RECENT LEGAL DEVELOPMENTS THAT COULD AFFECT SWFS

Sovereign wealth funds and SOEs have sometimes been juxtaposed together given that SWFs – like SOEs – are state-owned or controlled. However their purposes can differ, and hence, there have been attempts to distinguish them. The concerns they raise also differ. As Mandelsohn succinctly explained:

There is . . . a tendency to lump Sovereign Wealth Funds in with state-owned enterprises. We routinely hear the Dubai Ports deal, the China National Offshore Oil Corporation bid for Unocal and Gazprom’s activities invoked as salutary warnings. But not only is there nothing inherently wrong in these companies’ international ambitions, none of the bids actually involved sovereign wealth funds at all. And while sovereign wealth funds generally take non-controlling equity stakes, Dubai Ports was, perfectly legitimately, about the takeover of one operator by another. *Both kinds of asset sales can in certain circumstances raise important issues. But treating them the same ignores the difference between a state acting like a business and a state acting like an investor*[italics added].<sup>31</sup>

As mentioned, the Santiago Principles aim to distinguish SWFs and SOEs and apply only to the former.<sup>32</sup> As observed by Professor Bassan, the points of distinction relate to “the source of their funding, their function, the form of their respective investments: SWFs by portfolio investments, SOEs by Foreign Direct Investments (FDIs, implying the control of the company).”<sup>33</sup> He further postulates a subjective and an objective element in distinguishing the two categories of entities.<sup>34</sup>

<sup>27</sup>No. 92 of 1975. Australia’s Foreign Investment Policy may be found at *Policy*, FIRB, <http://www.firb.gov.au/content/policy.asp> (last visited Feb. 17, 2014).

<sup>28</sup>See generally *Foreign Investment Review Board Annual Report 2011-12*, FIRB 45, [http://www.firb.gov.au/content/Publications/AnnualReports/2012-2013/\\_downloads/FIRB-Annual-Report-2012-13.pdf](http://www.firb.gov.au/content/Publications/AnnualReports/2012-2013/_downloads/FIRB-Annual-Report-2012-13.pdf) (last visited Feb. 17, 2014) (under “Foreign Government Investors”). The policy states, for example:

Where a proposal involves a foreign government or a related entity, the Australian Government also considers if the investment is commercial in nature or if the investor may be pursuing broader political or strategic objectives that may be contrary to Australia’s national interest. This includes assessing whether the prospective investor’s governance arrangements could facilitate actual or potential control by a foreign government (including through the investor’s funding arrangements). Proposals from foreign government entities operating on a fully arm’s length and commercial basis are less likely to raise national interest concerns than proposals from those that do not.”

*Id.*

<sup>29</sup>A *Common European Approach to Sovereign Wealth Funds*, *supra* note 3. See generally Bassan, *supra* note 8, at 64–71. For further information on EU discussions on the Communication, see Julien Chaisse, *The Regulation of SWFs in the EU: Can the Supranational Level Limit the Rise of National Protectionism?*, in SOVEREIGN INVESTMENT – CONCERNS AND POLICY REACTIONS 462 (Sauvant, Sachs & Yongbloed eds., 2012). See also generally Mark Thatcher, *National Policies Towards Sovereign Wealth Funds in Europe: A Comparison of France, Germany and Italy*, LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE (2013), available at <http://www.lse.ac.uk/IDEAS/programmes/kuwait/documents/National-policies-towards-sovereign-wealth-funds-in-Europe.pdf>.

<sup>30</sup>See EUROPEAN COMM’N COMPETITION, EU COMPETITION LAW: RULES APPLICABLE TO MERGER CONTROL 95 (2010), available at [http://ec.europa.eu/competition/mergers/legislation/merger\\_compilation.pdf](http://ec.europa.eu/competition/mergers/legislation/merger_compilation.pdf) (Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C 95/01)).

<sup>31</sup>Mandelsohn, *supra* note 12.

<sup>32</sup>SANTIAGO PRINCIPLES, *supra* note 6.

<sup>33</sup>Bassan, *supra* note 8, at 21–23 n.16 & 17 (citing Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience*, 19 TRANS. L. & CONTEMP. PROBLEMS 101–228).

<sup>34</sup>Bassan, *supra* note 8.

Some national laws have recently begun to address foreign government-related investments more specifically, either through the concept of SOEs that invest, or through provisions on “foreign government investors.”

#### 1. Some recent national laws on investments by “SOEs” or foreign government investors

Some national laws have specifically increased their scrutiny over investments by SOEs through legislative channels. However, there is no uniform definition as to SOEs within national systems, nor do all systems contain specific references to these in the context of investment. Under US law, the term SOE is not used in legislation.<sup>35</sup>

It was only in December 2012, for example, that Canada issued updated investment guidelines with regard to such investments and the application of the “net benefit” test under her investment legislation. The guidelines include the consideration of factors such as corporate governance and structure of the non-Canadian investor and who controls it.<sup>36</sup> Further, in 2013, an amendment to section 3 of the Investment Canada Act<sup>37</sup> was enacted to define SOEs whose investments may fall under scrutiny, as follows:

“[S]tate-owned enterprise” means

- (a) the government of a foreign state, whether federal, state or local, or an agency of such a government;
- (b) an entity that is controlled or influenced, directly or indirectly, by a government or agency referred to in paragraph (a); or
- (c) an individual who is acting under the direction of a government or agency referred to in paragraph (a) or who is acting under the influence, directly or indirectly, of such a government or agency.<sup>38</sup>

The amendment formally introduces into the legislation a definition of “SOE,” embracing the broad scope of the Guidelines to include SOEs that are “controlled or influenced, directly or indirectly” by a foreign government. The new provision signals the concern over state-*influenced* entities – and not just state-controlled entities – in making investments in Canada. It does not however define “influence” or indicate how it would be measured. The Guidelines do suggest that the Canadian authorities will require the SOE investor to explain its structure and governance and to assure them as to its commercial orientation.<sup>39</sup> This would apply to SWFs seeking to make an investment that is subject to review under the legislation.

In 2009, the Australian Senate Economics References Committee issued a report after a public enquiry on SOEs and their investments in Australia. In September 2009, the Australian Government issued its Response to the Report.<sup>40</sup> With regard to SWFs and SOEs, the Australian Senate Economics References Committee stated as follows:

<sup>35</sup>ORGANISATION FOR ECON. CO-OPERATION AND DEV., DISCUSSION ON CORPORATE GOVERNANCE AND THE COMPETITIVE NEUTRALITY OF STATE-OWNED ENTERPRISES 2 (2009), available at <http://www.ftc.gov/sites/default/files/attachments/us-submissions-oecc-and-other-international-competition-fora/antitrustlawroundtable.pdf>.

<sup>36</sup>See *Investment Canada Act*, GOVERNMENT OF CANADA, <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2> (last visited Feb. 17, 2014).

<sup>37</sup>Vide Bill C-60, enacted as The Economic Action Plan 2013 Act, No. 1, S.C. 2013, c. 33 (Can.), available at <http://www.parl.gc.ca/LegisInfo/BillDetails.aspx?Language=E&Mode=1&billId=6108103>.

<sup>38</sup>See *Investment Canada Act*, R.S.C. 1985, c. 28 (1st Supp.), as amended, available at <http://laws-lois.justice.gc.ca/eng/acts/l-21.8/page-1.html#h-3>.

<sup>39</sup>The relevant portion of the Guidelines states:

It is the policy of the Government of Canada to ensure that the *governance and commercial orientation of SOEs* are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada. In doing so, *investors will be expected to address in their plans and undertakings, the inherent characteristics of SOEs, specifically that they are susceptible to state influence*. Investors will also need to *demonstrate their strong commitment to transparent and commercial operations* [italics added].

See *Changes to Investment Canada Act Implemented*, MCMILLAN (2013), [http://www.mcmillan.ca/Files/155579\\_changes%20to%20Investment%20Canada%20Act%20implemented.pdf](http://www.mcmillan.ca/Files/155579_changes%20to%20Investment%20Canada%20Act%20implemented.pdf) (last visited Feb. 13, 2014) (observing that Industry Canada’s Investment Review Division has a “structured list of questions” to determine the extent, if any, of “influence”).

<sup>40</sup>The Report and the Response are available at *Inquiry into foreign investment by state-owned entities*, PARLIAMENT OF AUSTRALIA, [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Completed%20inquiries/2008-10/firb\\_09/index](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Completed%20inquiries/2008-10/firb_09/index) (last visited Feb. 13, 2014).

While the committee welcomes the fact that organisations like the International Working Group of Sovereign Wealth Funds have sought to codify the behaviours of SWFs, through establishing a set of core principles related to governance, accountability and transparency, the committee believes that the *best way for Australia to regulate the conduct of foreign investors (be they SWF, SOE or private commercial operator), is through developing robust domestic legislation* [italics added].<sup>41</sup>

It concluded that the existing regulatory framework was “sufficient.”<sup>42</sup> The Australian Government generally agreed with the recommendations of the majority report.

According to the Foreign Investment Review Board policy document of 2013, a “foreign government investor” making a “direct investment” in Australia must notify and obtain approval from the government.<sup>43</sup> Annex A of the document defines a “foreign government investor” to include:

[A] body politic of a foreign country;  
 entities in which governments, their agencies or related entities from a single foreign country have an aggregate interest (direct or indirect) of 15 per cent or more;  
 entities in which governments, their agencies or related entities from more than one foreign country have an aggregate interest (direct or indirect) of 40 per cent or more;  
 or entities that are otherwise controlled by foreign governments, their agencies or related entities, and any associates, or could be controlled by them including as part of a controlling group.

The Policy states that “entities” include companies, trusts and limited partnerships.

Annex 2 of the document further defines “direct investment” to include any investment of an interest of 10 percent or more. Investments below 10 percent may still be covered if a strategic stake is being built, or the investment can be used to influence or control the target investment, such as through preferential, special or veto voting rights.<sup>44</sup>

The EU has been examining foreign-SOE dealings under its Merger Regulation.<sup>45</sup> In 2011, China, herself a major player in the field of SWFs and SOEs, enacted regulations on national security reviews for certain mergers with and acquisitions of Chinese enterprises by “foreign investors,” in implementation of her Anti-Monopoly Law.<sup>46</sup>

## 2. FTAs – Emerging disciplines?

Apart from national laws that may affect SWF activity, some recent treaties may also have an impact on them. Countries frequently amend their laws in order to comply with FTA commitments, and where such commitments call for changes in the way domestic SOEs (and SWFs) operate or are governed, they may have an important impact.<sup>47</sup> While SOEs have existed for many years, interest in them has arisen in two more recent contexts: first, over disciplines introduced in bilateral trade treaties to ensure a level competitive playing field where SOEs exist, and secondly,

<sup>41</sup>*Id.* at ¶ 4.25; *see also id.* at ¶ 4.70.

<sup>42</sup>*Id.* at ¶ 4.72.

<sup>43</sup>FIRB, AUSTRALIA’S FOREIGN INVESTMENT POLICY (2013), available at [http://www.firb.gov.au/content/\\_downloads/AFIP\\_2013.pdf](http://www.firb.gov.au/content/_downloads/AFIP_2013.pdf).

<sup>44</sup>*Id.* at 15.

<sup>45</sup>Council Regulation (EC) 139/2004, On the control of concentrations between undertakings, available at <http://ec.europa.eu/competition/mergers/legislation/legislation.html>. For an example of a case applying this Regulation to a Chinese SOE merger, *see* EUROPEAN COMM’N, CASE NO COMP/M.6113 – DSM/SINOCHEM/JV, COMMISSION DECISION PURSUANT TO ARTICLE 6(1)(b) OF COUNCIL REGULATION NO 139/2004 (2011), available at [http://ec.europa.eu/competition/mergers/cases/decisions/m6113\\_20110519\\_20310\\_1812856\\_EN.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m6113_20110519_20310_1812856_EN.pdf).

<sup>46</sup>Art. 31 of China’s Anti-Monopoly Law permits a national security review of certain foreign investor dealings. Text of the Law is available at *Anti-monopoly Law of the People’s Republic of China*, MINISTRY OF COMMERCE PEOPLE’S REPUBLIC OF CHINA (Aug. 3, 2008), <http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045909.shtml> (last visited Feb. 20, 2014). Implementing regulations were enacted in 2011. *See Circular of the General Office of the State Council on the Establishment of Security Review System Regarding Merger and Acquisition of Domestic Enterprises by Foreign Investors*, MINISTRY OF COMMERCE PEOPLE’S REPUBLIC OF CHINA (Mar. 4, 2011), <http://english.mofcom.gov.cn/article/policyrelease/aaa/201103/20110307430493.shtml> (last visited Feb. 20, 2014).

<sup>47</sup>Support for this view is found for example in OXFORD HANDBOOK ON INTERNATIONAL COMMERCIAL POLICY 137 (Mordechai E. Kreinin & Michael G. Plummer eds., 2012); AHMED GALAL & ROBERT Z. LAWRENCE, ANCHORING REFORM OF SOES WITH US-EGYPT FTA 37 (2005). The converse has also been raised: reform on SOE regulations has also been argued to be helpful to FTA negotiations. *See* Ngoc Lan, *SOE reform will help FTA talks with EU: expert*, THE SAIGON TIMES, Mar. 13, 2013, <http://www.vietmaz.com/2013/03/soe-reform-will-help-fta-talks-with-eu-expert/#.UtpsAT8RWM8>.



over their activities beyond their own borders.<sup>48</sup> State-owned enterprises are relatively common in Asia, and certain states in Asia have made specific carve-outs when it comes to investment disciplines in treaties.<sup>49</sup>

In the first context, states have in some cases taken the opportunity when negotiating FTAs to include disciplines – particularly to address anticompetitive conduct of SOEs – with their counterpart treaty states. Examples are the US FTAs with Oman and with Singapore.

The Trans-Pacific Partnership Agreement (TPP) negotiations currently underway between twelve states may bring into being new disciplines affecting SOEs. In September 2012, the Assistant US Trade Representative, Ms. Barbara Weisel, reportedly said:

There are sovereign wealth funds that are just managing their portfolio investments, and there are sovereign wealth funds that do that as well as own companies . . . . So we're making a distinction between the companies they own, and the portfolio investment they're managing. . . . And so for those [sovereign wealth funds] that own commercial companies, we seek to have those companies - those state commercial enterprises - disciplined as well.<sup>50</sup>

If this approach is indeed adopted in the TPP, the proposed disciplines proposed by the US will apparently not discipline SWF portfolio investments. It will then be important to see how the negotiating parties define “portfolio investment,” i.e., by passivity in holdings, or some other means.<sup>51</sup> There has been some suggestion that the US-Singapore FTA provisions may provide an example of the TPP approach.<sup>52</sup> Ms. Weisel reportedly explained: “We don't see sovereign wealth funds as entities that raise the immediate concerns about competition that we have from other entities.”<sup>53</sup> One might surmise from this that the TPP provisions will probably carve out SWFs that make portfolio investments from any competition-centric provisions adopted from the USSFTA. Beyond this, it is not presently publicly known how exactly – if at all – SWFs will be dealt with in the TPP, and whether an Investment Chapter would apply in entirety to such investors and their investments.

Apart from the TPP, SOEs have also been an important subject in the ongoing negotiations for an Australia-China FTA.<sup>54</sup> Any specific FTA provisions on SOEs or SWFs would augment broader treaty disciplines and dispute settlement (usually arbitration) mechanisms of such a treaty, unless expressly exempted.<sup>55</sup> While most existing treaties have not made a clear distinction between

<sup>48</sup>SOEs have been a subject of discipline under GATT and GATS for some time. See Bassan, *supra* note 8, at 56. They have also been the subject of “soft” codes of conduct, such as the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD, <http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf> (last visited Feb. 17, 2014).

<sup>49</sup>See, e.g., *ASEAN Comprehensive* [sic] *Investment Agreement Reservation List*, ASSOCIATION OF SOUTHEAST ASIAN NATIONS (Feb. 26, 2009), <http://www.asean.org/news/item/asean-comprehensive-investment-agreement-reservation-list> (last visited Nov. 30, 2014). The text of the ACIA is available at <http://www.asean.org/images/archive/documents/FINAL-SIGNED-ACIA.pdf>; *Malaysia*, SINGAPORE GOVERNMENT, <http://www.fta.gov.sg/afta/9malaysia.pdf> (last visited Feb. 17, 2014); *Myanmar*, SINGAPORE GOVERNMENT, <http://www.fta.gov.sg/afta/9myanmar.pdf> (last visited Feb. 17, 2014); *Singapore*, SINGAPORE GOVERNMENT, <http://www.fta.gov.sg/afta/9singapore.pdf> (last visited Feb. 17, 2014); *Vietnam*, SINGAPORE GOVERNMENT, <http://www.fta.gov.sg/afta/9viet%20nam.pdf> (last visited Feb. 17, 2014).

<sup>50</sup>See *U.S. Clarifies Treatment of Sovereign Wealth Fund Investment In TPP*, WORLD TRADE ONLINE - INSIDE US TRADE (Sept. 20, 2012), <http://insidetrade.com/Inside-Trade-General/Public-Content-World-Trade-Online/us-clarifies-treatment-of-sovereign-wealth-fund-investment-in-tpp/menu-id-896.html?S=LI> (last visited Jan. 17, 2014).

<sup>51</sup>See Paul Rose, *SWFs: Active or Passive Investors?*, 118 YALE L.J. 104 (2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1307182](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1307182); OXFORD HANDBOOK OF CORPORATE GOVERNANCE 593 (Mike Wright, Donald S. Siegel, Kevin Keasey & Igor Filatotchev eds., 2013). In stating a Canadian view, Marc LeBlanc states: “In practice, SWFs are a distinct type of SOE because they are typically passive investors that tend to invest in financial assets (stocks and bonds) instead of acquiring real assets (factory and land) of a business and taking an active role in its operation.” SOVEREIGN WEALTH FUNDS: INTERNATIONAL AND CANADIAN POLICY RESPONSES6 (2010), available at <http://www.parl.gc.ca/Content/LOP/ResearchPublications/2010-09-e.pdf>. See also Kavaljit Singh, *Majority of SWFs are passive, and patient, investors*, Financial Times (Oct. 23, 2008, 3:00 AM), <http://www.ft.com/cms/s/0/d9bde982-a09a-11dd-80a0-000077b07658.html>.

<sup>52</sup>Lists of Reservations of Malaysia, Myanmar, Singapore and of Vietnam to the ASEAN Comprehensive Investment Agreement, *supra* note 51.

<sup>53</sup>Lists of Reservations of Malaysia, Myanmar, Singapore and of Vietnam to the ASEAN Comprehensive Investment Agreement, *supra* note 51.

<sup>54</sup>See Mark Kenny, *PM seeks to fast-track China free-trade deal*, SYDNEY MORNING HERALD, Oct. 8, 2013, <http://www.smh.com.au/federal-politics/political-news/pm-seeks-to-fastrack-china-freetrade-deal-20131007-2v4ce.html>; *Australia PM Pledges to Finalize FTA with China in 12 Months*, XINHUA (Oct. 8, 2013, 8:18), <http://english.people.com.cn/business/8417931.html>.

<sup>55</sup>For a discussion on such broader investment provisions, see, e.g., Bassan, *supra* note 8, at 116-148.

SOEs and SWFs, this might change, especially through the TPP, if and when it comes to fruition. Its provisions may be ground-breaking as it is seen as a “template” for further agreements.<sup>56</sup>

### 3. State investors in FTAs/BITs – observations from some recent US FTAs

#### *State-owned or state-controlled entities as “investors”*

Some bilateral and regional treaties refer to the private or public ownership of an entity when defining an “investor,” with a view to including both kinds. For example, the US Model Bilateral Investment Treaty 2012 defines an “enterprise,” “investor of a Party,” and “state enterprise” respectively as follows:

“[E]nterprise” means any entity constituted or organized under applicable law, whether or not for profit, and whether privately or *governmentally owned or controlled*, including a corporation, trust, partnership, sole proprietorship, joint venture, association, or similar organization; and a branch of an enterprise. . . . “investor of a Party” means a Party or *state enterprise thereof*, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his or her dominant and effective nationality. . . . “state enterprise” means an enterprise *owned, or controlled through ownership interests, by a Party*” [italics added].<sup>57</sup>

Such language has been reflected in some, though not all, of the US’ bilateral FTAs. For example, in its FTAs such as that signed with Peru, Bahrain, and with Oman, the above terms and definitions - including “state enterprise” - is used.<sup>58</sup> The US-Korea FTA also includes a definition of state enterprise and further carries an accompanying footnote: “state enterprise means an enterprise that is owned, or controlled through ownership interests, by a Party; . . . For greater certainty, ownership, or control through ownership interests, may be direct or indirect.”<sup>59</sup>

However, in Chapter 15 of the US-Singapore FTA (USSFTA) on Investment, while “enterprise” and “investor of a Party” appear and are similarly defined as above, the term “state enterprise” is not used in that chapter.<sup>60</sup> Instead, in the context of anti-competition disciplines, the term “government enterprise” is used instead in the FTA.<sup>61</sup> For Singapore, the definition of government enterprises there means an enterprise in which Singapore has “effective influence.”<sup>62</sup> Effective influence is in turn defined in Art. 12.8.5:

[E]ffective influence exists where the government and its government enterprises, alone or in combination:  
(a) own more than 50 percent of the voting rights of an entity; or

<sup>56</sup>Mr. Michael Froman, the current United States Trade Representative, has reportedly stated that the TPP is “being developed as a potential platform for regional integration as a whole as well as a possible template for how these emerging issues might be addressed in future broader trade agreements.” Lists of Reservations of Malaysia, Myanmar, Singapore and of Vietnam to the ASEAN Comprehensive Investment Agreement, *supra* note 51.

<sup>57</sup>OFFICE OF THE U.S. TRADE REPRESENTATIVE 2, <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> (last visited Oct. 21, 2014). Such definitions were already present in the 2004 Model BIT. *See 2004 Model BIT*, U.S. DEP’T OF STATE, <http://www.state.gov/documents/organization/117601.pdf> (last visited Oct. 21, 2014).

<sup>58</sup>Trade Promotion Agreement, US-Peru, Art. 1.3, Apr. 12, 2006 (entered into force Feb. 1, 2009), *available at* [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset\\_upload\\_file78\\_9547.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file78_9547.pdf); PERU TRADE PROMOTION AGREEMENT, OFFICE OF THE U.S. TRADE REPRESENTATIVE, <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa> (last visited Oct. 22, 2014); Free Trade Agreement, US-Bahrain, Art. 1.3, (entered into force Aug. 1, 2006), *available at* [http://tcc.export.gov/Trade\\_Agreements/All\\_Trade\\_Agreements/exp\\_006966.asp](http://tcc.export.gov/Trade_Agreements/All_Trade_Agreements/exp_006966.asp); FREE TRADE AGREEMENTS, OFFICE OF THE U.S. TRADE REPRESENTATIVE, <http://www.ustr.gov/trade-topics/industry-manufacturing/industrial-tariffs/free-trade-agreements#U.S.-Oman%20Free%20Trade%20Agreement> (last visited Oct. 22, 2014); Free Trade Agreement, US-Oman, Art. 1.4, [Jan. 19, 2006] (entered into force Jan. 1, 2009), *available at* [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/oman/asset\\_upload\\_file976\\_8810.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/oman/asset_upload_file976_8810.pdf) (last visited Feb. 17, 2014); FREE TRADE AGREEMENTS, OFFICE OF THE U.S. TRADE REPRESENTATIVE, <http://www.ustr.gov/trade-topics/industry-manufacturing/industrial-tariffs/free-trade-agreements#U.S.-Oman%20Free%20Trade%20Agreement> (last visited Oct. 22, 2014).

<sup>59</sup>*See* Free Trade Agreement, US-Korea, Art. 1.4, [June 30, 2007] (entered into force Mar. 15, 2012), *available at* [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset\\_upload\\_file816\\_12698.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file816_12698.pdf) (last visited Oct. 22, 2014).

<sup>60</sup>*Overview of United States (USSFTA)*, SINGAPORE GOVERNMENT (Apr. 26, 2012), [http://www.fta.gov.sg/fta\\_ussfta.asp](http://www.fta.gov.sg/fta_ussfta.asp) hl=13 (last visited Oct. 20, 2014) [hereinafter *USSFTA*].

<sup>61</sup>The term “government enterprises” is used in Chapter 12, covering “Anticompetitive Business Conduct, Designated Monopolies and Government Enterprises.” *Id.*

<sup>62</sup>*USSFTA* at Art. 12.8.

(b) have the ability to exercise *substantial influence* over the composition of the board of directors or any other managing body of an entity, to determine the outcome of decisions on the strategic, financial, or operating policies or plans of an entity, or otherwise to exercise substantial influence over the management or operation of an entity. Where the government and its government enterprises, alone or in combination, own 50 percent or less, but more than 20 percent, of the voting securities of the entity and own the largest block of voting rights of such entity, there is a *rebuttable presumption* that effective influence exists. Annex 12A provides an illustration of how the analysis of effective influence should proceed [italics added].

The provision does not, however, explain how the presumption may be rebutted, such as the nature or the level of proof required; nor is the related notion in (b) of “substantial influence” defined or clarified. Annex 12A (in supplementary file) provides an illustrative chart and notes but these do not answer these questions either.

Further, the following discipline, *inter alia*, applies to such entities:

Singapore shall take no action or attempt in any way, directly or indirectly, to *influence* or direct decisions of its government enterprises, including through the exercise of any rights or interests conferring effective influence over such enterprises, except in a manner consistent with this Agreement. However, Singapore may exercise its voting rights in government enterprises in a manner that is not inconsistent with this Agreement [italics added].<sup>63</sup>

Singapore is also obliged to adhere to certain disclosure obligations with regard to a “covered entity.”<sup>64</sup>

Two observations are raised here: First, the use of the notion of “effective influence” expands the scope of actions covered by the obligations. Second, the use of a presumption for when such effective influence exists is a powerful tool, as it places the onus on the other state to rebut or disprove effective influence. The use of this presumption is clever as state and state-related influence is not always easy to prove. It remains to be seen whether and how effective influence and its presumption may be reprised in the context of the TPP vis-à-vis competition provisions, and whether they are applied in relation to investment disciplines under the agreement.

While the treaty practice of the United States – a recipient of SWF investments – does not appear to reflect a totally uniform approach on the use of “state enterprise” in its FTA investment provisions at this point, it generally does include government-owned enterprises within its investment provisions. This permits SWFs investors who fulfill other criteria in the investment provisions to be able to benefit from the FTA’s protection and investor-state dispute settlement mechanism as well, as is the case with private investors under the FTA.

Likewise, as the Singapore-Australia FTA includes investors which are government-owned or controlled. Art. 1.1 defines an “enterprise”(that may be an “investor”) as follows:

“[E]nterprise” means any corporation, company, association, partnership, trust, joint venture, sole-proprietorship or other legally recognised entity that is duly incorporated, constituted, set up, or otherwise duly organised under the law of a Party, including branches, regardless of whether or not the entity is organised for pecuniary gain, *privately or otherwise owned*, or organised with limited or unlimited liability [italics added].<sup>65</sup>

Within ASEAN, the ACIA expressly includes government-owned entities as possible investors within its definition of “investor,” read with that of “juridical person:”

(d) “investor” means a natural person of a Member State or a juridical person of a Member State that is making, or has made an investment in the territory of any other Member State; (e) “juridical person” means any legal entity duly constituted or otherwise organised under the applicable law of a Member State, whether for profit or otherwise, and *whether private-owned or governmentally-owned*, including any enterprise, corporation, trust, partnership, joint venture, sole proprietorship, association, or organization [italics added].<sup>66</sup>

<sup>63</sup>USSFTA at Art. 12.3(2)(e).

<sup>64</sup>USSFTA at Art. 12.3(2)(g); USSFTA at Art. 12.8(1).

<sup>65</sup>See text of the Agreement after 2<sup>nd</sup> Review, available at [http://www.fta.gov.sg/safta/fta\\_safta\\_chp8\\_2nd%20review.pdf](http://www.fta.gov.sg/safta/fta_safta_chp8_2nd%20review.pdf). The original Chapter 8 text is available at [http://www.fta.gov.sg/safta/fta\\_safta\\_chp8.pdf](http://www.fta.gov.sg/safta/fta_safta_chp8.pdf).

<sup>66</sup>Entered into force Mar. 29, 2012. See ASEAN Comprehensive Investment Agreement (ACIA) Enters Into Force Creating a Stable and Predictable Business Investment Environment, ASSOCIATION OF SOUTHEAST ASIAN NATIONS (July 24, 2012), <http://www.asean.org/news/asean-secretariat-news/item/asean-comprehensive-investment-agreement-acia-enters-into-force-creating-a-stable-and-predictable-business-investment-environment> (last visited Oct. 22, 2014);

In addition, an explicit exclusion of “portfolio investments” that applied under an earlier ASEAN investment agreement (now superseded by the ACIA) does not exist under the ACIA.<sup>67</sup>

The EU’s negotiating stance on investments reflects a general policy of openness to investments by entities such as SWFs and it remains to be seen how treaty provisions (if at all) will deal with them specifically.<sup>68</sup> So far, provisions appear to address “state trading enterprises,” a term found in the WTO’s General Agreement on Tariffs and Trade 1994.<sup>69</sup> The EU-Korea FTA, for example, the first of the EU’s “new generation” FTAs, which entered into force in July 2011, includes a provision on “state trading enterprises” which reprises largely WTO disciplines, in the context of trade in goods.<sup>70</sup> The FTA does not include an Investment Chapter. However, in the FTA, the EU Schedule of Commitments relating to trade in services does include at least one EU member’s reservation on establishment of enterprises by government-related entities. The reservation by Spain lists the following for “all sectors”: “ES: Investment in Spain by foreign governments and *foreign public entities*(g), directly or through companies or other entities controlled directly or indirectly by foreign governments, needs prior authorisation by the government” [italics added].<sup>71</sup> Footnote (g) of the reservation, which does not define the term “foreign public entities,” states instead what may appear to be the rationale for the reservation: “Such investment tends to imply not only economic interests, but also non-economic interests for these entities.”

On a more general note, it appears that the government-related nature of an entity (such as a SWF) generally does not prevent it from benefiting from the range of investment protection afforded in the treaties, which may include most favored nation treatment, national treatment and fair and equitable treatment guarantees. In addition, as qualifying “investors” the treaties’ investor-state dispute settlement processes should also be available in the event of a dispute.<sup>72</sup>

Additionally, so far only the USSFTA has sought to impose treaty disciplines on SOEs based on *influence*, presumed or actual. What challenges does such a provision pose to treaty states with SWFs? On one hand it may be difficult for a recipient to prove influence. If the rationale is to ensure the investor operates on a commercial basis like private investors, is this a realistic solution? Influence, if it is wielded, can be asserted in a variety of invisible, subjective ways, outside formal corporate structures and codes. On the other hand, the use of a presumption based on objective facts such as structure or holdings makes it difficult for the investor as it has to prove a negative, or the absence of influence. It is unclear what kind of satisfactory evidence could be brought in this regard. While recipient countries use national laws, treaties and non-binding codes of conduct to press SWFs for transparency and disclosure of ownership,

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*Footnote continued*

text available at <http://www.asean.org/images/2012/Economic/AIA/Agreement/ASEAN%20Comprehensive%20Investment%20Agreement%20%28ACIA%29%202012.pdf>.

<sup>67</sup>The exclusion was found in Art. 2(a) of the Framework Agreement on the ASEAN Investment Area, which is now superseded *vide* Art. 47(1) of the ACIA.

<sup>68</sup>See *generally Sovereign Wealth Funds*, EUROPEAN COMM’N (Oct. 17, 2014), [http://ec.europa.eu/internal\\_market/capital/third-countries/sovereign\\_wealth\\_funds/index\\_en.htm](http://ec.europa.eu/internal_market/capital/third-countries/sovereign_wealth_funds/index_en.htm) (last visited Feb. 17, 2014); see also *A Common European Approach to Sovereign Wealth Funds*, *supra* note 3.

<sup>69</sup>Art. XVII, GATT 1994. *WTO Legal Texts*, WORLD TRADE ORGANIZATION, [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm#goods](http://www.wto.org/english/docs_e/legal_e/legal_e.htm#goods) (last visited Feb. 19, 2014).

<sup>70</sup>Art. 2.13 provides as follows:

Article 2.13  
State trading enterprises

1. The Parties affirm their existing rights and obligations under Article XVII of GATT 1994, its interpretative notes and the Understanding on the Interpretation of Article XVII of GATT 1994, contained in Annex 1A to the WTO Agreement which are incorporated into and made part of this Agreement, *mutatis mutandis*.

2. Where a Party requests information from the other Party on individual cases of state trading enterprises, the manner of their operation and the effect of their operations on bilateral trade, the requested Party shall have regard to the need to ensure maximum transparency possible without prejudice to Article XVII.4(d) of GATT 1994 on confidential information.

See *generally South Korea*, EUROPEAN COMM’N (Sept. 9, 2014), <http://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/> (last visited Feb. 17, 2014) (EU information on this FTA).

<sup>71</sup>*Id.* At Annex 7A-2 (in relation to Art. 7.13 on establishment of presence of investors in relation to the supply of services).

<sup>72</sup>See also PROSPECTS IN INTERNATIONAL INVESTMENT LAW AND POLICY – WORLD TRADE FORUM 93 (Roberto Echandi & Pierre Sauvé eds., 2013).

reporting, governance structures and principles, certain SWFs may still be subject to influence of their governments behind the scenes. However, those which are not, may be hard put to prove satisfactorily they are not, as a provision such as that in the USSFTA does not make it clear as to what level of proof is sufficient to rebut the presumption.

## VI. SEEKING AN IDENTITY IN TREATIES: “YES” TO DIFFERENTIATION BUT “NO” TO DISCRIMINATION?

SWFs continue to defy universal definition and treatment. As one author has put it, SWFs are “in search of a direct relationship” with host states.<sup>73</sup> Should SWFs be treated differently from other investors, and if so, why, and how?

Some have argued against SWFs as a unique category from other foreign investors, mainly for fear that SWFs would be subject to discriminatory, i.e., less favorable, treatment as compared with other foreign investors.<sup>74</sup> While *differential* and *discriminatory* treatment may sometimes have been conflated, it is important to distinguish these notions.<sup>75</sup> It may be viable to provide differential yet non-discriminatory treatment for SWFs. Sovereign wealth funds may for example wish to be treated like other foreign investors insofar as their treaty remedies are concerned.<sup>76</sup> OECD guidelines that were formed alongside the establishment of the Santiago Principles in 2008, for example, specifically address *discriminatory* treatment of recipient states.<sup>77</sup>

It may be desirable for SWF home states that negotiate treaties to request differential treatment that would allow SWF investors and their investments to be treated favorably when compared with “like” investors and investments, i.e., other SWFs, or, even more specifically, other SWFs of either similar legal nature (e.g., whether a central bank or a corporate entity owned by a foreign government). So far, no treaty appears to have incorporated such express features.

Such an approach would pay due regard to their hybrid nature, without necessarily subjecting them to discriminatory (less favorable) treatment as compared with other foreign investors. Even the non-discrimination provisions in Investment Chapters of FTAs and bilateral investment treaties (BITs) often refer to a comparison of treatment of “like” investors or of “like investments.”

In negotiating treaties, other relevant considerations that could provide greater certainty include, for instance, whether a minimum threshold of share ownership should apply before any differential treatment should arise with respect to an SWF; below such a threshold it will be treated as any other foreign investor. A SWF home state may also consider requesting that its treaty partner specify sectors or industries that are considered sensitive or strategic (by a “positive list” approach), so that SWF investment only in these would trigger any differential treatment or processes. With such provisions, SWFs investing in all other sectors or industries would enjoy the same scrutiny as other foreign investors.

## VII. CONCLUSION

The status of SWFs continues to be controversial and much debated, and this debate is likely to go on for the foreseeable future. Since it is unlikely that a multilateral set of rules for SWFs will be decided on in the immediate future, bilateral treaties such as FTAs are the next possible staging

<sup>73</sup>Bassan, *supra* note 8, at 55.

<sup>74</sup>See, e.g., Murray, *supra* note 7, at 9-15, 18-21.

<sup>75</sup>Murray, *supra* note 7, at 18. See also Carolyn Ervin, Director, OECD Directorate for Financial and Enterprise Affairs, *Should sovereign wealth funds be treated differently than other investors?*, OECD OBSERVER, [http://www.oecdobserver.org/news/archivestory.php/aid/2610/Sovereign\\_wealth\\_funds.html](http://www.oecdobserver.org/news/archivestory.php/aid/2610/Sovereign_wealth_funds.html) (last visited Feb. 17, 2014).

<sup>76</sup>Bassan, *supra* note 8, at 143-44, opines:

... in the practice of treaties or in past arbitration awards, the difference between public or private control of the legal person is never relevant. Therefore, state-owned entities can legitimately claim a violation of the BIT; the same is true for SWFs, the difference being the two vehicles being irrelevant for this purpose. ... the capability of a SWF to raise a claim under a BIT will depend much on the text of the BIT ... ” (citing an example in the Kuwait-Germany BIT 1994 identifying the state (Kuwait) acting through investor Kuwait Investment Authority as an “investor.”).

He goes on to mention the agreements between Kuwait-France, Qatar-Germany, Qatar-France and Qatar-China as well.

<sup>77</sup>See *OECD Declaration on SWFs and Recipient Country Policies and Guidelines for Recipient Country Investment Policies on National Security*, OECD, <http://www.oecd.org/investment/investment-policy/oecdguidanceonsovereignwealthfunds.htm> (last visited Feb. 17, 2014). See also generally Chaisse, *supra* note 29, at 462.



ground for commitments which affect SWFs. Such commitments may take the form of investment-related and/or competition law-related disciplines which are designed to apply to SOEs, a broader category than SWFs. The competition model has already begun to appear, such as that in the USSFTA. The question is what further disciplines will be introduced in coming treaties such as the TPP, which has a number of Asian negotiating states that have both SWFs and SOEs.<sup>78</sup> As the negotiations for the TPP – and any new disciplines on SOEs and/or SWFs – are still evolving at this point, there is an opportunity for both recipient states and SWF investor states to find a way to have the relevant concerns and interests of both to be best represented in the coming Agreement, since this is hailed as a “template” for future agreements. While national laws will continue to exist particularly to safeguard scrutiny based on national security concerns, treaty provisions can be used to define more clearly the types of state-owned/-controlled entities which are to be included/excluded, and for those that *are* included, the kind of provisions that will best deal with concerns relating to them, on the part of all treaty parties concerned. This is necessary in order for a balanced, sustainable relationship to be maintained between recipient states, SWFs and SOEs within the context of the TPP (and other future treaties). Distinct provisions that are relevant will be competition provisions, national security provisions, and investment provisions as they apply to SWFs (if these differ from how they apply to other foreign investors under the treaty).

Some key guiding principles in crafting a treaty-based “identity” for SWFs are the following:

- Provisions could draw key ideas from the Santiago Principles, the OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies and the OECD Guidelines for Recipient Country Investment Policies on National Security, improving on them to the extent that negotiating agendas permit;
- reflecting the hybrid nature of SWFs and ensuring non-discrimination against them in such agreements, while permitting non-discriminatory differentiation;
- providing clarity as to whether provisions on SOEs would or would not apply to a treaty state’s SWF investments; and
- considering how any investment or competition policy provision on government “influence” could be crafted in a balanced way to neither make proof (or disproof, in the case of the USSFTA’s use of a presumption, mentioned above) of such a factor, an unfeasible task.

There is certainly much room for further debate as to how a balanced and appropriate approach to handling SWFs could be incorporated in coming trade and investment treaties. The above provides some suggestions on the way forward as FTAs continue to play an important role in shaping investor-host state relations. For now though, it seems that SWFs will remain a “Janus” among investment funds, with the duality of their private-public aspects caught in a state of transition.

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<sup>78</sup>For general information on SOEs in Asia, see ORGANISATION FOR ECON. CO-OPERATION AND DEV., POLICY BRIEF ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN ASIA (2010), available at <http://www.oecd.org/countries/philippines/45639683.pdf>.