The Regulatory Landscape for Sovereign Wealth Funds Investment and Lessons for China

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ABSTRACT

Sovereign wealth funds (SWFs) have become important players in the domestic and international market. The development of SWF investment, as the rise of 'state capitalism', is shaping the current global economic order and the trend of international capital flows. As state-owned investment instruments step into the financial market, SWF investments bring political, economic and regulatory challenges (particularly in the form of the Chinese state capitalism), while also providing opportunities for the global and national economies.

However, existing regulatory approaches in reality can only be regarded as *ex-post* and *ex-parte* reactions from more practical and political considerations. These approaches mainly consider the interests of host countries by imposing protective measures but neglect sufficient protection for SWFs, which may easily result in far-going protectionism. A more comprehensive and balanced view/approach is needed for the benefits of both sides. For China, addressing issues involved in SWFs investment is necessary, since China acts as the home country of several of the largest SWFs and the host country of foreign SWF investment. This thesis, therefore, aims to find a plausible approach/option to regulate SWFs internationally and in China by exploring and assessing relevant existing national and international regulations.

The thesis analyses the features of SWFs, and the nature of SWF investment, as well as the legal rationale and conflicting interests behind it. By undertaking doctrinal and comparative studies, this thesis analyses national regulations in relation to SWFs investment in the UK, US and China, and assesses international hard law and soft law approaches on general foreign investment and/or particular SWF investment. This thesis finds that unilateral actions vary from jurisdiction to jurisdiction while international measures do not explicitly reflect or incorporate issues of SWFs. The only exclusive approach is a kind of soft-law instrument without binding.

The thesis suggests that the phenomenon of SWFs requires a regulatory response for SWF investment not solely relying on practical and unilateral considerations but considering theoretical and practical perspectives under a broader framework. The regulations on SWF investment, in the thesis, cannot put an over-emphasis on restrictions without providing sufficient protection.

The thesis finds that although existing national and international regulations have flaws they are adequate to regulate SWF investment. Striking a balance between the interests of both sides is important, which needs further improvement of existing approaches. In this thesis, incorporating soft law guidelines into hard-law international investment treaties (IIAs) is a more appropriate way.

This thesis recognises the state sovereignty of the host state over economic activities in its jurisdiction. There is no one-fit-all suggestion for every country at the national level while there could be a plausible approach at international level and an appropriate option for China (as a selected case). By considering these factors, the thesis proposes three regulatory models for regulating or treating SWF investment at a general level, and puts forward further suggestions for IIAs and soft-law regulations.

The thesis tests proposed regulatory models in the context of China with an analysis of relevant legislative and economic reform in China. It finds that China adopts a flexible approach to regulate Chinese SWFs and foreign SWFs. It further concludes that in the short-term, the combined regulatory models could serve China's policy demands while in the long-term, treating SWFs as other private investors (model one) helps to attract long-term and high-quality capital inflows. The thesis insists that the system of state ownership should not be biased and the focus should be put on the modern corporate governance of sovereign investors. By incorporating internationally accepted standards into domestic legislations, together with further domestic reforms, China would provide a better response towards SWFs investment and also other foreign investment.

TABLE OF CONTENTS

LIST OF CHARTS

LIST OF ABBREVIATIONS

ADIA	Abu Dhabi Investment Authority
BIT	Bilateral Investment Treaty
CAD Fund	China-Africa Development Fund
CETA	Canada-EU FTA
CFIUS	Committee on Foreign Investment in the US
ChAFTA	China-Australia FTA
CIC	China Investment Corporation
CJEU	Court of Justice of the European Union
CMA	Competition and Markets Authority
CN	Competitive Neutrality
CSR	Corporate Socially Responsibility
CSRC	China Securities Regulatory Commission
DSB	Dispute Settlement Body
DSS	Dispute Settlement System
ECT	Energy Chapter Treaty
ELR	Exhaustion of Local Remedies
FCA	Financial Conduct Authority
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FIE	Foreign Invested Enterprise
FINSA	Foreign Investment and National Security Act of 2007
FPC	Financial Policy Committee
FSA	Financial Services Authority
FSIA	Foreign Sovereign Immunity Act of 1976
FSMA	Financial Services and Markets Act 2000
FTA	Free Trade Agreement
FTZ	Free Trade Zone
FX reserve	Foreign Exchange Reserve
GAPP	Generally Accepted Principles and Practices for Sovereign Wealth Funds
GATS	General Agreement on Trade and Service

GATT	General Agreement on Tariffs and Trade
GIC	Government of Singapore Investment Corporation
GPFG	Government Pension Fund Global-Norway
ICC	International Chamber of Commerce
ICISD	International Centre for Settlement of Investment Disputes
ICJ	International Court of Justice
ICS	Investment Court System
IFSWF	International Forum of Sovereign Wealth Funds
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
IMF	International Monetary Fund
ISDS	Investor-State Dispute Settlement
IWG	International Working Group of Sovereign Wealth Funds
KIA	Kuwait Investment Authority
KIC	Korea Investment Corporation
M&A	Merger and Acquisition
MAI	Multilateral Agreement on Investment
MIGA	Multilateral Investment Guarantee Agency
MOFCOM	Minister of Commerce of China
MST	Minimum Standard of Treatment
NAFTA	North American Free Trade Agreement
NDRC	China's National Development and Reform Commission
NGO	Non-Governmental Organisation
NSSF	National Social Security Fund (China)
OBOR	One-Belt and One-Road Initiative
OECD	Organisation for Economic Co-operation and Development
Ofcom	Office of Communications
Ofgem	Office of Gas and Electricity Markets
Ofwat	Office of Water Services Regulation Authority
OISF	Oil Income Stabilization Fund
PBOC	People's Bank of China
PCA	Permanent Court of Arbitration
POE	Private-Owned Enterprise
PPRFs	Public Pension Reserve Funds

PRA	Prudential Regulation Authority
QFII	Qualified Foreign Institutional Investor
QIA	Qatar Investment Authority
RF	Reserve Fund (Russia)
RCEP	Regional Comprehensive Economic Partnership
SAFE	State Administration of Foreign Exchange
SASAC	Chinese Government's State Asset Supervision and Administration Commission
SCC	Stockholm Chamber of Commerce
SEC	US Securities and Exchange Commission
SIA	State Immunity Act of 1978
SIC	SAFE Investment Company Limited
SOE	State-Owned Enterprise
SRI	Socially Responsible Investment
SWF	Sovereign Wealth Fund
TFEU	Treaty on the Functioning of the European Union
TPP	Trans-Pacific Partnership
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
UNCITRAL	United Nations Commission on International Trade Law
WIO	World Investment Organization
WTO	World Trade Organisation

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INTRODUCTION

1. Research Background

Sovereign wealth funds (SWFs), as a form of state capitalism, have attracted large attention since the 2008 financial crisis. SWFs have become the emerging institutional investors in international market in recent years and they have experienced an increasing growth because of imbalances in high commodity prices and global trade. Many countries establish their own SWFs for various purposes. Currently, SWFs' operations are highly concentrated in and are dominated by three types of economies: the Asian economies (e.g. China, Singapore, Korea), the Middle East countries (e.g. Saudi Arabia, Qatar, Kuwait, and Abu Dhabi), and the Europe countries (e.g. Norway, Russia). Among these countries, China has four large SWFs. These Chinese SWFs have attracted special attention from host countries owing to economic and political reasons.

Most SWFs are funded by revenue from commodity exports or foreign-exchange reserve surplus. Owing to the diversity of funding sources, investment objectives and institutional structures of SWFs, there is no widely accepted definition of SWFs to date. However, various definitions for SWFs can be found in different literature or documents,[1] among which the IMF defines SWFs in the so-called 'Santiago Principles'.[2] As sovereign-background players (which usually trigger controversial debates), SWFs are established or managed in diversified forms rather than in a uniform pattern. Each one is unique, and the difference lies in the capital size, structures, risk preferences, as well as level of transparency in management and operation, in addition to the impact of the state system and national interests.[3]

Apart from these differences that lie in the groups of SWFs, SWFs, which are established for macroeconomic or social objectives, are generally regarded as state-owned/controlled investment funds that invest domestically and globally in a wide range of assets, alternatives, and even undertake direct equity investment for financial returns. During the 2008 financial crisis, SWFs actively invested in financial

[1] For a detailed discussion of the definition of SWFs, see Ch.1. s. 1.1
[2] For the discussion of the SWFs' definition in 'Santiago Principles', see Ch.1. s. 1.1
[3] This research proposes a definition for SWFs, see Ch.1. s. 1.2

institutes for short-term interests. However, the adverse effect of the financial crisis was also spread to SWFs, resulting in large losses.[4] SWFs, therefore, started to diversify their portfolio and to pursue long-term interests.

Despite the increasingly growing size of SWFs, academic studies on SWFs are fairly limited, most of which are discussed from an economic perspective rather than from the perspective of legal regulation, or focus on corporate governance issues.[5] One of the reasons to explain this phenomenon could be attributed to the low transparency of SWFs. It is also the reason why several Western host states expressed concerns over SWFs investment. Existing literature focuses on the corporate governance of SWFs, i.e. the operation and structure of some large and important SWFs,[6] and the investment strategies, objectives and financial returns of SWFs.[7] However, the debate on policy and regulatory issues arising from the growth of SWFs is relatively new for academia. A comprehensive analysis of SWFs investment from the perspective of investment regulation and from the Chinese perspective is relatively scant, which is the main purpose of this thesis.

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[4] R. Wray, 'Revealed: How Sovereign Wealth Funds Were Left Nursing Multibillion Losses' *The Guardian* (22 March 2008) <https://www.theguardian.com/business/2008/mar/22/banking.investmentfunds> accessed 30 June 2017

[5] For example, the literature from economic or financial perspective, see S. Johnson, 'The Rise of Sovereign Wealth Funds' (2007) 44(3) Fin. & Dev. 56; R. Beck and M. Fidora, 'The Impact of Sovereign Wealth Funds on Global Financial Market' (2008) 43(6) Intereconomics 349; S. Butt et al., 'Sovereign Wealth Funds: A Growing Global Force in Corporate Finance' (2008) 20(1) J. App. C. F. 73. In terms of corporate governance, see R. Gilson and C. Milhaupt, 'Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Merchantilism' (2008) 60 Stan. L. Rev. 1345; A. Monk, 'Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance' (2009) 14(4) New Pol. Econ. 451

[6] For example, there are researches focusing on Norwegian SWF, see L. Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment' (2009) 41(2) Georgetown J. Int'l L. 101; G. Clark and A. Monk, 'The Legitimacy and Governance of Norway's Sovereign Wealth Fund: the Ethics of Global Investment' (2010) 42(7) Env't & Plan. A 1723. There are also researches discussing SWFs from China or other countries, see V. Shih, 'Tools of Survival: Sovereign Wealth Funds in Singapore and China' (2009) 14(2) Geopolitics 328; H. Li, 'Depoliticization and Regulation of Sovereign Wealth Funds: A Chinese perspective' (2011) 1(2) Asian J. Int'l L. 403

[7] For example, see V. Chhaochharia and L. Laeven, 'Sovereign Wealth Funds: Their Investment Strategies and Performance' (2008) CEPR Discussion Paper No. NP6959 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1308030&rec=1&srcabs=1095023&alg=7&pos=2> accessed 20 December 2014; I. Petrova et al., 'Investment Objectives of Sovereign Wealth Funds – A Shifting Paradigm', (2010) IMF Working Paper 11/19 <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Investment-Objectives-of-Sovereign-Wealth-Funds-A-Shifting-Paradigm-24598> accessed 20 December 2014; J. Kotter and U. Lel, 'Friends or Foes? Target Selection Decisions of Sovereign Wealth Funds and Their Consequences' (2011) 101 J. Fin. Econ. 360; A. Knill, 'Sovereign Wealth Fund Investment and the Return-to-Risk Performance of Target Firms' (2012) 21(2) J.Fin. Intermediation 315

SWFs played a positive and important role in the 2008 financial crisis when host countries in crisis were in urgent need of capital injections; SWFs hence faced fewer restrictions concerning their direct or indirect investments. However, after that, the concern over the large amount of capital controlled by these government background investors led to a call for additional regulations. Issues surrounding SWFs mainly are derived from the state ownership, low transparency, and even the origin/nationality of SWFs.

It was supposed that SWFs might be used as the investment instruments of their home countries driven by political motivations rather than commercial considerations. Issues of SWFs also lie in the preferential treatment or regulatory advantages they might receive, and the market integrity or stability if SWFs suddenly withdraw from the market. Another controversial issue is that SWF investment might threaten the national security of host countries, especially those investments (or takeovers) made in critical infrastructures. In order to reduce the concerns and barriers to market access, SWFs chose to undertake portfolio investment and waive controlling powers. However, SWFs also embrace direct investment for higher returns, albeit there being far less transparency in the content of their portfolios.

Among existing SWFs, Chinese SWFs, as one of the world largest groups of SWFs, have attracted large attention, and have even raised concerns and fears from developed countries. On one hand, this is because Chinese SWFs and SOEs are treated as state-backed/controlled entities that are used to fulfil or support China's political objectives. On the other hand, the reason is that the increasing growth of Chinese overseas investment is dominated by sovereign investors. Although SWFs and SOEs differ in many aspects, they are usually treated as the same. SWF investment along with or supporting other SOEs investment, particularly direct investment, has faced a backlash in many countries. Even though they engage in portfolio investment without controlling powers, there is concerned that the influence of SWFs on investee companies can exist without controlling powers.

In order to defend the national security and reduce the concerns that arise from these state-owned investors, many host countries have tightened their foreign investment

regulations or have established or intend to establish national security mechanism to review or block foreign investment that might threaten national interests, especially foreign government-controlled investment. It was even suggested that the regulatory responses in the US and Australia are in place to target Chinese investments made by state-owned investors or even some private investors.[8]

However, the overreaction of host states might lead to discrimination and protectionism, thus discouraging foreign investment from stepping into their markets. For host countries, especially those experiencing economic downturn or recession, how to balance the interests between attracting foreign investment and maintaining legitimate national security is an important question to be considered. For SWFs, how to comply with required obligations and receive sufficient protection is also an important question. It is crucial to address the interest between protection of SWFs investment and the host country's national security is crucial to be addressed when discussing issues of SWF investment.

Compared with studies from corporate governance, economic or financial perspectives, studies from legal aspects are limited. Some existing research focuses on the internal governance of SWFs, or analyses the operation or structure of SWFs from a corporate law perspective.[9] Studies on the regulation of SWFs as investors mainly focus on domestic law, e.g. foreign investment law in host countries, especially

[8] For regulation in US, see F. Wu and A. Seah, 'Would China's Sovereign Wealth Fund Be a Menace to the USA?' (2008) 16(4) China & World Econ. 33; B. Bean, 'Attack of the Sovereign Wealth Funds: Defending the Republic from the Threat of Sovereign Wealth Funds' (2009) 18 Mich. St. U. Coll. LJ Int'l L. 65; F. Wu et al, 'Dos and Don'ts for Chinese Companies Investing in the United States: Lessons from Huawei and Haier' (2011) 53(4) Thunderbird Int'l Bus. Rev. 501; T. Moran, 'Chinese Investment and CFIUS: Time for an Updated (and Revised) Perspective' (2015) Policy Brief 15-17 1 <https://piie.com/publications/pb/pb15-17.pdf> accessed October 2015. For regulation in Australia, see P. Drysdale, 'A New Look at Chinese FDI in Australia' (2011) 19 (4) China & World Econ. 54; V. Bath, 'Foreign Investment, the National Interest and National Security – Foreign Direct Investment in Australia and China' (2012) 34(1) Syd LR 5; R. Mendelsohn, 'Australia's Foreign Investment Review Board and the Regulation of Chinese Investment' (2014) 7(1) China Econ. J. 59; S. Globerman, 'A Policy Perspective on Outward Foreign Direct Investment by Chinese State-Owned Enterprises 1' (2016) 11(4) Frontiers Econ. in China 537

[9] See C. Chen, 'Corporate Governance of State-Owned Enterprises: An Empirical Survey of the Model of Temasek Holding in Singapore' (2014) Singapore Management University School of Law Research Paper No. 6 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2366699> accessed 15 November 2014; P. Rose, 'Sovereign Shareholder Activism; How SWFs Can Engage in Corporate Governance' (2013) Ohio State Public Law Working Paper <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461227> accessed 15 November 2014; P. Rose, 'Sovereign Investing and Corporate Governance: Evidence and Policy' (2013) 18 Fordham J. Corp. Fin. L. 1

national security review, shareholding ceiling or voting rights.[10] Since there is no specific international agreement that explicitly addresses the issue of SWFs, existing studies from the international perspective mainly focus on self-regulation of SWFs at international level, i.e. the 'Santiago Principles'.[11] With the growing investment activities and enlarging size, state-owned entities (SWFs and SOEs), have increasingly become important investors worldwide. Among these state-owned investors, Chinese SWFs (and SOEs) have attracted much more attention than other investors from other countries, especially during recent years. Since China has become the net capital exporter, the dual role of China (as capital exporting and importing country) affects the position of China towards inbound investment and outbound investment, especially investments under China's 'Belt and Road' initiative.

However, SWFs investment, as an emerging issue, has not been reflected well in existing international investment law. Studies concerning the international regulation of SWF investment from both theoretical and practical perspectives are limited. Moreover, although China is an important player, researches with regard to regulating SWFs investment (local or foreign) from the Chinese perspective is also lacking. At international level, it is important for the international community to consider the appropriate approach to regulate state capitalism and the relevant issues under the international framework. At domestic level, since China is the home country of a group of large and important SWFs, and is also the host country of many foreign SWF investments, it is crucial for China to provide a justified regulatory model on SWF investment in China. This thesis therefore intends to fill in this gap.

[10] See P.Rose, 'Sovereign Wealth Fund Investment in the Shadow of Regulation and Politics' (2008) 40 Geo. J. Int'l L. 1207; J. O' Brien, 'Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds' (2008) 42 Int'l Lawy. 1231; J. Cooke, 'Finding the Right Balance for Sovereign Wealth Fund Regulation: Open Investment vs. National Security' (2009) 2009 (2) Colum. Bus. L. Rev. 728; S. Ghahramani, 'Sovereign Wealth Funds and Shareholder Activism: Applying the Ryan-Schneider Antecedents to Determine Policy Implications' (2013) 13(1) Corporate Governance: The Int'l J. Bus. in Society 58; G. Kratsas and J. Truby, 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1(1) J. Fin. Reg. 9

[11] See J. Buhi, 'Negocio de China: Building upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation' (2009) 39 HK L. J. 197; J. Norton, 'The 'Santiago Principles' for Sovereign Wealth Funds: A Case Study on International Financial Standard-Setting Processes' (2010) 13(3) JIEL 645; P. Donghyun and G. Estrada, 'Developing Asia's Sovereign Wealth Funds: The Santiago Principles and the Case for Self Regulation' (2011) 1(2) Asian J Int'l L 383; R. Bismuth, 'The 'Santiago Principles' for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 6 EULR 69

2. Research Purposes and Questions

This thesis aims to analyse and assess the existing regulatory landscape for SWFs investment, to provide regulatory models for regulating SWFs investment in general and to give suggestions for China in particular, from the theoretical and practical perspectives. It aims to offer a theoretical underpinning in the field of investment regulation through analysing substantial issues and procedural problems when regulating SWF investment. The theoretical underpinning and legal conflict involved are analysed as a fundamental support for the thesis. The regulatory suggestions are mainly based on the analysis of existing regulations with regard to SWFs, while the lesson for China is mainly based on the assessment of domestic and international experiences and practices but also with a particular consideration on its domestic situation.

For domestic experiences, this thesis compares existing regulations in the US, UK and China, to help China find a proper position. In terms of international experience, this research examines existing international hard law (bilateral or international treaties) and soft law (guidelines or code of conducts) regulations, in order to find a plausible approach to regulate SWF investment internationally, i.e. combing the soft law approach with hard law approach. Based on the analysis, this thesis proposes three regulatory models to regulate SWFs investment at a general level, further regulatory suggestions on international investment treaties, and discusses a proper option that could be adopted by China.

To achieve this goal and address the regulatory issues of SWF investment, this thesis should answer: why and how SWF investment need to be regulated internationally and in China? This question inherently includes concerns such as why is it necessary to regulate SWF investment? What are the key issues when regulating SWF investment? What are the problems of existing regulatory regimes for SWF investment? What kinds of regulatory model(s) is/are plausible to regulate SWF investment from a general perspective and the Chinese perspective?

3. Research Method and Structure

The thesis is conducted primarily through a library-based research approach. It

consists of the literature review from diverse sources, such as books, journals, information and data from official websites, and documents from international organisations (e.g. UNCTRAL, IMF, OECD) or professional institutions (e.g. SWF Institute). It involves a process more complicated than the accumulation of relevant materials; furthermore, it integrates different arguments systematically and develops new thoughts concerning the regulation for SWF investment in a creative way.

In order to achieve the goal of the thesis, this research mainly analyses substantive and procedural issues concerning SWF investment by undertaking doctrinal research and comparative study.

3.1 Doctrinal research

To provide a comprehensive approach with regard to the regulation for SWFs investment, this thesis analyses various legal documents concerning the general foreign investment, financial regulation and specific state capital investment. It analyses legal regulations in selected jurisdictions, i.e. the US, UK and China, in order to provide an overview of current situation of SWF investment in major host countries. The main reason to select these three jurisdictions as the examples is that although the UK and US have mature capital markets and they advocate open market, they adopt different and even opposite views toward inward SWFs investment (or sovereign investment). The US takes a more restrictive approach while the UK adopts a more permissive approach towards SWF investment (although the UK government currently proposes to reform domestic legislation to address national security issues in critical infrastructure). Since China is upgrading and opening up its domestic market, as home country and host country of SWFs investment, it is wise for China to consider or analyse experiences from the US and UK thus finding a proper position in the regulatory response to SWF investment.

The thesis also examines the international regulations of foreign investment, especially specific regulations for SWFs investment, e.g. international principles concerning foreign investment and national policy-making, international investment agreements (IIAs) (including BITs and investment chapters in FTAs), and international agreements or conventions concerning investment dispute settlement.

This helps to understand the existing regulatory landscape for SWF investment and then find a plausible way to regulate SWFs relevant issues for the interest of both SWFs and host countries.

3.2 Comparative study

The thesis develops a comparative study among the UK, US and China in order to explore the current policy landscape for SWF investment activities, to survey the development and to identify challenges that legislators or policymakers have encountered in each country. It observes and explains the differences and similarities among these countries and explores whether the future development of regulations for SWF investment in China can be inspired by other experiences.

It also develops a comparative study among existing international regulations with respect to SWF investment. It compares the bilateral and multilateral (or international) approaches; the hard law regulations (IIAs) and international soft law regulations (guidelines provided by IMF and OECD), to find an appropriate approach to regulate SWF investment, i.e. combining the soft regulation with hard law approach under a broader framework. In terms of dispute resolution, it compares existing major dispute resolution mechanisms, e.g. local remedies, investment treaty protection, DSB under WTO and other possible mechanisms. It aims to find a plausible way to address issues arising from SWF investment and to provide deserved rights and sufficient protection for SWFs.

Based on the analysis, this thesis could answer the research questions and further propose regulatory models to regulate SWFs at the general international level and find a proper option for China to regulate SWF investment.

3.3 Structure of the thesis

Chapter one questions the necessity to regulate SWF investment from a general perspective. It involves the analysis of the rationale to regulate SWFs from the theoretical and practical aspects. This discussion relies on a comprehensive analysis of SWFs *per se* and a theoretical analysis of 'regulation' *per se*. The following

questions are firstly considered: what is SWF? What are the features of SWF investment? Why does it need to be regulated? It is important to sort out these fundamental issues before questioning the choice of applicable rules. This chapter examines these issues in details. In particular, it examines the nature of SWFs and their characteristics. It further assesses the role of SWF investment in the global market, and the challenges and issues caused/raised by the development of SWFs. Finally it provides the theoretical and practical reasons for regulating SWF investment. Various forms of regulations that could apply to SWF investment are examined in this chapter.

Chapter two examines the legal relations, legal conflicts as well as the proposed regulatory measures in literature, to clarify what should fundamentally be considered when regulating SWFs investment. It firstly examines the legal relations involved in SWF investment. It then discusses the conflicting interests between investment protection and state sovereignty. The phenomenon of SWFs suggests that developed countries have changed their position toward investment protection. Thirdly, it examines the conflicting interests between open market (liberalisation) and national security to assess how to balance these interests between or among involved parties. Finally, this chapter examines existing regulatory proposals in literature designed for SWF investment. By considering the theoretical underpinning of legal regulation, SWFs should be regulated in a justified framework to avoid protectionism and to protect their deserved rights.

Chapter three examines and compares domestic regulations in selected jurisdictions to see whether SWFs are regulated under a justified framework at the national level. It mainly compares relevant regulations with regard to foreign investment in the UK, US and China. It firstly discusses legal responses and attitudes towards SWFs in major host countries in general. It then examines relevant regulations on foreign investment in the UK and its attitudes towards SWF investment. These regulations and positions not only reflect its domestic policy but also are affected by the EU law. Thirdly, it analyses the existing regulations in the US, where relevant regulations have been reformed and special national security review mechanism has existed to tackle foreign-controlled investment or investment with foreign government background. It analyses the foreign investment regulatory regime in China. Apart from being the

home country of several large SWFs, China has become an attractive destination to foreign SWFs investment as well. It finds that relying only on unilateral measures cannot help balance the interests between SWFs and host countries, and issues of SWFs should be discussed under a broader framework.

Chapter four analyses whether the existing international regulations of SWFs investment can address potential issues, and can provide legitimate protections for SWFs. It firstly examines regulations at the bilateral level, to see whether SWFs are covered by existing IIAs, especially BITs. An arrangement related to SWFs investment is discussed. It then discusses whether SWF investment could be regulated under the WTO framework and whether WTO is a suitable platform to address foreign investment issues. It examines the investment provisions in TPP and in the draft context of TTIP, to see whether SWFs and SWF investments are covered by these IIAs. It then examines international soft law regulations provided by the IMF ('Santiago Principles') and OECD to regulate SWFs relevant issues. It finally compares the existing regulatory approaches at the international level to assess the advantages and weakness of each approach and find out a plausible way to regulate SWFs, i.e. combining the hard law approach with the soft law approach and promoting the cooperation between IMF and OECD.

Chapter five discusses issues of SWF investment regarding dispute resolution. It aims to find out the legal standing of SWFs in available dispute settlement forums. To further understand the legal status of SWFs, it firstly discusses the implication of procedural treaty protection for SWF investment. It questions whether SWFs could invoke state immunity in selected jurisdictions. The conclusion reached on the definition and characteristics in Chapter one helps identify this question. It then analyses the existing dispute settlement mechanisms that may apply to SWF investment disputes. It analyses the role of local remedies in treaty protection and argues whether it is suitable to address SWFs relevant disputes via domestic legal system. It further questions whether SWF investment can be effectively monitored via investor-state dispute settlement (ISDS), especially the legal standing of SWFs under ICSID jurisdiction. If SWFs are accountable in ISDS, they will increasingly behave as private investors. Lastly, it analyses other forums to address SWF investment. The ICC arbitration, SCC arbitration, and ad hoc arbitration under UNCITRAL Rules, as

well as dispute settlement mechanism within the WTO framework are discussed, followed with an assessment of the investment court system proposed by the EU.

Chapter six proposes suggestions for existing regulatory framework and provides a choice of regulatory models from the general perspective. It tests these models in the context of China and further proposes suggestions for China to regulate and protect SWF investment. This chapter firstly assesses issues of SWFs (Chinese SWFs in particular) that remain to be clarified. Three regulatory models based on the legal status and issues of SWFs are proposed in this section. It secondly provides a series of suggestions or proposals for existing international regulations. It suggests that host states and home states can choose to regulate SWFs and to address remaining issues in IIAs, with a further clarification in substantive and procedural provisions. The GAPP as code of conduct for SWFs should be further improved. The third section examines the regulatory concerns of SWFs and tests proposed regulatory models in the context of China. It further discusses the current domestic reforms and treaty practices of China to help China find a plausible way to regulate Chinese SWFs and foreign SWF investment, and to balance conflicting interests.

CHAPTER 1 THE NECESSITY TO REGULATE SOVEREIGN WEALTH FUNDS IN THE GLOBAL MARKET

Chapter Introduction

Sovereign wealth funds (SWFs), or government investment funds, as institutional investors,[1] have not attracted widespread attention until the outbreak of 2008 financial crisis. SWFs have become important players in the financial market and have sparked a heated discussion. Some see SWFs as an opportunity for boosting international investment, capital flow, while others view SWFs as threats to market stability and national security of host countries. Although various regulations are in place to protect public interest or national security and to control foreign investment, the fear of SWF investment results in a call for additional or special regulations at domestic and international level. But, SWFs, as foreign investors, should receive sufficient or deserved protection. It therefore remains to be seen a plausible or considerable approach to regulate SWF investment.

This chapter aims to lay a foundation for the entire research, by questioning the necessity to regulate SWFs. The following questions should be firstly considered: what is SWF? What are the features of SWF investment? Why does it need to be regulated? It is important to sort out these fundamental questions before considering plausible regulations for SWF investment. In particular, this chapter examines the nature of SWFs, and the differences between SWFs and other similar sovereign investment instruments. It further assesses the role of SWF investment in the global market and its relevant implications, as well as challenges caused by the development of SWFs. It argues the theoretical and practical underpinnings for regulating SWF investment, with a brief discussion on various forms of regulations that apply to SWF investment.

[1] Institutional investors are entities that invest money or resources to securities and assets. SWFs are usually regarded as 'alternative' institutional investors since they are relatively new and have merged as a complement to traditional types of institutional investors. See S. Çelik and M. Isaksson, 'Institutional Investors and Ownership Engagement' (2014) 2 OECD Journal: Fin. Mar. Trends 93, 100

1. The Definitions and Characteristics of SWFs

The term of 'SWF' is familiar to economist but is relatively new to policy makers or regulators. Before analysing the theoretical and practical issues of SWFs, it is reasonable to revisit the concept and features of SWFs.

1.1 SWFs defined and classified

1.1.1 Definitions in literature

The definition of SWFs can be found in various literature and official documents, but these suggested definitions are various standpoints without a shared notion. The term of 'SWF' was firstly coined by Andrew Razanov. According to Razanov, SWFs are 'a by-product of national budget surpluses, accumulated over the years due to favourable macroeconomic, trade and fiscal positions, coupled with long-term budget planning and spending restraint.'[2] He treats SWFs differently from traditional public-pension funds (benefiting social welfare) and reserve assets (supporting national currencies). SWFs are regarded as a reflection of the availability of national reserve or revenue surplus and of the desire to diversify the source of the revenue via SWF investments.[3] Scholars and economist further narrow or extend this term.[4]

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[2] A. Razanov, 'Who Holds the Wealth of Nations?' (Aug 2005) SSGA, 1 <http://www.libertyparkusafd.org/Hancock/Special%20Reports/Sovereign%20Wealth%20Funds/Who%20Owns%20the%20Wealth%20of%20Nations%20-%202005.pdf> accessed 30 November 2014

[3] S. Kern, 'Sovereign Wealth Funds – State Investment on the Rise' (10 Sep 2007) Deutsche Bank Research, 2 <http://faculty.nps.edu/relooney/0_New_2679.pdf> accessed 30 November 2014. See also J. Chaisse et al., 'Sovereign Wealth Funds in the Making: Assessing the Economic Feasibility and Regulatory Strategies' (2011) 45 (4) J. W.T. 837, 838

[4] For the narrow definition, Rose suggests that SWFs are a pool of capital established by government to invest surplus wealth in private market. See P. Rose, 'Sovereign Wealth Funds: Active or Passive Investors?' (2008) 118 Yale L. J. Pocket Part 104. Lyons points out that SWFs are an investment tool managed by Monetary Authority, but it does not include the traditional foreign exchange reserves and the government pension funds. See G. Lyons, 'State Capitalism: the Rise of Sovereign Wealth Funds' (2008) 14 L. & Bus. Rev. Am. 179. For the broad definition, see E. Truman, 'Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications' (2007) Testimony before the Committee on Banking, Housing, and Urban Affairs, 2 <http://www.iie.com/publications/testimony/testimony.cfm?ResearchID=842> accessed 15 October 2014. He explains:

> Sovereign wealth fund is the descriptive term applied to separate pools of international assets owned and managed by governments to achieve a variety of economic and financial objectives. They sometimes include domestic assets as well. Those assets may be managed directly by a government entity or may be subcontracted to a private entity inside or outside the country.

For the expansive definition, Balding states that the definition of SWFs encompasses government For the expansive definition, Balding states that the definition of SWFs encompasses government pension funds, development banks, and other sovereign investment vehicles. See C. Balding, 'A Portfolio Analysis of Sovereign Wealth Funds' (2008)

Some scholars suggest that three common requirements/criteria should be considered when defining SWFs, i.e. ownership, source of funding, and the purpose and form of investment.[5] Bassan claims that the ownership and investment purpose should be taken into consideration, as it helps to meet the purpose of 'regulation' and to tackle those SWFs that could raise concerns.[6] These suggested definitions consist of subjective elements,[7] and objective elements.[8] But most of them remain certain ambiguities and are not authoritative, as some include other similar investment instruments or elements while others are not.

1.1.2 Classification of SWFs in literature

According to different institutional structures, some scholars classify SWFs into five categories, i.e. stabilising funds, offsetting funds, saving funds, preventive funds and strategic funds.[9] Stabilising funds are established to reduce the implication of accidental fluctuations over fiscal and economy budget, and to stabilise national revenue; offsetting funds are created to assist the central bank to balance foreign exchange reserve (FX reserve), and to absorb excessive liquidity; saving funds are established to stabilise and ensure national wealth for future generations; preventive funds are created to prevent the hazard from national social and economic crisis, and to promote stable development of the society and the economy; strategic funds are established to support national development strategy, to optimise asset allocation, and to better serve national interest in international economic activities.[10]

Some, by analysing the source of funding, argue that SWFs can be funded through (i)

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1141531> accessed 15 October 2014

[5] P. Xie and C. Chen, 'The Theoretical Logic of Sovereign Wealth Funds' (2009) 2 Econ. Res. J. 4 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420618> accessed 19 December 2014

[6] F. Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar Publishing 2011) 31-32. He suggests that SWFs are:

> 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.

[7] Subject elements in this thesis refer to the sovereign background (state ownership), funding resources, legal status or legal structure of SWFs.

[8] Object elements refer to the nature of SWFs investment e.g. investment objectives, investment policy or the form of investment activities.

[9] C. Chao, 'The Rise of Global Sovereign Wealth Fund' [2006] Modern Bankers, 10; See also Xie and Chen (n 5)

[10] ibid

pension contributions; (ii) fiscal revenue from the direct ownership, or taxation, or commodities; (iii) non-commodity based assets, e.g. FX reserve.[11] Some, focusing on the legal status of SWFs, classify SWFs into three categories: SWFs are (i) a pool of assets without a separate legal identity, owned by the state or monetary authorities; or (ii) state-owned corporations with independent legal liabilities; or (iii) separate from other part of central banks' reserves.[12] In terms of their forms, as sovereign investment instruments,[13] it is assumed that SWFs are sometimes used indiscriminately to include in one or more categories, e.g. state-owned enterprises (SOEs), stabilisation funds, public pension funds, central banks, or government investment corporations.[14] Although SWFs and other sovereign investment instruments share similarities, SWFs can hardly be classified into only one group, since SWFs *per se* are a heterogeneous group.

Others classify SWFs in light of liability or accountability. According to Razanov, SWFs could be classified based on their liabilities, but the source of funding and the purposes to operate SWFs were not analysed.[15] Some authors emphasise the relevance of accountability, i.e. private and public accountability, internal and external accountability, when identifying SWFs, but cannot properly explain the way to operate SWFs.[16] Although liability and accountability are relevant elements to define or classify SWFs, these elements can hardly be used to explain the whole

[11] A. Lenihan, 'Sovereign Wealth Funds and the Acquisition of Power' (2014) 19 (2) New Pol. Econ. 227, 231-232. Based on the Sovereign Investment Lab Database, some scholars believe that the source of funds come from commodity (oil or gas), trade surplus, non-commodity and some SWFs are government-linked firms. See B. Bortolotti et al., 'The Rise of Sovereign Wealth Funds: Definition, Organization, and Governance' in S. Caselli et al. (eds) *Public Private Partnership for Infrastructure and Business Development* (New York: Palgrave Macmillan, 2015) 300-301

[12] A. Al-Hassan et al., 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management' (2013) IMF Working Paper 13/231, 3 <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Sovereign-Wealth-Funds-Aspects-of-Governance-Structures-and-Investment-Management-41046> accessed 10 November 2014. See also Beck and Fidora (n 5) 354 in Introduction

[13] Sovereign investment instrument is often regarded as state-backed investor, which means that the investor is owned or controlled by the general government as a tool to carry out public investment policies and strategies. The main forms of sovereign investment instrument include state-owned enterprises (SOEs), sovereign wealth funds (SWFs), and public pension funds. See K. Sauvant et al., *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 496

[14] E. Greene and B. Yeager, 'Sovereign Wealth Funds – A Measured Assessment' (2008) 3(3) CMLJ 247, 249

[15] The liabilities of SWFs can be divided into four profiles: contingent liabilities, typical of stabilization funds; fixed future liabilities, typical of national pension reserve funds; mixed liabilities; open-ended liabilities. See A. Razanov, 'Sovereign Wealth Funds: Defining Liabilities' (2009) 9 Revue d'économie financière (English ed.) 283, 284

[16] A. Gelpern, 'Sovereignty, Accountability, and the Wealth Fund Governance Conundrum' (2011) 1(2) AsianJIL 289

picture of SWFs, as these partly depend on the level of democracy of sponsoring countries.

1.1.3 SWFs defined by authorities and international organisations

Compared with definitions in academic literature, several state authorities and international organisations try to define SWFs from a more practical perspective. The US Treasury defines SWFs as 'a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves.'[17] International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD) have made efforts to address issues of SWF investment and provided relevant guidelines.

IMF commits itself to eliminate the uncertainty of SWFs and to enhance the understanding of SWFs. With the support of IMF, the International Working Group of Sovereign Wealth Funds (IWG),[18] provided a definition for SWFs in *Generally Accepted Principles and Practices for Sovereign Wealth Funds* (GAPP) (or the so-called 'Santiago Principles'):

> SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macro-economic 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.[19]

Three elements are included in this definition, i.e. ownership, investment strategies,

[17] US Treasury, 'Remarks by Acting Under Secretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System' (21 June 2007) <https://www.treasury.gov/press-center/press-releases/Pages/hp471.aspx> accessed 19 December 2014

[18] IMF established the IWG in 2008 to develop and identify best practices or code of conducts for SWFs as a response to worries of SWFs raised by host countries. In October 2008, 25 countries hold SWFs agreed on the GAPP designed by IWG. These principles provide a framework for SWFs in aspects of legal, organisational, investment and risk. The IWG, in 2009 was changed into International Forum of Sovereign Wealth Funds (IFSWF) as a voluntary organization for global SWFs. As of September 2017, the IFSWF has 30 member funds including some large SWFs e.g. China Investment Corporation (CIC), Kuwait Investment Authority (KIA), Abu Dhabi Investment Authority (ADIA).

[19] IWG, 'Sovereign Wealth Fund, Generally Accepted Principles and Practices' (2008) IMF Working Paper, 27 <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> accessed 5 January 2015

and purposes and objectives. Further on this definition, GAPP recognises the heterogeneous characteristics of SWFs and then classifies SWFs into saving funds, reserve investment corporations, fiscal stabilization funds, development funds, and pension reserve funds without explicit pension liabilities. Moreover, GAPP defines SWFs by exclusion:

> This definition excludes, inter alia, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.[20]

However, although this definition provides a kind of clarification for SWFs, it still contains several limits.[21] Firstly, the 'investment strategy' cannot be treated as an accurate element, as SWFs can change strategies over time. At least two specific groups of sovereign funds cannot be covered. The first group includes those funds that primarily or exclusively invest in domestic markets.[22] Market barriers in several host countries or the cost of compliance (high standards or requirements) may lead some funds to keep focusing on domestic businesses, in which they can act as more powerful roles than in offshore.[23] The other includes the excess assets or FX reserve hold by monetary authorities or central banks that are invested in non-traditional financial products (e.g. central banks in Singapore, China, and Saudi Arabia).[24]

Secondly, this definition may exclude those funds owned by sovereign regulators, especially in Middle East countries.[25] Another limit lies in the fact that this definition

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[20] ibid

[21] SWFs included in the database of Sovereign Wealth Funds Institute (SWFI) are more than those falls into the definition of SWFs in the GAPP. For example, Hong Kong Monetary Authority Investment Portfolio (China-Hong Kong), SAFE Investment Company (China) and National Social Security Fund (China) are included by SWFI but excluded by the definition in GAPP. See SWFI, 'Sovereign Wealth Fund Rankings' (updated Sep 2017) <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/> accessed 5 October 2017

[22] These funds are mainly established in developing countries, such as State Capital Investment Corporation (Vietnam), Samruk-Kazyna National Wealth Fund (Kazakhstan), Mubadala Development Company (Abu Dhabi). Some of these funds already actively undertake overseas investment. Temasek Holdings (Singapore), which is classified by GAPP as an SWF, was originally established as sovereign fund investing exclusively in domestic businesses and operated domestically for at least two decades, while a large number of its portfolio is currently invested overseas. See A. Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds' (2011) 1 AsianJIL 249, 258.

[23] Bassan (n 6) 30

[24] Rozanov (n 22) 258

[25] ibid

is reached on an assumption that pubic pension funds are totally different from SWFs, while sometimes they overlap.[26] Some public pension funds have the capacity to invest in a same manner like a SWF and to raise same issues for public policies. It is suggested by some scholars that this definition should be extended, to encourage those sovereign funds that behave like these covered SWFs as members of GAPP.[27]

Rather than providing any specific definition, OECD only describes the issues of SWFs in general. OECD has had tried to create a more friendly investment environment for SWFs by providing guidelines for host countries.[28] SWFs are described by OECD as the effort by owners of foreign exchange assets to manage these assets in a more proactive and sophisticated way.[29]

A decision made on whether or how a subject or a conduct should be regulated and protected cannot disregard its preliminary qualifications. Any specific constraints on SWF investments or any exceptions used by host countries to protect national security or public order would only be justified if the nature of SWFs and of their investments were clarified, defined or considered within the same framework for other types of investors. Several definitions mentioned above, however, are mutually incompatible with one another. Hence the scope of SWFs group could be easily narrowed or expanded, which does not help to understand issues of SWF investments and even to protect them. In addition, so far, only IMF has provided a specific regulation, i.e. GAPP for SWFs. But the limits of this definition might narrow the scope of the regulation for SWFs.

1.2 Suggested definition and classification

The above analysis suggests that a single, specific and shared notion on SWFs has not been achieved. Definition and classification of SWFs are important to understand

[26] A. Blundell-Wignall et al., 'Sovereign Wealth and Pension Fund Issues' (2008) OECD Working Papers on Insurance and Private Pensions No.14, 5 <http://www.oecd.org/finance/private-pensions/40345767.pdf> accessed 10 November 2017

[27] Rozanov (n 22) 259. See also E. Truman, *Sovereign Wealth Funds: Threat or Salvation?* (Peterson Institute for International Economics 2010) 10

[28] The OECD disciplines indicate that host countries are supposed to adopt those principles and rules not legitimately but voluntarily.

[29] OECD, 'Sovereign Wealth Funds and Recipient Country Policies' (2008) Investment Committee Report, 2 <http://www.oecd.org/investment/investment-policy/40408735.pdf> accessed 3 March 2015

SWFs *per se* and possible issues of SWFs investment. The rise of SWFs is indeed an economic and financial phenomenon, but a 'purely economic' or narrow definition cannot help regulators to address specific concerns.[30] Furthermore, if general rules and regulations are not sufficient to address these issues, specific or additional regulations may be required.[31]

The plausible way to regulate SWFs, in the thesis, should aim to encourage SWFs to act in good faith and to comply with rules in host countries and minimum international standards, and also to provide sufficient protection for SWFs. Besides, it is important that the measures of host countries would be justified, non-discriminatory, proportionate for legitimate public interests via due process. Moreover, the definition from a legal perspective would consider the main concerns of host countries.[32]

1.2.1 Proposed definition in this research

A definition for regulation should consider the subjective factor,[33] objective factor (nature of investment, investment strategies), and the purpose (purpose of establishment and of operation).[34] It should be emphasised that although the final goal of existing SWFs inevitably and inherently contains social and macroeconomic considerations, SWF investment activities focus on maximising profits and returns, and then they can guarantee the objectives when they were created. Hence, in this thesis:

SWFs are investment funds (existing as independent corporations or operated by

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[30] Bassan (n 6) 30

[31] ibid 31

[32] For example, the U.S. government expressed the concern of SWFs investment in its territory:

> Sovereign wealth funds have been around for decades, but China's recent entry into this field, together with investments in large Wall Street firms by the funds of Middle Eastern countries, have raised questions about the power that these massive funds may have over United States national security interests.

See E. Truman, 'The Rise of Sovereign Wealth Funds: Impacts on U.S. Foreign Policy and Economic Interests' (2008) Testimony before the Committee on Foreign Affairs <https://piie.com/commentary/testimonies/rise-sovereign-wealth-funds-impacts-us-foreign-policy-and-economic-interests> accessed 10 November 2014

[33] In this research, subjective factors refer to how SWFs are created, by which they are created and who owns or controls them i.e. legal identity/structure, funding resources, governance structure and accountability.

[34] The operational purposes include the aims and motivations when SWFs investing in domestic and overseas markets, such as commercial consideration, social consideration (e.g. stabilization, improvement of national welfare). In this research, although their purposes of establishment and their final functions may various, including sovereign or commercial, but their investment activities are based on proceeds even value-added.

governmental authority) established, owned, or managed by the (central or subnational) government with special investment purpose. This fund aims to achieve financial objectives by managing or investing surplus national wealth, and undertaking portfolio and direct equity investment.[35]

This definition, on one hand, does not exclude those SWFs that primarily or exclusively invest in domestic assets, and those public pension funds that are similar to the behaviours of SWFs, as well as funds controlled by central banks that invest in non-traditional foreign assets. On the other hand, it does not exclude those sovereign funds conducting strategic investment. For the purpose of 'regulation', from the subjective perspective, if funds are not established and owned by the government, or if they are not funded by surplus national revenue or special fiscal arrangement, they may be excluded from the SWFs group. From the objective perspective, if funds (directly or indirectly operated by the government or central bank but separately from traditional assets) engage in commercial activities rather than perform or exercise governmental functions, they are covered. In addition, in this thesis if funds do not invest in strategic sectors or do not have risk profile, additional requirements or special regulations should not be enacted, or adopted or considered. Existing special rules for specific concerns should not target SWFs only due to the state ownership but impose on all investors.

1.2.2 Suggested classifications

Subjective factors, objective factors and purposes are helpful to classify SWFs. In terms of legal identity or legal structure, SWFs could be independently from or be tied to the government, and SWFs could be a public entity or private entity based on the public law or private law support.[36] The governance structure is based on the legal structure of SWFs. If a SWF has no separate legal identity, its governing agency may

[35] This means that SWFs investments not only include buy-sale securities, holding shares of companies without voting power in listed companies, or in equity market, or in real states and infrastructure etc., but also acquisition of equity interest in listed companies in domestic and international market, and investments in industrial sectors that considered strategic by host country.

[36] Among current SWFs, some of them do not have a separate legal identity from their home state, e.g. Government Pension Fund (Norway), Oil Revenues Stabilization Fund of Mexico (Mexico), Reserve Fund and National Wealth Fund of the Russian Federation (Russia). In these cases, there are specific rules governing the asset pool. Other funds are independent legal entities but some of them are established under public law (specific constitutive law) such as Korea Investment Corporation (KIC), Kuwait Investment Authority (KIA), Abu Dhabi Investment Authority (ADIA), while others are governed by private law as state-owned corporation (generally company law or other SWF-specific laws), such as China Investment Corporation (CIC), Singapore Temasek Holdings Limited and Government of Singapore Investment Corporation (GIC). See IWG (n 19).

consist of government officials while its operation management may be delegated to the central bank or a statutory management body.[37] Suggested by Bassan, those funds with independent governance structure, their actual degree of independent operation from the government should also be assessed.[38] Those funds should find a proper way to manage independently from the government, e.g. employing professional institutions or external manager. It should be emphasised that SWFs usually have the board of directors, but in fact, some are simultaneously government officials while others are mixed with government officials and external managers.[39]

The legal structure and governance structure can influence the accountability of SWFs to the government, the stakeholder, the shareholder and also the creditors, i.e. the public and private accountability of SWFs. In terms of funding sources, the government, citizens or taxpayers are both stakeholders and shareholders of SWFs. The private law concerning the governance and legal structure affects the accountability of those independent SWFs to shareholders and creditors while public law affects both independent and non-independent SWFs to stakeholders by requiring the disclosure of audited financial reports or regularly reporting to relevant government authority.[40] Apart from that, the level of democracy of the home country and the level of transparency also affect their accountability.

In terms of purposes and objectives, those funds that aim to provide benefits to the public welfare or public policies are typically sovereign while those funds that aim to increase financial returns from investments are more commercial. For example, in terms of sovereign purposes, Kuwait Investment Authority (KIA), Reserve Fund (RF) in Russia, Oil Income Stabilization Fund (OISF) in Mexico, etc. are SWFs for the sake of stabilisation; Abu Dhabi Investment Authority (ADIA), Qatar Investment Authority (QIA), etc. are SWFs with purposes for future generation savings. For

[37] For example, According to the Pension Fund Act, the owner of the Government Pension Fund (Norway) is the Ministry of Finance while the operational management is delegated to Norges Bank. The fund is partly managed internally by the Bank and partly managed by external managers appointed by the Bank on a commercial basis. ibid

[38] Bassan (n 6) 33

[39] For example, CIC is a state-owned corporation under the Company Law in China. Although the government officials set in the board of CIC, it has also employed external managers. CIC operates independent from the governmental authorities e.g. the People's Bank of China (PBOC, central bank) and the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), but it is account to the State Council.

[40] Bassan (n 6) 33

commercial purposes, China Investment Corporation (CIC), Government of Singapore Investment Corporation (GIC), and Korea Investment Corporation (KIC), etc. are those with return-optimisation purposes. There are also some SWFs with diversified purposes such as Singapore Temasek Holdings (Temasek), Public Investment Fund in Saudi Arabia. The purpose element is relevant to concerns of host countries, protectionist measures and state immunity. It is therefore necessary to differentiate SWF investments with sovereign purposes (public investment) from those with commercial purposes (private investment).[41]

However, the focus should be put on the purpose/objective of investment rather than the purpose of establishment. The purpose/objective of investment may change due to various reasons. Therefore, it is hard to solely judge or investigate the purpose behind their investments, while it is important to examine the nature of their investments (commercial or sovereign, portfolio investment or direct investment, and which sectors SWFs invest in), on a case-by-case basis.

This thesis classifies SWFs into following types: SWFs (i) without separate legal identity, can independently make decision within their legal and governance structure; (ii) without separate legal identity, cannot independently make decision; (iii) with separate legal identity and proper legal and governance structure, operate independently; (iv) with separate legal personality, can hardly make decision independently and can hardly manage separately from relevant government authorities within their legal and governance structures. Besides, it is important to notice that elements that might raise concerns from host countries are the purpose of investment (sovereign or commercial), the nature of investment (form of investment

[41] In the view of some scholars, the commercial purpose of SWFs investment is used to conceal the political motives from home countries, or their commercial purposes may only exist in initial stage during investment. See Lenihan (n 11) 228. Lenihan explains that:

> Even if a SWF does not invest on the basis of political motivations today that does not mean that it will not (or cannot) do so tomorrow. Similarly, though these investment generally have not been found to cause market distortions or volatility, it cannot be implied that they may not eventually cause other negative economic impacts.

Green and Forry are afraid of that:

> The motive principally to maximize financial profits from investments – which characterizes most private investors – may be displaced by political motives, so that SWFs are used in a political capacity either to benefit the investing country (outside of financial gains on investments) or to harm the investment host or another country, essentially undermining the usual operations of financial markets.

See M. Green and J. Forry, 'Sovereign Wealth Funds: International Growth and National Concerns' (2010) 127 Banking L. J. 965, 971

and invested sectors) and the governance structure of SWFs (the level of independence from government in decision-making and management).

1.3 Differences between SWFs and other sovereign investment instruments

To further understand SWFs, the similarities and differences between SWFs and other similar entities should be clarified.

1.3.1. SWFs and Foreign Exchange Reserves

Since some SWFs are funded by revenues from FX reserves held by the central bank and are established to manage these reserves, sometimes, it is easily to treat those SWFs as traditional FX reserve.[42] Although SWFs and FX reserve share certain similarities, differences are obvious.

Firstly, FX reserve is foreign currency held by central bank or monetary authority, which is an important part of a country's debt-servicing capacity, and a means to influence domestic exchange rate, and to back domestic currency.[43] It is a reflection of balance sheet of central bank. But SWFs are separated from FX reserve and are established for social and macroeconomic consideration to pursue long-term returns generated from their investment activities. SWFs have their own independent balance sheets and financial reports.

Secondly, FX reserve as an important means of macro-control by the government is greatly influenced by the balance of payments (vice versa) and policy of exchange rate. Whereas, SWFs are seldom affected by international payments and exchange rate policy as they operate independently from official FX reserve.

Thirdly, SWFs operate in a more active way. SWFs utilise diversified investment

[42] For example, The Pula Fund (Botswana), GIC (Singapore) and CIC (China) are funded by the balance of payments surpluses or foreign reserves. But, actually, CIC is not directly funded by foreign reserves, but is funded via a special treasury bonds issued by the Ministry of Finance, to operate these currency reserves for the benefit of the state.

[43] IMF, 'Debt – and Reserve – Related Indicators of External Vulnerability (23 March 2000) <http://www.imf.org/external/np/pdr/debtres/> accessed 20 November 2014

strategies with a wide variety of instruments or portfolios (e.g. equity, debt, private investments, alternatives, real estate, etc.) to create financial returns. On the contrary, FX reserves are usually managed in a very conservative or passive manner with little profit-making motives.

Many countries set aside excessive FX reserve from central bank and then establish SWFs to spin off its traditional function, which are, no longer, associated with exchange rate or monetary policy. Another reason to differentiate SWFs from FX reserve is that usually FX reserve held by central bank to pursue sovereign strategies or in exercise of governmental function can invoke state immunity.

1.3.2 SWFs and State-Owned Enterprises

When discussing issues of SWFs, some policy-makers usually treat SWFs and SOEs as the same, since they are sovereign investors that may raise similar concerns, while some scholars attempt to distinguish SWFs from SOEs.[44] However, although both of them are state-owned and undertake direct investment, several differences exist.[45]

Firstly, it could be suggested that SWFs and SOEs can engage in a same transaction, but their relationship with their funding is different.[46] SWFs, funded by excessive national revenue, are totally owned by the state, while SOEs, funded by corporate profits and government grants, are partly controlled by the central or local government.[47]

Moreover, SOEs are corporations with independent legal personality according to corporate law, while as discussed before SWFs may have different legal and governance structures so that not all of them are totally separate from the

[44] L. Backer, 'Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience' (2009) 19 Transnat'l L. & Contemp. Probs. 101
[45] Different countries may have different definitions for SOEs. According to OECD, "any corporate entity recognised by national law as an enterprise, and in which the state exercise ownership, should be considered as an SOE". See OECD, 'OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition' (2015) <http://www.keepeek.com/Digital-Asset-Management/oecd/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en#.WcRQShRtbhg#page4> accessed 20 January 2015
[46] Backer (n 44) 179-184
[47] Bassan (n 6) 22

government.[48] As to the accountability, SOEs are responsible to their shareholders while whether SWFs are accountable to their stakeholders and shareholders depends on the requirements of their home countries.

Furthermore, SOEs are usually product-providers or service-providers, while SWFs as institutional investors are usually shareholders of these providers.[49] Moreover, SWFs usually prefer undertaking portfolio investment with passive investment strategies while SOEs often undertake direct investment, i.e. merger and acquisitions (M&A) or green-field investment.[50] Being more active, SOEs usually seek to control over target companies. It should be noticed that several SWFs are increasingly actively making direct equity investment. But, owing to the fears of the valuations of private business and the low commodity prices, direct investments made by SWFs have fallen during the last two years.[51]

In terms of purposes and/or objectives, SOEs pursue a private interest, which means the development of and profit to themselves, while although SWFs invest for financial returns they are established for public or social interest. However, both SOEs and SWFs are often suspected to pursue political objectives because of their sovereign background/state ownership, which is particularly the case when talking about Chinese SOEs and SWFs.[52]

But, in practice, it is usually SOEs rather than SWFs that trigger political anxiety or backlash. This could be attributed to their direct investment in strategic assets and the

[48] Xie and Chen (n 5). They explain that "SOEs are corporations regulated by the general company law while SWFs may take three forms: a pool of assets, a legal entity under a specific public law, or a legal entity under the general company law. Most SWFs take the third form and act strictly as a business entity."

[49] SWFs are financial investors, when investing into corporations, holding shares of these companies that provide different types of services, while SOEs is are enterprises directly involved in manufacturing, operating infrastructure, extracting natural resources and delivering services. See D. Gallo, 'The Role of law, the Rule of Law and the Rise of Sovereign Wealth Funds: the Need for A Greater External and Internal Activism of European Union' (2014) LUISS Academy Working Paper No.1, 3 <http://eprints.luiss.it/1295/1/WPG_01-14_Gallo.pdf> accessed November 2014

[50] Backer (n 44) 109

[51] A. Mooney, 'Sovereign Wealth Funds Steer Clear of Direct Investment' *Financial Times* (20 July 2016) <https://www.ft.com/content/42c80bee-4447-11e6-9b66-0712b3873ae1> accessed 30 July 2017; J. Espinoza, 'Sovereign Wealth Funds Move beyond Trophy Assets' *Financial Times* (19 March 2017) <https://www.ft.com/content/ac407e16-0b30-11e7-97d1-5e720a26771b> accessed 30 July 2017

[52] Backer (n 44)126; see also Qingxiu Bu, 'The Impact of the Chinese Sovereign Wealth Funds (SWFs) on Sino-EU Relations: The Leverage between Investment and Human Rights' (2015) 7 (2) Asian J. L. Econ. 197

role of SOEs played in domestic economy and in overseas investment of their home countries (in particular Chinese SOEs). The suspicion towards SWFs is aggravated due to the fact that Western economies treat investors with sovereign background (SOEs and SWFs) from other countries as a hostile to their interests, especially those sovereign investors undertaking direct investment or with low transparency profile and those from their hostility or competitors.

1.3.3 SWFs and Public Pension Reserve Funds

The concepts of public pension reserve funds (PPRFs) and of SWFs lead to some confusion, since some existing SWFs are funded by pensions via fiscal transfer.[53] To certain extent, SWFs and PPRFs share several similarities.[54] As PPRFs are increasingly undertaking overseas investment and investing in fixed income, listed equities, or alternatives (e.g. hedge funds-HF, private equity-PE), which are similar to SWFs, both of them may raise the concern of financial stability.[55]

However, there are still differences between SWFs and PPRFs. Firstly, being different from PPRFs, which are funded by employer and/or employee's contributions or governmental fiscal transfer, most SWFs do not have future liabilities that they are constrained to pay for. SWFs have long-term investment horizons and often are relatively free to invest in various assets.[56]

Secondly, in terms of the purpose of establishment, SWFs, as discussed before, are established for various economic and social considerations, while PPRFs are

[53] Like SWFs, there is no single, widely accepted definition of PPRFs. According to Blundell-Wignall, PPRFs could be defined as "funds set up by governments or social security institutions with the objective of contributing to financing the relevant pay-as-you-go pension plans". There are usually two sub- categories of PPRFs. The first type is Social Security Reserve Funds (SSRFs) as a part of the overall social security system, which is primarily funded by the payouts surplus from individuals or enterprises, with the shortage being made up by fiscal funds or other funds from the government. The second type is Sovereign Pension Reserve Funds (SPRFs), which refers to those funds directly established by the government via direct fiscal payment transfer, separate from the social security system. See Blundell-Wignall (n 26) 5

[54] Norway's Government Pension Fund-Global (GPFG) fit both the definition of SWFs and SPRFs. Australia Future Fund (FF) and New Zealand Superannuation Fund (NZSF) are also treated as SWFs. And GIC has a mix of SWF (FX reserves) and pension assets to manage. See IWG (n 19)

[55] For information about PPRFs investments, see OECD, 'Annual Survey of Large Pension Funds and Public Pension Reserve Funds: Report on Pension Funds' Long-Term Investments' (2015) <http://www.oecd.org/daf/fin/private-pensions/2015-Large-Pension-Funds-Survey.pdf> accessed 20 December 2015

[56] J. Oyedele, 'Infrastructure Investment and the Emerging Role of Institutional Investors: The Case of Pension Funds and Sovereign Wealth Funds' (2014) 3 Academic J. Interdisc. Stud. 43, 51

established to pay for future pensions and serve as long-term financing vehicle of public pensions and other related benefits.

Thirdly, regulatory requirements imposed on PPRFs investment are more specific and their managements are restricted with a clear time limit and scope. PPRFs usually invest in domestic capital market with the pressure from conservative investment requirements while SWFs usually invest in overseas markets and some SWFs are increasingly undertaking direct investment.[57] Although some SWFs invest in the domestic market, they are rarely assigned to meet specific governmental expenditures. Conversely, PPRFs invest assets to meet clearly defined liabilities.

Finally, as trustee, PPRFs must exercise their duties to obligees or creditors and are regulated by high transparency requirements. Most PPRFs are required to undertake social responsible investment,[58] while most SWFs are not constrained by these requirements.[59] However, it is still hard to differentiate SWFs from certain PPRFs (i.e. sovereign pension reserve funds). The database of SWF Institute suggests that some PPRFs are included in the list of SWFs.

1.4 The characteristics of current SWFs

SWFs are investors with hybrid features (public and private), i.e. sovereign background and commercial investment objectives.[60] Regarding sovereign background, the following arguments could be made. Firstly, since a SWF is funded by its government, the state ownership differentiates it from private capital. It implies that the government, acting as the regulator and shareholder, could supervise and manage this SWF. However, the state ownership does not mean that the operation of

[57] Blundell-Wignall (n 26)

[58] See S. Sethi, 'Investing in Socially Responsible Companies is A Must for Public Pension Funds – Because There Is No Better Alternative' (2005) 56 (2) J Bus. Ethics 99

[59] However, several SWFs has legal mandates or ethics guidelines to conduct socially responsible investment e.g. GPFG, NZSF and FF. This could be explained that these SWFs are also public pension funds.

[60] On one hand, SWFs invest in various assets in pursuit of commercial returns; on the other hand, SWFs are funded by government for the purpose of social development consideration. Moreover, SWFs are investment funds with sovereign background invest into private market. This kind of form and their operations may challenge the divisions between public and private spheres. Some scholars, however, suggest that this phenomenon can be treated as public power using private transnational power to intervene or influence private market even international market from both economic and political aspects. See Backer (n 44)

this SWF is inevitably affected by the government. As discussed before, the independent operation or decision-making of a SWF depends on the legal and governance structure of this SWF.

Secondly, compared to other private investors, SWFs are characterised by their distinct purpose and investment horizon. Private investors are usually driven by profit maximisation and conduct short-term investment, while SWFs mix commercial considerations (purpose of investment) with macroeconomic and social consideration (purpose of establishment) and they undertake long-term investment.[61] This feature may affect not only the investment objectives and asset allocations of SWFs, but also the risk tolerance of SWFs.

In addition, owing to their close ties with the government, it is usually of concerned that SWF investments are driven by political motivation and/or they conduct strategic investments with political and military purposes.[62] For example, CIC, a Chinese SWF, is suspected of acting as an extension of China's political strategy globally, which is controlled by the Chinese Communist Party.[63] Likewise, Russia is suspected of utilising its SWFs to achieve political objectives,[64] whereas, these doubts that blame state ownership and country of origin are usually based on an assumption or even discrimination for political rather than economic reasons. Concerns of SWFs could be reduced/addressed via a more neutral approach (e.g. building modern corporate governance and increasing transparency) but not via political/ protectionist measures.

Regarding commercial objectives, the following argument could be made. Firstly, SWFs are special-purpose vehicles,[65] in pursuit of high risk-adjusted returns.[66] They

[61] For example, Fiscal Responsibility Funds (Chile), is established to contribute to "macroeconomic stability and provide public assets increasing opportunities and social protection to Chileans"; the Libyan Investment Authority (Libya) aims at creating "a sustainable source of revenue, with a view to reducing dependency on oil"; the objectives of Oil Revenues Stabilization Fund of Mexico is to "lessen the effects on public finances of changes in the level of oil revenues derived from sudden variations in international oil prices". See IWG (n 19) 20, 34, 39-40

[62] H. McVea, 'Corrupting capitalism? Sovereign Wealth Funds and the United Kingdom's Regulatory Framework' (2013) 4 JBL 434, 437

[63] Backer (n 44) 263

[64] O' Brien (n 10) 1237 in Introduction

[65] Special purpose vehicle or entity (SPV or SPE) is usually a subsidiary firm, which are used to isolate the principal firm from financial risk. It has separate liability structure and legal status. As Gorton said "An SPV, or a special purpose entity (SPE), is a legal entity created by a firm (known as the sponsor or originator) by transferring assets to the SPV, to carry out some specific purpose, or

use specialised and market-oriented measures as well as diversified strategies to seek long-term benefits with higher risk tolerance.[67] In practice, the adoption of commercial operation helps to differentiate SWFs from government agencies and to distinguish their investments from public investment. Some SWFs, as independent corporations, have established independent decision-making systems, risk management, and internal control.[68] Moreover, some SWFs have employed professional third-party or external fund managers to design investment portfolios and analyse investment risks. Furthermore, SWFs attempt to convince host countries that their motives are purely commercial by waiving control or voting rights in portfolio companies, which is also aimed to avoid additional adverse regulatory constraints or a political backlash.[69]

2. The Role of SWFs in Domestic and International Market

2.1 Emerging players in international market

The history of SWFs can be traced back to nearly 19th century.[70] In modern times,

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circumscribed activity, or a series of such transactions." See G. Gorton and N. Souleles, 'Special Purpose Vehicles and Securitization' (2005) 11190 NBER Working Paper Series, 2 <http://www.nber.org/papers/w11190> accessed 10 November 2014. Here, SWFs are different from traditional SPV as they are not created by a firm to isolate financial risks, but they are created by their sponsor (the government or central bank) and operate under a much broader consideration apart from commercial returns.

[66] Oyedele (n 56) 49. For example, until 2012, at least 56% of all SWFs invest into infrastructure industry. The vast bulk of these investments are motivated by commercial consideration. They have typically been focused on bankable infrastructure projects, especially high-return existing infrastructure. See A. Gelb et al., 'Sovereign Wealth Funds and Long-Term Development Finance: Risks and Opportunities' (2014) Policy Research Working Paper No.6776, 5 <http://documents.worldbank.org/curated/en/788391468155724377/pdf/WPS6776.pdf> accessed 15 January 2015

[67] E. Truman, 'A Scoreboard for Sovereign Wealth Funds' (Conference on China's Exchange Rate Policy at Peterson Institute, Washington, 19 October 2007) 23 <https://pdfs.semanticscholar.org/1d16/ccc4469806db14450be63a660e1eaac63d0b.pdf> 15 January 2015

[68] For instance, CIC, KIC, GIC. Actually, many SWFs are established under corporate law and operate as a corporation so that they exist like the traditional investment company. And they also structure their holdings to maximize investment returns. See IWG (n 19)

[69] Rose (n 4) 105

[70] Some scholars suggest that the oldest SWF was established in France as Benoit Coeuré of the French Treasury. Hildebrand points out that "SWFs are not a new phenomenon. With its Caisse des Dépots et Consignations, France set up a SWF in 1816". See P. Hildebrand, *The Challenge of Sovereign Wealth Funds* (SNB 2007) 4. Senn also explains that: "SWFs are not a new phenomenon. Coeuré has shown that France established a SWF already in 1816 with its Caisse des Dépots et Consignations." See M. Senn, 'Sovereign Wealth Funds as a Public-Private Challenge for Institutional Governance' (2009) 19 Jusletter, 2 <http://www.academia.edu/8062692/Sovereign_Wealth_Funds_as_a_Public-Private_Challenge_for_Institutional_Governance> accessed 2 February 2015

SWFs were established in the 1950s, and the KIA is regarded as the first modern SWF in many literature and documents,[71] which can be traced back to 1953.[72] SWFs had not attracted a large attention until the 2008 global financial crisis, when they were injecting capitals into weak financial market. SWFs are now important players and institutional investors in the financial market.

Although it was argued that SWFs may threaten financial stability, conversely, they were recognised by IMF as contributors to the global economy growth and financial stability by long-term investment, which provide liquidity to stabilise rising fiscal deficits, support economic activities, and boost productivity.[73] Before the 2008 financial crisis, the assets managed by SWFs were expected to reach $ 12 trillion by 2015, but SWFs suffered huge losses because of the sharply fell of stock market.[74] However, by showing their willingness to act as long-term and passive investors, in the following years, they went through the financial turmoil and restored most of their losses. Relevant data shows that as of September 2017, SWFs had $ 7.4 trillion in assets under management.[75] To increase return, SWFs have adjusted their investment strategies, and currently several SWFs have become more actively in engaging in direct investment and high-profits assets.

What is new about SWFs is not their form as sovereign investment instruments but the accumulated assets under management, the anticipated rate of growth, the recent trend of asset allocation and countries of origin.[76] Approximately half of top forty

[71] Depending on the foreign exchange income surplus of oil exports, Kuwait government use these assets to establish the Kuwait Investment office in London, which is designed to reduce dependence on the limited oil resources. In 1982, KIA was formally established and has become the world's first sovereign wealth fund. See KIA, 'Overview on the Kuwait Investment Authority', <http://www.kia.gov.kw/En/About_KIA/Overview_of_KIA/Pages/OverviewofKIA.aspx> accessed 5 January 2015.

[72] According to Robert, KIA was perhaps the "first-ever' sovereign wealth fund'". See R. Kimmitt, 'Public Foot Prints in Private Market: Sovereign Wealth Funds and the World Economy' (2008) 87 Foreign Affairs 119. Besides, according to Truman and Steffen, the first SWF was established by the Pacific island national of Kiribati (the British colonial administration in Gilbert Islands), called Revenue Equalisation Reserve Fund (REPF), to manage revenues from phosphate mining, but KIA was the first modern SWF. See Truman (n 4) 2. See also Kern (n 3) 4

[73] IWG (n 19)

[74] A. Curzio and V. Miceli, *Sovereign Wealth Funds: A Complete Guide to State-Owned Investment Funds* (Harriman House Ltd 2010) 39-46

[75] H. Ellyatt and K. Bishop, 'The World's Biggest Sovereign Wealth Funds in 2017' *CNBC* (20 Sept 2017) <https://www.cnbc.com/2015/07/17/the-worlds-biggest-sovereign-wealth-funds.html#slide=1> accessed 30 September 2017

[76] D. Drezner, 'Sovereign Wealth Funds and the (In) Security of Global Finance' (2010) 62 J. Int'l Aff.

SWFs are created since 2000.[77]

2.2 Private and Public law implications

The phenomenon of SWFs seems complicated. They have been operating in the domestic market for almost half a century, and they have never created problems or raised concerns in their home countries. But when they invest in the international market, especially in advanced economies, concerns arise. In several host countries, regulations that tackle foreign-controlled or government-background investment apply to both SOEs and SWFs,[78] whereas SWFs claim that they should be treated as other private investment funds (e.g. PE, HF) that bear less transparency obligations rather than be treated as government agencies.[79] However, because of the state ownership and low transparency, host countries fear that foreign governments would exercise political leverage over host countries via their SWFs.[80] This might be the reason why there are several proposals that require SWFs to increase their level of transparency.

Furthermore, both state-owned and private-owned companies engage in domestic and international market, and they compete with each other; hence it is difficult to simply treat SWFs as public or private entities. It should be admitted that there is no a separate market or playing field where states (or state-owned entities) and private companies operate respectively.[81] State-owned and private-owned corporations, acting as participants in the market, are monitored by the regulator, while both of

115, 116

[77] M. Maslakovic, 'Sovereign Wealth Funds 2009' (2009) IFSL Research Report, 3 <http://www.afi.es/EO/swf_IFSL_2009.pdf> accessed 15 November 2015

[78] According to Reed, there is no example indicating that SWFs behave like SOEs. He argues that "the essence of the problem with SOEs is their close ties with manipulative governments", while this problem does not exist to the same extent with SWFs because "SWFs are often managed by professional third parties, unrelated to the government". See B. Reed, 'Sovereign Wealth Funds: The New Barbarians at the Gate? An Analysis of the Legal and Business Implications of their Ascendancy' (2009) 4 Virginia L. & Bus. Rev. 97, 111

[79] But there are increasingly trends that HF and PE fell in target of proposal or regulation in term of disclosure requirements. However, these requirements mainly focus on the behaviours of the fund manger. In the UK, the FCA intends to include HF and PE mangers into its drive to increase transparency on fess and charges, which will likely force HF and PE to adhere to these transparency guiltiness on fess. See T. Kinder, 'Hedge Funds and Private Equity Caught in FCA's Fee Dragnet' *Financial News London* (28 June 2017) <https://www.fnlondon.com/articles/hedge-funds-and-private-equity-caught-in-fcas-fees-dragnet-20170628> accessed 20 September 2017

[80] Truman (n 4) 9

[81] Bassan (n 6) 3

them could interfere with regulations via different approaches. It is often suggested that the state participating in the market tries to influence the market via sovereign investment instruments,[82] and SWFs are used by the state to export regulatory values or policies (e.g. the socially responsible investment by GPFG- Norway). Moreover, in terms of establishment, SWFs are created according to public constitutive law, or corporate law, or specific law for SWFs; depending on this, the legal status of SWFs could be various. Therefore, there is a particular cross-relationship between public law and private law.

2.3 The effect of national and international laws

The investment activities of SWFs involve both national and international laws. States act as regulators in domestic market, but if they invest abroad through sovereign investment instruments in recipient countries, they cannot exert their regulatory power. If those instruments, such as SWFs, SOEs, are not well-governed or regulated in home countries, they may face the barriers and resistance from host countries. When states act as sovereign enterprises that invest in their own territory, they can regulate these activities because states act as both the participant and regulator. However, when they invest abroad, these states are only participants in host countries rather than the regulator.[83] SWFs, as sovereign investment instruments, their investments cannot be only analysed at the domestic level or from the internal aspect when investing overseas.[84]

It should be clarified that SWF overseas investments are mainly regulated by host countries while measures of host countries to certain extent are constrained by international obligations under international treaties or customary international law.[85] For specific international regulations that apply to SWF investment, only principles or soft law regulations could be found.[86] In fact, host countries are interested in boosting

[82] Backer (n 44). See also A. Halvorssen, 'Using the Norwegian Sovereign Wealth Fund's Ethical Guidelines: A Model fro Investors' (2011) 8 EUR. CO. L. 88
[83] Bassan (n 6) 4
[84] The regulation of home country (private and public law) mainly focuses on fiscal issues, tax issues, legal personality, and corporate governance of SWFs etc.
[85] Some scholars point out that nation ought to obey international law because of the meaning of 'obedience' from both legal and moral aspect and requirements. See H. Koh et al., 'Why Do Nations Obey International Law' (1997) 106(8) Yale L. J. 2599, 2659
[86] Many legal scholars use the term of 'hard law' and 'soft law' nowadays, but it is too simple to only

foreign investment (direct investment and indirect investment) but meanwhile they fear the political objectives behind foreign investment or foreign control over their strategic assets or critical infrastructure in relation to the national security (the current situation of SWFs investment is alike). Moreover, if protectionist measures or discriminatory treatment were imposed on SWFs, SWFs may claim protection or compensation according to international treaties between their home countries and host countries. Therefore, both national law and international law are relevant to SWF investment.

2.4 Issues raised by the development of SWFs

2.4.1 Causes and influence of the development of SWFs

In the past, SWFs had a low "risk propensity",[87] and they played a passive role in the financial market. Conversely, recent SWFs investments are characterised by higher risk propensity, and even some SWFs are playing an active role in portfolio companies. Furthermore, despite the slowdown (owing to the influence of the economic crisis and low oil price), the assets managed by SWFs (see Chart 1) and the group of SWFs have grown.

distinguish hard law from soft law by considering whether or not this rule is binding or nonbinding. See G. Shaffer and M. Pollack, 'Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance' (2010) 94 Minn. L. Rev. 706, 712. According to Abbott and Snidal, the hard law 'refers to legally binding obligations that are precise (or can be made precise through adjudication or the issuance of detailed regulations) and that delegate authority for interpreting and implementing the law,' while 'the realm of 'soft law' begins once legal arrangements are weakened along one or more of the dimensions of obligation, precision, and delegation.' See K. Abbott and D. Snidal, 'Hard and Soft Law in International Governance' (2000) 54 (3) Int'l Org. 421, 422

[87] Bassan (n 6) 6

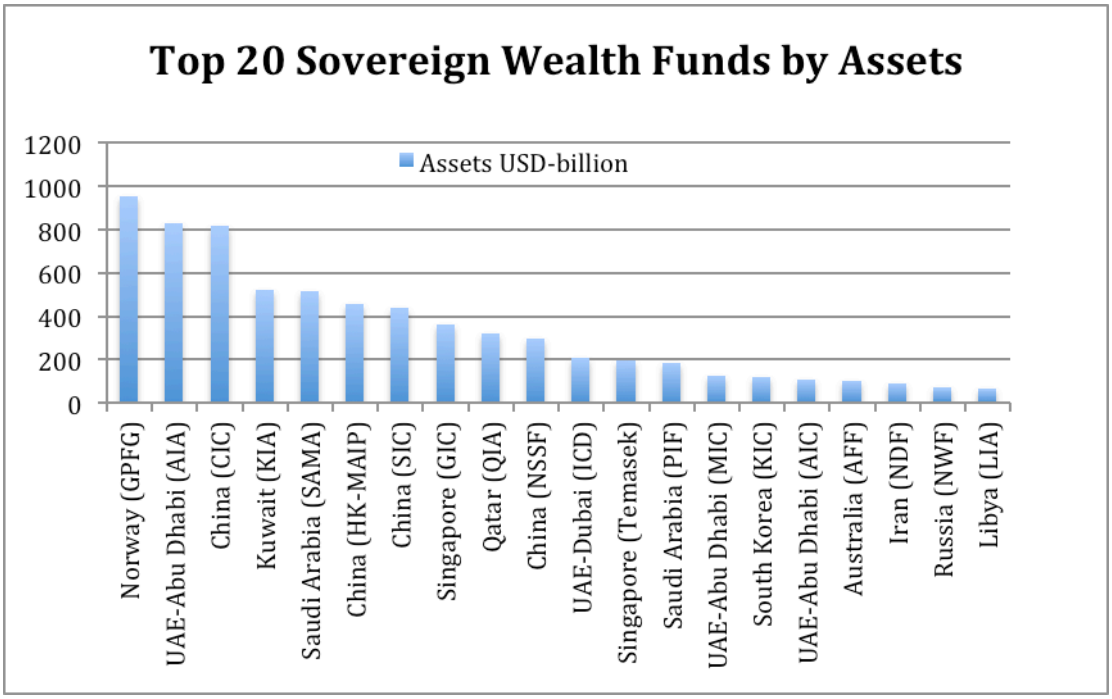

Chart 1: Top 20 Sovereign Wealth Funds by Assets (USD-billion) as of Sep 2017

Source: Figures from Sovereign Wealth Fund Institute (SWFI)

The development of SWFs results from two main reasons, i.e. the market and the assets accumulation. For the former, financial globalisation provides a realistic basis for the increase of SWFs.[88] Owing to the globalisation of trade and investment, and the promotion of financial liberalisation with endless incentive of financial innovation, global financial market has become prosperous. Financial globalisation is mainly characterised by the globalisation of capital flows, globalisation of financial institutions and the globalisation of financial market. Financial globalisation facilitates the global capital flows, which is beneficial to the efficiency of resources allocation, thus providing opportunities for foreign investment from countries and regions that hold large amounts of assets. Financial innovation has produced many financial products thus providing more choices for SWFs investment. The

[88] Here, it can be understood as globalisation and financialisation. It creates a new environment for economic and finance vehicles i.e. the international financial market; it has opened up flows of capital, technology, resources and labour force etc. to international market. See M. Sollod, 'Sovereign Wealth Funds: Global and Domestic Implications of the Rise of a New Major Player in International Finance' (2011) Syracuse University Honors Program Capstone Projects Paper 294, 13 <https://surface.syr.edu/cgi/viewcontent.cgi?article=1302&context=honors_capstone> accessed 20 November 2014. Dixon and Monk point out "by definition, economic and financial globalization – in particular the expansion of trade – necessitates that governments cede some portion of their domestic autonomy to the global marketplace". See A. Dixon and A. Monk, 'Rethinking the Sovereign in Sovereign Wealth Funds' (2012) 37 Transactions of the Institute of British Geographers 104, 106 <http://onlinelibrary.wiley.com/doi/10.1111/j.1475-5661.2011.00447.x/pdf> accessed 20 November 2014.

development of financial market provides wide space/destination for SWF investment.

As to the latter, firstly, Asian countries adopted various measure to defend economic crisis and to fight against exchange volatility, i.e. increasing fiscal revenue and FX reserve, using precautionary measure of crisis prevention and self-insurance, and reducing domestic investment while increasing overseas investment.[89] Secondly, the rise of raw material prices (e.g. oil and gas) had resulted a significant increase in export revenue. Developed countries suffered from current-account deficit while developing countries gained large trade surpluses. Since Asian emerging economies and some exporters of the raw materials (e.g. Middle East countries) remain persistent trade surplus, they have accumulated a large amount of revenue surplus that have changed their previous status as capital importers.[90] The emergence of SWFs therefore satisfies the needs of developing countries and emerging economies.

It has had three main implications. The first one is the increase in international investment (direct and indirect), because of those countries operating special funds and benefiting from the growth of these funds. The second one is the structural change in investment flows: it is no longer one-way but two-way flows. The investment flow is no longer only from industrialised countries to less developed countries or developing countries but also from those developing or less developed countries that are now exporting capitals. However, the new two-way flows respectively are not the same.[91] It should be noticed that the capital flow from developing countries is not mainly driven by private investment but through sovereign investments, which is regarded as 'state capitalism'.[92] Therefore, at this stage, there are connections and also conflicts between countries sponsoring SWFs (home countries) and countries receiving SWFs investment (host countries).

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[89] A. Monk, 'Sovereign in the Era of Global Capitalism: the Rise of Sovereign Wealth Funds and the Power of Finance' (2011) 43 Env't & Plan. A 1813

[90] For information about SWFs investments from emerging countries (e.g. China) and Gulf countries, see D. Haberly, 'Strategic Sovereign Wealth Fund Investment and the New Alliance Capitalism: A Network Mapping Investigation' (2011) 43 Env't & Plan. A 1833.

[91] Y. Lee, 'A Reversal of Neo-Colonialism: The Pitfalls and Prospects of Sovereign Wealth Funds' (2009) 40 Georgetown Int'l L. J. 1103, 1106

[92] I. Bremmer, 'State Capitalism Comes of Age: The End of the Free Market?' (2009) 88 (3) Foreign Affairs 40, 48. See also Lyons (n 4) 228

The third one is that the form of investment made by SWFs has changed with flexible and diversified investment objectives, ranging from purchasing shares in major listed companies to commercial banks; from bonds, securities to derivatives; from real estate market to alternatives; from energy industry to infrastructure industry.[93] SWF investments in part have helped many financial institutions surviving from insolvency, helped minimise the adverse effects of the global financial crisis, and allowed states to accumulate economic power in a manner that not disrupts the economic system.[94] In search of higher returns, some SWFs are looking for direct investment opportunities in alternative investment and are increasingly interested in emerging markets, e.g. China and India;[95] some Asian SWFs have been seeking more co-investment projects.[96] Moreover, many countries increasingly consider setting up some forms of SWFs, since they see the value in founding SWFs as tools to help stabilise national economy in times of market turmoil.[97]

Nevertheless, the rapid development of SWFs and their active performance have triggered diverse reactions. Several host countries concern that home countries of SWFs may use SWFs as a means to control companies in strategic sectors, thus threatening the national security, and that if SWFs suddenly withdraw from the market, it may undermine the market stability. Host countries have formulated special approval system or review mechanism in succession, especially during and after the financial crisis, to strengthen the supervision and control over foreign investment (even focusing on sovereign investment). In response to the claim from developed countries, international organisations have drafted relevant best practices or principles. These initiatives mainly focus on two profiles. On one hand, the initiative for SWF investment mainly considers the requirements for transparency, accountability, and

[93] M. Weiss, 'Sovereign Wealth Funds: Background and Policy Issues for Congress' (2009) Congressional Research Service Report for Congress RL34335, 2 <https://www.everycrsreport.com/files/20090115_RL34336_a7ea655551d2435a8e05992d4ac1b1367b3e3635.pdf> accessed 15 January 2015

[94] Lenihan (n 11) 227

[95] 'Sovereign Wealth Funds Boost Private Investments in Emerging Markets' (10 September 2017) <http://www.themalaymailonline.com/money/article/sovereign-wealth-funds-boost-private-investments-in-emerging-markets#sO5gL1wUYh5FVY2e.97> accessed 20 September 2017

[96] S. Dang 'Asian SWFs Step Up Their Co-investment Game' (18 April 2017) <https://www.institutionalinvestor.com/article/b1505q66qwlr7j/asian-swfs-step-up-their-co-investment-game> accessed 20 September 2017

[97] 'Much More Governments Eyeing Sovereign Prosperity Resources' (1 May 2017) <https://good-stockinvest.com/2017/05/01/much-more-governments-eyeing-sovereign-prosperity-resources/> accessed 20 September 2017

governance structure. On the other hand, the initiative for host countries aims to avoid the risk of foreign investment and reduce unjustified protective constraints imposed on SWF investment. So far, the debate on SWF investment, which previously was limited to the economic or financial theory, has recently added to the legal level.

2.4.2 Issues of the development of SWFs

It can hardly deny that host countries welcome well-organised and commercial-oriented SWFs. International institutions have recognised the positive influence of SWFs as a market stabilisation force,[98] and SWFs have set profit maximisation as their main operational purpose. To reduce concerns and avoid tightened restrictions, SWFs usually maintain a passive role in portfolio companies and waive voting rights. However, in spite of the existence of codes of conducts for SWFs, concerns cannot be easily alleviated.

Many researchers believe that concerns raised by SWF investment mostly are derived from two aspects: sovereign motivations and low transparency.[99] These concerns are not limited to the existing SWFs but could be extended to prospective SWFs. Issues may arise if there is no available information concerning SWFs investments, e.g. their investment strategy, purposes and governance rules, as well as methods to manage risk, or if too strict constraints were imposed on SWFs. In terms of transparency, a survey suggests that eight large SWFs including Kuwait, Libya, Qatar, etc. have never disclose their investment structure, trading information and asset scale hence Western countries worry that SWFs may lead to the market volatility and systemic risk.[100]

It was argued by many scholars that if SWFs suddenly withdraw from the market or if they are utilised as political leverages, SWF investment might be detrimental to the market stability;[101] might pose risk to market allocation;[102] might allow states as

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[98] Beck and Fidora (n 5) 358 in Introduction

[99] For example, see Truman (n 4); Lyons (n 4); Drezner (n 76); S. Behrendt, 'Sovereign Wealth Funds in Nondemocratic Countries: Financing Entrenchment or Change?' (2011) 65 J. Int'l Aff. 65; J. Piro, 'Welcome to Fabulous Las Vegas: The Nevada Gaming Regulatory Response to Sovereign Wealth Fund Investment' (2011) 2 UNLV Gaming L. J. 167; Kratsas and Truby (n 10) in Introduction

[100] P. Toledano and A. Bauer, 'Natural Resource Fund Transparency' (2014) Revenue Watch Institute Policy Brief, 2 <https://resourcegovernance.org/sites/default/files/NRF_RWI_BP_Transp_EN_fa_rev1.pdf> accessed 15 January 2015

[101] T. Gomes, 'The Impact of Sovereign Wealth Funds on International Financial Stability' (2008)

participants to gain a competitive edge;[103] might reduce the incentives and confidence of private investors; might threaten national security as a result of state ownership;[104] might facilitate state-controlled champions from domestic to global market etc.[105] However, many of these concerns are still 'in the realm of hypothetical',[106] or exist only under limited circumstances. But over-reaction of host countries may easily result in investment protectionism.[107]

The reason why host countries pay much attention to strategic assets is that SWFs could influence or control investee companies and obtain core technology, intellectual property, gain sensitive information from energy and military industries or improve competitive positions for their domestic markets, or home countries of SWFs may use SWFs as a leverage for diplomatic purpose.[108] The key point here is the national security (including economic security) of host countries.[109] But it is very controversial, since it is often implied that each state is free to set limitations and to define the national security on its own interest.[110]

Bank of Canada Discussion Paper No.4 <http://www.bankofcanada.ca/wp-content/uploads/2010/01/dp08-14.pdf> accessed 15 January 2015.

[102] K. Gordon and A. Tash, 'Foreign Government-Controlled Investors and Recipient Country Investment Policies: A Scoping Paper' (2009) OECD Working Paper <https://search.oecd.org/industry/inv/investment-policy/42022469.pdf> accessed 5 February 2015

[103] Kimmit (n 72)

[104] C. Cox, 'The rise of Sovereign Business' *Security Industry News* (2007) <http://www.sec.gov/news/speech/2007/spch120507cc.htm> accessed 5 February 2015.

[105] Truman (n 4) 4.

[106] E. Truman, 'A Blueprint for Sovereign Wealth Fund Best Practices' (2009) 9 Revue d'économie financière (English ed.) 429

[107] Hildebrand (n 70) 77

[108] M. 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' (2008) 118 Yale L. J. Pocket Part 88

[109] The term of 'national security' was firstly put forward by U.S. It includes but not limited to economy security, military security, and environmental security. The UN Sub-Commission on Prevention of Discrimination and Protection of Minorities has attempted to explain this in its Siracusa Principles. Principle B (iv) indicates that:

> 29. National security may be invoked to justify measures limiting certain rights only when they are taken to protect the existence of the nation or its territorial integrity or political independence against force or threat of force. 30. National security cannot be invoked as a reason for imposing limitations to prevent merely local or relatively isolated threats to law and order. 31. National security cannot be used as a pretext for imposing vague or arbitrary limitations and may only be invoked when there exists adequate safeguards and effective remedies against abuse.

See O. De Schutter, *International Human Rights Law: Cases, Materials, Commentary* (2th edn, CUP 2014) 361. However, the concept of national security may vary from country to country.

[110] Gilson and Milhaupt (n 5) in Introduction

3. The Necessity to Regulate SWFs Investment

Although the positive influence of SWFs investment is recognised, concerns regarding their sovereign status and low transparency cannot be easily ignored by several host countries, especially when SWFs undertaking direct equity investment. Host countries, in particular several developed countries, redeem the national security outweigh the market openness after the outbreak of the financial crisis.[111] Policy-makers and scholars have discussed responses towards SWF investment and even considered additional regulations. Some of proposed and existing/adopted measures could be regarded as a means of investment protectionism,[112] which might have detrimental effects on the national welfare.[113]

Apart from the practical concerns, what is the rationale for regulation? Why SWFs need to be regulated? The following section intends to address these questions. This could provide the rationale for assessing existing regulations for SWF investment and help to find a plausible way to regulate and protect SWFs in later chapters.

3.1 Theoretical reasons for regulating SWFs

Every nature person or legal entity, not matter in global market or domestic market, should act within a certain regulatory framework and comply with relevant obligations (and received certain protections). The principle of law is that any person or entity (public and private), should comply with the law, including the government and the state, and the law should be equally enforced and implemented.[114] Whether for the interest of host countries or SWFs, it is necessary that SWFs could be regulated and protected under a justified regulatory framework. The focus cannot only be put on separate jurisdictions but a broader scope.

[111] Even though many developed countries are going through debt crisis and they need foreign capital incentives in their domestic market, they won't be willing to bear the risk of the sacrifice of national interests.
[112] Protectionism in the economic sense is defined as "the imposition of tariffs, quotas, or other non-tariff barriers to restrict the inflow of imports". See G. Bannock and R. Baxter, *The Penguin Dictionary of Economics* (Penguin Books 2011) 315. The investment protectionism by host countries usually include restrictions imposed on foreign investors and the inflow of foreign capital.
[113] Kratsas and Tash (n 10) 9
[114] Gallo (n 49) 2

3.1.1 General theory for regulation

3.1.1.1 The rationale for regulation

'Regulation',[115] in the proper sense, in which people use this term, contains various "industrial and non-industrial" activities, and opposite to natural law different forms of rules usually have binding force, i.e. statutory law.[116] Firstly, 'regulation' represents the idea of control by the superior or authorities. Each regulation has a directive goal and function. In order to achieve this goal and perform this function, the superior designs rules (substantive and procedural) to direct the conducts of individuals (nature person or legal entity) in a particular way with the threat of sanctions if disobedience.[117]

Secondly, compared to the self-regulation or natural law,[118] statutory regulation is the public law that generally obligations can only be enforced by the state (authority or agent) rather than by the private agreement between concerned parties.[119] It contains the required facts and definite consequence of various conducts and activities in society.[120] Generally, regulation has three functions, i.e. setting standard, gathering information, and modifying behaviours.[121] Since the development of SWFs is a financial phenomenon, the regulation on their activities is mostly from the economic aspect.[122] Concerning the nature of SWFs investment, the focus should be put on

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[115] Regulation is generally written by executive authority to enforce laws (not include case law and natural law) and is passed by the legislature. Other forms of regulation are self-regulation, which promulgate by an industry such as trade association, social norms, third-party regulation etc. According to Black, regulation is defined as follows:

> Regulation is the sustained and focused attempt to alter the behavior of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes, which involve mechanisms of standard setting, information gathering and behavior modification.

See J. Black, *Critical Reflections on Regulation* (London: London school of Economics and Political Science 2002) 20

[116] A. Ogus, *Regulation: Legal form and Economic Theory* (Oxford: Clarendon Press 1994) 4

[117] ibid 2

[118] Self-regulation is regarded as a set of regulatory instruments or standards through which the behavior is regulated. Although sometime it may have been formulated to meet external public regulatory requirements, it is established within individuals or industries and relies on consensus and co-operation. See B. Morgan and K. Yeung, *An Introduction to Law and Regulation—Text and Materials* (Cambridge University Press 2007) 92; see E. Bardach and R. Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Transaction Publishers 1982) 218

[119] ibid

[120] J. Black, *Rules and Regulators* (Oxford: Clarendon Press 1997) 20

[121] Black (n 115) 134

[122] In addition to the regulation from economic aspect, there are also rules or regulatory from social

general foreign investment regulation and sectoral regulations (e.g. financial regulation). These regulations might contain the control over activities in market access phase, operation phase and exit phase.[123]

It is a fundamental role of the state to formulate and enforce the rules of regulation, and this power cannot be released to private associations only if this power is delegated to them under certain circumstances.[124] When drafting regulations, regulators would primarily consider the public interest grounds and to some level, private interests, with regard to whether a particular subject or conduct should be regulated. But connotation and extension of public and private interest are hard to define and may vary from jurisdiction to jurisdiction.

The private interest of 'economic' regulation attempts to explain not only the regulation that protects the benefits of service-provider or goods-producers but also the regulation that protects more generalised interests (e.g. consumers).[125] This nevertheless cannot provide a proper and effective explanation for the variety of regulatory measures, and it therefore is necessary to focus on the public interest when regulating SWF investment. But, for public interest, it is hard to formulate a comprehensive or exhaustive list of goals of public interests, since what the public interests consist of may vary according to different situations and considerations.[126] Therefore, the necessity to regulate SWFs investment, from both host country and home country perspectives, cannot ignore the consideration of public interests.[127]

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aspect, especially the ethic issue, since the socially responsible investment (SRI) is called on by international community. More detail about SRI, see R. Sparkes, *Socially Responsible Investment: A Global Revolution* (John Wiley & Sons Ltd 2002); see also J. Park and S. Kowal, 'Socially Responsible Investing 3.0: Understanding Finance and Environmental, Social, and Governance Issues in Emerging Markets' [2013] Georgetown Pub. Policy Rev. 17 <http://www.gppreview.com/wp-content/uploads/2013/04/park-and-kowal.pdf> accessed 15 January 2015

[123] The market entry phase (or pre-establishment) includes the admitted types of investments and forms of investors, allowed industries, the minimal requirements of quota or price, and time etc.; the operation phase (pro-establishment) means the existed or completed investment, continuing operation; the market exit phase may involve insolvency, liquidation, debt and also tax issues etc.

[124] Ogus (n 116) 2

[125] ibid 71

[126] These aspects may include but not limited to time, place, and specific values held by a particular society or the culture or political standing of a state.

[127] According to Ogus, the public interest goals include economic and non-economic goals. The economic goal may contain: monopolies and natural monopolies; public goods; other externalities (e.g. transaction costs); information deficits and bounded rationality; co-ordination problems; exceptional market conditions and macro-economic considerations. The non-economic goals may include:

3.1.1.2 Types of regulation

Regulation exists not only in one form. Different types of regulations can help to offset some inherent limitations of other rules and to achieve certain compromises when certain agreements were concluded, as well as to follow particular types of regulatory system.[128] Regulations can be classified in various types according to different standards/criteria. Judging by whether it is enforced by governmental authority, regulation can be divided into the statutory regulation (rigid) and the self-regulation (flexible).[129] However, to some extent, the characteristics of self-regulation would fail to be 'sufficiently objective and independent' to provide protections for investors, especially for SWFs.[130] The typical examples of statutory regulations are national regulations of foreign investment, banking and securities regulation, and provisions in international investment agreements (IIAs). Self-regulation on SWFs is primarily supranational guidelines, e.g. the GAPP.

Moreover, Ogus classifies regulation into the social regulation and economic regulation. This helps to understand regulations from specific goals and to identify circumstances when those goals are unlikely to be met by the unregulated market. Social regulation, on the account of public interests, deals with inadequate information, externalities in relation to issues such as the consumer protection, and environmental and health protection. It can be identified into following regulatory forms: information regulation, 'private' regulation, economic instruments and also a prior approval.[131] The economic regulation covers a narrower range of activities, which primarily deals with monopolies and is usually used to ensure fair competition.[132]

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distributional justice; paternalism; community values. See Ogus (n 116)

[128] Black (n 120) 29

[129] Self-regulation would simply be regarded as self-interested regulation. According to Black, self-regulation could work only "where there was a common community of understanding; where shared norms, culture, practices enabled business to be conducted on the basis of trust, with the collective norm being reinforced by representatives of the group on their behalf if any one dissented". Compared with statutory regulation, which is more detailed and rigid, self-regulation is seemed to be more flexible. ibid 52, 240

[130] Ogus (n 116) 60

[131] ibid 5

[132] ibid

There are rule-based regulation and principle-based regulation,[133] both of which are regarded as the policy-based regulation.[134] The rule-based regulation suggests that regulators mainly depend on detailed and prescriptive rules to set standards and requirements for the target subjects, under which the regulated parties can hardly require regulators to set more specific rules, whereas the principle-based regulation indicates that regulators depend on broadly stated principles/standards under which the regulated parities can claim the most appropriate implementation.[135] These standards in the principle-based regulation may be accompanied by guidelines regarding how to achieve desired outcomes.[136] Generally, rules are defined by regulators and are usually settled *ex ante* before being implemented, while principles are usually settled *ex post* and are given more spaces for interpretation that requires more professional knowledge.[137]

However, the principle-based and rule-based regulations are not in the 'black-and white' relation, sometime, they can be combined by regulators to achieve desired goals.[138] Currently, existing regulations at the domestic level and international level that apply to SWFs investment include both rule-based and principle-based norms. For example, national regulations in most host countries are mainly rule-based (which is also statutory regulation) regulations, while the guidelines of IMF and OECD are mainly principle-based (which is also a self-regulation) regulations. Each of them has its own advantages and disadvantages; in this thesis, the mixed use of them in a proper way is a more desirable choice.

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[133] Principle-based regulation is regarded as an alternative way to fulfill policy. See M. Tanke, 'Investigating A New Policy Model: Principles Based Regulation: A Case-study on the Effects of Principles Based Regulation for Policy that Regulates Emissions' (Master Thesis, University of Twente Student 2011) 11

[134] The rules-based regulation and principle-based regulation are approaches to achieve the policy of regulators or the interest of the public.

[135] Tanke (n 133) 16

[136] A. Anand, 'Rules v. Principles as Approaches to Financial Market Regulation' (2008) 49 Harv. Int'l L. J. 111

[137] B. Burgemeestre et al., 'Rule-based versus Principle-based Regulatory Compliance' in G. Governatori (ed.), *Frontiers in Artificial Intelligence and Applications* (JURIX) (IOS Press 2009) 39

[138] There is no "one size fits all" regulation, because

> The advantages and disadvantages of certain types of rules will be the same for all actors in the regulatory regime. Instead, different types of rules can help or hinder the supervision and compliance activities of regulators and others in different ways.

See J. Black et al., 'Making a success of Principles-based regulation' (2007) 1 LFMR 191, 195

3.1.2 Regulation from financial regulation perspective

The financial market is assumed to operate efficiently with well-allocated resources, adequate information, free and fair competition etc., and self-adjusting of the market can bring about economic welfare. However, these can hardly be achieved in the short-term, and sometime, there is a 'market failure',[139] which needs the regulatory intervention, since "private law cannot always provide an effective solution".[140] When the 'market failure' occurs, there is a *prima facie* case for a regulatory intervention on account of the public interest.

Firstly, the market failure arises in relation to public goods.[141] Concerning SWFs, it is the national security or national interest. Such public goods typically occur when target companies are publicly owned or regarded as strategic assets. In fact, if SWFs invest in sectors, such as the military and energy industries, the concern of national security may arise and if SWFs invest in the financial sectors, the concern of financial stability (which is usually regarded as part of economic security) may arise. Therefore, host state may intervene in transactions on defined public interest or national security grounds in specified circumstances to restrict market participants (including SWFs).

Secondly, monitoring is a fundamental principle of any form of regulation and it applies to participants in financial market. Whether these participants may arouse the concerns of financial stability, national security or economic efficiency, they should comply with the rules promulgated by regulators. SWFs, as a kind of public financial entities and institutional investors, should undoubtedly operate under the monitoring of regulators.

Thirdly, whether the unregulated market generates optimal or insufficient information

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[139] Market failure can be also regarded as market imperfections, which means that the market per se cannot produce a socially optimal outcome. The market imperfections such as information asymmetries, agency problems, negative externalities and imperfect competition etc. can 'equally arise from the behavior of, or affect, public entities as much as private ones'. See Kratsas and Truby (n 10) 13 in Introduction. According to Bator, the 'market failure' at least in allocation theory, means:

> [T]he failure of a more or less idealized system of price-market institutions to sustain "desirable" activities or to stop "undesirable" activities. The desirability of an activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem.

See F. Bator, 'The Anatomy of Market Failure' in T. Cowen (ed.), *Public Goods and Market Failures: A Critical Examinations* (Transaction Publishers 1992) 35

[140] Ogus (n 116) 29-30

[141] ibid 33

is closely relevant to the decision-making. Whether the state or government authority could allocate resources to make them highly and efficiently valued partly depends on the information collected from the market. The efficiency of resource allocation is based on the adequate information held by decision-makers, and their capacity to process information.[142] If neither of these requirements can be fulfilled, the regulatory intervention is required. Not every host country is familiar with the operation and activities of SWFs, and many surveys even demonstrate that a majority of SWFs are in low transparency.[143] The lack of transparency distresses many policy-makers, since it is hard to assess risks and to identify investment strategies and the mismanagement of SWFs. The absence of 'perfect information' cannot be solved by the market itself but requires the regulatory intervention.

Moreover, in order to maintain financial stability, the regulatory intervention ought to be asserted by considering macro-economic factors. Although usually the economy is subject to the cyclical patterns of demand, the shortage in supply of sudden circumstances, the inflation, and structural changes in the economy can result in a crisis if these are not properly regulated. Individuals are not readily able to find a plausible or satisfactory alternative, thus a call for the regulatory intervention is necessary.[144] For the consideration of national economy, the state agencies must collect and process the data on a particular market in order to make predictions, and must notice the interaction between the interlinked markets. According to Ogus, 'effective policy-making has to anticipate how industry will respond to those measures,'[145] so that for a proper economic plan the state has to regulate the conducts of market participants and set necessary and corresponding standards. Therefore, by considering the economic goals of public interest, SWFs as participants in financial market should be regulated by regulators.

3.1.3 Regulation from investment regulation perspective

National investment regulation is not completely free of restriction on market access

[142] For example, it may include the information about alternatives available in the market, the consequences of the exercising choice in different ways.
[143] A. Keller, 'Sovereign Wealth Funds: Trustworthy Investors or Vehicles of Strategic Ambition? An Assessment of the Benefits, Risks and Possible Regulation of Sovereign Wealth Funds' (2009) 7 Georgetown J. L. & Pub. Pol'y 333, 342
[144] Ogus (n 116) 42
[145] ibid 45

for foreign investment.[146] Market access is the first threshold when investors seek to invest in host countries, which may contain the quality and quantity requirements. The United Nations (UN) *Charter of Economic Rights and Duties* emphasises that each state has the right to regulate foreign investment in its territory and the activities of transnational corporations within its national jurisdiction.[147] Whether foreign investors or foreign capitals are allowed into its territory is the sovereignty of the state under international customary law. The legitimate basis confers on host countries the right to implement their policies and impose obligations on foreign investment, e.g. what form of investment is admitted, who the qualified investor is and which industry or sector are allowed to invest in.

In host countries, foreign investments, whether made by foreign state-owned or private-owned enterprises are subject to existing substantive national laws. This enables governments to 'bring foreign companies and investors in line with domestic economic and competition policy objectives.'[148] Apart from these substantive laws, which set standards and rigid requirements for market participants, host countries also design the approval process or special national security review mechanism to ensure whether these foreign investments meet their national economic and social policies.[149] The review or approval process aims to assess whether a particular foreign investment transaction poses risk to the national security or results in foreign government control. Host countries also provide the reporting and disclosure requirements to gather the necessary information of foreign investments to ensure that these transactions operate within well-defined framework.

Although SWFs are positive and stabilising investors for the global economy thus far, the public policy discussion dominated by concerns is still on going among politicians

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[146] I. Shihata, 'Recent Trends Relating to Entry of Foreign Direct Investment' (1994) 9 ICSID Rev 47, 48

[147] See Charter of Economic Rights and Duties (Article2) 2. Each State has the right:
(a)To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No state shall be compelled to grant preferential treatment to foreign investment; (b) [t]o regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies.

[148] Kern (n 3) 14

[149] A. Blackman and X. Wu, 'Foreign Direct Investment in China's Power Sector: Trends, Benefits and Barriers' (1999) 27 Energy Policy 695

and government officials from a more political view rather than economic perspective. However, regulations of foreign investment cannot do nothing but only impose restrictions on foreign investment, since it might unduly restrict the global capital flows and lead to the rise of protectionism.[150] Regulations should provide sufficient protections for foreign investors/foreign investment, as many foreign investments, especially SWFs investments, can bring benefits to the public goods. The regulation, moreover, should balance the interest of national security and of free capital flows. Therefore, being regulated by host country does not mean only being imposed amount of obligations/restrictions on foreign investors (including SWFs); deserved rights and sufficient protections should also be provided under the regulatory regime.

3.2 Practical reasons for regulating SWFs

In the absence of common standards and clear guidelines, many countries have developed a set of regulations to safeguard their own interests. Home countries provide regulations or policy guidance for outbound investment while host countries provide several regulatory measures to control inbound investment and to guarantee security or public order. However, if there is no sufficient communication and mutual understanding between home countries and host countries, the regulation cannot help to support the normal operation of the market but lead to instability and conflicts. Therefore, a well-designed and considered regulation is necessary for the purpose of solving issues of SWFs investment and promoting the development of SWFs. However, this kind of regulation cannot be reached without incorporating minimum standards and widely recognised principles. Different countries, because of different legal cultures and legal systems as well as different national situations, cannot stay at the same level in the absence of uniform rules or a consensus.

Owing to the concern of strategic investment made by foreign investors (especially SOEs and SWFs with a government background), special agencies have been set up or special regulations have been enacted in relation to foreign direct investments (FDI) (or on investments in the form of indirect investment but with an intention to exert influence or control on investee companies) in many developed economies, e.g. the US, Canada, Germany, and Australia (more details will be analysed in Chapter

[150] Gomes (n 101).

three).[151] The national security review mechanisms in many countries have frequently been used to tackle sovereign investments, which indicates that unilateral measures on these investments are strict.

In the context of economic globalisation, SWF investments not only have an impact on the domestic economy but also on the global market. Therefore, if we only depend on unilateral measures, it is impossible to achieve a good effect; on the contrary, it may result in the rise of protectionism if host countries overreact. At international level, the IMF and OECD have taken efforts to formulate codes of conduct and guidelines with regard to SWF investment, but these approaches still have flaws and deficiencies, which need to be improved or reformed (these guidelines will be analysed in Chapter four).[152]

So far, there are very few studies which have investigated or questioned what type of regulations and measures are plausible to regulate SWF investments in both theoretical and practical aspects, especially analysing it under the international regulatory framework (and from the Chinese perspective). To explore the underpinnings of regulation on and protection for SWF investments, the features of SWFs cannot be ignored but emphasised, since concerns (both political and economic) of host countries are mainly derived from their characteristics and nature of investments. Therefore, regulation of SWF investment needs to fit these features.

Chapter Conclusion

The development of SWFs, once again, has triggered the debate regarding concerns of sovereign investors and investment (similar concerns previously and continually are

[151] Most countries protect their strategic industries and corporations through blacklist so that the foreign investors are prohibited from making acquisitions in a list of specific companies. Most countries do not have special oversight agencies like CFIUS to analysing existing foreign investments in strategic industries or in companies that may threaten national security.

[152] There are three reasons why IMF and OECD committed to deal with the issues of SWFs investment. Firstly, as SWFs have raised concerns over financial market and host countries, conversely host countries impose strict measured on SWFs. In order to help adverting protectionism, IMF and OECD engaged in negotiations to set out guidelines for SWFs investment. Secondly, most host countries are members of OECD and IMF, and most home countries of SWFs are members of IMF, so that IMF and OECD, as international institutions, could offer a better platform for both host and home countries to negotiate and better understand SWFs investment. Thirdly, G7 put pressure on IMF along with the OECD (from the foreign direct investment perspective) and the World Bank, to oversee the SWFs investment activities and set the 'best practices'. See Chaisse (n 3) 839. See T. Cottier et al., *International Law in Financial Regulation and Monetary Affairs* (OUP 2012) 118-119

caused by SOEs). SWFs, as state-owned or sovereign investors, participating in the private market and competing with private entities, have not been broadly discussed until the outbreak of 2008 financial crisis. The sovereign background of SWFs inherently easily makes them to be linked to political policy consideration. Owing to the rapid development and the nature of SWFs investment, host countries call for additional regulations for SWFs investment to address political and economic concerns. However, if there is no sufficient and clear analysis of the rationale for the regulation and of conflicting interests in regulatory proposals or policy discussions, it may give rise to investment protectionism and thus in turn posing threats to the national welfare.

There is yet no consensus on how SWFs should be treated or dealt with from a legal perspective where SWFs are involved in. Nevertheless, a close analysis of SWFs comes to the conclusion that a plausible or justified regulation should consider the subject *per se* (i.e. SWFs) which it intends to regulate, and consider a trade-off in respect of the national security and market openness. This chapter suggested that regulatory proposals of SWF investment ought to take into account of the reality and the actual characteristics of SWFs, and the nature of investment.

This chapter analysed the definition and classification of SWFs as well as proposed a definition for SWFs (as it may help identify specific regulations and standards that are applicable to SWF investment). Although SWFs may have different legal and institutional structures, and sources of funding, all of them reflect the demand for the development of national economy. Indeed, they are owned or operated by government agencies as a means to achieve the final goal of market stability and national welfare, while their investment objectives focus on long-term financial returns; hence they are sovereign investment vehicles operating commercially. But, the commercial operation claimed by SWFs cannot reduce the concerns of host countries, because of the potential risks behind their sovereign background and those SWFs acting in low transparency. Actually, other than these risks, every participant in financial market more or less needs to be regulated (SWFs are no exception). Various types of regulations could apply to foreign investors/investment, from the economic regulation to social regulation, from the statutory regulation to self-regulation, from the rule-based regulation to principle-based regulation. Existing regulatory measures are

in the form of the aforementioned regulations.

In addition to specific practical reasons (i.e. particular political and economic risks), SWFs need to be regulated in view of the general rationale for regulation from the perspective of financial regulation and investment regulation. SWFs, as market participants, should be regulated based on the need for reducing and controlling market failure, implementing the monitoring, gathering adequate information, as well as ensuring public goods and market stability. As foreign investors, SWFs need to be regulated, since it is the right of host countries to control foreign investment within their jurisdictions on account of their national security and domestic economy.

CHPATER 2 LEGAL RATIONALE AND CONFLICTING INTERESTS IN SOVEREIGN WEALTH FUNDS INVESTMENT

Chapter Introduction

SWFs, as an emerging force in the financial market, suggest a new trend in the investment landscape. This trend of capital flow results from the globalisation and the adoption of neo-liberal policies by developing countries or emerging economies.[1] At first glance, SWF investments are similar to those made by other private investors while they have aroused much concern among policy-makers. To find a plausible approach to regulate and protect SWF investment, relevant legal relations and legal rationale should be discussed in advance. The phenomenon of SWFs, as a kind of 'state capitalism', brings about political, economic, and regulatory challenges. There is no doubt that SWFs would encounter similar obstacles as general investors did, and they would also face special issues in light of their unique characters and the nature of investment.

This chapter aims to clarify what should be considered fundamentally when regulating SWF investment, by analysing the theoretical rationale and proposed measures in literature. It firstly analyses legal relations involved in SWF investment to find out the main elements that influence the responses of host countries. It secondly discusses the conflicting interests between investment protection and state sovereignty, since currently many developed countries have changed their traditional liberal view towards foreign investment. Thirdly, it examines the conflicting interests between open market (liberalisation) and national security to assess how to strike a balance when regulating SWFs. Then it examines the proposed regulatory suggestions in literature for regulating SWF investment to see whether the proposed measures have balanced and considered these conflicting interests.

1. Legal Relations Involved in SWFs Investment

The legal relation involved in SWF investment is a prerequisite when clarifying and

[1] M. Sornarajah, *International Law on Foreign Investment* (CUP 2017) 68

analysing existing regulations. SWF investments in host countries, generally, are constrained by two kinds of regulations: (i) domestic law, i.e. general foreign investment regulation or policies and industry-specific regulations; (ii) international regulations, i.e. provisions in IIAs and international principles. In practice, these regulations are mainly implemented according to the form of investment, invested industries, types of investors, and specific investment phase (pre- or pro-establishment). The whole picture of SWFs investment involves several types of legal relations, which in turn would influence the type of regulations that are imposed on them.

1.1 The theory of legal relation

The law, established by authorities or regulators with binding force, provides rules and directions concerning the conducts of nature person or legal entity.[2] These rules stipulate the legal effect of "operative facts", which normally are followed by certain consequences in the form of action or non-action by the judicial and executive authorities.[3] Corbin further explains that, 'Whenever any such operative facts exist the persons who will be affected by the states consequences are said to have a legal relation to the other.'[4] If a particular legal relation exists, it means that certain facts exist and relevant consequences will follow. Usually a legal relation exists between two individuals, which indicates that no one has a legal relation to himself and no one has a legal relation with other two individuals. When it comes to the state or a corporation, in theory, the legal relation may be divided into several different legal relations with those individuals that compose the state or the corporation,[5] while in practice, in some circumstances, they are grouped as a subject to other individuals.[6] When claiming that some facts might create a particular legal relation, it means that there are pairs of opposite or correlative right and obligation of each party or

[2] These authorities may be a monarch, a council, a court, or a legislature consists of representatives etc.
[3] A. Corbin, 'Legal Analysis and Terminology' (1919) 29(2) Yale L. J. 163, 164
[4] ibid
[5] ibid 165
[6] For example, each State as a whole is a subject under international law and each State stand coequal legal status. States, with the inherent right of sovereignty, are entitled to address their territory affairs; accordingly they should bear obligations under international law. A corporation usually is regarded as a legal person with deserved rights and required obligations as a whole to external creditors.

individual.[7] It is usually believed that there are eight named pairs of legal relations, i.e. several kinds of *rights* and *obligations* (see Chart 2).[8]

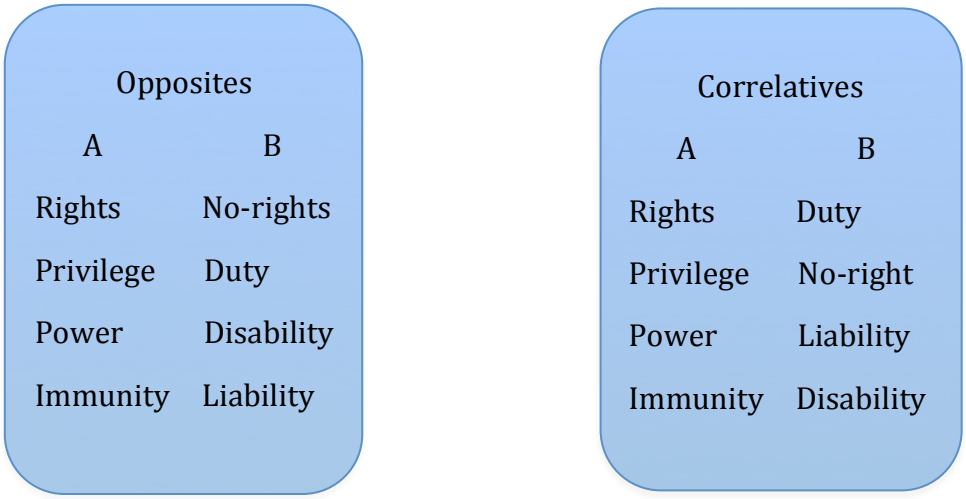

Chart 2: Pairs of Opposites and Correlatives in Legal Relations

More narrowly, these concepts could be explained generally in the following ways: *right* means that an enforceable claim of A to action or forbearance by B, and if disobedience by B, B will be penalised. Inversely, *duty* means that B, commanded by society, acts or forbears for the benefit of A. *Privilege* herein means the relation between A and B that A is free to behave as he pleases without the command of society or regulation for the benefit of B and A is not threatened with any penalty for disobedience in a situation that society has made no command. *No-right* herein means that A has no control over B or the society command nothing of B to act for the benefit of A. *Power* means that the voluntary act or behaviours of A will create or cause new legal relation between B and him or between B and a third party, i.e. A has control over a given legal relation as against B. *Liability* means that A may involve in new legal relations (with B, or with third parties or with both) by the voluntary act of B or through the exercise of B's power. *Immunity* herein means that B has no legal power to affect the existing legal relations of A or A is free from the legal power or control of B. *Disability* means that A has no legal power over the existing legal

[7] For example, the opposite here means that if A has a right, he cannot have no-right with respect to the same subject matter and the same person. When he has a privilege, he cannot have a duty. The correlative here means that if A has a right to B; B has a duty to A. See W. Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 Yale L. J. 16, 30

[8] For detailed discussion of the eight named legal regulations or pairs of opposites and correlatives, please see Corbin (n 3) 167; see also ibid

relations of B.

1.2 Relevant legal relations in SWFs investment

The SWF investment involves four main subjects, which are the SWF *per se*, home country, host country and the target company in SWF portfolios. Legal relations between these four main subjects (see Chart 3) and regulations that might be imposed on SWF investment are interrelated. In part, each pair of legal relation between two involved parties would influence the attitudes or legal measures adopted by host countries towards SWF investment.

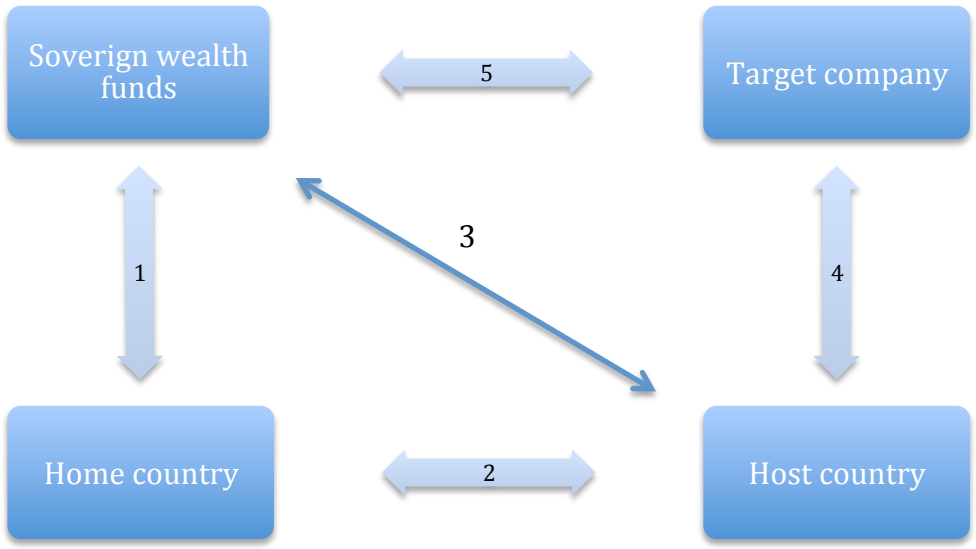

Chart 3: Legal Relations Involved in SWF Investment

Generally, there are five pairs of legal relations involved in SWF investment. The first one is the relation between a SWF and its home country. This relation at least contains two sub-relations. From the private law perspective, the government of home country acts as the owner and shareholder of its SWF (in the form of corporation), which means that there are duties and rights between the SWF and the government. This legal relation seems similar to the relation between a company and its ordinary shareholder, e.g. those SWFs in the form of a state-owned corporation - CIC, Temasek and GIC.[9] From the public law perspective, SWFs are participants in

[9] Analysing from the principal-agent relation, the government acts as the principal that delegate the operation of SWFs to fund managers. Those SWFs in the form of independent company, delegated by

domestic market, and they are established according to domestic law, in which case, the government of home country acts as regulators to supervise the activities of SWFs within its territory. SWFs may be required to disclose relevant information, take public accountability to stakeholders.[10] Under this circumstance, there are power and liability between the home country and the SWF. States cannot interfere with the domestic affairs of each other so that the home country can hardly regulate the activities of its SWFs in other jurisdictions.

The second pair of legal relation (a special relation) is between the home country and host country of SWF investment, which is constrained by international law. Generally, pursuant to customary international law, a state could do whatever it pleases on its territory and independently regulate inbound foreign investment.[11] But this state sovereignty should comply with obligations in the customary principles and treaty-based international law.[12] If an international agreement exists between two states, their relevant domestic regulations on foreign investment would be restricted by treaty obligations once ratified by national authority. Furthermore, if home country and host country has signed a bilateral investment treaty (BIT) including issues of SWF investment or a special agreement concerning sovereign investment, this agreement might influence regulatory measures of host countries.[13]

The third legal relation is between a SWF and the host country, which is the primary relation concerning SWF overseas investments in this thesis. In this legal relation, the host country has a power to monitor the activities of a SWF in its domestic market while the SWF has liability to comply with regulations in host country. There is no doubt that SWF investment is supervised by regulations of host countries, e.g. foreign

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the government, manage funds along with rights and duties; those SWFs that can not separate from the government, exist as part of government or monetary authority and the government delegate itself to operate and take responsibilities to creditor and stakeholders.

[10] For discussion of public and private accountability of SWFs, see P. Bolton et al., *Sovereign Wealth Funds and Long-term Investing* (Columbia University Press 2012) 206

[11] Sornarajah (n 1) 119

[12] According to Neufeld, "The subjection of state sovereignty to these principles may be explained either on the ground that international law is a system of higher law or on the positivist basis that there has been consent of the state to be bound by treaty and customary principles of international law." See H. Neufeld, *The International Protection of Private Creditor from the Treaties of Westphalia to the Congress of Vienna* (Sijthoff 1971) 55

[13] So far, there is no bilateral investment treaty to explicitly deal with SWFs investments. They only so-called bilateral arrangement on SWFs is a bilateral announcement between the US as host country and Abu Dhabi and Singapore are home countries of SWFs, which is discussed in chapter four.

investment law, bank law, and securities law. National security scrutiny/review in several countries has been an important measure to investigate and even block potential (and completed) transactions, especially those made in strategic assets or made by investors with sovereign background. The domestic regulations of host country determine which kinds/forms of foreign investment are encouraged, restricted and prohibited, and which sectors are allowed to invest. In addition, national regulations in some countries may provide immunity or exemption, i.e. state immunity or tax exemption on certain investments made by particular investors. Under this circumstance, if SWF investment meets relevant requirement, there is the immunity and disability between SWFs and host country.

The fourth type of legal relation is between the target company of SWF investment and the host country. Host country acts as the regulator to supervise the operation of the target company (local company). Under this circumstance, host country has the legal power while the target company has liabilities to conduct within the legal framework. In terms of SWF investment, if the target company was regarded as strategic assets or critical infrastructure of the host country, SWF investment in this company might trigger national security scrutiny.[14] For example, the critical infrastructure usually includes but not limited to sectors of major energy and nature resources, materials, critical technologies, and it varies from country to country.

The last legal relation is between the target company and a SWF. This relation occurs and exists under the private law, and the two involved parties have equal legal standings in a particular transaction.[15] Both of them have corresponding rights and duties to each other. There are two main types of transactions between them: (i) the purchase contract between a SWF and a private company (in private market); (ii) merger and acquisition (M&A) or purchasing shares via security market between SWFs and public-listed companies. When a SWF investing in a target company that

[14] For example, in the US, the critical infrastructure (or critical technology) is the backbone of nation's economy, security and health. It is closely relevant to the national security review in the US. The definition of critical infrastructure in US and in other selected developed countries is discussed in chapter three.

[15] Although some researchers redeem SWFs as public entities, when SWFs contract with other company and trade with other company, as well as invest into financial market, these are commercial activities. The relation between SWFs and the target company is constrained by their contracts.

intends to control this company via M&A, this kind of investment is FDI,[16] which may cause the concern or the fear of national security. When a SWF purchasing securities in a portfolio or investing in a group of assets that does not involve in the active management or the control of the target company (e.g. transactions in equity securities or debt securities), this is portfolio/indirect investment, which usually cause the concerns of low transparency and financial stability. The nature of SWF investment determines whether SWFs have rights to control or influence decision-making, thereby lead to the application of different regulations to them. In addition, it is usually claimed that sovereign investors (including SWFs) may receive preferential treatment or regulatory advantages from the government of home country, i.e. these investors have privileges while other private investors do not. This usually results in the discussion of competitive neutrality and a level playing field between sovereign investors and other private investors, on which host countries may take certain actions or measures.

The first threshold or dilemma SWFs would encounter in host countries is the investment barrier in market access. Therefore, the primary factor to determine the success of the outbound investment of a SWF is whether this SWF is a qualified investor in host country, or whether this SWF is allowed to invest in certain sectors (e.g. financial market and strategic assets), which is reflected by the relation between a SWF and host country. Whether the regulation concerning market access is strict or not relies on not only the identity of the investor but also which sectors the target company belongs to.[17] Accordingly, the relation between the home country and the SWF may influence the governance and legal structure of this SWF and might also influence its investment objectives, which may further influence the regulatory measures adopted by host country. It can be seen from the above analysis that the

[16] FDI is defined by OECD as:

> [C]ross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise. Ownership of at least 10% of the voting power, representing the influence by the investor, is the basic criterion used.

See OECD 'OECD Factbook 2013: Economic, Environmental and Social Statistics' (2013) <http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en> accessed 17 June 2015

[17] They should consider whether these industries, areas are encouraged, restricted or prohibited by domestic law or whether these industries are regarded as critical infrastructure.

legal relations involved in SWF investment are complex and interactive. Clarifying these couples of legal relations can help deeply understand SWF investment and elucidating the basic things with regard to certain regulations.

2. The Conflict between Foreign Investment Protection and State Sovereignty

2.1 The conflicting theories on foreign investment and investment protection

The history of foreign investment could be traced back to the very early period. The claim of foreign investment protection was highlighted by John Adams as early as 1796 when US negotiated the Treaty on Friendship, Commerce and Navigation with France.[18] Different theories towards foreign investment have had an impact on the legal attitudes and responses of host countries.

There might be at least three conflicting theories from the perspective of the economic development of host countries, especially developing countries as host countries: (i) the most positive one towards foreign investment claims that foreign investment is wholly beneficial to host countries, which highlights the positive effect of foreign investment on economic development, i.e. the classical economic theory;[19] (ii) the negative one claims that the state cannot achieve development if the state cannot veer away from the reliance on foreign investment, i.e. the dependency theory;[20] (iii) the last one that adopts a neutral view on foreign investment recognises the advantages and disadvantages of foreign investment, i.e. the middle path or the balance view.[21] It should be noticed that the classical economic theory and the dependency theory were developed when investors are mainly from developed countries investing in developing countries, while, the middle path has increasingly received a wide acceptance during recent decade, especially during and after the financial crisis.

[18] R. Dolzer and C. Schreuer, *Principles of International Investment Law* (OUP 2012) 1
[19] Sornarajah (n 1) 61
[20] ibid 67
[21] All these theories focus on the economic development of the host countries, particularly those developing countries. For statements from an economic point of view, see T. Biersteker, *Multinationals, the State and the Control of the Nigerian Economy* (Princeton University Press 1987) 3-51

The acceptance of classical economic theory is promoted by the phenomenon of globalisation; this theory advocates that economic neoliberalism helps to promote the movement of capital, goods, and people.[22] This theory supports maximising the economic freedom for individuals and reducing state intervention on transnational transactions.[23] The globalisation is regarded as an inevitable trend, under which the international trade and investment have been given a great boost. As a product of globalisation, this theory argues that the free movement of multinationals should be promoted and their investments should be protected, which could further advance the process of global integration.[24]

For many developing countries, economic neoliberalism could provide the capital inflow while they should be receptive to provide protections for these capital flows. The classical view on foreign investment was not only spread by multinationals but also by international organisations, e.g. the World Bank and the IMF, which set the acceptance of this view as a condition for offering loans.[25] Moreover, the notion of economic neoliberalism was reflected in the area of international trade, e.g. disciplines under the WTO framework – Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS), General Agreement on Trade and Service (GATS) and Agreement on Trade-Related Investment Measures (TRIMs).

The current order of international law is maintained by economic powers, and most international institutions are controlled by traditional capital-exporting countries, i.e. Western economies. Therefore, the work and effort undertaken by international institutions/organisations mainly reflect the demands of these countries and support their investment activities or their multinationals abroad. Many bilateral and international agreements or conventions have expressed or asserted this view. For example, it can be found that the preambles in many BITs usually (especially before 21st century) state the benefits of capital flows to economic development or reciprocal

[22] A. Harmes, 'The Rise of Neoliberal Nationalism' (2012) 19 (1) Rev. Int'l Pol. Econ. 59, 64-69
[23] J. Cohen and M. Centeno, 'Neoliberalism and Patterns of Economic Performance, 1980-2000' (2006) 606 ANNALS, AAPSS 32, 36
[24] Sornarajah (n 1) 61-67
[25] B. Boockmann and A. Dreher, 'The Contribution of the IMF and the World Bank to Economic Freedom' (2003) 19 (3) Europ. J. Pol. Econ. 633

promotion and protection of investments.[26] Moreover, several multilateral agreements are also clearly based on the classical theory. For example, the Multilateral Investment Guarantee Agency (MIGA) is regarded as a policy initiative that has 'considerable potential to remove barriers to international investment and give a new vigour to the development process.'[27] The Convention on the Settlement of Investment Dispute between States and Nationals of Other States (ICSID Convention) also includes such view on foreign investment.[28]

While, the classical economic theory in practice has been questioned for various reasons. Firstly, the absence of regulatory control over these capital flows may lead to social and environmental problems. There are many cases where multinational corporations violate the human rights or labour rights, or lead to the environmental pollution.[29] Secondly, although many developing countries have provided or adopted measures or regulations that favour foreign investment, there seems to have no notable increase or even have worsened the economic situation (e.g. Argentina).[30] Thirdly, the classical theory has been challenged because of the successive financial crisis. For example, the Asian financial crisis was owed to the sudden withdrawal of foreign portfolio investment,[31] and the 2008 global financial crisis was widely attributed to the adoption of neo-liberal policies with a notion of deregulation on the

[26] For example, the BIT between United Kingdom and India (1994), the BIT between United Kingdom and Malaysia (1981), and the BIT between United Kingdom and China (1986) concerning the reciprocal promotion and protection of investments; the BIT between the United States and Kazakhstan, the BIT between United States and Turkey, the BIT between United State and Ukraine also concerning the investment protection and the benefit of the capital flow to economic development. Most of these BITs were signed between developed countries and developing countries and concluded before 21st century. For more discussion, see J. Hatchard and A Perry-Kessaris, *Law and Development: Facing Complexity in the 21st Century* (Routledge 2012)

[27] I. Shihate, *The MIGA and Foreign Investment* (Dordrecht: Martinus Nijhoff 1988) 22. MIGA was established in 1988 under the World Bank as an international financial institution, which provides political risks insurance and credit enhancement guarantee for FDI and helps to protect FDI against political and non-commercial risks in developing countries.

[28] The preamble in the ICSID Convention states that the Contracting States "considering the need for international cooperation for economic development and the role of private international investment therein".

[29] The harmful effects on environment, human right or corruption brought by Multinationals in developing countries has lead to the discussion of corporate social responsibility (CSR) and Multinationals. For more discussion see D. Weissbrodt and M. Kruger, 'Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights' (2003) 97 (4) AJIL 901; J. Zerk, *Multinationals and Corporate Social Responsibility: Limitations and Opportunities in International Law* (CUP 2006)

[30] M. Feldstein, 'Argentina's Fall: Lessons from the Latest Financial Crisis' (2002) 81 (2) Foreign Affairs 8

[31] S. Radelet and J. Sachs, 'The Onset of the East Asian Financial Crisis' (1998) NBER Working Paper 6680 <http://www.nber.org/papers/w6680.pdf> accessed 15 September 2015

financial market.[32] But, the influence of this theory will remain if only those powerful economies (and international institutions dominated by them) still claim the acceptance of economic liberalisation. However, it seems that the rise of 'state capitalism' has resulted in a more conservative attitude of these developed countries toward foreign capital flows from emerging and developing economies.

For the dependency theory, which is opposed to the classical theory, it was popular in Latin American countries.[33] This theory claims that most multinational corporations invest in developing countries but serve for the interests of developed countries where their headquarters are situated and for a part of elite class in developing countries.[34] It comes to an entirely opposite conclusion compared to the classical theory, and this theory believes that foreign investment cannot promote development but results in their over-dependence on the economies of developed countries.[35]

However, many Latin American countries are now supporting or adopting the notion of liberalisation and have participated in the negotiation of IIAs. In spite of adopting liberalisation, the economic crisis in Argentina occurs. Nevertheless, the dependency theory that recognises the development rights of people rather than of the state would become attractive on account of the social and environmental impacts. The opposition to the Multilateral Agreement on Investment (MAI) which was supported/initiated by the OECD,[36] and the anti-globalisation protests in several countries (e.g. threats in the US and EU) concentrate on the fact that the states should not focus on providing protections for foreign investment or multinational corporations but do not address the social and environmental issues caused by foreign investment.[37]

Unlike the classical theory that supports liberalisation and free movement of

[32] W. Davis and L. McGoey, 'Rationalities of Ignorance: on Financial Crisis and the Ambivalence of Neo-Liberal Epistemology' (2012) 41 Econ. & Soc'y 64

[33] For discussion on the approach of Latin America, see C. Kay, *Latin American Theories of Development and Underdevelopment* (Routledge 2010)

[34] H. Myint, 'The "Classical Theory" of International Trade and the Underdeveloped Countries' (1958) 68 (270) The Econ. J. 317, 335

[35] Sornarajah (n 1) 67-70

[36] E. Graham, 'Regulatory Takings, Supernational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations' (1998) 31 Cornell Int'l L. J. 599

[37] A. Issac, 'IMF: the Global Recovery Is at Risk from the Forces of Anti-Globalisation' Telegraph (10 October 2017) <http://www.telegraph.co.uk/business/2017/10/10/imf-global-recovery-risk-forces-anti-globalisation/> accessed 15 October 2017

multinationals or the dependency theory that is hostile to multinationals, the newer theory, i.e. the balance view, recognises the beneficial and harmful effects of foreign investment to economic development.[38] By identifying this, it could be easily to adopt the position that host countries could harness foreign investment to achieve economic development but they should take sufficient regulatory measures to address relevant issues or adverse consequences. At the international level, this view has been supported by international institutions, which have taken efforts to generate codes of conducts or principles for multinationals (e.g. OECD).

Unlike the classical theory supporting the absolute investment protection, the balance view suggests that foreign investments are entitled to protection but the level of protection depends on the extent to which foreign investments could bring benefits to host countries and to promote the economic development.[39] Thus, the approval mechanism or regulatory intervention is necessary to enhance and ensure the economic objective of the state when receiving foreign investment. If some benefits exist, owing to the competition for capital, especially during economic turmoil, states should also try to ensure that their regulations are attractive to foreign investment compared with other states and could accommodate interests of foreign investment. It seems that a mixed use of regulatory control and openness is desirable and the interest of foreign investment and the state should be considered.

In addition, the international law and international initiatives start to reflect these changes. Recent trends in IIAs drafting practices indicate that states are increasingly trying to balance the interests of the state and of foreign investors.[40] The practices of

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[38] Sornarajah (n 1) 65-70

[39] It is relevant to the application of fair and equitable treatment (FET). It is argued that the fairness should not only consider the effects of the regulatory measures adopted by the host state on foreign investors but also the effect of the investment on the host state. ibid. For treaty protection, it is argued that the role or the conduct of the investor is an important consideration when applying the FET. See P. Muchlinski, ''Caveat Investor'? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard' (2006) 55 (3) Int'l and Comp. L. Quart. 527. See also I. Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (OUP 2008) 228

[40] To strike a balance between the investment protection and the state's right to regulate, recent reforms in IIAs is on-going including reform in substantive protections and reform in ISDS. For substantive protections, IIAs drafting practices suggest following changes: clarification of the definition of investment, clarification of FET, clarification of indirect expropriation, and inclusion of public policy exceptions. See E. Tuerk, 'Reforming the IIA Regime: Are We Getting There? Lessons from Recent Treaty Practice' (26 November 2016) <http://investmentpolicyhub.unctad.org/Blog/Index/46> accessed 30 January 2017

many states indicate a shift from the notion that all foreign investments are entitled to the international minimum standards of treatment. Alternatively, foreign investments can only seek the protection of minimum standards of treatment in international law when they meet the requirements in IIA provisions.[41] International law may on the other hand, requires multinationals or investors to conduct responsible businesses or comply with environmental or labour standards.[42] It could be argued that under this balance view, the compliance with national regulations of host countries is a precondition to access domestic market and access protection provided by international agreements.

2.2 The theory of state sovereignty

The notion of sovereignty is complex.[43] From the perspective of domestic law, the state acts as a sovereign power, and a political organisation of a society. From the perspective of international law, each state participates in international relations based on sovereign equality, which provides another meaning of sovereignty. Sovereignty is an essential element of a state, since it represents the supremacy of state sovereignty and the independence of the state in expressing and achieving the will of the governors under international law.[44] This 'sovereignty' is asserted by two principles of economic sovereignty, i.e. the principle of economic self-determination and the principle of permanent sovereignty over natural resources.[45] The Seoul Declaration

[41] For example, the concluded Trans-Pacific Partnership (TPP) has incorporated a clarification on FET (Article 9.6 (3)(4)(5)) by clarifying that certain situations or the breach of other legal provisions does not constitute a breach of FET. However, due to the undefined "fairness" and "equity" in the FET clause, it may lead to problems in interpretation in dispute resolution. See K. Leite, 'The Fair and Equitable Treatment Standard: A Search for A Better Balance in International Investment Agreements' (2016) 32 (1) Am. U. Int'l L. Rev. 363, 397

[42] The 'Guiding Principles for Global investment Policymaking' endorsed by G20 in 2016 also emphasises the host countries' right to regulate and the responsible business conduct.

[43] The term 'sovereignty' has a variety of meanings. According to Kelsen, "the most current of these meaning is, according to the etymological origin of the term that derives from the Latin *superanus*, that of a special quality of the state, the quality of being a supreme power or supreme order of human behavior." See H. Kelsen, 'Sovereignty and International Law' (1960) 48 Georgetown L. J. 627

[44] See J. Maftei, 'Sovereignty in International Law' (2015) 11 Acta U. Danubius Jur. 54, 55

[45] The history of the notion of sovereignty in international law is almost identical with the full-scale history of international law itself. See S. Helmut, 'Sovereignty', in Bernhardt, R. (ed.), *Encyclopedia of Public International Law*, Vol. IV (Amsterdam, etc.: Elsvier 2000) 501. State sovereignty in past time is regarded as a principle of exclusive territorial jurisdiction. During the 17th and 18th centuries, State sovereignty "meant a State's independence from and legal impermeability in relation to foreign powers on the one hand and the State's exclusive jurisdiction and supremacy over its territory and inhabitants on the other." The principles of non-intervention in domestic affairs was developed and then the theory of 'absolute sovereignty' was developed, See M. Masahiro, 'Sovereignty and International Law' (2012) <https://s3.amazonaws.com/academia.edu.documents/40401431/Research_paper_Soverignty.pdf?AW

of the International Law Association emphasised these two principles by providing the notion of 'permanent sovereignty',[46] which was then extended to all economic activities rather than limited to natural resources.[47] It is an inherent part of the state sovereignty to control all people, activities and properties within its territory.

However, within the order of international law, the effect of state sovereignty is different from that at the national level. It is subject to the principles of customary international law and treaty-based international law. The reason could be explained in two ways: (i) international law is a system superior to domestic law; or (ii) the state agrees to be bound by international law.[48] Acknowledged by the *Charter of Economic Rights and Duties of States* (the Charter), the state sovereignty over foreign property is subject to the fulfilment of obligations mutually agreed by all States in good faith.[49] This means that if the state accepts the international law or ratifies international treaties, the freedom of the state might therefore be limited, i.e. the state responsibility to foreign investors or to relevant parties.

In light of foreign investment, the state's consent to the treaty-based international law limits the standards of treatment that the host state could offer to foreign investment, and limits the regulatory flexibility of the host state if the state violates the treaty protection for foreign investment. The customary international law is related to the state responsibility to the treatment of aliens, which limits the state sovereignty to impose restrictions on or to apply standard of treatment to aliens. It has been incorporated into many IIAs as the international minimum standards or standard of fair and equitable treatment (FET). It could therefore be argued that if there are rules about the state responsibility at international level, it might have impacts on the requirements and restrictions that would be imposed on foreign investment by host states.

SAccessKeyId=AKIAIWOWYYGZ2Y53UL3A&Expires=1508438408&Signature=DsKHnC2OdpO4GHtJuY60GK4%2Fwm0%3D&response-content-disposition=inline%3B%20filename%3DResearch_paper_Soverignty.pdf> accessed 5 September 2015

[46] Section 5 of the Seoul Declaration of the International Law Association (1988)

[47] International Law Association, *Report of the Sixty-Fourth Congress* (1990)

[48] Sornarajah (n 1) 119

[49] Article 2 (2) (c) of the Charter of Economic Rights and Duties of States

2.3. Conflicting interests between SWFs and host countries

There are strong claims that certain minimum safeguards should be provided for an alien and host countries should not violate these minimum standards. The standards of treatment for foreign investments are in part based on state responsibility.[50] These standards are usually incorporated into treaties as a means of protection for foreign investors or foreign investments. It is well accepted that state sovereignty over a purely domestic matter would be restricted if there is a ratified treaty dealing with such matter.[51]

IIAs seek to provide substantive treatment and procedural protection for foreign investment. These provisions not only aim to safeguard the FET of foreign investment but also to provide certainty for their operations in host countries. However, relevant administrative agencies or special review agencies are increasingly gaining greater discretion to review or even block foreign investment. These review procedures mainly assess whether such transaction is beneficial to the domestic economy or whether it is detrimental to the national security. States try to ensure greater regulatory spaces by giving regulators more discretion and setting up special review mechanisms. Even some review decisions are not subject to judicial review. Under this circumstance, the legal environment and legal risks would be less predictable to investors.[52]

SWFs are foreign investors, and as such their investment activities are entitled to receive protection and non-discriminatory treatment if their investments are covered by IIAs. In general, the investment of SWFs is not totally different from that of other private investment. Moreover, the majority of SWFs undertake portfolio investment.[53]

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[50] S. Subedi, *International Investment Law: Reconciling Policy and Principle* (2nd edn, Hart Publishing 2012) 9

[51] As stated by Asante, 'the development of the law of State responsibility was inspired by Western *laissez-faire* ideas and liberal concepts of property. From the juristic standpoint, one of the underlying principles is the duty of the host State to display fair and equitable treatment or good faith in its conduct towards aliens.' The law of State responsibility was subsequently extended to foreign investment and foreign companies. See S. Asante, 'International Law and Foreign Investment: A Reappraisal' (1988) 37 ICLQ 588, 590

[52] N. AI-Adba, 'The Limitation of State Sovereignty in Hosting Foreign Investments And The Role of Investor-State Arbitration to Rebalance The Investment Relationship' (PhD thesis, University of Manchester 2014) 12

[53] Petrova (n 7) in Introduction

However, barriers and suspicions of host states regarding SWFs will affect the level of protection and types of restrictions they may receive. Firstly, it is the state sovereignty for each host country to impose conditions on those sovereign background investors, e.g. SOEs and SWFs or the investments made by them. Since most SWFs are funded by developing countries or political rivals of developed countries, those countries that usually claim full protection for foreign investment change their attitudes when a large number of state capitals managed by SWFs from developing or emerging economies invest in their markets.

Secondly, a state is usually not strictly constrained by the commitment it made to foreign investment at the time of entry with regard to future changes in regulations or conditions unless the state is constrained by treaty obligations.[54] Treaty obligation requires the state to honour or observe commitments it made to other contracting party in terms of investment treatment for nationals of the contracting party. Although theoretically, state sovereignty may be restricted or ceded under international law, there are no binding treaties and international regulations that explicitly address issues of SWF investments. At present, most regulatory responses to SWF investment mainly rely on national regulations and international soft law.

Thirdly, if an investment is made by a foreign investor that poses a threat to national security, in accordance with relevant domestic law, it will be blocked or be required to accept mitigation measures imposed by a review agency in order to allow the transaction to continue. If a completed investment that is found to be adverse to national interests, it will be removed. Although SWFs act as private investment funds in pursuit of financial returns via portfolio and direct investments, their investments are easily regarded as threats to national security or market stability due to the sovereign background (e.g. state ownership, legal and governance structure). But usually, host countries can easily use the national security as an excuse to address political rather than economic concerns thus resulting in unfair or discriminatory treatment of foreign investors. This therefore suggests that there are conflicts between SWFs' requirement for protection and host countries' demand for regulatory control.

[54] Sornarajah (n 1) 113

3. The Conflicting Interests between Open Market and National Security

3.1 Open market and free movement of capital under the theory of liberalisation

The concept of 'open market' is often used to define a market,[55] which is accessible to all economic actors and all actors have an equal opportunity to entry in this market and in a situation of free competition.[56] Open market has been highlighted with the trend of globalisation and the development of international trade. Open market is usually mentioned with free trade.[57] Free trade herein can only exist when businesses can actually have the access to the market. Being the promoter of open market and free trade, many western economies intend to secure that the access to market is facilitated for all market participants.

These western economies have long been the countries that call for the open market in

[55] The concept of open market refers to an economic situation close to free trade. In this research, the open market refers to equal market access to market participants, especially in terms of investment transactions. In many economics theories, economists often discuss the 'open market' and 'free market'. They are based on being free from government intervention or restrictions. But the free market does not give equal access. It is the opposite of equal access. A free market economy in the strict sense is an economy in which individuals can freely trade goods or commodities without the intervention of an external authority (usually, government take on this external regulatory role). The free market in terms of financial market is often linked to the 'neo-liberal capitalism'. As one of the features of neo-liberal capitalism is under which market participants are less regulated to allow the invisible hand of the free market system to promote economic prosperity and achieve free mobility of capital. An open economy is a different concept. It refers to an economy that interacts with other economies: for example, trade between different countries, or financial transactions taking place across borders. In practice, all economies in the modern world are "open" to varying extents. For more information about the concept of 'open market' and 'free market', see D. Rigby and C. Zook, 'Open-market Innovation' (2002) 80(10) Harv. Bus. Rev. 80; see also G. Borts and J. Stein, *Economic Growth in a Free Market* (Columbia University Press 1964); C. Bergsten, 'Competitive Liberalization and Global Free Trade: A Vision for the Early 21st Century' (1997) Peterson Institute for International Economics Working Paper 96-15 <https://piie.com/publications/working-papers/competitive-liberalization-and-global-free-trade-vision-early-21st> accessed 16 September 2015; B. Hoekman and D. Konan, *Deep Integration, Nondiscrimination, and Euro-Mediterranean Free Trade Vol.2095* (World Bank Publications 1999); W. Baumol, The Free-market Innovation Machine: Analyzing the Growth Miracle of Capitalism (Princeton University Press 2002); M. Olssen, 'Neoliberalism, Higher Education and the Knowledge Economy: From the Free Market to Knowledge Capitalism' (2005) 20(3) J. Edu. Pol. 313

[56] This contrasts with a market closed by a monopoly or oligopoly, which dominates an industry, and with a protected market in which entry is conditional on certain financial and legal requirements or is subject to tariff barriers, taxes, levies or state subsidies. These effectively present some economic actors from participating in such market.

[57] The benefits of liberalization and free market access are tremendous and well-documented. Kern (n 3) 14 in Ch. 1

order to gain benefits from trade and investment activities, since it could help exploit resources, exchange goods and technology.[58] Open market under the international investment regime mainly refers to the free movement of capital and the freedom of establishment.[59] An open capital market or investment environment enables the development of an integrated, open, competitive and efficient financial market and services, and helps to stabilise the economy through diversification.[60] The notion of open market and free movement of capital were embedded into many national policies and international documents. It aims to provide a regulatory framework for countries progressively to remove barriers to the movement of capital while it also aims to provide the flexibility to ensure the economic and financial stability.

Taking European Union (EU) as an example. The European Community was established to promote the cooperation and integration within the internal territorial limits with the core notion of 'common market' or 'single market'.[61] The EU has been working on promoting free trade and open market within EU and with other trade partners worldwide. Free movement of capital is at the heart of the common market and is one of 'four freedoms' in EU.[62] Certain articles in Treaty on the Functioning of the European Union (TFEU) and their implementing provisions mandate the abolition of all restrictions on the free movement of goods, persons, services and capital.[63] Opening investment environment to avoid protectionist attitudes/actions is within the EU policy consideration. In order to create the growth

[58] Although to some extent open market may undermine domestic market in developing countries, especially the infant industries, as these countries have not been highly equipped sound economic and legal system as well as relevant infrastructure. Open market could help them to fully compete in international market and flourish their domestic market.

[59] The basic premise of open global capital markets is the idea that capital flows freely worldwide seeking investment opportunities that yield optimal risk-adjusted rates of return. See Hildebrand (n 70) 7 in Ch.1

[60] See J. Stigliz, 'Capital Market Liberalization, Economic Growth, and Instability' (2000) 28 World Dev. 1075, 1077

[61] The previous form of the European Community was the European Economic Community (EEC), which was an economic union created by the Treaty of Rome of 1957. Upon the formation of the European Union in 1993, the EEC was incorporated and renamed as the European Community.

[62] According some scholars, a common market in which goods, services and persons circulate freely can function efficiently only if there is freedom to move capital associated with such economic activities. The economic freedom on which the common market is based will be merely illusory without the corresponding liberalisation of financial operations by a migrant worker, capital investors or multinational corporations. See S. Mohamed, 'Evolution of the European Common Market', (1992) 2 Law Gazette 40, 41. See also S. Mohamed, *European Community Law on the Free Movement of Capital and the EMU* (Martinus Nijhoff Publishers 1999)

[63] Article 28 TFEU, Article 45 TFEU, Article 56 TFEU, and Article 63 TFEU. Part Three, Union policies and internal actions, Title II and IV TFEU.

and jobs for Europeans, the EU seeks to increase opportunities to trade with key partner countries. One of the approaches regarding the open market is to negotiate better conditions and market access for trade and investment through free trade agreements (FTAs) and BITs.

At the international level, several international institutions have devoted themselves to promote liberalisation. The G20 meeting discusses measures and ways to help countries to make the most of capital flows. The OECD *Code of Liberalisation of Capital Movements* tries to extend the benefits of liberalisation to all member states.[64] Under the Code, each member country is entitled to the benefits from the liberalisation of other member country regardless of its own degree of openness. Moreover, the OECD takes endeavours, cooperating with IMF, to extend these liberalisation measures to non-OECD countries.[65]

However, it has been increasingly clear that the liberalisation of capital market, if done in rash, without *ex ante* setting up an effective regulatory framework in place, problems may occur. The general case that favours the financial liberalisation and the free movement of capital has been called into question by a series of bank panics and collapses in the financial crisis.[66] Some scholars argue that it is not an accident that despite the global economic recession or turmoil, the two large developing countries, i.e. China and India could survive the crisis and continue to grow with remarkable progress, both of which exert strong regulatory control over capital flows.[67] The onset of 2008 financial crisis has challenged the neo-liberal policy, and it has led to an increasing trend in adopting regulatory intervention over capital inflows and foreign investment, particularly in developed countries. To ensure the market stability, to avoid crisis and enhance the protection on security and public order, investment protectionism as an increasing phenomenon, witnesses the control over the entry of

[64] The Code of Liberalisation of Capital Movements was born with the OECD in 1961 at a time when many OECD countries were in the process of economic recovery and development and when the international movement of capital faced many barriers.
[65] OECD, 'The OECD Code of Liberalisation of Capital Movements: Update on Developments' (June 2017) OECD Report to the G20 <https://www.oecd.org/daf/inv/investment-policy/OECD-Code-Capital-Movements-Update-to-G20-June-2017.pdf> accessed 15 July 2017
[66] R. Mckinnon, *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy* (JHU Press 1993) 3
[67] Stigliz (n 60) 1075

foreign investment either through existing foreign investment regulations or national security mechanism or even through the adoption of new investment control.[68]

3.2 Protection of national security

Recently, 'national security' has been increasingly highlighted when dealing with inbound foreign investments. It is usually a legitimate right of the state, since it is the state sovereignty to maintain the stability of domestic market and protect the national interest. National security, generally, refers to protecting the state and its citizens from all kinds of crisis in its territory via a variety of powers or forces, e.g. military force, political and economic power. Initially, this concept mainly focused on the military might and national defence and it was developed mostly in US after World War II.

The scope of national security now consists of a broad range of aspects including but not limited to the non-military security or economic security, energy security, environmental security, and the cyber security etc. The value of 'national security' may vary from country to country according to their national situations and political, economic considerations. The term of 'national security' or similar wording like 'public security', 'public interests', and 'national interest' can be found in different regulations of each country.[69] Neither the statute nor the implementing regulation provides a clear definition of national security,[70] but it does contain a non-exhaustive list of factors to be considered when determining whether a threat to the national security exists.[71] Moreover, 'national security' or 'essential security' is incorporated

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[68] Sornarajah (n 1) 77

[69] Some scholars argue that when "national interest" or "national security" gains popularity they need to be scrutinised with particular care. They may not mean the same thing to different people. They may not have any precise meaning at all. See A. Wolfers, '"National Security" as an Ambiguous Symbol' (1952) 67 PSQ 481

[70] National security firstly appearing into legal documents is the Exon-Florio statute in US. However neither Congress not the Administration have attempted to define the term national security. CFIUS has indicated that in order to assure an unimpeded inflow of foreign investment it would implement the statue 'only insofar as necessary to protect the national security,' and 'in a manner fully consistent with the international obligations of the United States.' See US Senate, Committee on Armed Services, ' Briefing by Representatives from the Departments and Agencies Represented on the Committee on Foreign Investment in the United States (CFIUS) to Discuss the National Security Implications of the Acquisition of Penisular and Oriental Steamship Navigation Company by Dubai Ports World, A Government-Owned and – Controlled Firm of the United Arab Emirates (UAE)' (February 23, 2006) Senate Hearing 109-782 <https://www.gpo.gov/fdsys/pkg/CHRG-109shrg32744/html/CHRG-109shrg32744.htm> accessed 16 September 2015

[71] G. Georgiew, 'The Reformed CFIUS Regulatory Framework: Mediating Between Continued

into many international agreements as an exception clause to deprive foreign investors of their rights or certain treatment. But so far, this concept still remains ambiguous and leaves large spaces for host states exerting discretion or being interpreted by domestic authorities or international tribunals.

As a host country, taking the US as an example, on one hand, the government has taken every possible step to protect the national security in light of the threat posed by terrorist attacks or other activities.[72] Meanwhile, the US has been an active supporter and pioneer of the free trade and open market policies. However, the goals of protecting national security and promoting foreign investment may conflict with each other when inbound foreign investment transactions pose the national security risk.[73] Due to the far-reaching influence of the financial crisis, the US has adopted conservative measures on foreign investment (especially from China) in strategic assets.

The rise of 'state capitalism', on the other hand, has added concerns of the US, since increasing number of investments are made by SOEs and SWFs, i.e. investors with foreign government background. National security is taken as of the utmost importance and necessary and it is hierarchically above the financial stability considerations and economic efficiency.[74] The national security review mechanism thus has become a strategic resort for the US to block or suspend any transaction that it may deem as threats to its broad notion of national security (whether direct investment or passive or portfolio investment)[75] or any transaction that lead to

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Openness to Foreign Investment and National Security' (2008) 25 Yale J. on Reg. 125, 127. In US, the President may suspend or prohibit a transaction that threatens to impair the national security of the US. The President shall consider various factors, e.g. domestic production needed for projected national defence requirements, the capability and capacity of domestic industries to meet national defence requirements, the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet national security requirements, the potential effects of an acquisition on sales of military goods, equipment, or technology to countries supporting terrorism or raising proliferation concerns, and the potential effects on U.S. technological leadership in areas affecting national security. See 50 U.S.C. app. § 2170(f) (2000) (pre-amendment). In Australia, the national security is an important factor to be considered when the government assess foreign investment proposals under its national interest test.

[72] Address Before a Joint Session of the Congress on the United Stated Response to the Terrorist Attacks of September 11, 2 PUB. PAPERS 1140 (Sept. 20, 2001)

[73] M. Byrne, 'Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance' (2006) 67 Ohio St. L. J. 849, 850

[74] Kratsas and Truby (n 10) 11 in Introduction

[75] Foreign direct investment is regarded as a threat to "national security" because foreign ownership of a defense contractor may compromise confidential information; may threaten access to critical

foreign 'control' over its critical technology or critical infrastructure.

No one can deny the state's right to protect its legitimate national security. But if it over-reacts to or over-focuses on the state-ownership of foreign investors or the origins of investors, national security would be used as a pretext for investment protectionism, or discrimination.[76] National security in disguise is opposite to open market policy or free movement of capital, and to some degree, might undermine the domestic economy. Firstly, the vague definition of national security incorporated into domestic regulation or used in review mechanisms may add to uncertainty among foreign investors and may increase their transaction costs. The review agency may use it as an excuse to block and hinder foreign investments by exercising discretion.[77] Secondly, if the government or relevant agency arbitrarily utilises national security review or other mechanisms, it may undermine the incentives of foreign investment and force them to invest in other markets or divest. It may also influence the domestic market, especially when many countries are suffering economic turmoil and competing for capital inflows. These protectionist measures imposed on foreign investment may be motivated by political strategy or short-term economic

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technology or equipment; may seriously damage domestic producers of critical components thereby making the United Sated further dependent on foreign sources of supply. See M. Tlochin and S. Tolchin, *Buying into America: How Foreign Money Is Changing The Face of Our Nation* (Paperback edition, 1988) 219, 261-64. See also J. Alvarez, 'Political Protectionism and United States International Investment Obligations in Conflict: The Hazards of Exon-Florio' (1989) 30 Va. J. Int'l L. 1, 5. Foreign portfolio investment is also regarded as potentially threatening to the "national economic interest" because a withdrawal of foreign funds could seriously disrupt the economy. For many observers, the actions of foreign portfolio investors both in the US and in overseas market contributed to Black Monday, the stock market crash of October 19, 1987. See N. Glickman and D. Woodward, *The New Competitors: How Foreign Investors Are Changing the U.S. Economy* (Basic Books, Inc. 1989) 6. Merely having the power to make such a credible threat to U.S. economic security gives foreign portfolio investors tremendous political leverage and is regarded as proof that the US has entered a period of "economic colonialism." See M. Tlochin and S. Tolchin, *Buying into America: How Foreign Money Is Changing The Face of Our Nation* (Farragut Pub Co 1988). See also E. Fry, 'Foreign Direct Investment in the United States: The Differing Perspectives of Washington, D.C. and the State Capitals' (1989) B.Y.U. L. Rev. 373, 386

[76] Sometimes, the government of host country may take advantages of gaps in investment regulations to discriminate against foreign investors. See S. Evenett et al., *Effective Crisis Response and Openness: Implications for the Trading System* (CEPR 2009) 211

[77] This new wave of protectionism has many forms. Governments can adopt national regulation that blocks foreign investment by certain entities based on their identity as government-owned entities or based on the type of industry of the invested company. It can also implement 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 commerciality and associated risks. Several countries have excluded certain industries from being available for acquisition by foreign entities. See E. Chalamish, 'Protectionism and Sovereign Investment Post Global Recession' (2009) OECD Global Forum on International Investment, 5 <http://www.oecd.org/investment/globalforum/44231385.pdf> accessed 16 September 2015

consideration;[78] however, these measures usually come with a significant economic cost to national welfare.

3.3 The conflict between open market and regulatory intervention

It is the Western economies that usually support the liberalisation according to which barriers should be reduced or eliminated for the global trade. The influence of trade liberalisation, afterwards, was extended to the investment liberalisation. It calls for the actions of host states to provide protections for foreign investment, and to reduce restriction on the movement of capital or multinationals, and the integration of domestic and global market.[79] But, in the past, developing host countries had established regulatory measures to constrain foreign investment and to limit the access to their markets.

There is a shift in paradigm taking place within the international law in general and the international investment law in particular.[80] Those developed countries that maintain or assert an open policy towards foreign investment are now turning to tighten the regulatory control over the inbound capital flow. For example, the US previously had a reputation for being a state that had openly admitted foreign investment and was more protective of foreign investment via IIAs with higher standards of liberalisation provisions. However, it has now become more protective of its state sovereignty. Moreover, under the Trump's administration, the notion of the globalisation, free trade and investment liberalisation are being challenged. The US is discussing the reform of its existing special review agency, i.e. Committee on Foreign Investment in the US (CFIUS), to broaden the scope of review and block investment activities from a more political perspective.[81] Comparatively, China, which was more protective of the state sovereignty and adopted restrictive measures, is now becoming more protective of foreign investment. It could be attributed to the rapid expansion of

[78] P. Messerlin, *Measuring the Costs of Protection in Europe-European Commercial Policy in the 2000s* (Institute for International Economics 2001) 41
[79] S. Chaudhuri and U. Mukherjee, 'Removal of Protectionism, Foreign Investment and Welfare in A Model of Informal Sector' (2002) 14 Japan and the World Econ. 101
[80] Subedi (n 50) 218
[81] See Covington & Burling LLP, 'Update on CFIUS Developments: Proposed Legislation and Reflections on CFIUS Under the Trump Administration' (23 June 2017) <https://www.cov.com/-/media/files/corporate/publications/2017/06/update_on_cfius_developments_proposed_legislation_and_reflections_on_cfius_under_the_trump_administration.pdf> accessed 30 July 2017

its investment abroad, and China is further reforming and opening up its market. The reason for the changing attitudes of these two countries lies in the rapid changes that are taking place in the picture of investment flows around the world.

Since the traditional capital exporters are increasingly becoming the capital importers, it can be expected that their attitudes towards foreign investment may change and they may even adopt a protectionist stance. The conflict between the liberal idea of free flow of investment and the notion of regulatory control over entry of investment is evident here. Powerful countries, which see benefits in maintaining the stance of neo-liberalism, have not been able to adhere to such liberal idea in their current policies.[82] It is undeniable that the globalisation and the neo-liberal policies enable capital to move around the world more rapidly.[83] In spite of this, the liberal capitalism model failed to predict the 2007-2008 global financial crisis. A succession of crisis has added to the fear that the rapid withdrawal of capital from states and the deregulation could destabilise their economies. According to Kotz, the on-going economic crisis is not simply the aftermath of financial panic or an unusually severe recession but instead it is a structural crisis of the neoliberal, or free-market capitalism.[84]

The development of SWFs suggests a shift in the pattern of investment flow. It results from the globalisation and the adaptation of the neo-liberal policy by some developing countries and emerging economies. The phenomenon of SWF investment is regarded as the re-emergence of 'state capitalism'.[85] This 'state capitalism' in overseas market leads to the fear that SWFs have political and strategic objectives, which may affect the national economy and market stability.[86] Such fear has resulted

[82] S. Neff, *Friends but No Allies: Economic Liberalism and the Law of Nations* (Columbia University Press 1990)

[83] The main features of neoliberal capitalism are as follows: deregulation of business and finance, both domestically and internationally; privatisation of many state services; the introduction of market principles inside large corporations; high-risk activities of the financial sectors. See D. Kotz, 'The Financial and Economic Crisis of 2008: A Systemic Crisis of Neoliberal Capitalism' (2009) 41 (3) Rev. Radical Pol. Econ. 305, 307; see also D. Harvey, *A Brief History of Neoliberalism* (OUP 2005)

[84] D. Kotz, *The Rise and Fall of Neoliberal Capitalism* (Harvard University Press 2015) 4

[85] State capitalism embodies a phenomenon that the government controls most of capital, industry, and nature resources and actively promotes economic growth and subject those to global competition. See A. Musacchio and S. Lazzarini, 'Leviathan in Business: Varieties of State Capitalism and their Implications for Economic Performance' (2012) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id-2070942> accessed 4 April 2016

[86] The concerns from host countries are largely because of the unknown motives and objectives of

in increasing controls over the entry of these sovereign investments in industries that are deemed strategic and critical to host countries. There is even a move to widen the scope of national security and to tighten regulatory measures on foreign investment. This is the direct result of the opaque nature of SWFs, since it is difficult to determine the motives of SWF investment and other sovereign investment alike.

However, during the financial crisis and in the post crisis period, SWFs had injected a large amount of money to help many financial institutions recovering from economic turmoil. It is undeniable that host countries are aware of the economic benefits of SWF investments, particularly during the period of depression.[87] However, the internal political pressure for a quick and radical response to a potential threat to the national interests forces these governments to adopt protectionist measures, which aim to reduce the incentive of SWFs to invest in sensitive sectors.[88] Although they are eager for capitals, many leading developed economies tend to control/restrict foreign investment, especially sovereign investment in strategic sectors. Therefore, SWFs may find themselves facing protective measures that are driven either by a genuine national security interest or by the classical protectionism. Under this circumstance, their investments may not be regulated under a justified framework. Defeating protectionism implemented by host countries are complex issues faced by SWFs and other sovereign investors, which needs to be addressed under a broader framework.

4. Regulatory Measures for SWF Investment in Literature

A majority of regulations imposed on foreign investment are through domestic law concerned.[89] Since SWF investments have attracted a level of attention, and most of them are in low transparency, a debate on whether a special or additional regulation is necessary occurs. The considerable debate surrounding the issues of SWF investments largely focuses on the regulatory responses around the world, especially the responses

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these SWFs. See Cooke (n 10) 735 in Introduction

[87] Hildebrand (n 59) 2

[88] In rough economic times takeovers by sovereign entities are perceived as a source of weakness and not a source of strength in spite of the immediate need for liquidity. Thus, policy makers cannot completely trust national legislators' response to the new SWFs investment. Indeed, the protectionist national legislation has encouraged inter-governmental organizations to explore ways to offer additional and more cohesive rules that will balance this wave of protectionism in national legislation. See Chalamish (n 77)

[89] Subedi (n 50) 55

that host countries should and could adopt. Various regulatory measures/models have been proposed or discussed,[90] most of which require additional or special restrictions to be imposed on SWF investment. Analysing these proposed measures could offer a chance to assess whether the conflicting interests in SWFs investment are reflected or balanced or whether issues of SWF investment are regulated under a justified regulatory framework in literature.[91] Regulatory proposals most commonly suggested in relevant literature are as follows.[92]

In terms of the enforcement of regulations, these proposals can be divided into two basic categories. The first category, executed by governmental authority, is the statutory regulation or 'hard law' regulation while the other is the self-regulation or 'soft law' regulation.[93] A majority of these statutory regulations are the rule-based regulation, which stipulate particular clauses and provisions. The second category is the proposal that allows SWFs to regulate their behaviours by themselves, which is the principle-based regulation. Under the first category, there are four proposals. The first one is a ceiling on the amount of shares that SWFs can acquire or hold in portfolio companies (with an additional approval requirement for shareholdings that exceed a certain percentage or threshold) or the restriction of entry in certain industries. The second type favours the restriction imposed on voting rights or waive of voting rights. The third one requires the additional reporting or disclosure requirements of SWFs. The last one advocates taxing on SWF investment until they transfer their assets to private actors.

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[90] Kratsas and Truby (n 10) 19 in Introduction

[91] In chapter one, this research has analysed the character of SWF as well as the potential issues and concerns caused by its increasing assets and sovereign background. The general theory for regulation and theoretical underpinning for regulating SWFs investment are clarified in chapter one. In this section, specific models proposed in literatures for regulating SWFs are analysed.

[92] In this section, the proposed regulatory models are from theoretical aspects. In chapter three and chapter four, this research analyses existing regulations applied to SWFs investments. Chapter three mainly examines regulations at national level, which are all statutory regulations and rule-based regulation. Chapter four mainly examines regulation at international level, especially bilateral treaties and multilateral initiatives, some of which are soft law regulation and principle-based regulations while others are binding international agreement and rule-based regulations.

[93] "The exact legal status of soft law has long been a matter of controversy. To the extent that such standards represent widely shared expectations, they may, through repeated invocation and appropriate utilization, move to the status of a binding and enforceable rule." See United Nations, 'Trends in International Investment Agreements: An Overview' (1999) UNCTAD Series on Issues in International Investment Agreements 1, 49 <http://unctad.org/en/Docs/iteiit13_en.pdf> accessed 16 September 2015

Although SWFs are funded by the government, their investments are similar to those made by other investors; hence, this thesis believes that there is no need to impose additional or special regulations on SWFs but to require them comply with same requirements imposed on other private investors. Moreover, if new regulations are not justified and contain many vague concepts, significant costs will be imposed on not only SWFs but also on all market participants. The self-regulation at a broader dimension can help to promote the good governance of SWFs. Moreover, it can build up a mutual understanding between SWFs and host countries. Thus, the minimum standards may be easily recognised and implemented at international level that in turn, may be reflected or adopted in domestic regimes.

4.1 Statutory regulatory models on SWFs in literature

4.1.1 Limiting shareholding and entry

The first proposal, as a kind of the statutory or normative regulation, suggests the ceilings on the shares that SWFs can acquire, and/or protects certain industries from the investment ambit of SWFs. This regulatory measure originally adopted to address concern of foreign investment that was previously caused by SOEs. Many EU member states, e.g. the UK purported to exercise the regulatory control over the ownership and activities of certain sectors via 'golden share'.[94] This enables the host country to control shares held by foreign investors in the target company or ensures its veto rights for the execution of significant business activities, e.g. M&A and sale of strategic assets.

Some propose a similar regulatory approach.[95] Many host countries planned adopting measure to protect their industries from SWF investments, but failed to 'admit that dealing with SWFs may require departures from the conventional liberal orthodoxy concerning global trade and investment flows',[96] which was believed necessary. Garten suggests a requirement of reciprocity in market access of SWF investment, i.e.

[94] A. Baev, 'Is There a Niche for the State in Corporate Governance? Securitization of State-Owned Enterprises and New Forms of State Ownership' (1985) 18 Hous J Intl L 20

[95] J. Garten, 'We Need Rules for SWFs' *Financial Times* (7 August 2007) <http://www.ft.com/cms/s/0/1a968284-44fd-11dc-82f5-0000779fd2ac.html#axzz3oRHm0Jf3> accessed 13 October 2015

[96] ibid

the ability of SWFs to buy assets in host developed countries depends on whether the home countries of SWFs grant a similar access to foreign funds of those developed countries. In his view, the fundamental premise is that SWFs are inherently political entities rather than commercial entities hence SWFs should be treated as such.[97]

Das highlights that the legal response of host countries 'is to limit the stakes that SWFs can have in a certain category of industries'.[98] Under such model, the regulatory authority of the host country can determine both the accessible/permitted industries and the limit of shares that SWFs can purchase in these industries. Besides, the 'negative list' approach could be utilised to limit or block SWF investment in certain industries. According to the customary international law, states are not obliged to accept foreign investment and thus have the right to control the proposed investments entering into their territories.[99] Restrictions or prohibitions on the entry of certain sectors could be listed in domestic regulations that prevent foreign investors, especially sovereign investors from investing in these industries, while these excluded industries could be set as an exception or reservation in schedules or appendix of IIAs.

4.1.2 Restricting voting rights

The second regulatory proposal is to restrict or deprive the voting rights of shares held by SWFs,[100] which is a historic protectionist measure against foreign corporate control.[101] According to this, SWFs are prohibited from taking controlling powers over the target company. Gilson and Milhaupt developed this idea concerning SWFs. Their 'minimalist approach' aims to remove the voting rights of equities of US firms acquired by foreign government controlled entities, until these equities are transferred to private hands.[102] The rationale is that, in principles, there are conflicts of interests between the sovereign state and private investors. By accepting Keynes's maxim

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[97] ibid

[98] D. Das, 'Sovereign-Wealth Funds: The Institutional Dimension' (2009) 56 Int'l Rev Econ 85, 99

[99] E. Chalamish, 'Global Investment Regulation and Sovereign Funds' (2012) 13(2) Theoretical Inquiries in Law 645, 651

[100] Gilson and Milhaupt view this as a "minimalist" approach, see Gilson and Milhaupt (n 5) 1346 & 1352 in Introduction. Others have pointed out that it "negates the essential nature of equity investment." See P. Rose, 'Sovereigns As Shareholders' (2008) 87 NC L. Rev. 101, 139. See also R. Epstein and A. Rose, 'The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow' (2009) 76 (111) U. Chi. L. R. 111, 120

[101] H. Chang, 'Regulation of Foreign Investment in Historical Perspective' (2004) 16(3) EJDR 687

[102] Gilson and Milhaupt (n 5) 1354 in Introduction

'international cash flows are always political', they named this state capitalism as 'mercantilism'.[103]

By removing the voting rights, SWFs are refrained from exercising influence over the management and decision-making of target companies, and those who have purely financial motives could continue to invest.[104] Gilson and Milhaupt accept that their model may lead to unsuccessful results if it is applied in an under-inclusive or an over-inclusive manner. In the first case, this model would lack effectiveness if it does not apply to other manipulative transactions. For instance, it happens when requiring strategic concessions before an SWF injects more capital into a portfolio company or if this model does not cover sovereign investment entities other than SWFs that may also be used to advance political goals, such as government-controlled companies.[105] In the second case, measures may apply to other public pension funds other than SWFs, e.g. the US pension fund – California Public Employees' Retirement System (CalPERS).[106] However, they believe that although this proposal may affect the shareholder activism of public pension funds, it is not expected to have much impact since the role played by these pension funds in improving corporate governance has not been the central.[107]

4.1.3 Increasing transparency

This type of regulation advocates forcing SWFs to submit or publish reports with specific information, thus aligning themselves with the regulated part of the industry, such as mutual funds, banks, and insurance companies.[108] Some researchers suggest

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[103] ibid 1345

[104] ibid

[105] ibid 1371-1373. The authors believe that these problems can be managed under existing disclosure rules in developed countries or via other measures dealing with the phenomenon of state capitalism in general.

[106] ibid. They argue that suspending the voting rights of US state pension fund in foreign equity investments should not hurt the funds' performance for the same reason that vote suspension should not deter US equity investments by foreign SWFs who do not have a strategic motive. Conversely, this negates the positive impact that shareholder activism by US state pension funds has had on corporate governance standards in other countries.

[107] ibid

[108] For examples, in the US, the Employee Retirement Income Security Act of 1974 (Pub. L. No. 93-406, codified in part at 29 U.S.C. s1001 and the following) apply to pension funds; the Investment Advisers Act of 1940 (15 U.S.C. s 80b-6) apply to institutional advisors; See also S. Blome et al., 'Pension Fund Regulation and Risk Management: Results from an ALM Optimisation Exercise' (2008) OECD Working Papers on Insurance and Private Pensions 161, 168 <http://www.oecd-ilibrary.org/finance-and-investment/protecting-pensions/pension-fund-regulation-an

that an 'indirect' supervisory and regulatory framework to address the specific concerns of SWF investments could be based on 'the mandatory requirement for a SWF to conduct investments over a certain threshold (or investments of certain kinds) through third-party professional asset managers,' or alternatively 'to disclose its shareholder voting records when the ownership percentage in a company exceeds a given threshold.'[109]

A more detailed model proposed by Mezzacapo, suggests a two-layer approach, i.e. putting self-regulation within a statutory framework,[110] which is similar to the one widely adopted in stock exchange regulation in Europe.[111] In this respect, she recalls the provisions introduced in the Italian Financial Consolidated Act in 2005. This Act aims to increase transparency (e.g. information concerning their establishment, assets and liabilities, and operations), in relations between Italian companies with shares listed on regulated markets and foreign companies 'having their registered office in a country whose legal system does not ensure transparency'; it also applies to Italian companies 'with financial instruments widely distributed among the public that affiliated with or controlled by such foreign companies.'[112] Truman also highlights the requirement of greater transparency on SWFs that it would be desirable to have substantial quantitative disclosure about the investment strategies, outcomes, and the nature and location of actual investments.[113]

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d-risk-management-results-from-an-alm-optimisation-exercise_9789264028111-5-en> accessed 16 October 2015

[109] Keller (n 143) 351 in Ch.1

[110] S. Mezzacapo, 'The So-Called "Sovereign Wealth Funds": Regulatory Issues, Financial Stability and Prudential Supervision' (2009) European Commission, Economic Papers No.378 1, 45. <http://ec.europa.eu/economy_finance/publications/publication_summary15062_en.htm> accessed 13 October 2015.

[111] T. Boskovic et al., 'Comparing European and US Securities Regulations: MiFID versus Corresponding U.S. Regulations' (2009) World Bank Working Paper No. 184 <http://documents.worldbank.org/curated/en/120301468029665421/Comparing-European-and-U-S-securities-regulations-MiFID-versus-corresponding-U-S-regulations> accessed 16 October 2015

[112] Legislative Decree n 58 of 24 February 1998. Pursuant to Article 165ter-165septies of the Italian Financial Consolidated Act, Italian listed companies linked, controlled or under the influence of 'foreign non-transparent companies', e.g. SWFs, should attach to their Annual Report a Relation illustrating the relationship existing with 'foreign non-transparency companies'. Italy's Securities Commission is entrusted with significant supervision and onsite inspection powers, while relevant countries are identified in joint decrees issued by the Minister of Justice and the Minister of the Economy and Finance (using criteria listed in the same Italian Financial Consolidated Act).

[113] E. Truman, 'Sovereign Wealth Funds: The Need for Greater Transparency and Accountability' (2007) Peterson Institute for International Economics Policy Brief 07-6, 7 <https://piie.com/publications/policy-briefs/sovereign-wealth-funds-need-greater-transparency-and-accountability> accessed 16 October 2015

4.1.4 Imposing taxes

Another proposal in regard to taxing SWFs is provided by Fleischer.[114] The basis of his discussion is that current US tax regime treats SWFs as sovereigns for tax purposes.[115] The sovereign status/background in this context could be a significant benefit compared to other private investors. As long as the SWF does not engage in commercial activity other than 'portfolio investment' (acquisition of non-controlling stakes), the fund can avoid US income taxes and withhold taxes on its US investments.[116] Private foreign investors, conversely, are generally taxed lightly on their portfolio investments, but they do face significant taxes on some types of income, such as dividends from US corporations and certain real estate investments.[117]

Fleisher argues that such exemption is not required under the international law, as 'the international doctrine of sovereign immunity as such imposes no restrictions' on the US's right to tax SWFs.[118] He develops a theory of taxing sovereign wealth as a complementary instrument to other regulations.[119] He conducts a cost-benefit analysis (CBA) of the operation of SWFs and concludes that the negative externalities outweigh the positive ones.[120] In his view, SWFs should be taxed if they were private foreign corporations and there is no compelling reason to subsidise SWFs via preferential tax. Funk argues that, the US tax exemption, in reality, is unlikely to exert impact on the structure of an investment made by a SWF, given the usual nature of such investment.[121]

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[114] V. Fleischer, 'A Theory of Taxing Sovereign Wealth' (2009) 84 NYU L. Rev. 440

[115] 26 U.S.C. § 892

[116] See M. Knoll, 'Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?' (2009) 82 S. Cal. L. Rev. 712

[117] Fleischer (n 114) 463-465

[118] ibid 459

[119] Fleischer sketches out a few tax reform alternatives. First, and most modestly, the U.S. could strive for sovereign tax neutrality, eliminating the unwarranted tax subsidy that SWFs enjoy under current law. A second, more aggressive, alternative would impose an excise tax on sovereign wealth. Additional reform alternatives are more tuned, linking the tax rate to a fund's compliance with best practices or other measures of transparency, accountability, and professionalization. See V. Fleischer, 'Should We Tax Sovereign Wealth Funds?' (2008) 118 Yale L. J. Pocket Part 93.

[120] He argues that SWFs threaten American foreign policy interests; support the inefficient allocation of resources; increase managerial slack (for example, when China acquired a non-voting stake in Blackstone); may have a contagion effect as a result of their lack of transparency; encroach on the autonomy of the American enterprise (in exchange for foreign investments), and support autocratic regimes. ibid

[121] W. Funk, 'On and Over the Horizon: Emerging Issues in U.S. Taxation of Investments' (2010) 10 Houston Bus & Tax L J 1, 6

4.2 Self-regulation model on SWFs

At the beginning of the debate on regulating SWFs, the idea of self-regulation had not received a wide support in the literature. Most commentators seem unlikely to accept that if it is left to SWFs themselves, SWFs could produce a reliable regulatory framework to address the issues raised by their investments. Two theories, i.e. realism,[122] and constructivism,[123] could be adopted by scholars who argue that SWFs would not comply with the code of conduct or self-regulation. An alternative view encourages a 'self-regulation' option at a broader level, which could address the potential negative impact of SWFs while preserve the benefits of their investments.[124] The EU and many international institutions (especially the IMF and OECD) take efforts to provide and promote voluntary self-regulation models for SWFs (or guidelines for host counters). Furthermore, a proposal prioritising international initiative is founded upon the belief that a set of commonly accepted shared values is of central importance for the effectiveness and legitimacy of such a governance structure,[125] and the international responses are harmonised.

The self-regulation model is typically implemented through the means of a code of conduct. The code of conduct, as a policy instrument, is usually on a voluntary basis, which means that the negotiating members were not obliged to participate by a central decision body.[126] Rather, this body provides its members with an opportunity to negotiate and agree on a set of rules. The model of self-regulation or 'qualified

[122] Under international realism, a state behaves out of its own self-interest. A state is aware that no supranational legal enforcement body exists that has jurisdiction over all states. Although supranational bodies of law do exist, there is no way to compel any state to behave in any particular legal fashion, as the international system is inherently anarchic. See D. Baldwin, *Neoliberalism, Neorealism, and World Politics, in Neorealism and Neoliberalism: The Contemporary Debate* (Columbia University Press 1993) 14; see also S. Lindberg, 'Sovereign Wealth Fund Regulation in the E.U. and U.S.: A Call For Workable and Uniform Sovereign Wealth Funds Review within the E.U.' (2009) 37 Syracuse J. Int'l L. & Com. 95, 116

[123] According to Kelly, 'Constructivists contend that states share and influence each other's expectations and understandings of international law. Thus, the constructivist view seems to directly contradict the realist view that interests and identities are formed outside of the inter-state system.' Without overwhelming compliance by SWFs, the voluntary protocol will become nothing more than recommendations. See C. Kelly, 'The Value Vacuum: Self-Enforcing Regimes and the Dilution of the Normative Feedback Loop' (2001) 22 MICH. J. INT'L L. 673, 678-679. See also Lindberg (n 122) 118

[124] Kratsas and Truby (n 10) 3 in Introduction

[125] For the importance of shared values in the modern global financial regulatory architecture, see E. Avgouleas, *Governance of Global Financial Markets* (CUP 2013) 435-439

[126] Kratsas and Truby (n 10) 34 in Introduction

self-regulatory' process was,[127] nevertheless, the one opted for/by the IWG to draft the GAPP.

Besides the GAPP, which was designed to interpret and clarify issues in relation to SWFs investments, the OECD took effort to reduce the conflicts and misunderstanding between SWFs and host countries thus resulting in *OECD Declaration on Sovereign Wealth Funds and Recipient Country Polices* on June 2008, and *OECD Guidance on Sovereign Wealth Funds* in 2008. Similar to all self-regulations, the GAPP and the OECD declaration and policies (details will be discussed in Chapter four) are well-intentioned but somewhat bland documents, which cannot be implemented by the legal force.[128] The EU does not have a uniform code for SWF investment but a "voluntary code of conduct" for SWF investment, which is the Common European Approach to Sovereign Wealth Funds (it will be discussed in Chapter three). This voluntary code of conduct that the EU adopted sets out five principles that aim to enhance the transparency, predictability and accountability of SWFs operations.

Chapter Conclusion

The phenomenon of SWFs is complex owing to their various forms of legal status/structure and diverse investment objectives. SWF investment activities involve several kinds of legal relations. The interaction of these legal relations makes the issues of SWF investment complicated. When considering the legal response to SWFs, it is necessary to clarify these legal relations. This chapter found that the background (determined by home country's regulation and policy) of SWFs and the background (determined by host country's regulation and policy) of the target company might influence the attitudes of host country towards SWF investment. Furthermore, the internal policies and political views of host country as well as the legal relation between host country and home country may also have impacts on the regulation and even protection on SWF investment. In addition, different forms of investment made by SWFs may trigger different regulatory requirements or restrictions.

[127] According to Norton, the GAPP process does not create a conventional 'self-regulatory' regime, system of private-regulation or a code of conduct due to the mix of participants and due to the complex set of overriding pressures referred to above. At best, the environment would be quasi-self-regulatory or self-regulatory in a very constrained manner. See Norton (n 11) 656 in Introduction

[128] J. Farrar and D. Mayes, *Globalisation, the Global Financial Crisis and the State* (Edward Elgar Publishing 2013) 284

Moreover, before examining existing regulations on SWFs, it is important to understand and clarify the conflicting interests behind regulations. Firstly, there is conflict between protection for foreign investment and state sovereignty (or regulatory control). On one hand each state has inherent rights to address issues and affairs within its territory. On the other hand, foreign investors require sufficient protection and high standards of treatment during pre-establishment and post-establishment phases. However, these treatment and protection are under the discretion of particular authority of host country, which would be constrained only if there are treaty obligations under international law. Furthermore, in the past, those who claim protection for foreign investment are developed countries while at present it is the developing countries that claim those protection and treatment for their investors overseas (including SWFs). Therefore, to safeguard the right and protection of SWFs and consider deserved interest of host country, it is necessary to put the issues of SWFs under a broader framework but not solely rely on unilateral measures.

Furthermore, the conflict also exists between liberalisation (open market) and the regulatory flexibility to protect the national security. Under the theory of liberalisation, open market and free movement of capital were widely supported and accepted. Yet, it has been challenged and retreated due to the outbreak of global economic crisis. The increasingly highlighted national security has also challenged the theory of liberalisation. Compared to economic efficiency, host countries value more on their national security (including economic security). This is also a view adopted by many developed countries, since currently they are capital-importing countries of SWF investment. The uncertain and opaque notion of the national security can be utilised to implement protectionist measures thus it may lead to the discriminatory treatment of SWFs and add uncertainty to their investments. It found that the question of what kind of treatment SWFs may receive should firstly address the conflict between liberalisation and national security. However, how to balance the interest of the open market and national security cannot be achieved within a narrow framework, since balancing these interests (particular interest of SWFs and host countries) and resisting protectionism, are multilateral challenges.

Regulatory measures proposed by many scholars, contain both statutory regulation

models and self-regulation model. Among these models, some do not consider the theoretical challenge and conflicts behind, thus calling for additional requirements of SWFs. Some are *ex parte* which are only on account of interests of host countries or ignore the deserved rights of SWFs, while the self-regulation approach lacks enforcement mechanism without binding. Next chapter will analyse existing regulations under the domestic framework in selected countries to see whether and how the government of host countries can reconcile the need to maintain an open investment environment for SWFs with their duty to safeguard the essential security interests of their national welfare.

CHAPTER 3 NATIONAL REGULATIONS ON SOVEREIGN WEALTH FUNDS INVESTMENT

Chapter Introduction

It is the sovereignty of the state to regulate and monitor foreign investment in its jurisdictions. The conducts of SWFs indicate that their investments are generally similar to those made by other investment funds. It may be easy to take the equal treatment for granted in term of the nature of investment, and any restrictions equally apply to all participants. However, those sovereign-background investors (including SWFs) have triggered concerns in relation to the national security, and market stability in host countries. Due to the political resistance and sensitivity, several host countries, e.g. the US, Australia, Canada and some EU member states have tightened relevant regulations of foreign investment, particular putting an eye on 'state ownership'. It is wise to see whether SWFs investments are regulated under justified domestic regimes and whether relevant conflicting interests have been reflected or balanced.

This chapter therefore examines and compares foreign investment regulations and certain industry-specific regulations that could apply to SWF investment in selected countries, i.e. the UK, US and China. It firstly discusses the legal responses and attitudes towards SWFs in primary host countries in general. It then examines regulations of foreign investment in the UK and its attitudes towards SWFs, which is not only a reflection of the UK's policy consideration but also is affected by the EU law. Thirdly, it analyses regulations in the US, where relevant legislations have been reformed and special national security review mechanism already exists. It analyses the foreign investment regulatory regime in China. China is the sponsor of large SWFs and increasingly attracting foreign inward SWF investment. It concludes that relying only on the unilateral measures cannot help to balance the interest between SWFs and host countries, and the issues of SWFs should be discussed under a broader framework.

1. Unilateral Legal Responses in General

When discussing the legal regulations of foreign investment, the domestic law stands at the foremost position.[1] At the international level, treaty obligations should firstly be translated into domestic law via the national ratification process and then these obligations can play an efficient role. Foreign investment regulations in host countries mainly consider the type of the investments and the identity of the investors, since different subjects and conducts may lead to different reactions/treatments. Existing SWFs are established by different economies (in particular Asian countries and Middle East countries) that have their own cultures, legal systems and purposes to create SWFs. The legal identity and structure of SWFs influence the legal measures imposed on them. Previous chapters have analysed and clarified the fundamental issues of SWFs from the theoretical perspective. However, the practical aspects remain to be examined, to see whether issues of SWFs have been well addressed in existing legal practices and whether the existing unilateral regulations trade off the conflicting interests. This section briefly analyses the general trend of legal responses to the phenomenon of SWF investment.

1.1 Legal response in major developed countries

The rise of state capitalism has changed the traditional economic order and the trend of capital flows. Those developed countries that output capitals into developing countries have become the recipient countries of capitals from emerging countries or Gulf countries with large SWFs.[2] What raise concerns from developed host countries are the proportion of assets managed by SWFs and those newly SWFs established by their political rivals.

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[1] The Article 2 (2) (a) of the Charter of Economic Rights and Duties of States stipulates that each state has the right to regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities.

[2] Here, the developed country means those countries that have developed markets. As the phrase itself implies, these countries are usually the most advanced economically. As well, they have highly developed capital markets with high levels of liquidity, meaningful regulatory bodies, large market capitalization, and high levels of per capita income. Developed markets are found mostly in North America, Western Europe, and Australasia, including nations like the U.S., Canada, Germany, the U.K., Australia, New Zealand and Japan. See Emerging Money, 'What is the difference between a developed, emerging, and frontier market' (May 11 2012) <http://www.nasdaq.com/article/what-is-the-difference-between-a-developed-emerging-and-frontier-market-cm140649> accessed 16 Jan 2016

Since SWFs experienced losses during the 2008 financial crisis, in the pursuit of high-returns, SWFs diversified investment allocations,[3] and even invested in sectors that are regarded as "critical infrastructure" of host countries. This results in a more conservative instead of the liberal attitude of host countries. However, not all developed countries treat SWF investment as threats. Among those developed countries, which are the top targeting markets of SWF investment, some countries have reassessed their laws in light of fears associated with the global expansion of and the investment of SWFs and they intend to restrict the sovereign-background investment via the national security scrutiny, while others treat SWFs similar to other investors and welcome SWFs investments (see Chart 4).[4]

Country	Attitude towards SWF Investment	Definition of 'Critical Infrastructure'[5]	Relevant Regulations and National Security Scrutiny
The US	The legislative reform (CFIUS reform) requires a heightened scrutiny of foreign acquisitions of US firms by government-controlled investors, including SWFs.[6] There is an on-going discussion on	The general critical infrastructure represents: 'systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national	E.g. Exon-Florio Amendment; CFIUS; Foreign Investment and National Security Act of 2007 (FINSA).

[3] More information about SWFs investment allocation, see V. Chhaochharia and L. Laeven, 'The Investment Allocation of Sovereign Wealth Funds' (8 July 2009) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1262383> accessed 16 Jan 2016

[4] Among developed economies, the US is the first country that established special body i.e. the Committee on Foreign Investment in the United States (CFIUS) to review foreign acquisitions that could undermine national security. However, by imposing burdensome restrictions on foreign capital inflows, the US's approach has triggered other countries to create similar scrutiny body and enact similar restrictive policies towards FDI. See J. Masters and J. McBride, 'Foreign Investment and US National Security' (14 December 2016) <https://www.cfr.org/backgrounder/foreign-investment-and-us-national-security> accessed 16 Jan 2017

[5] See OECD, 'Protection of 'Critical Infrastructure' and The Role of Investment Policies Relating to National Security' (May 2008) <http://www.oecd.org/daf/inv/investment-policy/40700392.pdf> accessed 16 Jan 2016

[6] In 2008, the US Committee on Foreign Relations organised a Senate Hearing concerning SWFs. Some senior officials seem to consider SWFs as a serious risk while others treat SWFs as an important source of capital that can bring benefits to the US economy. See US Senate, Committee on Foreign Relations, 'Sovereign Wealth Funds: Foreign Policy Consequences in An Era or New Money' (11 June 2008) Senate Hearing 110-765 <https://www.gpo.gov/fdsys/pkg/CHRG-110shrg48061/html/CHRG-110shrg48061.htm> accessed 16 Jan 2016

	further reforming CFIUS to expand CFIUS's jurisdiction and increase scrutiny, especially tightened scrutiny on Chinese investment in the US.	public health or safety, or any combination of those matters.' [7] For investment policies, it means 'systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.'[8]	
Canada	Generally welcome SWFs investments as long as they are of a commercial orientation and they operate in transparency manner; foreign investment is reviewable even if it falls below relevant thresholds (portfolio investment of SWFs); special consideration for SOEs (SWFs are a distinct type of SOEs).[9]	Critical infrastructure refers to 'processes, systems, facilities, technologies, networks, assets and services essential to the health, safety, security or economic well-being of Canadians and the effective functioning of government.'[10]	E.g. Investment Canada Act; Guidelines for investment by SOEs (including SWFs)--'net benefit' assessment; [11]
Australia	Investors owned or controlled by a foreign government (e.g. SOEs and SWFs) generate additional factors that must be examined	Critical Infrastructure are 'those physical facilities, supply chains, information technologies and communication networks which, if destroyed,	E.g. Australian Foreign Investment Guidelines; Foreign Acquisitions and Takeovers Act of 1975; Foreign Investment Review Board (FIRB); National

[7] USA Patriot Act of 2001 (Pub. L. No. 107-56, 18 U.S.C. § 1016 (e))
[8] USA Foreign Investment and National Security At of 2007 (Pub. L. No. 110-49, 50 U.S.C. app. 2061 § 2 (6))
[9] See M. LeBlanc, 'Sovereign Wealth Funds: International and Canadian Policy Responses' (9 February 2010) Library of Parliament Research Publications <https://lop.parl.ca/Content/LOP/ResearchPublications/2010-09-e.htm> accessed 16 Jan 2016
[10] See Public Safety Canada, 'Critical Infrastructure', <https://www.publicsafety.gc.ca/cnt/ntnl-scrt/crtcl-nfrstrctr/index-en.aspx> accessed 16 Jan 2016.
[11] See Government of Canada, 'All Guidelines-Investment Canada Act' (updated 19 December 2016) <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2> accessed 16 Jan 2016; see also 'Statement Regarding Investment by Foreign State-Owned Enterprises' (updated 7 December 2012) <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81147.html> accessed 16 Jan 2016.

	concerning national interest implications; Concerns over the lack of transparency and non-commercial investment motives.[12]	degraded or rendered unavailable for an extended period, would significantly impact the social or economic wellbeing of the nation or affect Australia's ability to conduct national defence and ensure national security.'[13]	interest test/assessment; Australia's new Critical Infrastructure Centre.
Germany	Restrictive policies on non-EU share purchases, especially investments by SWFs; the public opinion at first was sceptical with regard to SWFs, while policies towards SWFs became increasingly positive, especially during and after financial crisis.[14]	Critical Infrastructure are 'organizational and physical structures and facilities of such vital importance to a nation's society and economy that their failure or degradation would result in sustained supply shortages, significant disruption of public safety and security, or other dramatic consequences.'[15]	E.g. Amendment of the Foreign Investment Act (replaced by the Capital Investment Code in 2013) in 2009 to tackle SWF investment; [16] National security screening mechanism introduced in 2004; amendment of the Foreign Trade and Payments Act – German Foreign Trade Act (AGW) and the Foreign Trade Ordinance (AWV).[17]

[12] See K. Sanyal, 'Foreign Investment Rules and Sovereign Wealth Funds' (24 June 2008) Parliament of Australia <http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/0708/ForeignInvestmentRules> accessed 16 Jan 2016

[13] See Australia Government Critical Infrastructure Centre, 'Strengthening the National Security of Australia's Critical Infrastructure: A Discussion Paper' (21 February 2017) <https://www.ag.gov.au/Consultations/Documents/Strengthening-national-security-infrastructure/Discussion-paper–Strengthening-the-national-security-of-Australias-critical-infrastructure.pdf> accessed 16 June 2017

[14] See M. Thatcher, 'National Policies towards Sovereign Wealth Funds in Europe; A comparison of France, Germany and Italy' (April 2013) Kuwait Programme on Development, Governance and Globalisation in the Gulf States Policy Brief No. 2 <http://eprints.lse.ac.uk/55667/1/__lse.ac.uk_storage_LIBRARY_Secondary_libfile_shared_repository_Content_Kuwait%20Programme_Thatcher_2_2013.pdf> accessed 16 Jan 2016

[15] See Federal Office for Information Security, 'Recommendations for Critical Information Infrastructure Protection' <https://www.bsi.bund.de/EN/Topics/Criticalinfrastructures/criticalinfrastructures_node.html> accessed 16 Jan 2016

[16] In the wake of broader discussions on the need for restrictions to foreign investment by sovereign wealth funds, the German Foreign Investment Act was amended in 2009 to apply to a German company of any size or sector in cases where a threat to national security or public order is perceived. See '2015 Investment Climate Statement-Germany' <https://www.state.gov/e/eb/rls/othr/ics/2015/241572.htm> accessed 16 Jan 2016. It gave powers to the Federal Economics Ministry to verify whether a state of 25 percent or above taken by a non-EU investor in a German company posed a threat to public order or security.

[17] The Federal Ministry for Economic Affairs and Energy may review any acquisition, direct or

France	Complex and conflicting policies towards SWF investment (nationalistic rights to attack SWFs equity purchases while also sought to attract SWF investment);[18] call for heightened regulatory protection against inbound investment controlled by foreign sovereigns; use its own SWF i.e. Strategic Investment Fund (SIF) to protect local business from acquisition by foreign SWFs.[19]	Critical Infrastructures are 'institutions, structures or facilities that provide the essential goods and services forming the backbone of French society and its way of life.'[20]	E.g. Monetary and financial Code & Decree on the foreign financial relations and the application of Article L 151-3 of the monetary and financial Code; the 2005 decree restricts investments in 11 strategic sectors.
The UK	Take liberal attitude to foreign investment, welcome SWFs equity investment; SWFs are not treated differently from privately owned firms.[21] The UK is a	Critical National Infrastructure is 'those facilities, systems, sites, information, people, networks and processes, necessary for a country to function and upon which	E.g. merger control under Enterprise Act 2002 and public interest grounds for intervention by the Secretary of State; 'golden share' provisions; Section 13 of the Industry Act.

indirect, of a domestic business or minority stake in such business in any industry sector if after the acquisition the foreign investor, directly or indirectly, holds 25 per cent or more of the voting rights. See H. Stabenau and S. Hemforth, 'Germany Foreign Investment Review' (March 2017) <https://gettingthedealthrough.com/area/48/jurisdiction/11/foreign-investment-review-germany/> accessed 16 June 2017.These legislative changes suggest an increased willingness of German government to control foreign investments in industries deemed to be strategic interest, particularly by investors from China. See S. Hirsbrunner, 'Towards a German CFIUS copycat? More Scrutiny on Foreign Investments in German Companies' (16 August 2017) <http://www.steptoeinternationalcomplianceblog.com/2017/08/towards-a-german-cfius-copycat-more-scrutiny-on-foreign-investments-in-german-companies/> accessed 16 August 2017

[18] Thatcher (n 14)

[19] SIF was established in 2008 and was integrated into Bpifrance in 2013, which was renamed Bpifrance Participations.

[20] 'The Critical Infrastructure Protection in France' <http://www.sgdsn.gouv.fr/uploads/2017/03/plaquette-saiv-anglais.pdf> accessed 16 June 2017

[21] See M. Thatcher, 'Western Policies towards Sovereign Wealth Funds equity investments: A comparison of the UK, the EU and the US' (August 2012) Kuwait Programme on Development, Governance and Globalisation in the Gulf States Policy Brief No. 1

	leading global destination for SWF investments.	daily life depends. It also includes some functions, sites and organisations which are not critical to the maintenance of essential services, but which need protection due to the potential danger to the public.'[22]	

Chart 4: Attitudes and Measures towards SWF Investment in Selected Developed Countries

Although most regulations and measures adopted by host countries are not specially designed for SWF investments but for general foreign investment (or even the foreign government-controlled investment), SWFs investments are inevitably restricted by these regulations. But, host countries' over-reaction to these state-owned investors might constitute an impediment to the open market or lead to protectionism.

The commonly used measures include two main aspects, i.e. the shareholding ceiling of investment (or a controlled investment) and the national security review. For example, in the US, the CFIUS is responsible to review and investigate foreign investment, which is held beyond 10% shares, or minority investment but result in the foreign control of a US business;[23] in Germany, the Federal Ministry of Economics Affairs and Energy reviews whether the acquisition of 25% or more stakes by foreign investors jeopardises the public order or security.[24] In addition to the CFIUS in the US, there are other attempts to set up a CFIUS-style review mechanism or to tighten regulations of foreign investment at the national or EU level.[25]

<http://eprints.lse.ac.uk/55668/1/__lse.ac.uk_storage_LIBRARY_Secondary_libfile_shared_repository_Content_Kuwait%20Programme_Thatcher_1_2012.pdf> accessed 16 June 2017

[22] See Centre for the Protection of National Infrastructure, 'Critical National Infrastructure' <https://www.cpni.gov.uk/critical-national-infrastructure-0> accessed 16 August 2017

[23] USA Foreign Investment and National Security At of 2007 (Pub. L. No. 110-49, 50 U.S.C. app. 2061 § 2 (b) (2))

[24] Stabenau and Hemforth (n 17)

[25] Germany intends to set up such mechanism. Germany, France and Italy have submitted a joint letter to the European Commission, which ask the EU to create a CFIUS-style mechanism to block foreign investment in strategic assets by state-backed investors. See K. Stratmann, 'Germany, Italy and France Push for EU Powers to Block Strategic Investors' (14 February 2017) <https://global.handelsblatt.com/companies-markets/germany-italy-and-france-push-for-e-u-powers-to-block-strategic-investors-704844> accessed 16 August 2017. The UK government is also pressing ahead with proposals to tighten foreign investment review concerning national security. See C. Clover and J. Pickard, 'UK to Tighten Foreign Investment Reviews' (24 July 2017) <

Certain relevant authorities (or the President) in some countries have the right to review or even block foreign investment when such transaction poses risks to or threaten the public interest or national security. The list of sensitive industries has been expanded or the 'critical infrastructure' has been included as a part of the national security or public interest. Compared with the open market policies and free movement of capital advocated by these developed countries, the political attitudes and legislative measures seem to be conservative to foreign investments in strategic industries, especially those investments made by state-owned investors.

It can be recognised that every country has its own regulatory framework or adopt different measures to tackle or deal with foreign investment. It is the state sovereignty that the state set up instruments to restrict foreign investment, in general, which cannot be intervened in by other countries.[26] However, these unilateral measures cannot guarantee that SWFs could receive a non-discriminate treatment and even sufficient protection but an increasing protectionism.

1.2 Legal response in other countries

Despite the SWFs' preference in developed countries, they invest into other destinations to find more opportunities, avoid harsh restrictions, or even promote sustainable development in developing countries.[27] The alternative investment destinations for SWFs range from developing countries to emerging economies,[28] including their home countries.

For developing countries, especially those countries without a sound legal system,

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https://www.ft.com/content/9cb95e84-6bc2-11e7-b9c7-15af748b60d0> accessed 16 August 2017

[26] A. Reinisch (ed.), *Standards of Investment Protection* (OUP 2008) 10

[27] UNCTAD, 'Developing countries and sovereign wealth funds ready for partnership on sustainable investment' (21 October 2014) <http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=217> accessed 17 Jan 2016

[28] The 'developing countries' and 'emerging countries' refer to entirely different groups of countries. The fundamental difference is that emerging nations are growing rapidly and becoming more important on the world economic stage, while developing nations are struggling in comparison and still need help from trade partners around the world. See J. Reynolds, 'Difference Between Developing Countries & Emerging Countries' (updated 26 September 2017) <https://bizfluent.com/info-10002682-difference-between-developing-countries-emerging-countries.html > accessed 27 September 2017

there is no specific restriction or review mechanism for sovereign investment. SWFs are welcomed, since the capital flows could help to boost their domestic economies, to diminish the poverty and to address the structural economic problems etc., and to allow for the full exploitation of local resources that have a competition advantage in the world economy.[29] Under this circumstance, SWFs can act as development funds to assist these developing countries, besides traditional official assistance offered by developed countries and international organisations.[30] Moreover, the financial markets in these developing countries are not well developed and are lack of sufficient regulations and rules.

For emerging economies, a majority of SWFs are established by emerging economies (or even the Middle East countries). They may also consider investing in their domestic markets for macroeconomic considerations. Other SWFs get more interests in direct investment opportunities in the equity market of emerging economies, e.g. China and India.[31] The investment environment for foreign investment in emerging economies has become more positive and open-minded compared with their traditional views on foreign investment of developed countries.[32] Those countries, promoting the outbound investment of their SWFs and receiving the inbound investment of other foreign SWFs, stand in an era to consider the way to respond and react to foreign SWF investment and to balance interests of protecting national interest and attracting foreign investment, herein particularly China.

It is, on one hand, necessary to value relevant existing regulations in developed countries. On the other hand, developing countries and emerging economies need to learn some experiences from developed countries.

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[29] P. McNellis, 'Foreign Investment in Developing Country Agriculture – The Emerging Role of Private Sector Finance' (2009) FAO Commodity and Trade Policy Research Working Paper 28 <http://www.fao.org/fileadmin/templates/est/INTERNATIONAL-TRADE/FDIs/mcnellis.pdf> accessed 17 January 2016

[30] M. Vellano and A. Viterbo, 'SWFs and development' in Fabio Bassan (ed.), *Research Handbook on Sovereign Wealth Funds and International Investment Law* (Edward Elgar Publishing 2015) 371

[31] O. Auyezov, 'Sovereign Wealth Funds Boost Private Investments in Emerging Market' *Reuters* (9 September 2017) <https://www.reuters.com/article/us-emerging-swf/sovereign-wealth-funds-boost-private-investments-in-emerging-markets-idUSKCN1BK0O4> accessed 20 September 2017

[32] IMF, 'Foreign Direct Investment in Emerging Market Countries' (2003) Report of the Working Group of the Capital Markets Consultative Group <https://www.imf.org/external/np/cmcg/2003/eng/091803.pdf> accessed 17 January 2016

2. Regulations on Foreign Investment in the UK

The EU is the world's leading host of FDI. As one of the EU Member States, the UK is the top destination for such investment,[33] and a leading global market for SWF investment.[34] The flow of international investment into Europe reflects the EU's open policy regarding the free movement of capital and the freedom of establishment. However, when it comes to SWF (and other SOEs) investment (especially from China and Russia), the EU and several member states intend to abandon their liberal approach toward foreign investment.[35] Some European politicians and experts expressed the fear that SWFs could be driven by political motivations that would see many EU companies under the heavy influence of foreign governments and skew the commercial playing field; it therefore calls for new restrictive rules at the EU level.[36] Some sought to strengthen the defence against sovereign investment, especially FDI investment, through legislative reforms, while others opposed altering the regulatory framework against SWFs but insisted on keeping the open policy, and many business leaders expressed their welcome toward SWFs.[37]

In the Europe, the UK has attracted the largest share of SWF capital flows (see Chart 5). In general, no restriction has imposed on foreign investment or foreign ownership except the regulatory controls to protect its national interest in specialised circumstances. These regulatory controls consist of international norms and obligations (some of which are binding on the EU and, in turn, its Member States), various components of EU law, and the UK's own domestic regulations, which may be relevant to the operation of SWF investment.[38]

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[33] UK Trade & Investment, 'UK wins a record number of investment projects and maintains position as top investment destination in Europe' (17 June 2015) <https://www.gov.uk/government/news/uk-wins-a-record-number-of-investment-projects-and-maintains-position-as-top-investment-destination-in-europe> accessed 17 January 2016

[34] TheCityUK, 'Key Facts about Sovereign Wealth Funds in the UK' (1 June 2015), <https://www.thecityuk.com/research/key-facts-about-soverign-wealth-funds-in-the-uk/> accessed 17 January 2016

[35] J. Chaisse, 'The Regulation of Sovereign Wealth Funds in the European Union: Can the supranational level limit the rise of national protectionism?' in K. Sauvant et al. (eds.) *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 462

[36] S. Tilford et al., 'State, Money and Rules: An EU policy for Sovereign Investments' (1 December 2008) <http://www.cer.eu/publications/archive/essay/2008/state-money-and-rules-eu-policy-sovereign-investments> accessed 12 February 2016

[37] Thatcher (n 14)

[38] See M. Harry, 'Corrupting Capitalism? Sovereign Wealth Funds and the United Kingdom's Regulatory Framework' (2013) J. B. L. 438

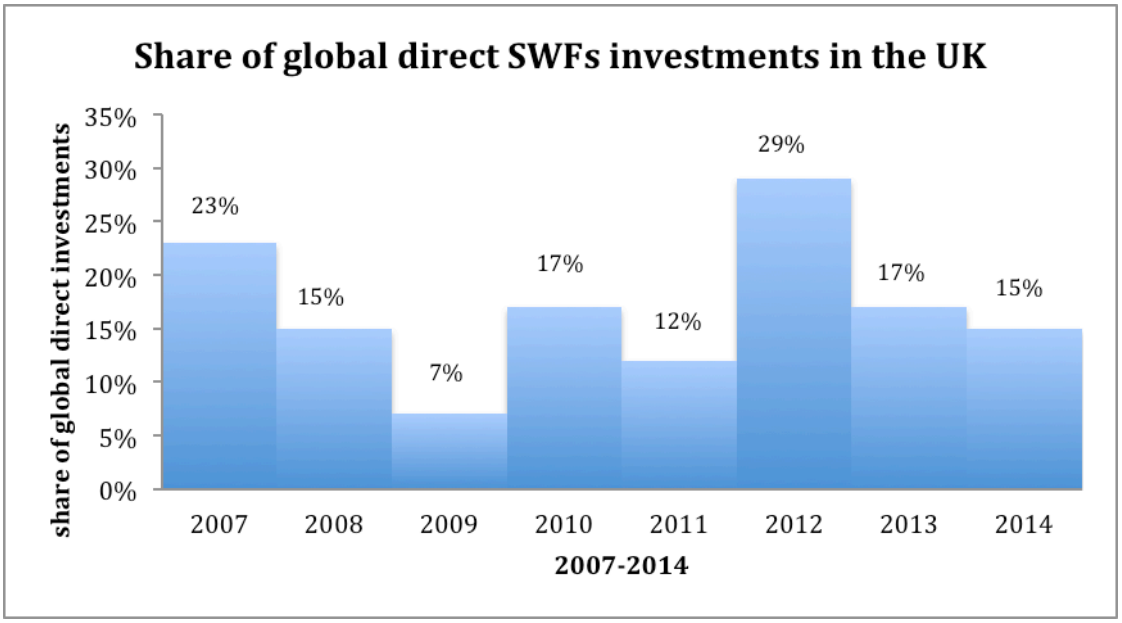

Chart 5: Share of Global Direct SWFs Investments in the UK (2007-2014)

Source: Statista, available at

<https://www.statista.com/statistics/476156/uk-share-of-global-direct-swf-investments/>

In the UK, it is thought that there is no need to set up new barriers or enact defences to restrict SWF investments, since these transactions are covered by the existing regulatory framework. Although there is an emerging trend that the UK government would like to consider a new review process to protect its national interests and critical infrastructure from the influence of foreign ownership, especially sovereign investors, so far SWF investments seems to be welcomed in the UK than investments made by SOEs.[39]

2.1 Domestic regulations concerning foreign investment

For SWF investment, the primary concern lies in SWFs' control of the target company for the political goals of their home countries and the irrationally withdraw

[39] It is argued that the concerns of critical infrastructure were raised by Chinese investment in sensitive sectors in the UK. See J. Hemmings, 'Safeguarding our Systems: Managing Chinese Investment into the UK's Digital and Critical National Infrastructure' (2017) <http://henryjacksonsociety.org/wp-content/uploads/2017/07/Safeguarding-Our-Systems-Report-FINAL-Digital.pdf> accessed 30 August 2017. However, due to the 2016 Brexit referendum, the UK has slipped to become least attractive developed market for SWFs, compared to Germany, France, and the US, according to a survey. See B. Moshinsky, 'Sovereign Wealth Funds are shunning British Investments after Brexit' (5 June 2017) <http://uk.businessinsider.com/invesco-report-finds-sovereign-wealth-funds-shunning-uk-after-brexit-2017-6> accessed 30 August 2017

from the market directed by political instructions.[40] Besides that, if the potential national or public interest issues occur caused by SWF investment, a regulatory intervention may apply. Several sectoral regulations (defence, finance, media etc.) include specific provisions that can be used to ward off unwanted transactions.[41] In practice, these regulations have hardly been used, since the UK has generally been very open to foreign investors, sovereign or otherwise.[42] UK regulations do not specifically differentiate local and foreign investors. Politicians and officials have repeatedly stressed that the City of London and British industry would continue to welcome investment from SWFs.[43]

2.1.1 Foreign investment regulations

Most foreign investments flowing in the UK are not restricted.[44] However, an authorisation or approval is required for the investment in sensitive areas. The UK has specific rules governing the acquisitions in certain regulated businesses. It concerns financial services and banking, telecoms, media and broadcasting, energy and utilities.[45] SWFs mainly undertake portfolio investment, such as purchasing shares, bonds, and they also pursue the controlling rights through direct investment.

2.1.1.1 Regulations on mergers and acquisitions

SWFs' direct investment herein means the direct equity investment rather than the green-field investment. Takeover activities in the UK could be divided into two

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[40] Kern (n 3) 13 in Ch.1

[41] Tilford et al. (n 36) 9

[42] ibid

[43] TheCityUK (n 34). See also S. Grene, 'Sovereign wealth funds choose the UK' (23 June 2014) <http://www.ft.com/cms/s/0/0c91042c-f7a0-11e3-b2cf-00144feabdc0.html#axzz3yxnU2Rsb> accessed 16 Jan 2016. See Financial Services Organisation, 'Fund management in the UK' (28 July 2015) <https://www.gov.uk/government/publications/asset-fund-management-in-the-uk/fund-management-in-the-uk-online-version> accessed 16 January 2016. See also SWFI, 'UK Mandelson encourages sovereign wealth fund investment' (8 April 2009) <http://www.swfinstitute.org/other-swf-news/uk-mandelson-encourages-sovereign-wealth-fund-investment/> accessed 17 January 2016. See S. Carvalho, 'UK open to investment from SWFs - minister' (8 April 2009) <http://www.arabianbusiness.com/uk-open-investment-from-swfs-minister-13932.html> accessed 17 January 2016

[44] Tilford et al. (n 36)

[45] Herbert Smith Freehills, 'A Legal Guide to Investing in the UK for Foreign Investors' (21 July 2014) <http://www.herbertsmithfreehills.com/insights/guides/legal-guide-to-investing-in-the-uk-for-foreign-investors> accessed 17 January 2016. See G. Souter et al., 'Doing Business in the United Kingdom' (1 May 2017) <https://uk.practicallaw.thomsonreuters.com/5-500-5090?service=crossborder&__lrTS=20170609175010782&transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1> accessed 15 June 2017

categories, i.e. takeover private companies and takeover public-listed companies. Generally, compared with domestic investors, no special or additional rules apply to the takeover of public or private UK companies by foreign investors. However, transactions involving the acquisition of UK business or the creation of a joint venture may be subject to review under the UK merger control regime, which set out in the Enterprise Act 2002 (or under the EU merger control regime that set out in the EU Merger Regulation).

These merger control provisions are of general application and are not solely relevant to FDI. The review, conducted by the Competition and Markets Authority (CMA) (or by the European Commission, EC),[46] primarily aims to assess whether a transaction is associated with any competition concern. Although the CMA plays a primary role in the UK merger control review, the UK government, acting via a Secretary of State, can intervene in a transaction on certain specified public interest grounds other than the competition law issues in the Enterprise Act, to protect the national security that is likely to arise in the case of a foreign acquirer. Express regulatory controls are prescribed in the Industry Act 1975. Pursuant to provision in Section 13 of the Act, the Secretary of State has the power to block an acquisition by a non-UK-based entity in certain circumstances.[47]

Acquisitions of interests in non-regulated private companies are generally not subject to specific procedural requirements. A takeover bid by a domestic or foreign investor of a UK public company is governed by the rules of the City Code on Takeovers and Mergers (the Takeover Code), which is administered by the Takeover Panel, pursuant to Part 28 of the Companies Act 2006.[48] The Takeover Code provisions cover, *inter*

[46] The CMA is a non-ministerial department, established under the Enterprise and Regulatory Reform Act 2013 whose aim is to promote competition, both within and outside the UK. The CMA inherited most of the functions and powers which the Office of Fair Trading (OFT) had retained as at 1 April 2013, and together these constitute a different but significant role in the consumer landscape from that previously held by the OFT. In exercising its statutory responsibilities, the CMA will co-operate with sectoral regulators and encourage sectoral regulators to use their powers to apply relevant consumer legislation, in the interests of consumers.

[47] If the Secretary of State believes that 'there is a serous and immediate probability of a change of control of an important manufacturing undertaking' and 'change of control would be contrary to the interests of the United Kingdom, or contrary to the interests of any substantial part of the United Kingdom.' There is no public record of this provision being used to prohibit a transaction.

[48] The City Code on Takeovers and Mergers has been developed since 1968 to reflect the collective opinion of those professionally involved in the field of takeovers as to appropriate business standards and as to how fairness to shareholders and an orderly framework for takeovers can be achieved.

alia, restrictions on and disclosure of the acquisitions of shares and interests in shares, the timetable for a takeover bid, the terms of the bid, and various obligations regarding announcements and documentation to shareholders of the target company. These rules are not designed solely for foreign investors, and there are no special requirements for sovereign investors. Therefore, if SWFs takeover the target company, whether it is private or public, there is no special restriction that affects their transactions in terms of the sovereign character.

2.1.1.2 Regulations in regulated businesses

There are specific rules governing the acquisitions of companies operating in regulated businesses. Investors, SWFs as well, should comply with relevant regulations in a number of these areas.

In light of the financial sector, the Financial Services Act 2012 provides a new regulatory framework for the financial services and the financial system in the UK, which amended the Financial Services and Markets Act 2000 (FSMA). It replaces the former Financial Services Authority (FSA) with the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). The PRA is a part of the Bank of England and is responsible for the prudential regulation and the supervision of systemically important financial institution.[49] The FCA regulates the financial services industry in the UK and supervises the conducts of all authorised firms. Another authority, the Financial Policy Committee (FPC), sits within the Bank of England and is responsible for the macro-prudential regulation and maintaining the financial stability.

Restrictions applying to the acquisition of interests in firms (with FCA authorisation to carry on banking, insurance or investment services business) can be found in Part XII of the FSMA,[50] and relevant subordinate legislations; and the FCA Handbook of

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Following the implementation of the Takeover Directive (2004/25/EC) by means of Part 28 of the Companies Act 2006, the rules set out in the Code have a statutory basis in relation to the United Kingdom and comply with the relevant requirements of the Directive. More information, see The Takeover Panel, 'The Takeover Code' (2016) <http://www.thetakeoverpanel.org.uk/the-code/download-code> accessed 17 June 2016.

[49] For example, banks, building societies, credit union, insurers and major investment firms.

[50] The Financial Services and Markets Act 2000 [hereinafter FSMA], s 178-191G

Rules and Guidance, in particular, Chapter 11 of the Supervision manual (SUP 11).[51] The change of control provisions in FSMA impose a range of obligations upon persons who are either proposing to become controllers of UK authorised firms or are already controllers of these firms.[52] An investor who intends to acquire shares or voting power or if his shareholding or voting power results in being able to exercise significant influence on the management of the UK company,[53] or increase its control over a UK company,[54] is required to obtain the FCA's approval before doing so.[55] Notice must be in writing and include such information and be accompanied by any such documentation as the FCA may reasonably require.[56]

Moreover, in order to enhance the necessary transparency requirement, the FCA is responsible to implement regulations for transparency and financial reporting under the EU Transparency Directive.[57] It provides the periodic financial reporting requirements, the disclosure of major shareholdings and the communications with investors. If the 3% disclosure is retained, further disclosure should to be made at each incremental 1% as a result of an acquisition or disposal of shares or financial instruments within the Disclosure Rules and Transparency Rules (DTR).[58] The disclosure obligation is tied to shareholdings and voting rights.

Acquisitions made in other regulated sectors are monitored by different authorities according to different rules (see Chart 6). These sectoral restrictions apply to all investors, ignoring the difference in their nationality or the private or public background. No special restriction is imposed on SWF investment. If SWFs undertake

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[51] FCA, 'Supervision (SUP)' (14 January 2016) <http://www.fca.org.uk/your-fca/documents/waivers/supervision-waivers> accessed 16 January 2016.
[52] FSMA, s 178
[53] FSMA, s 181
[54] If an existing controller increase his control and crosses the notification thresholds at 20%, 30% or 50%.
[55] FSMA s 182 (2)
[56] FSMA s 179
[57] On 20 March 2015 the FCA published a joint Consultation Paper (CP) with HM Treasury setting out the proposals to implement the Transparency Directive Amending Directive 2013/50/EU (TDAD) through changes to the Financial Services and Markets Act 2000 and the FCA's Disclosure Rules and Transparency Rules (DTR). See FCA, 'PS15/26: Implementation of the Transparency Directive Amending Directive (2013/50/EU) and other Disclosure Rule and Transparency Rule changes' (6 November 2015) <https://www.fca.org.uk/news/ps15-26-implementation-of-the-transparency-directive> accessed 16 January 2016.
[58] DTR s 5.1.2, see FCA, 'Disclosure Guidance and Transparency Rules sourcebook' (November 2017) <https://www.handbook.fca.org.uk/handbook/DTR.pdf> accessed 15 November 2017

portfolio investment rather than direct equity investment, there is no need for SWFs to implement or conduct special performance or requirements like other institutional investors. Therefore, from general perspective, in the UK, SWFs investments in private or public companies, or in regulated sectors are not treated differently from investments made by other (local and foreign) private investors.

Authority	Sector	Relevant Rules	Requirements	Others
Office of Communications (Ofcom)[59]	Telecoms, media, internet and broadcasting network and services and television and radio services	Communications Act 2003[60]	Companies providing electronic communications networks and services are subject to a general authorization regime and, in certain circumstances, specific additional conditions imposed by Ofcom. The general authorization regime does not, however, required regulatory approval for any change of control. Companies providing television or radio services require a licence from Ofcom. These licences will generally require companies to notify Ofcom in relation to	Ofcom has concurrent powers, under specific consumer protection legislation, with CMA to enforce competition law in the communications sector.[61]

[59] Ofcom is the communications regulator in the UK. Ofcom operates under a number of Acts of Parliament, including in particular the Communications Act 2003. Ofcom must act within the powers and duties set for it by Parliament in legislation. More details see Ofcom, 'What is Ofcom?' (2015) <http://www.ofcom.org.uk/about/what-is-ofcom/> accessed 18 January 2016

[60] The Communications Act says that Ofcom's principal duty is to further the interests of citizens and of consumers, where appropriate by promoting competition. See the Communications Act 2003, s11-9

[61] CMA, 'Memorandum of Understanding between the Competition and Markets Authority and Ofcom on the Use of Concurrent Powers under Consumer Protection Legislation' (February 2015) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/409247/CMA_and_Ofcom_MoU.pdf> accessed 18 January 2016

			the change of shareholding or control.	
Office of Gas and Electricity Markets (Ofgem)	Generation, supply, transmission or distribution of electricity, or the supply, shipping, distribution or transmission of gas onshore; the operation of an interconnector require a licence	The Energy Act 2008[62]	Legislative changes made in November 2011 to fully transpose the ownership unbundling requirements of the EU Third Energy Package [63] applicable to these services could affect the ability of foreign investors to acquire a controlling stake in such companies. Ofgem must notify the Secretary of State of the UK Government and the EC. Apart from it, potential investors in the electricity sector should keep up to date with progress regarding the implementation of the UK Government's Electricity Market Reform proposals.	Ofgem also has concurrent powers with the CMA to enforce the Competition Act 1998 and Articles 101 and 102 of the TFEU in the electricity and gas sector.[64]
Office of Water	A water or water and sewerage	Water Industry Act 1991	The terms of appointment (as a	The Ofwat, has concurrent

[62] The Energy Act 2008 introduced further requirements for licensing. The Energy Act 2008, s1 (4)

[63] The latest round of EU energy market legislation, known as the third package, has been enacted to improve the functioning of the internal energy market and resolve structural problems. More information, see European Commission, 'Market legislation' (2011) <https://ec.europa.eu/energy/en/topics/markets-and-consumers/market-legislation> accessed 17 January 2016

[64] CMA, 'Memorandum of Understanding between the Competition and Markets Authority and the Gas and Electricity Markets Authority – Concurrent Competition Powers' (18 January 2016) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/502666/OFGEM_MoU.pdf> accessed 4 April 2016

Services Regulation Authority (Ofwat)	undertaker		water or water and sewerage undertaker) include conditions that may be relevant to an acquisition. Unlike the electricity and gas sectors, there is also a requirement, for the CMA to make a mandatory reference to the Competition Commission in relation to mergers between water and/or water and sewerage companies.[65]	powers with CMA.[66]

Chart 6: Regulated Sectors by Ofcom, Ofgem, and Ofwat

2.1.2 Regulations for protecting public interests

In the UK, (and indeed across the Europe) there may be a need to review particular transaction on a case-by-case basis, particularly if such transaction involves a change of ownership/control from private into public hands. Under the current regime, the competition issue is covered, which provides a sensible restraint without the political interference.[67] While, if a foreign investment poses risks to national security or public interest, relevant provisions of regulatory intervention would apply to. One of major concerns of SWF investment is the national security (including economic security) risk, due to the fear of the political power behind it.[68]

The Enterprise Act 2002 provides a specified list of public interest considerations (i.e. public interest cases and special public interest cases) that the Secretary of State could rely on to intervene in transactions: the national security, the stability of the financial system and a threat to media plurality.[69] The Secretary of State also has the power to

[65] The Water Industry Act 1991, s2
[66] CMA, 'Memorandum of Understanding between the Competition and Markets Authority and the Water Services Regulation Authority – Concurrent Competition Powers' (23 February 2016) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/502668/Ofwat_MoU.pd> accessed 4 Aril 2016
[67] M. Stucke, 'Is Competition Always Good?' (2013) 1(1) JAE 162
[68] Harry (n 38) 454.
[69] Enterprise Act s 58. See A. Seely, 'Takeovers: The Public Interest Test' (2015) House of Commons

modify the specified list by specifying a new consideration, or amending or removing any existing specified consideration.[70] Generally, the government has very limited power to intervene in an M&A transaction and traditionally the UK is reluctant to restrict it.[71] It can be seen from the above UK regulations that the existing regulations mainly focus on competition issue rather than the national security in market access (or in relation to critical infrastructure), and these regulations do not intend to tackle sovereign background or foreign government-controlled investment.

2.2 Implication of the EU Law

Despite the Brexit, the UK is currently still a EU Member State; hence its regulatory restrictions imposed on foreign investment to protect the security or public interest should be in compatible with the EU law, which imposes certain limits on the exercise of these UK rules.[72] 'Every action taken by the EU is founded on treaties that have been approved voluntarily and democratically by all Member States.'[73] The EU law, which has equal force with national law, awards rights and obligations on the authorities in each Member State, as well as individuals and businesses.[74] Authorities in Member States are responsible to implement the EU law at domestic law and to enforce it correctly.

The EU legislation takes the form of treaties establishing the European Union and governing the way it functioning; EU regulations, directives and decisions have a direct or indirect effect on EU member states.[75] The EU case law consists of judgments from the Court of Justice of the European Union (CJEU), which interprets

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SN5374

[70] Enterprise Act s 42 (3) & 58 (3)-(4)

[71] S. Williams and D. Roland, 'In U.K., Barriers Rising Against Foreign Deals' *WSJ* (10 May 2015) <http://www.wsj.com/articles/in-u-k-barriers-rising-against-foreign-deals-1431294641> accessed 18 January 2016

[72] More information about EU rules and practices, see F. Hoffmeister, 'The Contribution of EU Practice on International Law' in M. Cremona (ed.), *Developments in EU External Relations Law* (OUP 2008) 62

[73] European Union, 'EU treaties' (28 September 2015) <http://europa.eu/eu-law/decision-making/treaties/index_en.htm> accessed 18 January 2016. See also D. Gowland, *Britain and the European Union* (Taylor & Francis2016) 364

[74] G. Falkner, *Complying with Europe: EU Harmonisation and Soft Law in the Member States* (CUP 2005)

[75] P. Craig and G. De Burca, *EU Law: Text, Cases, and Materials* (5th edn, OUP 2011)

the EU law.[76] The UK needs to comply with EU fundamental principles in the EU treaties and relevant regulations,[77] when it intends to review foreign investments (including SWF investment) for new reasons. The European Commission (EC) emphasises its commitment to an open investment environment and the free movement of capital, which are based on Articles 63 to 66 of the Treaty on the Functioning of the European Union (TFEU), supplemented by Articles 75 and 215 TFEU for sanctions. All restrictions imposed on capital movements between Member States or between Member States and third countries should be removed.

2.2.1 Restriction on free movement of capital

There is no CFUIS-like agency at the EU level to review foreign investments in the EU market in terms of the national security or public order. However, several Member States have such mechanism in place or intend to create one. The EC has proposed a regulation for scrutinising FDI in projects of Union interests to protect the EU's essential interests.[78] If the UK considers adopting this approach, it needs to comply with the principle of free movement of capital in Article 63 of TFEU. Article 63 (1) TFEU provides the legal underpinning for all cross-border investments in the EU, including investments from outside the EU. Protectionist measures against SWFs investments are thus prima facie in breach of Article 63 (1) TFEU. According to Article 65 TFEU, Member States retain the right in certain circumstances to impose restrictions on SWFs, on the public policy and public security grounds, or if it constitutes 'mandatory requirements' in compliance with CJEU case law.[79]

The EU competition law (merger control) permits Member States to scrutinise M&A that has a 'Community Dimension' (when a case falls within the antitrust competences of the EC and outside Member State competence) if a Member State intends to protect 'legitimate interests'.[80] But the question of what constitutes a legitimate interest is determined by the EU law but not the national law, therefore, a Member State cannot intervene in to protect any interest it intends to. In these cases, if

[76] ibid
[77] Falkner (n 74) 61
[78] Commission, 'Proposal for A Regulation of the European Parliament and of the Council Establishing a Framework for Screening of Foreign Direct Investments into the European Union' COM(2017) 487 final
[79] Mezzacapo (n 110) 40 in Ch.2
[80] I. Bael, *Competition Law of the European Community* (Kluwer Law International 2005)

the jurisdiction in this area is transferred in a manner prescribed under the EUMR Article 9 (1) and 4 (4), the merger control review is performed by the EC, whereas, the review of identified legitimate interest takes place under relevant domestic law, e.g. the Enterprise Act. However, these provisions only apply if an SWF acquires 'control' over a European company. Moreover, the EC law has specific rules on the acquisition of shares in the financial sector. For example, the EC Credit Institutions Directive,[81] provides that Member States can examine and even reject a plan by any natural or legal person to obtain a 'qualifying holding' in a credit institution.[82]

2.2.2 Transparency and disclosure requirement

The EC has been taking efforts to draft the mandatory disclosure and transparency requirements of institutional investors. The EC in its 2003 Action Plan put forward proposals of a mandatory disclosure for institutional investors to disclose their voting rights with regards to their portfolio companies and upon request to disclose to their beneficial holders concerning how these rights have been exercised in a particular case.[83] However, the terms of "institutional investors" and "beneficial holders" were criticised for being too broad to interpret.[84] Since these disclosure duties were designed for EU institutional investors, it was blamed for a distortion of the competition between EU and non-EU institutional investors (especially SWFs).

The EU 2010 and 2011 Green Papers further stressed requirements concerning the corporate governance and voting rights.[85] In the consultation following the Green Paper, the EC asked whether the disclosure of institutional investors' voting policies and practices should be compulsory and whether institutional investors should comply with a national or international code of practice.[86] However, a majority of

[81] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.
[82] The Credit Institutions Directive has been amended on 5 September 2007. See Directive 2007/44/EC of 5 September 2007 amending Council Directive 92/79/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC, 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase in shareholdings in the financial sector, OJ 2007 L247/1.
[83] Commission, 'Communication from the Commission to the Council and the European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to More Forwards' COM (2003) 284 final
[84] K. Schmolke, 'Institutional Investors' Mandatory Voting Disclosure: The Proposal of the European Commission against the Background of the US Experience' (2006) 7 EBOR 775
[85] 2010 Green Paper (COM (2010) 284 final) and the 2011 Green Paper (COM (2011) 164 final)
[86] H. Birkmose, 'European Challenges for Institutional Investor Engagement – Is Mandatory

respondents to the consultation on both the 2003 Action Plan and Green Paper were sceptical of a mandatory proposal but were in favour of a code of best practice for institutional investors.[87] Based on Green Papers, the EC in its 2012 Action Plan stated that it would propose an initiative on the disclosure of institutional investors' voting and engagement policies as well as their voting records.[88] But the EU, has not provided a uniform public disclosure requirement of SWFs, while it had supported the initiative of IMF to draft the GAPP, since at that time, the EU believed that such a code of best practice would take certain effects on the activities of SWFs.

2.2.3 'Golden share' provision

To protect 'national champions' and privatised companies, and to prevent sensitive sectors from foreign ownership control, several EU member states (e.g. the UK, France, Germany, Italy, Spain, Netherlands, Belgium) adopted the 'golden share' provision as a protective measure.[89] The 'golden share' is a term used to cover a number of special rights retained by the government with regards to a formerly SOE, which gives the government veto power over changes of the company's charter.[90] For SWF investment, the 'golden share' provision would provide the government the ability to prevent SWFs as shareholders in the target company from taking more than a ratio of ordinary shares and block an acquisition by SWFs. This golden share controls at least 51% of voting rights. These shares were most popular during the 1980s with those governments who intended to maintain the control of privatised companies. The use of golden shares was widespread throughout the EU as well as in Central and Eastern European nations and is mainly used in the UK.

However, CJEU (in the golden share cases) and EC (in its elaboration of state aid through shareholding) were concerned with the effects of privatisation and the old controlled economies of the Member States in the European private market.[91] Generally, the EC consider the use of golden shares incompatible with EU laws on the

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Disclosure the Way Forward' (2014) 2 ECFR 214, 218

[87] European Commission, Feedback Statement Summary of Responses to Commission Green Paper on Corporate Governance in Financial Institutions, Brussels, 2010, 17

[88] 2012 Action Plan (COM (2012) 740 final), s 2.4

[89] Mezzacapo (n 79) 43

[90] A. Pezard, 'The Golden Share of Privatized Companies' (1996) 21 Brook. J. Int'l L. 85

[91] Backer (n 44) 216 in Ch. 1

free movement of capital and freedom of establishment.[92] Hence the use of these shares is acceptable only in specific circumstances and subject to strict conditions. Since 2000, the CJEU has decided several cases,[93] in which the free movement of capital and the freedom of establishment were directly or indirectly restricted through the holding of 'golden shares' by the state.[94] In these cases, the assertion of state power was rejected due to the in breach of the obligation under Article 63 of the TFEU Treaty.[95]

It can be therefore argued that the golden share provision can hardly be used to intervene in SWF investment, especially portfolio investment. As the EU member state, the UK government would not intervene in SWF investment via this approach, which may be used as a last resort in very limited sectors.

2.2.4 EU approach towards SWF investment

For SWF investment, a Common European Approach to Sovereign Wealth Funds in 2008 could demonstrate the EU's attitude towards SWFs.[96] According to it, the EC emphases that the EU has both the capacity and the incentive to promote a common response to the challenges posed by SWFs. This communication addressed the issues posed by SWFs as a specific category of cross-border investments. It intended to show how a common approach could strike a right balance between addressing concerns of SWFs and maintaining the shared benefits of an open investment environment. The EC explained that it must remain its commitment to an open investment environment consistent with EU common market jurisprudence.

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[92] J. Houet, 'Golden Shares: No Shining Anymore?' (2011) 18 COLUM. J. EUR. L. F. 46. See C. Putek, 'Limited But Not Lost: A Comment on the ECJ's Golden Share Decisions' (2004) 72 (5) Fordham L. Rev. 2219

[93] For example, Case C-462/00, Commission v. Spain, 2003 E.C.R. I-4581, [2003] 2 C.M.L.R. 18 (2003); Case C-98/01, Commission v. United Kingdom, 2003 E.C.R. I-4641, [2003] 2 C.M.L.R. 19 (2003); Case C-367/98, Commission v. Portugal, 2002 E.C.R. I-4731, [2002] 2 C.M.L.R. 48 (2002); Case c-483/99, Commission v. France, 2002 E.C.R. I-4781, [2002] 2 C.M.L.R. 49 (2002); Case C-503/99, Commission v. Belgium, 2002 E.C.R. I-4809, [2002] 2 C.M.L.R. 50 (2002); Case C-58/99, Commission v. Italy, 2000 E.C.R. I-3811. ibid 2220

[94] ibid

[95] I. Kuznetsov, 'The Legality of Golden Shares under EC Law' (2005) 1 (1) Hanse L. Rev. 22

[96] The Commission proposes that the European Union adopts a common strategy aimed at enhancing the transparency, predictability and accountability of SWF operations. See Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 27 February 2008 – 'A Common European approach to Sovereign Wealth Funds' COM/2008/ 115 final

The EU prefers to support a multilateral effort rather than draw up its own rulebook for SWFs, reliance on existing instruments, adherence to the principles of transparency and proportionality. It in part reflects a view that issues of SWFs need to be dealt with in the widest possible format involving home countries of SWFs and the largest possible number of host countries. The EU supports a voluntary code of conduct as an important first step towards building the trust between SWFs and host countries, to enhance the governance standards of SWFs and the quality of information provided by SWFs. From the EU perspective, the multilateral approach and a code of conduct for SWFs are not only to the benefit of the EU, but in the mutual interest of all host countries and of home countries.[97] The EU indeed had contributed to the IMF's efforts to set up the GAPP. It can be argued that in the UK (and under the EU framework), SWFs investments are not restricted by any special or additional requirements and the UK welcomes SWF investment.

3. Regulations on Foreign Investment in the US

The US approach towards sovereign investment (including SWF investment), especially the Chinese sovereign investment, is more conservative and protective. Traditionally, the US is a leading driving force to support the liberalisation and an open market, and it advocates the sufficient protection of foreign investment. Moreover, the US, so far, has adopted or incorporated NT into the pre-establishment phase into its legislation, the model BIT, NAFTA and other regional agreement, and the TPP text as well (despite its withdraw from the TPP). Furthermore, the US is a leading host for foreign investment.[98]

However, with the development of liberalisation and globalisation, emerging economies and developing countries with ample oil and gas resources or FX reserve surplus have actively engaged in the global market. Sovereign investors of those countries have attracted a large attention and raised concerns and debates in relation to the national security and financial stability, especially in the US. The US national security review mechanism has been operated for a long time. There are two typical cases that triggered the legislative reform (i.e. the CFIUS reform) towards screening

[97] Norton (n 11) in Introduction

[98] The US, UK and China (including Hong Kong) are top three host economies of FDI inflows. See UNCTAD, 'World Investment Report 2017' (9 May 2017) <http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf> accessed 30 June 2017

foreign investment, i.e. the Dubai Port World Corporation (DP World) case and the China National Offshore Oil Corporation (CNOOC) case.[99] These two cases triggered a discussion on the need for the legislative reform concerning national security. Hence, the FINSA 2007 came into force, to support national security review of foreign investment, especially those with foreign-government background and those resulting in 'control'. Under the Trump's administration, the US intends to broaden the scope of this review.

The US congress held a hearing in 2007 to discuss a response to the concerns of SWFs, while views were various towards SWFs. Scholars hold different opinions towards whether special regulations are needed to regulate SWFs.[100] These concerns could be partly attributed to their increasing size and sensitive background, and origin of investment, particularly from China and Russia. Hence, in the US, there was a contest between the acceptance of SWFs as part of free trade policy and the restriction on the ground of national security.[101] But the anti-globalisation and nationalism in the US under Trump's administration bring about many uncertainties about what the US foreign investment policy would be. Moreover, there are increasing signs that the US might adopt a more conservative attitude towards foreign investment in strategic assets and critical technologies, especially those from China, and might embrace a unilateral/bilateral rather than a mega-regional or multilateral approach towards trade and investment.

3.1 General regulations concerning foreign investment

3.1.1 Securities regulation

SWFs investments in the US securities market are subject to relevant regulations and

[99] In 2004, China National Offshore Oil Corp (CNOOC Ltd), a Chinese SOE tried to acquire an American company called Unocal Corp, but finally it failed since US officials argued that this deal would jeopardise the national and economic security if CNOOC was controlled by Chinese government. In 2005, the DP World launched a bid for Peninsular and Oriental Steam Navigation Company (P & O), a British company that ran the ports of New York and Long Beach. Finally, it failed after long time security review; DP World was forced to cease this transaction. See M. Castelli and F. Scacciavillani, *The New Economics of Sovereign Wealth Funds*. Vol.658 (John Wiley & Sons Ltd 2012) 5-6

[100] Reed (n 78) 97 in Ch.1

[101] More about free trade policy and national security, see F. Bassan, 'Host States and Sovereign Wealth Funds, Between National Security and International Law' (2010) 21(2) E. B. L. R. 165

disclosure requirements. For example, under Section 13 of the Securities Exchange Act of 1934 (the Exchange Act), if an SWF, or any other investor, acquires a beneficial ownership of more than 5% of any registered securities, it must disclose its share ownership to the US Securities and Exchange Commission (SEC).[102] If it has the intention of changing or influencing the control of the issuing company, a further disclosure is required. It must disclose to the SEC, e.g. the source of funds used to purchase the securities, the number of shares owned, and its voting power.[103] If the acquisition was not made with the intent to change or influence the control of the company, the shareholder, as long as it holds less than a 20% stake, is required to disclose only the number of shares beneficially owned, its voting power, and the percentage of the class owned.[104]

Institutional investors with the discretion over accounts holding more than $100 million of registered equity securities are also required to file quarterly reports to the SEC, which indicate the aggregate fair market value of the holding, number of shares, and sales and purchases of each security during the reporting period.[105] In addition, Section 16 of the Exchange Act requires a shareholder with a beneficial ownership of greater than 10% of a class of registered equity securities to disclose to the SEC the amount of its holding, and give notice of any transaction that results in a change in beneficial ownership.[106]

But if SWF investment results in ownership of less than 5% of securities, there is no additional disclosure requirement. When disclosure is required, the information to be disclosed is fairly minimal, particularly if SWFs are passive investors. It thus is concerned that the disclosure requirement does not address concerns raised by the governance of SWFs and their investment objectives.[107] It can be found that only when an investment reaches the 5% threshold and the SWF is willing to disclose its intention to influence the operation of the target company, does it requires the substantive information of the SWF and any special arrangements it has regarding the

[102] The Williams Act § 13, 15 U.S.C. § 78m (d) (2006) (amending the Securities Exchange Act of 1934); Exchange Act Rules, 17 C.F.R. § 240. 13d-1 (2007)
[103] 171 C.F.R. § 240. 13d-1 (2007); 171 C.F.R. § 240. 13d-1 (2008)
[104] 171 C.F.R. § 240. 13d-1; 171 C.F.R. § 240. 13d-102 (2007)
[105] 171 C.F.R. § 240. 13f-1 (2008)
[106] Securities Exchange Act of 1934 § 16(a), 15 U.S.C. § 78p (2006)
[107] Epstein and Rose (n 100) in Ch. 2

securities. Although disclosing information is beneficial, these regulations do not prevent a SWF from claiming that it has no intention to influence the company. As a result, the disclosure requirement imposed by the SEC through the Exchange Act is criticised for not being sufficient to reduce concerns about SWF's possible non-commercial motives.[108]

3.1.2 Regulations in banking sectors

SWFs investments in banking sectors are subject to the same standards that apply to investments made by local and other foreign investors. The US has a control mechanism to ensure that when SWFs acquire control in a bank, the stability of the bank and the public confidence in the banking system in general, are not endangered.[109] In all cases, the competent authority has to evaluate the suitability of the acquirer. Criteria for rejecting a approval are usually as follows: 'the financial condition of the acquiring person or the future prospects of the institution as might jeopardise the financial stability of the bank or prejudice the interests of the depositors of the bank' or 'the competence, experience, or integrity of the acquiring party or of the proposed management indicate that it would not be in the interests of the depositors and the public for such persons to control the bank.'[110] Hence, in any case where a SWF obtains the control of a bank in the US, a careful scrutiny of this acquisition will be conducted to ensure that the financial stability is not endangered.[111]

The Change in Bank Control Act of 1978 (CIBC Act) requires that any acquisition of 10% or more of any class of voting securities of a state member bank or bank holding company should obtain prior approval, and it imposes on-going restrictions on the acquirer.[112] The CIBC Act requires the applicant to disclose extensive information about the proposed transaction and extensive personal and financial information about

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[108] Keller (n 143) in Ch.1

[109] This mechanism is elaborated in the Bank Holding Company Act of 1956 (12 U.S.C. §§ 1841-1848) and the Change in Bank Control Act of 1978 (12 U.S.C. § 1817)

[110] 12 U.S.C. § 1817 (j) (7) (C) and (D). Similar requirements are present in the Bank Holding Company Act: 12 U.S.C. § 1817 (c) (2) and (3). In case of foreign banks, the latter provision indicates that approval of an acquisition can be refused if the acquiring foreign bank is not subject to comprehensive supervision and regulation on a consolidated basis.

[111] B. De Meester, 'International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State' (2009) 20 Eur. Bus. L. Rev. 779

[112] 12 U.S.C. § 1817(j)

the applicant. But it does not apply to transactions that require approval under Section 3 of the Bank Holding Company Act of 1970 (BHC Act) or the Bank Merger Act.

The BHC Act requires prior approval by Federal Reserve of any direct or indirect investment in a US bank or bank holding company if the company acquires ownership or control of at least 25% of any class of voting securities, or controls the election of a majority of the board of directors, or exercises a controlling influence over the management or policies.[113] In the case of SWF investment, the bank holding company is created by a SWFs or a SWF acquires the control over such company. If a SWF already owns a bank and intends to acquire more than 5% of shares of another bank or a bank holding company, the approval of Federal Reserve is required.[114] Since most SWFs can be regarded as a 'company', SWFs investments are covered by the BHC Act. However, those SWFs have no independent legal personality and cannot be separated from the state authority may be excluded, as the BHC Act does not cover investments made by a government.[115]

These provisions help prevent controlling shareholders from exploiting banks for their own benefit. However, in addition to the limitation for only applying to investments made in banking sectors, SWFs portfolio investments are not formally review under these banking laws. SWFs, like many hedge funds and private equity funds, 'structure their investments so as not to trigger the thresholds for review and approval under either the BHC Act or CIBC Act.'[116] In fact, most SWFs investments are usually below 10% of shares or even below 5%.

3.2 National security review

The most relevant statute applicable to foreign control or foreign government-controlled transaction and to tackle issues of national security is the FINSA. The CFIUS is responsible to review foreign investment in the US. The

[113] 12 U.S.C. § 1841 (a) (2)
[114] 12 U.S.C. §1841 (a) (4)
[115] 12 U.S.C. §1841 (a)
[116] Foreign Government Investment in the U.S. Economy and Financial Sector: Hearing before the Subcomm. on Domestic and International Money Policy, Trade, and Technology and the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Fin. Services, 110th Cong.4 (2008) (statement by Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System).

FINSA introduces several reforms to Exon-Florio Amendment and provides more flexibility to the CFIUS (and the President). It authorises the President to investigate transactions that were to result in a foreign-government control over a US company and block such transaction or force divestment if the transaction raised the national security concern. Prior to the Exon-Florio Amendment, foreign acquisition could be blocked only if the President declared a national emergency or regulators found a violation of federal antitrust, environmental, or securities laws.

Among other reforms, the FINSA has strengthened the investigation process of the CFIUS,[117] a panel of executive branch officials charged with reviewing transactions that could result in control of a US business by a foreign government, to assess any potential threat to national security.[118] Although 'national security' is not defined in the FINSA, CFIUS's practices have shown that the national security concern may arise when an acquisition involves the defence sector, critical infrastructure, telecommunications, energy assets and critical technology etc. The CFIUS is authorised to work with the parties of a transaction, set the conditions on the approval of the transaction, require parties to make agreements, and monitor the parties' actions post-approval, to mitigate any threats to national security. Alternatively, if the CFIUS concludes that a threat exists that cannot be mitigated, its findings are forwarded to the President, who makes the final decision on whether to block this transaction.

The national security review has two stages, i.e. a preliminary 30-days review process (to determine whether the transaction could affect national security) and a 45-day deeper investigation period. Pursuant to the FINSA, the President, acting through the CFIUS is required to investigate the implication of a particular transaction if the review indicates that whether the transaction (i) is foreign government-controlled; (ii) threatens to impair national security, and that such impairment to national security has

[117] CFIUS is a regulatory agency, which has the right to review all foreign investments in U.S. including SWFs investment. If a foreign investor violates the stipulations, it can impose fines on foreign investor. If the foreign investment threatens the national interests, it can block this foreign investment into U.S. CFIUS operates pursuant to the section 721 of the Defense Production Act of 1950, which was amended by the FINSA and implemented by Executive Order 11858.

[118] 50 U.S.C. app. § 2170 (a) (3), (b) (1) (B) and (b) (2). It should be noticed that this mechanism not only applies to merger and takeovers, it also applies in case of minority states if they could result in foreign control.

not been mitigated; (iii) results in the control of a critical infrastructure by a foreign person, and could impair national security, and such impairment to national security has not been mitigated. It indicates that there is no preliminary requirement any more to determine by the CFIUS on government-controlled transaction. There is thus a presumption that the government-controlled transaction is a much greater danger.

The foreign government-controlled transaction is defined as 'any covered transaction that could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign government.'[119] This may cover transactions that involve the control by foreign government agencies, SOEs, public pension funds and SWFs.

The President, however, is not obliged to follow the recommendation of the CFIUS to prohibit or suspend a transaction. The President can exercise his authority only if he has 'credible evidence' supporting that such transaction would impair the national security and other US laws are inadequate or inappropriate to protect national security.[120] The law also indicates that when making decisions, the CFIUS has to take account of the implication of a transaction for 'critical infrastructure' or 'critical technologies'.[121] But the 'national security' is not defined in the FINSA, thus the law provides more space for discretion, but it increases the uncertainty of investors over the success of investments.[122]

Although the FINSA has broadened the CFIUS's authority, the review mechanism under the reformed CFIUS has been criticised for two flaws in dealing with SWF investment. Firstly, the review will take place only if the foreign government background investor gains the 'control' of a US business. But the FINSA and CFIUS statute do not define 'control'.[123] Very few SWFs seek to control portfolio companies via M&A or acquiring controlling stakes, and most of them 'engage in market-based

[119] 31 C.F.R. § 800, 214
[120] 50 U.S.C. app. § 2170
[121] 50 U.S.C. app. § 2170 (f) (6) and (7)
[122] The FINSA suggested foreign entities might limit their investment in the United State because of the increased costs of transacting business in the United States imposed by the CFIUS process. See Rose (n 100) 112 in Ch.2
[123] FINSA does not define what constitutes "control", but the Treasury Department's proposed rules define control. 31 C.F.R. pt. 800

purchases of less than controlling positions' typically less than 10%.[124] As a result, it is unclear whether, or to what extent, SWF investment could be subject to CFIUS review. The second flaw is that the review only focuses on implications of 'national security'.[125] Its scope arguably needs to be broadened to include other implications of foreign investment on the US economy. This claim indicates or requires that additional legislative action may be necessary, as transactions that do not threaten national security may still pose risks to the US economic security and market integrity. However, a too broad or vague definition of national security would result in uncertainties and even be used as an excuse for protectionism.

When tracking transactions blocked by CFIUS or the President, it should be noticed that Chinese investments have become the main target of CFIUS national security review over the last decade due to the concern of their sovereign background or of their close relationship with Chinese government.[126] The increasing growth of Chinese investments (especially M&A or investments that result in the control of critical infrastructure and critical technology) in the US and the rise of Chinese state-capitalism (Chinese SOEs and Chinese SWFs) have even triggered debates in US Congress on tightening the oversight of foreign investment, and on broadening the authority of CFIUS to review transactions.[127] On December 2016, President Obama

[124] D. Rediker and H. Crebo-Rediker, 'Don't Pick on Sovereign Wealth' *WSJ* (23 July 2008) <http://www.wsj.com/articles/SB121674614256974043> accessed 18 January 2016

[125] Keller (n 143) 352 in Ch.1

[126] For example, Huawei (a Chinese private-owned enterprise in telecommunications) came under intense scrutiny under CFIUS when its subsidiary purchased assets from 3 Leaf. The CFIUS launched an investigation into its potential national security implications. Another case in 2012 is the Ralls Corp.'s acquisition of the four windfarm companies. Although Ralls theoretically an US company and outside of the CFIUS review, it was owned by two Chinese nationals. President Obama issues an order to terminate the transaction and force Ralls to divest its interest in these four companies. Ralls brought a constitutional claim and the court held that the presidential order deprived the company of it property interest without due process. See Ralls Corp. v. CFIUS, 758 F. 3d 296, 304, 325 (D. C. Cir. 2014).

[127] P. Griffin, 'CFIUS in the Age of Chinese Investment' (2017) 85 (4) Fordham L. Rev. 1757, 1777. On 15 November 2017, the US-China Economic and Security Review Commission (USCC) submitted its 2017 report to the US Congress. In this report, the USCC recommended the Congress to 'consider legislation updating the Committee on Foreign Investment in the United States (CFIUS) statue to address current and evolving security risks.' In terms of Chinese investment in the US, the USCC recommended the Congress various suggestions to tackle Chinese investment, especially to restrict Chinese investment in strategic assets. For example, the USCC recommended the Congress consider 'prohibiting the acquisition of U.S. assets by Chinese state-owned or state-controlled entities, including sovereign wealth funds', 'requiring a mandatory review of any transaction involving the acquisition of a controlling interest in U.S. assets by Chinese entities not falling under the above class of acquitting entities', 'prohibiting any acquisition or investment that would confer "control" with regard to critical technologies or infrastructure,' and 'including a net economic benefit test to assess the impact of acquisitions by Chinese entities in the United States to ensure they advance U.S. national economic interests'. It seems that the future U.S. foreign investment policy towards Chinese investment will be

issued an executive order to block the acquisition of the US assets of a German semiconductor manufacturer Aixtron SE by Chinese investor Fujian Grand Chip Investment Fund. The order indicates that the CFIUS review process can have extra-territorial effects, since the prohibition is extended to assets beyond the US border (if these assets are used in or owned for the benefit of activities in interstate commerce).

On 13 September 2017, President Trump issued an executive order to block the acquisition of a US semiconductor manufacturer Lattice Semiconductor Corporation by a Chinese government-backed private equity fund, Canyon Bridge Capital Partners.[128] This marks the fourth time that the US President has issued an order to block a transaction because of national security concern.[129] These newly prohibited transactions and the development of the CFIUS practices highlight the features of and trends in the CFIUS review. Firstly, the CFIUS has the authority to review the acquisition of a non-US company if it involves US businesses. Secondly, the review focuses on transactions in high-tech industries (particularly semiconductors). Thirdly, it reflects that the scrutiny is heightened with regard to the Chinese investment in US business. More generally, it is a signal that the CFIUS's jurisdiction may continue to be expanded and the current US foreign investment policy is uncertain, which poses increasing regulatory risks to foreign investors. Furthermore, the US Congress is taking efforts to reform the CFIUS and members of Congress have proposed legislations to substantially broaden the scope of CFIUS review. The intended changes in part directly address concerns regarding Chinese investments and their ties to the state by requiring the CFIUS to consider the governance and commercial orientation of foreign investors (especially state-backed investors).[130]

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getting more harsh and strict. For more recommendations of USCC, see USCC, '2017 Annual Report' (15 November 2017) <https://www.uscc.gov/Annual_Reports/2017-annual-report> accessed 16 November 2017

[128] M. Gershberg et al., 'President Trump Blocks Chinese Acquisition of Lattice Semiconductor Corporation' (24 September 2017) <https://corpgov.law.harvard.edu/2017/09/24/president-trump-blocks-chinese-acquisition-of-lattice-semiconductor-corporation/> accessed 30 September 2017

[129] The first one was President Bush's executive order blocking China National Aero-Technology Import and Export Corp to divest its interest in MAMCO Manufacturing Inc. The second one is Ralls and the third one Aixtron deal. See M. Gershberg et al., 'CFIUS Takeaways from Blocked Aixtron Deal' (16 December 2016) <https://www.law360.com/articles/873348/cfius-takeaways-from-blocked-aixtron-deal> accessed 30 June 2017

[130] Griffin (n 127) 1785-1787

3.3 The US approach to SWF investment

A healthy economy partly depends upon the investment capital and liquidity, of which SWFs are a significant and growing source.[131] It was argued that any resolutions to address the tension between the need for SWF investment and protectionist measures adopted by host states should be consist with the US tradition of open market.[132] Imposing heavy burdens on SWFs would hinder investments and reduce their incentives. However, there is increasing debate and controversy concerning sovereign background investment (whether it is made by SOEs, or state-back investment fund or POEs) and on-going discussion on the CFIUS reform to tackle Chinese state capitalism.

Previously, when SWFs actively undertook investment during the financial crisis, there was a discussion on whether an additional or special regulation on inbound SWF investment was necessary and urgent. Those who advocated additional regulations argued that current legislation was effective in mandating some level of disclosure and in limiting transactions made in particular sectors, and was effective only when SWFs acquired certain stakes, but was not sufficient to alleviate fear about ill-founded SWFs.[133] The opponents suggested that new restrictions were unnecessary.[134] It was argued that SWFs could manage potential risks they posed and what the US should do was to pressure home countries of SWFs to embrace best practice of SWFs and enhance the accountability of SWFs to stakeholders. At the same time, the US should minimise political and economic barriers to foreign investment existing in all forms and originating from all sources.[135]

It seems that the concern with regard to the role of foreign ownership in the US

[131] D. Rediker, 'Do Sovereign Wealth Funds Make the U.S. Economy Stronger or Posse National Security Risks?' (13 February 2008) Hearing before the J. Econ. Comm., 110th Cong <https://www.jec.senate.gov/public/index.cfm/hearings-calendar?ID=1E8B2EEB-7E9C-9AF9-7499-7A066AF08619> accessed 17 January 2016

[132] Keller (n 143) 355 in Ch.1

[133] ibid 356

[134] Committee on Foreign Affairs, 'The Rise of Sovereign Wealth Funds: Impacts on U.S. Foreign Policy and Economic Interests' (2008) Hearing before the Committee on Foreign Affairs, House of Representatives, Serial No. 110-190, 18. (The statement made by E. Truman)

[135] E. Truman, 'Sovereign Wealth Funds: New Challenges from a Changing Landscape' (10 September 2008) <http://www.moc.iie.com/publications/papers/truman0908.pdf> accessed 20 January 2016

economy and the fear of national security risk arguably have been increased by the changing global economic order, which is marked by the rise of emerging economies. The expansion of Chinese investment, and the growth of the Chinese economy, as well as the rise of Chinese state capitalism, have even changed the notions of national security in the US. Members of Congress have expressed concerns over investments made by government-controlled entities and investments from China. President Trump has been voicing concern over China and projecting strong opposition to Chinese investment in the US since his election. On 8 November 2017, the Senator submitted a bill, i.e. the Foreign Investment Risk Review Modernization Act of 2017 concerning the reform of the current national security review regime. SWFs, as state-owned investment funds, cannot easily avoid the enhanced and tightened review. However, these measures will increase the uncertainty of US foreign investment policies. It can be argued that in order to reduce the conflicts of interest between maintaining an open market and protecting national security, issues of SWFs are more suitable to be solved under a broader framework, while, it should be noticed that the main problem in the whole picture of international investment herein is not about the risks of SWFs investments, but the psychological barriers of host states or even home states in response to the change of global economic power.

4. Regulations on Foreign Investment in China

China is not a neo-liberal capitalist country and it has a capital control regime in place. Although in most cases, China has loosened constraints on the capital inflows and outflows, it does not have an appropriate regime to safeguard the financial market and attract foreign investment. In recent years, despite a slowdown in economic growth, China, as the largest emerging country, is gradually opening up its market via the market-oriented economy reform, together with corresponding legal reforms. Moreover, the active involvement of China in the global market has resulted in the increase of Chinese outbound trade and investment. Because of a large amount of FX reserve and revenue from the trade surplus held by China, in order to preserve and increase the value of the surplus, China established its SWF, i.e. Chinese Investment Corporation (CIC) in 2007.[136] CIC currently is one of the top ten largest SWFs

[136] Y. Wen, 'Making Sense of China's Excessive Foreign Reserves' (2011) Federal Reserve Bank of St. Louis Working Paper Series 2011-006A <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1753239> accessed 17 January 2016

worldwide and is also one of the largest Chinese SWFs.[137] China, as the home country of CIC, currently, is not only an important capital exporting country, but also a capital importing country. Besides investments made by SWFs in developed countries, SWFs are becoming more interested in emerging markets, e.g. China; thus, China would be a host of foreign SWF investment. In addition to providing sufficient legal support to improve the operation and governance of its own SWFs, the dual role of China requires it to consider the legal response to capital inflows of foreign SWFs.

Compared with the financial market in the UK and the US, China's financial market is not well developed and lacks a sound regulatory mechanism. But China is advancing reforms in various industries, e.g. financial market, market access, and SOEs.[138] These reforms provide China a chance to consider its reaction to the challenges of current global economy and sovereign investment. However, measures adopted by the Chinese government should not only rely on the experiences from developed markets but also consider the actual situation of its own market and legal system. Currently, China has not imposed any special regulation/restriction particularly on sovereign investments. China's existing national security review mechanism does not specially tackle or mention foreign government-controlled investments. Due to the lack of uniformed Foreign Investment Law (the draft has been submitted for review by MOFCOM) national wide, inward foreign investments are regulated by the industry Catalogue and relevant foreign regulations/interim provisions stipulated by foreign investment regulators.

[137] China has four largest SWFs i.e. CIC (2007), Hong Kong Monetary Authority Investment Portfolio (1993), SAFE Investment Company (1997), and National Social Security Fund (2000). SAFE is responsible for managing China's foreign exchange reserves. SAFE Investment Company (SIC) is the subsidiary of SAFE in Hong Kong, which has made purchases in foreign equity investments. It was opened in 1997, which is organized as a privately held firm, while SAFE officials serve on its board.

[138] However, the equity market has been evolving and growing towards a more even mix of investor classes, with institutions such as investment funds, pension funds, insurance companies, corporates, SWFs and Qualified Foreign Institutional Investors (QFIIs) playing a more prominent role. See KPMG, 'China's Capital Markets: the changing landscape' (2011) <https://www.kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Documents/China-Capital-Markets-FTSE-201106.pdf> accessed 19 January 2016

4.1 Existing regulations on foreign investment

4.1.1 Foreign investment regulations

4.1.1.1 General regulation for foreign investment

Regulations on general foreign investment in China are stipulated in the form of provisions, notices and guidelines provided by the State Council or other governmental authorities but not in the form of an Act or a Law enacted by National People's Congress. Foreign investments traditionally were constrained by a case-by-case approval system with the industry guidance.[139] But it is now regulated by filing-for-records plus negative list approach, which was firstly piloted in Shanghai Free Trade Zone (FTZ) in September 2013.[140] The establishment of and subsequent changes to foreign-invested enterprises (FIEs) carrying on business outside 'negative list' are no longer subject to prior approval but a filing-for-records to the Minister of Commerce (MOFCOM).[141] Moreover, The Catalogue for the Guidance of Foreign Investment Industries (the Catalogue) plays a key role in market access and in the negative list reform, which guides foreign investors when they seek the entry into China. In consistence with the market demand and newly released policies, Chinese government has modified the content of the Catalogue from time to time.[142]

Following the abovementioned reform in approval regime, to advance foreign

[139] Under the approval system, foreign investors mush apply for the prior approval from the Ministry of Commerce (MOFCOM) to establish any wholly-foreign-owned subsidiaries and/or Chinese-foreign joint ventures, which also refers to foreign-invested enterprises (FIEs), and for any subsequent changes to and in FIEs on a case-by-case basis.

[140] On September 3, 2016, the 12th National People's Congress Standing Committee passed amendments to the current four main foreign investment laws in China i.e. Law on Chinese-Foreign-Equity Joint Venture Enterprises, Law on Chinese-Foreign-Contractual Joint Venture Enterprises, Law on Wholly-Foreign-Owned Enterprises, and Law on the Protection of Investment of Taiwan Compatriots. On the same day, the MOFCOM issued the draft Interim Measure for Record-Filing Administration for Establishment of and Changes to Foreign-Investment Enterprises for public comment.

[141] J. Zhang and K. Yang, 'China Amends Its Foreign-Investment Law, Officially Reforming Its More Than Three-Decade-Old Foreign-Investment Approval Regime' (22 September 2016) <https://www.reedsmith.com/en/perspectives/2016/09/china-amends-its-foreigninvestment-laws-officially> accessed 30 June 2017

[142] T. Yang, 'China's New Industry Catalogue for Foreign Investment to Take Effect' (10 April 2015) <https://www.cliffordchance.com/briefings/2015/04/china_s_new_industrycatalogueforforeig.html> accessed 30 June 2017; see also R. Yao, 'Update: Latest Guidance Catalogue for Foreign Investment Industries Released' *China Briefing* (20 March 2015) <http://www.china-briefing.com/news/2015/03/20/breaking-news-updated-guidance-catalogue-foreign-investment-industries-released.html> accessed 30 January 2017

investment and negative list reforms, on 28 June 2017, the MOFCOM and China's National Development and Reform Commission (NDRC) released the latest 2017 version of the Catalogue. It provides the guidance for foreign investors concerning the market access of industries in China and introduces a national negative list. The new Catalogue cuts the numbers of special administrative measures restricting foreign investment from 93 to 63 compared to 2015 version. Although China has eased restrictions of emerging tech industries, manufacturing, and provided a greater access for foreign accounting firm and rating services etc., many of these relaxed industries are already dominated by Chinese companies. Restrictions of certain fields are increased, e.g. online media, and several key industries such as banking and securities, healthcare, while telecommunications remain highly restricted, leading to a on-going criticism from the foreign business community over China's closed market.[143]

4.1.1.2 Industry-specific regulations

Investment made in financial market is a controversial issue when discussing SWFs, since SWFs are regarded as a threat to financial stability in several literatures.[144] Regulations of financial market are redeemed necessary under the current economic environment and in current global trend, especially after experiencing the financial crisis. SWF investment in the financial market of China should comply with relevant provisions and requirements.

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[143] A. Koty and Z. Qian, 'China's 2017 Foreign Investment Catalogue Open Access to New Industries' *China Briefing* (11 July 2017) <http://www.china-briefing.com/news/2017/07/11/china-releases-2017-foreign-investment-catalogue-opening-access-new-industries.html> accessed 30 July 2017. However, According to a recent announcement made by Chinese government, China will intend to ease restrictions on foreign ownership of Chinese financial services sectors (e.g. commercial banking, securities and futures firms, asset management and insurance). The Vice-Minister of Finance Zhu Guangyao said China would lift the restrictions on foreign equity stakes in securities and futures firms and funds management company from generally 49 % to 51% ownership limit and the limits would be completely removed after three years (transition period). China will also eliminate the current ceiling on ownership of a Chinese commercial bank or financial asset management company (20 % individual ownership limit by a single foreign investor and 25% aggregate ownership limit for total foreign ownership of such companies). China intends to provide 'equal treatment' policy for foreign investors i.e. foreign investors will be treated the same as Chinese domestic investors when investing in Chinese commercial banks and Chinese financial asset management companies. This announcement indicates that subject to certain transition periods, China will allow foreign investors to own a majority of and eventually a 100% stake in many Chinese financial institutions. For more information, see G. Wildau and H. Lockett, 'China Pledges to Open Finance Sector to More Foreign Ownership' *Financial Times* (10 November 2017) <https://amp.ft.com/content/d4a85422-c5d5-11e7-b2bb-322b2cb39656> accessed 15 November 2017

[144] Beck and Fidora (n 5) in Introduction

Firstly, the Securities Law of the People's Republic of China (2014 Amendment) is formulated to standardise the issuance and trading of securities. The securities law sets up disclosure requirement that can apply to SWFs if SWFs invest in registered company in China as shareholders. The law requires a listed company to publicly disclose the actual controller of the company, and disclose a considerable change in the holdings of shareholders or actual controllers each of who hold or controls no less than 5% of the company's shares.[145]

Secondly, investments made in banking and insurance industries are restricted with the shareholding ceiling.[146] But the threshold that does not exceeds 20% or more would not be a restriction on SWFs portfolio investments as their investments in portfolio companies are usually below 10%. Thirdly, the M&A conducted by foreign a investor is regulated by the *Provisions of the Ministry of Commerce on M&A of a Domestic Enterprise by Foreign Investors*.[147] This Provision provides the general requirements and treatment of foreign investors when they takeover or acquire a domestic enterprise.[148]

In addition, to avoid or restrict SWFs from gaining the control of listed companies in China, the Qualified Foreign Institutional Investor Program (QFII) could be a suitable choice to limit the shareholding ratio.[149] The QFII regime in China is settle down by *the Provisional Measures on Administration of Domestic Securities Investments of Qualified Foreign Institutional Investors*. It is promulgated for the purpose of

[145] Securities Law of the People's Republic of China, Article 66 & 67.

[146] In terms of Bank, shares of a single overseas financial institution and related parties under its control or joint control as the originator or strategic investors shall not exceed 20% in a single Chinese commercial bank; total share of multiple overseas financial institutions and related parties under its control or joint control as the originator or strategic investors shall not exceed 25%.

[147] It revised and replaced the previous Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors.

[148] According to Article 9 of the Provisions, if the contribution made by a foreign investor to the registered capital of the foreign investment enterprise established after the merger or acquisition is more than 25%, such enterprise shall be treated as a foreign investment enterprise.

[149] More discussion on the QFII program in China, see K. Robinson et al., 'The Qualified Foreign Institutional Investor Program in China- Recent Developments, New Opportunities and Ongoing Challenges' (2013) 20 (2) The Investment Lawyer 1; see also PWC, 'Qualified Foreign Institutional Investors (QFII) Brochure' (August 2012) <https://www.pwc.de/de/kapitalmarktorientierte-unternehmen/assets/fuer-qualified-foreign-institutional-investors-oeffnet-sich-die-tuer-zu-chinas-kapitalmarkt-allmaehlich.pdf> accessed 20 January 2016. See also Ernst & Young, 'Investing in Chinese Securities Market through the QFII Scheme' (2013) <http://www.ey.com/Publication/vwLUAssets/QFII_2013_en/$FILE/QFII-Scheme_en.pdf> accessed 20 January 2016

governing QFII investments in China's securities market and promoting the development of China's securities market. A qualified investor is approved by the China Securities Regulatory Commission (CSRC) and is granted an investment quota with the Foreign Exchange Registration Certificates by the State Administration of Foreign Exchange (SAFE).[150]

However, instead of imposing more restrictions on investments, currently, China has significantly expanded foreign access to its stock market in recent years.[151] Chinese government currently has removed the ceiling on capital market investments for international SWFs and central banks.[152] Previously, a QFII institution can receive a proved quote (maximum $1 billion) to invest. According to revised regulations by SAFE, SWFs, central banks, and monetary authorities can exceed the US $ 1 billion limit set for other QFII.[153] Moreover, Chinese government has issued rules on overseas investment in the interbank bond market in China via the mainland-Hong Kong bond connect program. Qualified overseas investors (including SWFs) can purchase bonds in the interbank bond market and the application process is changed from approval to registration.[154] It can be seen from the mentioned regulations that the Chinese government intends to impose fewer restrictions on foreign SWFs and provide a relative open environment for SWFs.

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[150] According to the Article 20, shares held by each QFII in one listed company should not exceed 10% of total outstanding shares of the company; total shares held by all QFII in one listed company should not exceed 20% of total outstanding shares of the company.

[151] G. Wildau, 'China Widens Foreign Access to Domestic Bond Market' *Financial Times* (4 May 2015) <http://www.ft.com/cms/s/0/41502188-f22d-11e4-b914-00144feab7de.html#axzz3z6Tj4P3T> accessed 20 February 2016

[152] 'China Scraps QFII Limit on Sovereign Funds, Central banks' *Bloomberg* (17 December 2012) <http://www.bloomberg.com/news/articles/2012-12-17/china-scraps-qfii-limit-on-sovereign-funds-central-banks> accessed 20 February 2016

[153] SWFI, 'China Removes QFII Ceiling for Sovereign Wealth Funds and Central Banks' (swfinstitute.org, 15 December 2012) <http://www.swfinstitute.org/swf-news/china-removes-qfii-ceiling-for-sovereign-wealth-funds-and-central-banks/> accessed 20 February 2016

[154] In July 2015, People's Bank of China (PBOC) released "Notice on Foreign Central Banks, Monetary Authorities, International Financial Organisations and Sovereign Wealth Funds to invest in the China Inter-bank Bond Market using RMB Fund" (2015 PBOC Notice) [《中国人民银行关于境外央行、国际金融组织、主权财富基金运用人民币投资银行间市场有关事宜的通知》（银发［2015］220 号）]. In February 2016, PBOC released Announcement [2016] No. 3 concerning "Investment of Overseas Institutional Investors in the Inter-bank Bond Market" [《中国人民银行公告［2016］第 3 号》]. See 'Investment Regulation – China- China Interbank Bond Market' (17 October 2016) <http://www.clearstream.com/clearstream-en/products-and-services/market-coverage/asia-pacific/china/investment-regulation---china---china-interbank-bond-market/83656> accessed 30 June 2017

4.1.2 Antitrust and national security regulations

In addition to the general restriction of market access, there are other regulations in China to maintain the public interests and the healthy development of market economy. For the competition issues, the Anti-Monopoly Law of the People's Republic of China applies to both local and foreign investors. This Law is enacted for the purpose of preventing and curbing monopolistic conducts, protecting fair market competition, and restricting the concentration of business operators that may have the effect of eliminating or restricting competition. It aims to reduce the possibility of foreign and local investors to use their prominent status or advantages in terms of information collection compared to other private investors. But it does not concern critical industries or critical infrastructure in relation to national and economic security.[155]

Foreign investments, M&A in particular, may face the security review in China. The National Security Law (2015) sets the scope of national security, i.e. the threat to China's government, sovereignty and national unity as well as its economy,[156] society, and cyber and space interests.[157] The Law imposes restrictions and scrutiny on foreign activities in China on national security grounds but it needs to be clarified through implementing regulations. Before the Law came in to force, foreign M&A was reviewed by national security review committee, led by MOFCOM and NDRC, according to a Notice released by MOFCOM. *The Notice on the Security Review of Foreign M&A of Domestic Enterprises* includes specific procedures, more regulatory hurdles, and possible barriers to approvals for foreign investors.[158] The security review process, which took effect on 5 March 2011, apply to all foreign investors that conduct M&A in domestic enterprises in relation to national security as defined in the notice. Specifically, foreign investors that would become the controlling shareholder

[155] Article 31 of the Anti-Monopoly Law of the People's Republic of China. According to Article 31, where a foreign investor participates in the concentration of business operators by merging or acquiring a domestic enterprise or by any other means and the national security is involved, besides the examination on the concentration of business operators according to this Law, the examination on the national security shall also be conducted according to the relevant provisions of the State.

[156] According Article 59 of the National Security Law, those foreign investments that influence or possibly affect national security should be reviewed.

[157] 'China's New National Security Law' (7 July 2015) <http://www.natlawreview.com/article/china-s-new-national-security-law> accessed 20 February 2016

[158] C. Kahler, 'Foreign M&A in China Face Security Review' (1 April 2011) <http://www.chinabusinessreview.com/foreign-ma-in-china-face-security-review/> accessed 20 February 2016

or the actual controller of a domestic enterprise must submit an application to the MOFCOM for a general review process, which can last up to 30 business days. In 2005, China's State Council issued regulatory measures providing for an enhanced national security review regime that affects foreign investors in FTZs.[159]

However, in China, the national security regime is not supported by rules in the form of Law but Notice or Provisions. The draft of China's Foreign Investment Law contains chapters that deal with national security review on foreign investment.[160] It intends to establish a Joint Committee composed by the NDRC and MOFCOM under the State Council, which conducts national security review. This draft lists the impacts on information and network security, economic stability, and public order among others, making the notion of 'national security' very comprehensive. The main purpose of the law is to boost the Chinese economy with the capital and management of foreign investors.[161] (Chapter six provides further discussion on Chinese regulations.)

4.2 Comments on existing foreign investment regime in China

Foreign direct investment and the essential role it plays in financing of national economies, especially those in the developing and emerging countries, have received a great deal of attention in international business. Among many developing countries that seek economic growth via attracting foreign capital inflows, China has been an attractive destination during the past decades.[162] Many large Western multinational firms have made major investments in China.[163] The basic framework of China's foreign investment regulation and policy has been developed step-by-step owing to the promotion of open-door policy and economic development, which encourage

[159] Linklaters, 'National Security Review of Foreign Investment Further Developed in China's Free Trade Zones' (1 July 2015) <http://www.linklaters.com/pdfs/mkt/shanghai/A30225228.pdf> accessed 20 February 2016

[160] 中华人民共和国外国投资法（草案征求意见稿）[Foreign Investment Law (Exposure Draft) of the People's Republic of China] (promulgated by MOFCOM, 19 January 2015)

[161] Y. Bian, 'A Revisit to China's Foreign Investment Law' (2015) 8(2) J. East Asia Int'l L. 447.

[162] A. Yaprak and Y. Xiao, 'Foreign Direct Investment Growth in China: Implications for Politics, the Economy and Culture' in Svetla Marinova (ed.), *Institutional Impacts on Firm Internationalization* (Palgrave Macmillan, 2015) 86

[163] M. Hitt and K. Xu,'The Transformation of China: Effects of the Institutional Environment on Business Actions' (2015) 2(6) Long Range Planning 2

inbound foreign investment.[164] Changing/improving to a more capitalistic and open market system requires the appropriate policies and regulations to accept, allow and encourage participations in an open market. The Chinese government is implementing policies to liberalise the operation of market and the economy. Maintaining the market stability and public interests are also considered under the on-going reforms. Those criticise the restriction of China's foreign regulatory regime would see a progress in current reforms and the attitude of Chinese government towards foreign investment.

However, questions may arise with regard to whether the current regulatory framework is sufficient to cover potential issues caused by foreign investment and whether the conflicting interests of attracting foreign investment and protecting the national security have been balanced in China. In light of the analysis of current regulations and policies, China has a regulated investment structure and review process. Drawing upon the concept of 'national security', it has added an extra case-by-case review of certain foreign acquisitions on the basis of a 'national security' test. The on-going legislative reform in China suggests that China is trying to balance the interests of open market and national security concerning foreign investment. But the fear of foreign investors would be the market access in China and a level playing field in this typical state capitalist jurisdiction.

Since Chinese companies have expanded their global footprints and Chinese SWFs have actively engaged in the outbound investment, these Chinese investors may encounter different requirements and treatments in host countries. The regulation in China to deal with foreign investment may also have impacts on the treatment that Chinese SWFs may receive in counterpart country. Several countries receiving Chinese investment are considering and underlining the principle of reciprocity.[165] Accordingly, to certain degree, China needs to relax restrictions of foreign investments and open its market to foreign capital. National security is indeed important to each state, and protecting the legitimate national interest is necessary. However, if the concept of national security is too broad to implement and the process

[164] Bath (n 8) 6 in Introduction
[165] States should only provide access for foreign investments if their own investors have reciprocal access to countries where investments originate.

is opaque, though, there may be a concomitant undermining of legitimacy,[166] and may result in the abuse of discretion. Therefore, in China, the open market policy needs to proceed, and the legitimate national interests should be protected via a due process with unambiguous regulations.

Chapter conclusion

Currently, foreign investment is mainly regulated by unilateral measures. There is no doubt that SWF investment inevitably should comply with regulations of each country they invest in. As mentioned in Chapter two, the most important legal relation this thesis concerns is the relation between SWFs and host countries. Whether SWF investment will be successful or not mainly depends on the threshold set out by host countries. Since different countries have different cultures, legal systems, and public policies as well, foreign investment regulations/policies may vary from country to country. No one could intervene in the domestic economic arrangements and domestic affairs of other state except for the commitments or obligations set in the treaty-based international law or customary international law.

The top destinations for foreign investment are the US, EU and China globally, which are also major destinations of SWF investment. The EU member states, e.g. the UK, Germany, and France have attracted a large amount of foreign investment. Among EU member states, the UK is the number-one destination for FDI and London is an important centre for SWF investment. This thesis briefly examined the political attitudes and legal responses in selected developed economies, which suggested various attitudes and policies towards SWF investment. Some of them welcome SWF investment with fewer/no restrictions while others try to impose additional limitations and requirements on SWFs. This research further analysed regulations in three selected countries, i.e. the UK, US and China, and compared their relevant foreign investment regulations with regard to SWF investment.

In the UK, the current regime suggested that UK adopts an open policy towards foreign investment. The portfolio investment of SWFs does not fall within its disclosure requirements and shareholding quota limitations, unless their investments

[166] O' Brien (n 10) 1249 in Introduction

exceed certain threshold or they intends to take the control of the target company. These requirements do not differentiate foreign investors from local investors. If SWF investment poses risk to or undermines public interests or sensitive sectors in the UK, the Enterprise Act authorises the government to block such transaction on the ground of national security/public interest. But it mainly focuses on the implication of competition issues rather than critical infrastructure. The UK's regulatory measures are also affected by the EU law. The principle of free movement of capital stipulated in TFEU is an important rule to address EU investments and non-EU foreign investments. But restrictions based on the legitimate public interests may not be regarded as discordance under the TFEU. The 'golden share' provision was concerned for the incompatible with EU law, and the EU suggested its preference to address issues of SWFs via best practices at the multilateral level. The legal response in the UK to SWF investment is similar to those to other local and foreign investors, and no additional restriction has been implemented. However, within the EU, there is an increasing backlash against foreign investment in strategic assets, especially those with state-owned or foreign government background.

In the US, it is evident that measures adopted by the US government have become much more strict among developed countries and it has imposed additional requirement for sovereign investors via legislative reform. The US concerns every transaction involving government background/foreign government. SWFs investments are regulated by the industry-specific regulations if they undertake M&A or their shareholdings exceed certain ceiling. These regulations apply to SWFs investments are in the form of shareholding ceiling and transparency requirements, if only SWFs pursue the control of the target company. The CFIUS executes its authority to investigate transactions conducted by foreign government-controlled investment (foreign government controlled transaction should follow a 45 days investigation period compared to general review process for 30 days). Practices suggested the US' attempt to broaden the jurisdiction of CFIUS and also demonstrated the increasing number of blocked transactions made by Chinese investors (particularly state-owned or state-backed investors) for national security reason. Nevertheless, this thesis holds the view that the current regulatory regime in the US is sufficient to deal with issues of foreign investment and what should be improved are the concept of important terms, the transparency of the review process

as well as due process. It must ensure the fair treatment of foreign investment, but not direct an over-focus on the state-owned background and the origin of foreign investment.

In China, various regulations have been enacted or have existed to regulate foreign investments, especially the restrictions of market access, while the on-going legislative reform has suggested China's open policy for qualified foreign institutional investors. But the majority of existing regulations of foreign investment are in the form of provision, notice but not law or act. Detailed implementation provisions need to be provided. The most relevant regulatory measure to SWFs portfolio investments in securities and bond market is the QFII regime. Under this regime, China has removed certain limits for SWF investment, which suggests a positive attitude towards SWFs. For the potential national security concern, China has its national security review. A committee led by MOFCOM and NDRC is responsible to review foreign M&A transactions. The draft Foreign Investment Law emphases the review of those foreign investments that pose risks and threats to the national security of China. More specific applicable measures and implementation provisions can be found in the draft of Foreign Investment Law. If it comes into force, it will be a significant step for foreign investment regulation in China. Chinese policies and regulations suggested the consideration and resolution of the Chinese government to address the conflicting interests between attracting foreign capital and maintaining national security.

The guarantees afforded to foreign investors/investments must not jeopardise the States' right to regulate legitimate interests. In some areas of investments, public interests of the state are at stake, while burdensome restrictions or unnecessary limits imposed on SWF investment may lead to the rise of protectionism and divestment of SWFs, thus in turn undermining the domestic economy of host countries. Moreover, the deserved rights and protections of SWFs are also important. If no consensus and mutual understanding were reached at a broader level, each country may adopt any measure it likes to tackle SWFs issues. Therefore, the regulatory response under the international level is necessary.

CHAPTER 4 INTERNATIONAL REGULATIONS ON SOVEREIGN WEALTH FUNDS INVESTMENT

Chapter Introduction

SWF investments representing the rise of state capitalism have led several leading developed countries to enhance their capacity to better control and supervise proposed investment in sensitive areas made by sovereign investors. However, an uncoordinated series of unilateral measures adopted by host countries may easily result in far-going protectionism. Moreover, it may result in increasing compliance cost and drive away foreign capital inflows, and also may fragment the market and undermine the economy. Although domestic law acts as a concrete part in the regulatory framework of foreign investment, IIAs have increasingly played an important role.[1] Since state capitalism is regarded as a global challenge, it is necessary to analyse it under the international framework. A consensus reached at international level could help take the interests of both sides into account, create a level playing field and avoid over-regulation that results from emerging nationalist and protectionist pressures.

It is BITs that today constitute the driving force of the development of international investment law, which is the major instrument to promote and govern cross-border investment. Moreover, a growing number of FTAs contain investment chapter/provision. Besides bilateralism supported by BITs, the boom of mega-regional agreements suggests a trend of multilateralism.[2] Many international institutions have also actively participated in shaping the global governance of foreign investment.

This chapter aims to find out whether the existing international regulations could address the potential issues of SWF investment. It firstly examines the bilateral

[1] IIAs exist in three main forms: bilateral investment treaties (BITs) signed by two states; regional investment treaties signed by groups of states within a single region; and chapters of integrated trade and investment agreements that can be signed at the bilateral or regional level. See J. Chaisse, 'TPP Agreement: towards Innovations in Investment Rule-making' in C. L. Lim and others (eds.) *The Trans-Pacific Partnership: A Quest for a Twenty-Fist Century Trade Agreement* (CUP 2012) 147

[2] P. Yu, 'TPP and Trans-Pacific Perplexities' (2013) 37 Fordham Int'l LJ 1129, 1136

regulations in relation to SWF investment. Typical provisions in BITs are analysed. And a bilateral arrangement concerning SWF investment is assessed. It then assesses the multilateral initiatives and relevant international hard law regulations. This section mainly analyses the regulations under the WTO framework, and the concluded text of a regional-multilateral IIA, i.e. TPP and the temporary text of an on-going IIA negotiation, i.e. TTIP. Thirdly, it examines the existing international soft law regulations provided by the IMF and OECD to address issues of SWF investment. The final section compares and assesses these existing international regulations to see the advantages and weakness of each approach in addressing SWFs relevant issues.

1. Bilateral Agreements Concerning SWF Investment

Currently, a gap in the global economic architecture is the absence of a multilateral agreement on foreign investment. Although the OECD made efforts to draft a multilateral agreement on investment (MAI), no agreement was ever concluded.[3] The international investment regulatory framework functions via IIAs, particularly BITs, while newly concluded FTAs increasingly contain investment chapters. At present, a majority of bilateral treaties do not distinguish between investors on the basis of ownership or explicitly mention SWFs. But these treaties can influence measures taken by host countries and provide certain investment protection for SWF investment if they are covered.

1.1 SWF investment under bilateral treaties

Investment treaty law is mainly based on several thousands of BITs that grant investments made by covered investors a number of substantive and procedural protections with several restrictions and exceptions.[4] Firstly, the definitions of 'investors' and 'investment' are key elements that determine the scope of primary beneficiaries of investment treaty protection; hence only covered investors and covered investment are entitled to benefits of these treaties. Secondly, the standard of

[3] Y. Zhang and R. Wang, 'The Role of Foreign Direct Investment Flows and A Possible Multilateral Agreement' in Richard Baldwin and others (eds), *A World Trade Organization for the 21st Century: The Asian Perspective* (Edward Elgar Publishing 2014) 412. See also R. Bubb and S. Rose-Ackerman, 'BITs and Bargains: Strategic Aspects of Bilateral and Multilateral Regulation of Foreign Investment' (2007) 27(3) Int'l Rev. L. & Econ. 291

[4] A. Newcombe and L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009); see also Reinisch (n 26) in Ch.3

investment treatment granted reflects the level of liberalisation and foreign policy of the contracting parties. Once SWFs are regarded as qualified investors, and the forms of their investments are covered, certain substantive treatments would be awarded according to each agreement. Thirdly, some old BITs and newly concluded FTAs contain the competitive neutrality provisions, which attempt to ensure the fair competition or a level playing field between government-controlled entities (or SOEs) and private-owned enterprises (POEs). Fourthly, the general exception clauses, and the 'security exception' clauses are incorporated into several IIAs. These clauses are used to relieve host countries from treaty obligations for legitimate measures or good faith measures taken to protect the security or public interests.

1.1.1 Definition of investors and investments

From the perspective of a capital exporter, the definition of investor identifies the group of investors that a Party seeks to protect, while from the perspective of a capital importing country, it indicates the investors that a Party wishes to attract.[5] Some treaties also include "denial of benefit clauses" allowing exclusion of investors in certain categories that a Party would not wish to extend treaty protection.[6] The definition of 'investor' plays an important role in determining the types of investors are covered in the treaty, in particular in this thesis examining whether SWFs are specifically covered.[7] Similarly, the definition of 'investment' is important in determining which type of investments is protected. Since a great variety of assets are covered in the definition of investment, especially in IIA concluded by the US, the definition is regularly broad enough to cover portfolio and direct investment.[8]

A majority of bilateral treaties do not distinguish between investors on the basis of ownership,[9] most of which do not explicitly mention state entities

[5] A. Van Aaken, 'International Investment Law Between Commitment and Flexibility: A Contract Theory Analysis' (2009) 12(2) JIEL 507

[6] This provision gives the host states the authority to carve-out shell companies from treaty protections: investors owned by or under the control of investors (nationals) of a third country, or when these investors do not have any substantial activities in the country of corporation.

[7] Some treaties do not define the term "investor", but an equivalent term such as "nationals" and "companies" were used.

[8] In term of SWFs investment, the definition of investment in many IIAs usually includes shares, stocks and other form of equity participations in and bonds, debentures of an enterprise.

[9] For example, in the 2012 US Model BIT, the definition of enterprise does not distinguish private investors and government-controlled entities but includes all legal entities. The enterprise means "any entity constituted or organized under applicable law, whether or not for profit, and whether privately or

(government-owned or -controlled entities) or use similar wording,[10] let alone SWFs. However, treaties that explicitly include state entities are clearly rising, and recent treaties tend to refer to state entities regularly (and even the government itself).[11] Even some treaties explicitly mention SWFs.[12] It should notice that since most existing treaties were concluded/drafted before the prevalence of SWFs. The relative infrequency of explicit reference to state entities or SWFs may reflect the fact that at the time of drafting treaties sovereign investors have not attracted much attention.

In most cases, where treaties make it clear to state entities, SOEs are frequently mentioned rather than make explicit reference to SWFs.[13] So far, very few BITs specifically refer to SWFs, which are limited to those treaties concluded by countries with large SWFs, e.g. Saudi Arabia, Kuwait. These countries tend to include explicit references to state entities in the definition of 'investor'.[14] For example, Saudi Arabia-Singapore BIT (2006) and Saudi Arabia-India BIT (2006) provide that, in respect of Saudi Arabia, the term "investor" means 'the Government of the Kingdom of Saudi Arabia and its financial institutions and authorities such as the Saudi Arabian Monetary Agency, public funds and other similar governmental institutions existing

governmentally owned or controlled, including a corporation, trust, partnership, sole proprietorship, joint venture, association, or similar organization; and a branch of an enterprise." And investor of a Party means "a Party or state enterprise thereof, or a national or and enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party". Here, the state enterprise means "an enterprise owned, or controlled through ownership interests, by a Party." As a typical multilateral treaty, the Energy Charter Treaty defines an investor as a natural person or a company, according to Article 1 (7). This definition does not refer to state ownership. The MIGA Convention also clearly includes non-privately owned investor. Article 13 (a) (iii) of the MIGA Convention provides that an eligible investor is natural person or juridical person, whether or not it is privately owned, if it operates on a commercial basis.

[10] K. Sauvant, 'Driving and Countervailing Forces: A Rebalancing of National FDI Policies' in K. Sauvant (eds.) *Yearbook on International Investment Law and Policy* (New York: OUP 2009) 215

[11] For example, five IIAs concluded in 2013 explicitly cover state entities. These are Canada-Benin (BIT), Canada-Tanzania (BIT), Colombia-Korea (FTA), Japan-Mozambique (BIT), and Japan-Saudi Arabia (BIT).

[12] State entities herein include following three categories: (i) state-owned enterprises (SOEs), (ii) state-owned investment funds such as SWFs and (iii) a government itself acting as investor. See J. Low, 'State-controlled Entities as "Investors" under International Investment Agreements' (2012) Columbia FDI Perspectives No.80 <http://ccsi.columbia.edu/files/2014/01/FDI_80.pdf> accessed 30 September 2016

[13] Some IIAs include the government itself. For example, the government qualifies as an investor in Czech Republic – Kuwait BIT (1996), Belgium- Saudi Arabia BIT (2001), Kuwait-Netherlands BIT (2001), and Kuwait -Korea BIT (2004). But including the government itself as an investors caused concerns with respect to national security issues. The US, Australia, and Canada frequently include SOEs explicitly in the definition of investor.

[14] Y. Shima, 'The Policy Landscape for International Investment by Government-controlled Investors' (2015) OECD Working Papers on International Investment 2015/01, 15 <http://www.oecd.org/investment/investment-policy/WP-2015-01.pdf> accessed 30 September 2016

in Saudi Arabia.' The definitions of investor for Singapore and India have no such references. In Kuwait-Canada BIT (2011) the term of "investor of a Party" includes 'in the case of the State of Kuwait, the Kuwait Fund for Arab Economic Development and the Kuwait Investment Authority are investors of Kuwait.'

Although it may be reasonably assumed that state entities are covered by treaties unless explicitly excluded, the fact that most treaties do not mention state entities (and even SWFs) would give rise to some uncertainties with respect to whether state entities are covered. Moreover, these uncertainties would also be extended to treaty-based arbitration, since questions may still remain concerning whether they are entitled to claim protection before international arbitration. However, the legal standing of state entities in the treaty protection has not yet been tested frequently in the investment arbitration cases. In addition, the need for clarification in the future may be exacerbated, since countries have increasingly started to include an explicit coverage of such investors and there is a general increase in the specificities of these investors. Although China did not expressly include state entities or SWFs in the definition of investors in its previous BITs, in recent Chinese IIAs, government-controlled or -owned investors are now included as falling within the scope of treaty protections.[15] Therefore, it is important to consider whether SWFs or state entities should be covered by investment treaties for the purpose of treaty protection and for regulatory flexibility of host countries.

1.1.2 Treatment of foreign investment

Once investors and investments are covered by treaties, they will be granted with certain substantive protection, especially several standards of investment treatments provided in BITs. Besides BITs, some FTAs also award these treatments, e.g. US-Australia FTA, EU-Canada FTA (CETA), and China-Australia FTA (ChAFTA) (2015) in both trade and investment chapters. SWFs may claim certain standards of treatment during the pre- or post-establishment phrase according to relevant treaty provisions.

[15] For example, according to the Article 9.1 (b) of China-Australia FTA (2015), the definition of enterprise includes the wording of 'whether privately or governmentally owned of controlled'. Same wording can be found in Article 12.1 of China-Korea FTA (2015), Article 135 of China-New Zealand FTA

As the absolute standard of treatment,[16] the fair and equitable treatment (FET) plays a prominent role in the international investment law, and it is currently the most important standard that was widely claimed and tested in investment disputes.[17] FET generally refers to the obligation that requires not denying justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.[18] There is no consistent opinion reached on the FET. It is usually regarded as an independent standard of treatment for international law, or high-level standard of treatment not lower than regulations under the international law, or the minimum standard under the customary international law.[19]

No matter adopting which kinds of interpretation, FET requires not to implement discriminatory conducts and arbitrary measures, while it does not require treatment in addition to or beyond what is required by that standard, and does not create additional substantive rights. It is usually regarded as the minimum standard of treatment (MST) for foreign investors/investments, especially in IIAs concluded by the US. In reality, the inherent and real purpose of MST is to give the minimum protection to foreign investors when the NT and MFN treatment are below the expectation of investors or lower than expected fair treatment. The wide application of FET has also posed risks and uncertainties, since the expensive interpretation of FET by arbitrator results in the lack of predictability in regard to whether an action will breach this obligation, and the undetermined threshold of FET also challenges the decision-making of the

[16] It is an 'absolute', 'non-contingent' standard of treatment, i.e. a standard that states the treatment to be accorded in terms whose exact meaning has to be determined, by reference to specific circumstances of application, as opposed to 'relative' standards that define the required treatment by reference to the treatment accorded to other investment. See A. Fatouros, *Government Guarantees to Foreign Investors* (Columbia University Press 1962) 135-141, 214-215. See also OECD, 'Fair and Equitable Treatment Standard in International Investment Law', (2004) OECD Working Papers on International Investment 2004/3, 2 <https://www.oecd.org/daf/inv/investment-policy/WP-2004_3.pdf> accessed 30 September 2016

[17] C. Schreurer, 'Fair and Equitable Treatment in Arbitral Practice' (2005) 6 J. World Investment & Trade 357

[18] Subedi (n 50) 66 in Ch.2

[19] However, according to some scholars, FET and the international minimum standard are distinct and autonomous. "Unlike the FET, the international minimum standard did not originate as a treaty clause: its existence as a customary rule has long been debated between two different groups of States". See M. Valenti, 'The Protection of General Interests of Host States in the Application of the Fair and Equitable Treatment Standard' in G. Sacerdoti (ed.), *General Interests of Host States in International Investment Law* (CUP 2014) 29. The US adopted the FET as minimum standard of treatment in its 2012 Model BIT. The Article 5 clearly expresses that "Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security."

government.[20]

NT and MFN treatment are the relative standards of treatment, which means that the status of foreign investors is equal to domestic investors (in like circumstances) or not lower than investors from a third country.[21] NT is most relevant to the market access of SWFs, as the first threshold SWFs may encounter is during the pre-establishment phrase. This treatment may provide SWFs a preferential treatment, according to which they can be treated equally to local investors. Under this situation, if no exceptions were prescribed in the treaty, all investors at any stage have no legal difference.[22] Those SWFs sponsored by China and Russia may intend to claim NT while their investments sometimes are restricted or suspected because of the background of their home countries. In spite of this, the restriction during market access stage can be regarded as a kind of discrimination to SWF investment.

However, NT, which is applied to avoid the discrimination based on nationality, is a relative or contingent obligation.[23] At present, NT has not been widely applied to foreign investors/investment during the pre-establishment phase. Even in US Model BIT, there are exception clauses when applying this treatments or provisions, with the wording of 'self-judging' or 'in like circumstance'. Meanwhile, since the NT 'touches upon economically and politically sensitive issues,'[24] it might be the most difficult one to achieve. The MFN clause is also a source of international obligations that allows 'borrowing' treaty provisions from other treaties or possibly State practice regarding third States to claim a better treatment.[25]

In most BITs or FTAs, NT and MFN are awarded to investors and investments in the pro-establishment phase rather than pre-establishment phase, while the investment liberalisation provisions were increasingly included in IIAs, which were strongly

[20] J. Billiet, *International Investment Arbitration: A Practical Handbook* (Maklu 2016) 106
[21] T. Grierson-Weiler and I. Laird, 'Standards of Treatment' in P. Muchlinski et al. (eds.) *The Oxford Handbook of International Investment Law* (OUP 2008)
[22] Newcomb and Paradell (n 4) 289
[23] A. Bjorklund, 'National Treatment' in A. Reinisch (eds.) *Standards of Investment Protection* (OUP 2008) 29
[24] UNCTAD, 'National Treatment' (1999) IV UNCTAD/ITE/IIT/11 15 <http://unctad.org/en/Docs/psiteiitd11v4.en.pdf> accessed 5 October 2016
[25] The very nature of the MFN principle is contrary to a strict application of the reciprocity principle so cherished by States in their traditional diplomatic relations. See A. Ziegler, 'Most-Favoured-Nation (MFN) Treatment' in A. Reinisch (eds.) *Standards of Investment Protection* (OUP 2008) 65

supported and influenced by the US practice. It also affected the Canada Model BIT. China is negotiating a BIT with the EU, and the US, by adopting a negative list plus pre-establishment NT. But although the extension of NT and MFN to market access becomes a widely recognised practice, these treaties cannot provide a sufficient protection for SWF investment since obligations and requirements in these treaties are not higher than domestic regulations.

1.1.3 Fair competition provisions

Competitive neutrality (CN) provision or arrangement, introduced by several OECD countries, aims to mitigate the competitive advantages of state-owned entities. It could also be used to tackle the issues of SWF investment. It should be noticed that although some regulatory frameworks specifically refer to state-owned entities, others are ownership-neutral. Some IIAs include provisions that attempt to ensure a fair competition between SOEs and POEs, or specifically mention the principle of CN.[26] These provisions can be usually found in some relatively old BITs concluded by the US, and in the competition or state enterprise chapters of FTAs concluded since 2000s, as well as in relatively new FTAs concluded by the EU.

In terms of old BITs concluded by the US concerning the competition between state-owned investments and privately owned investments, the US-Panama BIT (1982) is an example of early treaty practice.[27] The US-Senegal BIT (1983) contains provisions expressing that 'the conditions of competitive equality should be maintained where investments owned or controlled by a Party or its agencies or instrumentalities are in competition,' within the jurisdiction of a Party, 'with privately owned or controlled investments of nationals or companies of the other Party.'[28] Article II (6) of both the US-Congo BIT (1984) and US-Turkey BIT (1985) have similar expressions. Apart from including similar provisions, the Article II (6) of the

[26] See P. Kowalski and K. Perepechay, 'International Trade and Investment by State Enterprises' (2015) OECD Trade Policy Paper No.184 <http://www.oecd-ilibrary.org/docserver/download/5jrtcr9x6c48-en.pdf?expires=1509575023&id=id&accname=guest&checksum=891FDF310A46ADA1B2768B6202B826E4> accessed 5 October 2016; T. Kawase, 'Trans-Pacific Partnership Negotiations and Rulemaking to Regulate State-Owned Enterprises' (29 July 2014) <http://voxeu.org/article/trans-pacific-partnership-negotiations-and-rulemaking-regulate-state-owned-enterprises> accessed 25 March 2016

[27] US-Panama BIT (1982), Article II (3)

[28] US-Senegal BIT (1983), Article II (7)

US-Bangladesh BIT (1986) expresses that 'the privately owned or controlled investments shall receive treatment which is equivalent with regard to any special economic advantage accorded the governmentally owned or controlled investments.'

Some FTAs also contain competitive neutrality provisions. For example, the Article 12.4 of Singapore-Australia FTA (SAFTA)(2003) states that 'the Parties shall take reasonable measures to ensure that governments at all levels do not provide any competitive advantage to any government-owned businesses in their business activities simply because they are government owned.' Similar provisions could be found in Article 15.4 of Singapore-Korea FTA (2005) and Article 14.5 of Australia-Chile FTA (2008). Article 8.2(b) of the New Zealand and Chinese Taipei FTA (2013) requires the Parties to ensure equal application of competition policies to public and private business activities. Article 15.4 of Australia-Japan Economic Partnership Agreement (2014) provides that 'the parties recognise that seeking to ensure that governments do not provide competitive advantages to state-owned enterprises simply because they are state owned can contribute to the promotion of competition.'

Chapter 12 of the EU-Singapore FTA and Chapter 18 of CETA include provisions to address competition or state enterprises related matters. A notable achievement of the FTA concluded by EU is the Chapter 10 of EU-Vietnam FTA, which provides provisions addressing issues of SOEs. Moreover, the EU-Vietnam FTA explicitly requires no prejudice on the system of state ownership.[29] It deals with the issues of SOEs by encouraging commercial considerations and compliance with internationally recognised standards of corporate governance, as well as increasing transparency.[30]

No matter whether SWFs are regarded as private entities or public entities, SWFs are constrained by the fair competition (between private entities in the market) or competitive neutrality requirements (between private and public entities).

1.1.4 Exception clauses

Although BITs provide a variety of substantive investment protections for foreign

[29] EU-Vietnam FTA, Article 10.3 (1)
[30] EU-Vietnam FTA, Article 10. 4 & 10.5 & 10.6

investors/investments,[31] a great majority of them contain the general or security exceptions of investment protections. These exceptions aim to maintain the public interest and regulatory flexibility of the state. There are usually two models of general and security exceptions in BITs: one follows the approach of Article XX and XXI of the General Agreement on Tariffs and Trade (GATT), and the other is modelled on Article XIV and XIV of General Agreement on Trade and Service (GATS).[32] Occasionally, BITs also make reference to both models, or contain a custom-tailored combination of these two models, or provide a unique exception provision.[33]

These exceptions on one hand are meant to enhance the regulatory flexibility, by allowing host countries to protect the national security or public interest from the risky SWF investment without incurring international liability; on the other, to diminish the degree of investment protection of foreign investors/investments. Therefore, although host countries may be willing to grant the NT during the pre-establishment phase in BITs (e.g. the US BITs), foreign investors cannot assume that they might be subject to the same legal restrictions as local investors. But the use of general exception clauses is not common, and a majority of states do not include such exceptions in IIAs.[34] Whereas, a study notes that these clauses appears in at least 200 IIAs, and most of them are related to specific obligations, e.g. NT, or exceptions for essential security interests, public order, prudential measures or taxation.[35]

However, the degree of this regulatory flexibility would depend on the way that tribunals interpret this provision. Tribunals have yet to interpret the general exception

[31] R. Adlung and M. Molinuevo, 'Bilateralism in Services Trade: Is There Fire behind the (BIT-) Smoke?' (2008) 11(2) JIEL 365

[32] CETA entails two general exception provisions applicable to investment obligations. One of them incorporates GATT Article XX, while the other is modelled on GATAS Article XIV. Both are found in Chapter 32, Article X.02 (1) and (2) of the CETA.

[33] L. Sabanogullari, 'The Merits and Limitations of General Exception Clauses in Contemporary Investment Treaty Practice' (21 May 2015) <https://www.iisd.org/itn/2015/05/21/the-merits-and-limitations-of-general-exception-clauses-in-contemporary-investment-treaty-practice/>_accessed 17 June 2016

[34] The rationale for a general exception clause is to exempt a contracting party from the obligations of the treaty in situations in which compliance would be incompatible with key policy objectives explicitly identified in the agreement.

[35] W. Burke-While and A. Von Standen, 'Investment Protection in Extraordinary Times: The Interpretations of Non-Precluded Measure Provisions in Bilateral Investment Treaties' (2008) 48(2) Va. J. Int'l L. 307

clauses, while in a number of decisions and awards,[36] tribunals have interpreted the security exception in Article XI of US-Argentina BIT (1991). The tribunals hold that since the term of 'essential security interests' is not defined, the requirement for justifying measures as necessary for this term is the same for invoking the plea of necessity in the customary international law. But these interpretations may not provide a reliable indication of their approaches to the general exceptions.[37] Moreover, the interpretation of general exceptions raises particular difficult issues in the case of MST. With respect to the breach of MST (including FET), it is unclear in what circumstances general exceptions would apply. For example, the Article 143 (5) of China-New Zealand FTA (2008) stipulates that the violation of any other article of Chapter 11 (Investment) does not establish that there has been a violation of the FET clause.

The regulatory flexibility is also affected by the treaty drafting. For example, if the contracting parties provide a more comprehensive list of permissible objectives, the clause will grant more regulatory flexibility to a host state. Similarly, vague and lenient language and wording (e.g. self-judging language) offer more leeway to host states. The Article 20 of US Model BIT (2012) (Financial Services) specially stipulates more vague exceptions in the field of financial investment.[38] In close with SWF investment, this language left a considerable leeway to impose special measures on SWFs. On the contrary, the Article 6.12 (4) of the India-Singapore Comprehensive Economic Co-operation Agreement (2005) expressly states that the security exception is non-justiciable, thereby avoiding uncertainties in terms of the interpretation of self-judging language by arbitral tribunals.

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[36] *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005 [CMS]; *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007 [Enron]; *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Award, 28 September 2007 [Sempra]. *Enron Corporation and Ponderosa Assets, L.P. v. Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007 [Enron]

[37] S. Spears, 'The Quest for Policy Space in a New Generation of International Investment Agreements' (2010) 13(4) JIEL 1037

[38] It stipulates that:

> Notwithstanding any other provision of this Treaty, a Party shall not be prevented from adopting or maintaining measures relating to financial services for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system. Where such measures do no conform with the provisions of this Treaty, they shall not be used as a means of avoiding the Party's commitments or obligations under this Treaty.

It is important to clarify that the general exceptions are intended to increase the legal certainty in investment adjudication rather than increase the uncertainty. The expression of the reference to which public interests consideration would be attached, helps host states to ensure that tribunals consider the clear stated or referred rationales of a challenged measure. Moreover, it offers more certainties for foreign investors when they calculating investment costs and the risk of adverse state action at the initial stage.

Due to the uncertainties and exceptions in treaty provisions, whether SWFs can invoke certain treaty protections seems questionable. Firstly, whether SWFs have the legal standing under investor-state dispute settlement (ISDS), especially before the ICSID or whether the issues of SWF investment should be address via a state-state resolution is still under discussion (it will be discussed in chapter five). Secondly, most BITs cover investment in the post-establishment phase and do not secure the market access. But once an investment has been made, investment agreements provide certain standard of protections. Nevertheless, since most concerns around SWFs investments arise when they seek the access to the market, the applicability of many treaty protections to the pre-establishment phase is questionable. Also it will be very difficult for SWFs to show damages if the protective action of the host state is to prevent SWFs from entering the market, unless they have experienced significant expenses when preparing such transaction.

1.2 Special Agreement on Principles for SWF investment

Currently, there is no binding bilateral agreement exclusively to address the issues of SWF investment. However, when talking about the specific agreement between host country and home country of SWFs, a soft announcement or bilateral arrangement cannot be ignored. It is a consensus between a host country (i.e. the US) and two home countries of SWFs (i.e. Singapore with GIC, Abu Dhabi with ADIA). On 20th March 2008, the US Treasury reached the agreement on principles of SWF investment, recipient country inward investment regimes, and efforts to develop best practices with the governments of Singapore and Abu Dhabi.[39] They issued a joint

[39] 'Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi' (20 March 2008)

statement embracing five policy principles of SWF best practices.[40] These principles contain two components: disclosure and governance.[41] They also provided and advocated four principles of countries receiving SWFs investments.[42]

The US government expressed that the government of host states can protect the public against investments that may jeopardise national security, but it makes no sense to deny foreign capitals, including those brought by SWFs investments, or to limit their access to the US market. But some US Congress members worry about the economic power that could be accumulated by the SWFs of Arab states, Russia and China.[43] However, these three countries expressed their interests in an open and stable international financial system in response to SWF investment in this arrangement.

A quasi-agreement or arrangement of a set of voluntary best practices could create a strong incentive among SWFs and host countries to embrace high standards. This effort, which was made before a widely recognised consensus on SWF investment (i.e. GAPP) and OECD guidelines for recipient countries, indicated that at the time of reaching this agreement the US welcomed foreign capital investing in its domestic market and it believed that a mutual understanding could be reached between host country and home country. However, after the release of GAPP and *Guidelines for*

<https://www.treasury.gov/press-center/press-releases/Pages/hp881.aspx> accessed 25 April 2016

[40] Five policy principles for SWFs: investment decisions should be based solely on commercial grounds, make this statement formally as part of their basic investment management policies; greater information disclosure (purpose, investment objectives, institutional arrangements, and financial information-particularly asset allocation, benchmarks, and rates of return over appropriate historical periods); strong governance structures, internal controls and operational and risk management systems; SWFs and the private sector should compete fairly; should respect host country rules by complying with all applicable regulatory and disclosure requirements of the countries in which they invest. ibid

[41] E. Truman, 'A Blueprint for Sovereign Wealth Fund Best Practices' (2008) Peterson Institute for International Economics Policy Brief No. 08-3 <https://piie.com/publications/policy-briefs/blueprint-sovereign-wealth-fund-best-practices> accessed 25 June 2016

[42] Four policy principles for recipient countries: should not erect protectionist barriers to portfolio or foreign direct investment/should ensure predictable investment frameworks; Inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law/should not discriminate among investors; Inward investment policies should treat like-situated investors equally/should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment; Any restriction imposed on investments for national security reasons should be proportional to genuine national security risks raised by the transaction. See (n 39)

[43] 'Bush: It's Our Money to Begin With' (15 March 2008) <http://emirateseconomist.blogspot.co.uk/2008/03/bush-its-our-money-begin-with.html> accessed 25 April 2016

Recipient Country Policies towards SWFs (OECD Guidelines in relation to SWF investment), no new bilateral initiative or official agreement has been made between host country and home country concerning SWF investment. This may suggest that international or multilateral efforts/initiatives may tend to cover issues of SWF investment or it may indicate that host countries prefer to adopt unilateral measures.

2. International Hard Law under WTO framework and Multilateral Initiatives

To assess how hard law and soft law could interact in the global governance of SWF investment, it is necessary to clarify these terms in advance. Generally, the division between the hard law and soft law is whether they are binding. The term 'hard law' has precise legally binding obligations with corresponding authorities to interpret and implement the law (e.g. international trade law, at least formally, comes closest to this type, but it is soft in certain areas).[44] Soft law instruments range from treaties (including only soft obligations), i.e. 'legal soft law', to the non-binding or voluntary resolutions and codes of conduct formulated and accepted by international or regional organisations (i.e. 'non-legal' soft law), to the statement prepared by individuals (in a non-governmental capacity, but claiming to lay down international principles).[45] The international agreements between contracting parties usually are hard law regulations, while the guidelines of international organisations and code of conduct (self-regulation) are soft law regulations. The hard law regulations impose obligations on both host countries and home countries as well as provide the dispute resolution mechanisms (i.e. state-to-state, and investor-to-state). This section assesses the hard law regulations with regard to investment under the WTO framework, followed by analysis of the relevant provisions in failed MAI, and investment provisions in the newly concluded TTP text and draft text of the TTIP negotiation.

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[44] Abbott and Snidal (n 86) in Ch.1

[45] C. Chinkin, 'The Challenge of Soft Law: Development and Change in International Law' (1989) 38(4) Int'l Comp. L. Quarterly 850, 851. Shaffer and Pollack proposed a more comprehensive explanation for soft law in terms of the dimension of obligation, precision, and delegation:

> If an agreement is not formally binding, it is soft along one dimension. Similarly, if an agreement is formally binding but its content is vague so that the agreement leaves almost complete agreement is soft along a second dimension.
>
> If an agreement does not delegate any authority to a third party to monitor its implementation or to interpret and enforce it, then the agreement again can be soft (along a third dimension) because there is no third party providing a "focal point" around which parties can reassess their positions, and thus the parties can discursively justify their acts more easily in legalistic terms with less consequence, whether in terms of reputational costs or other sanctions.

Shaffer and Pollack (n 86) 714-715 in Ch.1

2.1 The WTO framework and investment

Actions of the state with regard to trade and investment may be scrutinised at the WTO, where an SWF of a contract party to treaties under WTO framework.[46] If a state carries out transactions through the legal persons, e.g. SOEs or corporations sharing features of private corporations in formation, operation and compliance with corporate law, it may also be scrutinised.[47] This is because WTO obligations extend to the operation of SOEs or 'state trading enterprises'.

Under the WTO framework, the Trade Related Investment Measures (TRIMs), the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) include certain provisions relevant to international investment, marking an integration of trade and investment. However, these WTO agreements do not specifically deal with the issues of SWF investment. Instead some treaty provisions have a potential impact on the treatment of investment or exception clauses in IIAs. TRIMs provides some regulations of FDI, while it is relatively limited in scope, covering only investment measures with regard to the trade in goods, and it contains a relatively small number of obligations and quantitative restrictions.

The GATS is the only international agreement under the WTO framework that contains legally binding and enforceable rules in relation to investment in services. GATS does not only involve the provisions dealing with cross-border services, but also covers investment in services indirectly with regard to a service provider of one Member through 'commercial presence' in the recipient country. Commercial presence means 'any type of business or professional establishment.'[48] This is the so-called 'Mode 3' of service provision: a foreign service-provider can establish itself in a recipient country to provide services through the acquisition of a juridical person.[49]

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[46] From 1986 to 1994, GATT negotiated its Uruguay Round, which led to substantial, positive results on multilateral agreements. In 1995 it transformed GATT into the WTO, a full-fledged international organization. R. Carbaugn, *International Economics* (Cengage Learning 2008) 190

[47] L. Hsu, 'SWFs, Recent US Legislative Changes, and Treaty Obligations' (2009) 43(3) J.W.T. 451, 457

[48] GATS Article XXVIII (d)

[49] GATS Article XXVIII (d) (i); see also De Meester (n 111) in Ch.3

By requiring the elimination of existing discriminatory measures and prohibition of new discriminatory measures, GATS serves an important role in facilitating capital inflows in the service sector.[50] In the case of SWF investment, when a SWF of a WTO member country invests in a service provider of another member country, any attempt/action to block this SWF investment by imposing protective measures may trigger WTO procedures based on the obligations in GATS. These obligations of member states are based on various commitments or requirements in GATS. For example, it may be based on the MFN and NT (in the post-establishment phase), where a member state is committed not to discriminate between a local company and a foreign company or between companies from different countries; or on specific commitments in the schedules to the GATS as part of the market access principle.[51] In addition, GATS also introduced the general exception and security exceptions,[52] as well as exceptions under its Annex.

For example, under the Annex on Financial Services, the Article 2 (a) provides the prudential carve-out provisions for various reasons. A financial service supplier herein means 'any natural or juridical person of a Member wishing to supply or supplying financial services but the term "financial service supplier" does not include a public entity.'[53] The public entity herein does not include state entities engaged in supplying financial services on commercial terms.[54] Pursuant to this, SWFs undertake commercial investments, which are different from FX reserve, thus SWFs are not public entities.

However, it is important to note that obligations/commitments under the GATS only

[50] Chalamish (n 77) 7 in Ch.2

[51] For example, United States made specific commitments with respect to its financial services sector, which allow SWFs to invest in many of its financial institutions. As for market access commitments, it is reflected in Article XVI (market access) and Article XX (schedules of specific commitments).

[52] The former includes protection of public morals or public order, human and animal health, compliance with laws or regulations etc. The later includes national security, military, fissionable and fusionable materials, and taken in time of war etc. The public order and national security in particular, can be used an excuse for restricting market access. See GATS Article XIV

[53] GATS Annex on Financial Services 5(b)

[54] According to GATS Annex on Financial Services 5(c), the public entity means:
[A] government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, not including an entity principally engaged in supplying financial services on commercial terms; or a private entity, performing functions normally performed by a central bank or monetary authority, when exercising those functions.

apply if SWFs obtain the control of a service provider, whether this company has the nationality of the home country of SWFs as a WTO member. But it does not apply to the portfolio investment of SWFs. National measures to tackle minority participations thus do not fall within in the scope of GATS. Second, GATS includes an exception for the service provided by a sovereign government. The purpose of this exception is to ensure that the public entity can provide services without competing with the private entities. The application of this exception depends, among other factors, on the legal nature of the acquiring entity in any proposed transaction. Since some SWFs are not incorporated as a separate legal entity, the 'public entity' exception may apply. But if SWFs undertake commercial activities, this would not apply. Furthermore, WTO members can list specific reservations or limitations on specific commitments as part of their obligations of GATS. Each investment made by a SWF would be analysed separately.

2.2 Multilateral instruments on SWF investment

Unlike the system of trade liberalisation under the WTO, there has never been a comprehensive, multilateral agreement on international investment.[55] Binding international initiatives on foreign investment exist largely at bilateral, regional levels.[56] This is true despite the increasing growth in rates of international investment and the increasing complementariness of trade and investment.[57] However, although BITs remain a primary source of normative rules on FDI, there is an on-going attempt and discussion on structuring or negotiating a multilateral investment agreement. The prevalent of thousands of BITs has indeed been a legal source for both regional and multilateral agreements. As the FDI has skyrocketed in the last few decades, a multilateral agreement is currently necessary more than ever.[58]

These regional or multilateral initiatives of foreign investment might provide the

[55] J. Kurtz, 'A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment' (2002) 23(4) U. Pa. J. Int'l Econ. L. 713

[56] But there are multilateral agreements including provisions in relation to investment or investment dispute resolution e.g. MIGA, ICSID, Energy Charter Treaty.

[57] Kurtz (n 55)

[58] A. Aslund, 'The World Needs a Multilateral Investment Agreement' (2013) Peterson Institute for International Economics Policy Brief 13-1 <https://piie.com/publications/policy-briefs/world-needs-multilateral-investment-agreement> accessed 30 September 2016

sufficient and clear standards of treatment and strike a balance between the investment protection and regulatory flexibility, and between open market and national security. Due to the silence of most BITs, the question concerning whether the government and public entities are covered arises but the answer is not clear. It was suggested that the question concerning whether state-owned or controlled entities are covered by an IIA has to be treated differently from the question whether states parties to the agreement themselves can act as investors.[59] Usually, state entities are covered even if they are not explicitly expressed, while the government or state itself tend not to be unless it is expressly mentioned.[60]

2.2.1 The Multilateral Agreement on Investment

The MAI was discussed extensively from 1970 to 1998, but no agreement was ever concluded for many reasons. It implies the attempt to establish a parallel investment framework like the WTO for international trade. MAI was initiated to establish a high standard liberal and comprehensive regime for the protection and promotion of international investment, which opens to both OECD members and non-OECD members.[61] The negotiation of MAI was expressly geared towards existing IIAs, such as NAFTA Chapter 11, the Energy Chapter Treaty (ECT), and various BITs.[62] Similar to these existing IIAs, the text of MAI includes a broad definition of investment, high-level standard of substantive protections, and provisions for ISDS.

Despite its close similarity to existing IIAs, the failure of MAI can be blamed for a number of reasons. For examples, firstly a consensus on several controversial issues was unable to be achieved by OECD members and it was criticised for denying the voice from developing countries in the negotiation. Secondly, the MAI negotiation received opposition from non-governmental organisations (NGOs), which concerned

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[59] W. Hamida, 'Sovereign FDI and International Investment Agreements: Questions Relating to the Qualification of Sovereign Entities and the Admission of their Investments under Investment Agreements' (2010) 9 The Law and Practice of International Courts and Tribunals 17, 21

[60] UNCTA, *International Investment Agreements: Key Issues* (2004) 142, <http://unctad.org/en/Docs/iteiit200410_en.pdf > accessed on 10 May 2016

[61] S. Kobrin, 'Multilateral Agreement on Investment' The Wiley-Blackwell Encyclopedia of Globalization (2012) <http://onlinelibrary.wiley.com/store/10.1002/9780470670590.wbeog405/asset/wbeog405.pdf?v=1&t=io63xiov&s=8760ed4efa979c713b63ed89f456c1bbd8e1f255&systemMessage=Wiley+Online+Library+will+be+unavailable+on+Saturday+14th+May+11%3A00-14%3A00+BST+%2F+06%3A00-09%3A00+EDT+%2F+18%3A00-21%3A00+SGT+for+essential+maintenance.Apologies+for+the+inconvenience> accessed on 10 May 2016

[62] S. Schill, *The Multilateralization of International Investment Law* (CUP 2009) 53

about the impact of investment protections on environmental protection and labour standards.[63] Yet, the failure of MAI negotiation, on the other hand, reflects the complexity of issues regarding investment, in particular the conflicting interests between the state's legitimate right to regulate and investment protection.[64] These conflicts had long been the debate on competing and legitimate public interests and property protection at both domestic and international level.

However, the failure of the MAI is not an opposition for the trend of multilateralism in investment. The need for such an agreement has increased in the last decade. The objections in MAI negotiation appear to have been reduced, as more developing and emerging economies actively have engaged in IIAs negotiation and also due to the increasing awareness of the necessity to balance conflicting interests. There are even several on-going discussions on reforms of IIAs regime and IIA-based system of ISDS under United Nations Conference on Trade and Development (UNCTAD).[65] Moreover, the FDI and also the portfolio investment are sufficiently large and capitals flow from/in both directions between the 'North' and the 'South'. Furthermore, the expansion of state capitalism and development of SWFs have also amplified the need for an MAI. Rather than being an impediment to an MAI, the issues of state capitalism and the phenomenon of SWF investment are reasons why a MAI is needed in order to mediate the interests of state-owned investors and national security concerns of host countries.

2.2.2 The current trend of regional-multilateral initiatives

In recent years, there is an increasing trend that states prefer deeply integrating partnerships between countries or regions with a major share of work concerning trade and FDI via regional-multilateral or mega-regional FTAs.[66] This new development contributes to altering the balance of powers and brings more parties to

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[63] ibid 55

[64] R. Geiger, 'Regulatory Expropriations in International Law: Lessons from Multilateral Agreement on Investment' (2002) 11 NYU Envtl LJ 94

[65] UNCTAD, 'Reforming the IIA Regime – a Stocktaking' (1 March 2016) <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1208&Sitemap_x0020_Taxonomy=UNCTAD%20Home;#607;#International%20Investment%20Agreements%20(IIA)> accessed 30 June 2016

[66] Beyond simply increasing trade links, the deals aim to improve regulatory compatibility and provide a rules-based framework for ironing out differences in investment and business climates. See T. Hirst, 'What are mega-regional trade agreements?' (9 July 2014) <https://www.weforum.org/agenda/2014/07/trade-what-are-megaregionals/> accessed on 10 May 2016

negotiations.[67] The Trans-Pacific Partnership (TPP) Agreement and the Transatlantic Trade and Investment Partnership (TTIP) negotiation indicate that international investment relevant issues are gradually discussed or addressed within a broader framework.[68] These regional-multilateral initiatives will trigger the incentive for other countries to participate in or negotiate multilateral agreements and will affect the development of international investment law.

It is important to notice that a majority of parties involved in these initiatives are major recipient countries/regions of SWF investment, e.g. US, the EU, Australia, Canada. Some involved countries are also the home countries of SWFs, e.g. Singapore, New Zealand, Australia, Chile. But these two significant treaty negotiations do not include China as home country and host country of SWF investment. Nevertheless, these initiatives do have impact on China and China's future treaty negotiations, e.g. negotiations of RCEP, China-EU BIT and China-US BIT. Hence, these regional-multilateral initiatives, if come into effect, will exert certain influence on foreign investment. In addition, these initiatives can reflect view of the US and the EU towards state-owned entities.

2.2.2.1 Trans-Pacific Partnership

As for TPP, it essentially draws on the provisions in US BIT model, rather than existing Asian FTAs. Although President Trump withdraw from TPP, the US's interests has been incorporated into the TPP as a model agreement for Asian-Pacific region.[69] The definition of 'investor of a Party' is the same in the US BIT model and in North American Free Trade Agreement (NAFTA), which means a Party, or a national or an enterprise of a Party.[70] The definition of 'enterprise' includes the wording of 'whether privately or governmentally owned or controlled.'[71] The

[67] A. Titi, *The Right to Regulate in International Investment Law* (Hart Publishing 2014) 22
[68] There is also another on-going mega-regional FTAs negotiation i.e. Regional Comprehensive Economic Partnership (RCEP). It is composed of member states of the Association of Southeast Asian Nation (ASEN) and six states with which ASEAN has existing FTAs. It involves key players China and India but does not include the US. It should be noticed that many states involved in RCEP negotiation are home country of SWFs. However, this thesis only selects TPP and TTIP to discuss. It is important to note that despite US' withdraw from the TPP, the text of TPP could also be a simple to analyse.
[69] Chaisse (n 1) 148
[70] TPP Article 9.1
[71] TPP Article 1.3

definition of 'investment' still adopt a broad coverage, which includes every assets that an investor owns or controls, directly or indirectly in the form of an enterprise, shares, stock and other forms of equity participation in an enterprise. The TPP provides the NT and MFN treatment for investors of a Party in both pre- and post-establishment phrase,[72] and it also includes the ICSID for dispute resolution.[73]

To ensure the right to regulate of host states, the investment chapter in the TPP emphasises that a Party can take measures to ensure investment activities in consistent with environmental, health and other regulatory objectives of recipient countries.[74] Moreover, it further maintain the interests of host states by including corporate socially responsibility (CSR) requirements. The TPP encourages enterprises to adopt CSR standards and to incorporate these into internal policies when operating within the jurisdiction of a Party, i.e. a kind of quasi-obligation for investors.[75] Although the TPP provides high standard of treatment to investors and investments, it yet introduces the self-determine 'security exception' clause,[76] which was previously settled in US BIT model, into the TPP.[77]

Apart from general rules for general investors, the TPP has a chapter (Chapter 17) dealing with competitive neutrality with regard to SOEs. It sets out disciplines to ensure a level playing field between state-owned or controlled companies and their private competitors.[78] Moreover, in Chapter 17, it provides the definition of SWFs

[72] The NT obligation in the TPP is almost the same in NAFTA obligation. But it includes two additional features i.e. a footnote for the interpretation of the meaning of 'like circumstances' and a Drafters' Note on interpretation of this term. The footnote provides that "for greater certainty, whether treatment is accorded in "like circumstances" under NT or MFN provisions depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives." See R. Braddock, 'The Age of Mega-Regionals – TPP and Regulatory Autonomy in International Economic Law: Discrimination or Legitimate Government Regulation? Striking a Balance in the TPP' (15 May 2016) <http://law.unimelb.edu.au/__data/assets/pdf_file/0010/1954144/Braddock,-Discrimination-or-legitimate-government-regulation-Striking-a-balance-in-the-TPP.pdf> accessed 30 June 2017

[73] However, the investor-state dispute settlement in TPP is criticised for its intent to extend this investor privilege, but it also requires the process of arbitration should be transparent. Some provisions also restrict the capacity of investor to sue the government.

[74] TPP Article 9.16

[75] TPP Article 9.17

[76] The general exception clause in the TPP does not apply to the investment chapter.

[77] TPP Article 29.2

[78] The EU-Vietnam FTA also provides a chapter to deal with issues of SOEs. Although the EU and the US share similarities in terms of their prudent attitudes towards sovereign investors and the rough picture of their regulatory frameworks, the EU and US, are, in fact, approaching different regulatory models towards sovereign investors i.e. representing a EU model and US model towards the

and SOEs, which distinguishes these two similar entities.[79] The TPP, if come into effect, will be the first regional-multilateral initiatives that clearly mention SWFs as the subject. The GAPP (or 'Santiago Principle'), is mentioned in the Article 17.1 of TPP when defining SWF, which implies that a SWF shall comply with the certain requirements and principles as the code of best conducts for SWFs. It indicates the recognition of the GAPP as a common guideline for SWFs.

The Annex in Chapter 17 also addresses the issues of SWFs or provides some exemptions. For example, the Article 1 of Annex 17-E provides that the SWF of Singapore shall not take action to direct or influence decisions of a SOE owned or controlled by the SWF, including through the exercise of any rights or ownership interests over such SOEs. A SWF of Singapore may exercise its voting rights in these SOEs through ownership interests. In light of on-going development of SOE reform legislation in Malaysia, the footnote of the Annex 17-F provides that enterprises owned or controlled by Khazanah Nasional (Malaysia's SWF), can exempt from dispute settlement under Chapter 28 for a period of two years.

2.2.2.2 Transatlantic Trade and Investment Partnership

The negotiation of TTIP is suspended due to the Trump's administration. However, the draft text can also reflect conscious and attitudes of the US on foreign investment and state-owned entities as well. The EU proposes to include issues of state enterprises in a Chapter of TTIP. The main objective of the EU to include SOE-related disciplines in the TTIP is to develop a joint platform of rules on SOEs, which could be used in other agreements to tackle concerns of the development of

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governance of SOEs. Compared with US model, the EU model pursues higher levels of transparency and aims to apply the principles of good governance to SOEs. See EU-Vietnam FTA Chapter 10.

[79] TPP Article 17.1. SOEs means 'an enterprise that is principally engaged in commercial activities in which a Party: (a) directly owns more than 50 per cent of the share capital; (b) controls, through ownership interests, the exercise of more than 50 per cent of the voting rights; or holds the power to appoint a majority of members of the board of directors or any other equivalent management body.' SWFs herein means 'an enterprise owned, or controlled through ownership interests, by a Party that: (a) serves solely as a special purpose investment fund or arrangement for asset management, investment, and related activities, using financial assets of a Party; and (b) is a Member of the International Forum of Sovereign Wealth Funds or endorses the Generally Accepted Principles and Practices ("Santiago Principles") issued by the International Working Group of Sovereign Wealth Funds, October 2008, or such other principles and practices as may be agreed to by the Parties, and includes any special purpose vehicles established solely for such activities described in subparagraph (a) wholly owned by the enterprises, or wholly owned by the Party but managed by the enterprise.'

state capitalism.[80] From the EU's perspective, the state ownership is not problematic in itself but certain advantages provided by the government must be addressed.[81] This notion is also reflected in the provision of concluded EU-Vietnam FTA.

The definitions of 'State enterprise' and 'Enterprise granted special or exclusive rights or privileges' emphasise the commercial activity that enterprises involved in and the decisive influence by a Party on those enterprises. According to these definitions, SWFs are not clearly mentioned in this Chapter, but some SWFs may be classified as state enterprises, such as those that a Party holds the majority of capital in these SWFs or a Party appoint the managerial or supervisory body of the SWFs.

Whether SWFs will be included in TTIP remains to be clarified in the future text. But since the US and EU member states are not typical home countries of SWFs, it is less possible to include provisions that specially tackle issues of SWFs. The investment dispute resolution is an important part in both bilateral and multilateral treaties. In TTIP, this section introduces a proposal of the establishment of an investment court system (ICS), which intends to provide a two-tiered Tribunal to hear investor-state disputes, consisting of a Tribunal of First Instance and an Appeal Tribunal.[82] The Proposal's substantive standards of treatments are designed to ensure regulatory flexibility for states to guarantee public interests. However, whether SWFs can file a claim against the host countries under ISDS is questionable, hence whether this new system can apply to SWFs investments relevant disputes is still uncertain and needs to be clarified.

In sum, the TPP and TTIP share some common features as recent

[80] M. Griffith et al., 'Great Power Politics in a Global Economy: Origins and Consequences of the TPP and TTIP' (17 October 2015) <http://www.brie.berkeley.edu/wp-content/uploads/2015/02/Great-Power-Politics-in-a-Global-Economy-Origins-and-Consequences-of-the-TPP-and-TTIP.pdf> accessed 16 July 2017

[81] European Commission, 'Textual Proposal: Possible Provisions on State Enterprises and Enterprises Granted Special or Exclusive Rights or Privileges' <http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153030.pdf> accessed on 10 May 2016

[82] See European Commission, 'Commission Draft Text TTIP-Investment' <http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf accessed> accessed 10 May 2016; see also S. Schill, 'The European Commission's Proposal of an "Investment Court System" for TTIP: Stepping Stone or Stumbling Block for Multilateralizing International Investment Law?' (2016) 20(9) American Society of International Law <https://www.asil.org/insights/volume/20/issue/9/european-commissions-proposal-investment-court-system-ttip-stepping> accessed 30 June 2016

regional-multilateral initiatives for international investment. Firstly, they provide high standard investment protections while they consider restrictions on the capacity of investors to challenge host states. This demonstrates a trend that the states try to balance the interests of protection of investors and maintenance of sovereignty. Secondly, these initiatives intend to address the issue of "competitive neutrality", but it is not clear how they will further work on with it.[83] It also reflects that the TPP and TTIP groups recognise the development of state capitalism, and the former includes SWFs into the agreement. It suggests that emerging issues and development of international investment will be reflected and included in new agreements, e.g. the balance of open market and the right to regulate; the issues of state capitalism.

3. International Soft Law Instruments on SWF Investment

Currently, international regulations that address specific issues of SWFs are soft law regulations, i.e. code of conduct and guiding principles. Due to the pressure from major developed countries, the IMF and OECD have made efforts to introduce policies concerning SWF investment at a broader level. The principles provided by the IWG (with the support of the IMF) focus on the SWFs, while OECD guidelines focus on the policies of host countries. These initiatives are attractive because of their potential ability to alleviate certain concerns discussed in this thesis. Furthermore, although it is true that without an international regime a country can still impose disclosure requirements and other forms of restrictions/protections on SWFs, these international regulations provide several additional benefits.[84]

Beyond the ability to address concerns surrounding SWF investment, an international regulation could protect the interests of host and home countries, create a level playing field and avoid over-reaction. Although international regulations are unlikely to eliminate all protectionist problems, they do have the potential to reduce protectionist pressures.[85] It should be emphasised that these guidelines and principles are not a final product but a starting point for addressing issues of SWF investment or state capitalism and the role of SWFs in international financial and economic

[83] OECD, *Stated-Owned Enterprises in the Development Process* (OECD Publishing 2015) 206
[84] A. Wong, 'Sovereign Wealth Funds and the Problem of Asymmetric Information: the Santiago Principles and International Regulations' (2008) 34(3) Brook. J. Int'l L. 1081, 1098
[85] ibid 1102

systems.[86] But, these soft law regulations are criticised for having non-binding effect and lacking an enforcement mechanism.

The international initiatives to address issues of SWF investment can date back to 2007. During that time, G7 Finance Ministers and Central Banks Governors met in Washington for the IMF/World Bank annual meeting. They did agree that SWFs became essential participants in international finance system. Moreover, G7 stated that the economy could benefit from the openness to SWFs' investment flows, as shown during the global financial crisis. But they also stated that best practices for SWFs should be identified in areas such as institutional structure, risk management, transparency, and accountability. Therefore, participants asked the IMF, OECD and World Bank to examine these issues and to draft proposals on these matters.[87] Following the G7 Finance Ministers' request, these international institutions began to work on it, but from different point of view.

3.1 OECD guidelines regarding SWFs investment

The OECD focused on recipient countries' policies toward SWFs investment. The general idea was to encourage host countries not to infringe liberalisation of capital movements. Therefore, OECD started to develop best practices whereby adhering governments would commit to the principle of non-discrimination, the principles of transparency and the principles of liberalisation of capital movements.

During June 2008, ministers representing thirty-three host countries adopted a declaration, the *OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies*, which expresses their commitments to preserve and expand an open international investment environment for SWFs. In 2009, OECD developed an endorsed guideline, i.e. *Guidelines for Recipient Country Investment Policies Relating to National Security* (the Guidelines) to ensure that host countries do not disguise

[86] J. Norton, 'The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another Example of Ad Hoc Global Administrative Networking and Related "Soft" Rulemaking?' (2010) 29 Rev. Banking & Financial L. 465

[87] M. Audit, 'Is the Erecting of Barriers against Foreign Sovereign Wealth Funds Compatible with International Investment Law' (2009) 10 (4) J. World Invest. & Trade 617

protectionism as measures taken to safeguard national security.[88]

The Guidelines focus on four main aspects. The first one is non-discrimination. The Guidelines require host countries to treat similarly situated investors in similar fashions, unless measures adopted by host countries are inadequate to protect national security.[89] It calls for host countries to protect national security by addressing specific circumstances of individual investments rather than imposing discriminatory restrictions on all investments.[90]

The second one is transparency/predictability. By recognising the need to maintain confidentiality of sensitive information, the Guidelines require that regulatory objectives and practices should be made as transparent as possible via codification and publication, prior notification, consultation, and disclosure of investment policy actions, as well as by ensuring procedural fairness and predictability.[91]

The third one is "regulatory proportionality", i.e. recipient countries should not impose restrictions or conditions on investments that are greater than needed to protect national security.[92] Host countries should avoid undertaking protective measures when other existing measures can adequately and appropriately address national security risks.[93]

Another one is accountability. It states that 'procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions should be taken at high government levels and should be considered to ensure accountability of the implementing authorities.'[94] The accountability includes the following aspects: accountability to citizens, international accountability mechanisms, recourse for

[88] Cooke (n 10) 771 in Introduction
[89] K. Nakatani, 'Sovereign Wealth Funds: Problems of International Law Between Possessing and Recipient States' (2015) Int'l Rev. L. <http://www.qscience.com/doi/abs/10.5339/irl.2015.swf.7> accessed 20 October 2016
[90] OECD, 'Guidelines for Recipient Country Investment Policies Relating to National Security' (25 May 2009) <https://www.oecd.org/investment/investment-policy/43384486.pdf> accessed 16 June 2016
[91] ibid
[92] ibid
[93] ibid
[94] ibid

foreign investors, high-level involvement in important decisions and effective public sector management.[95]

In the part of accountability, the Guidelines mention the OECD notification and peer review obligations in relation to restrictive investment policies. In the peer review process, the OECD would produce a report to each country concerning a country's performance in a particular subject area, which is based on the consensus of participating countries. Theoretically, if a country's policies on SWF investment fall behind others, the peer pressure would force this country to improve its policies.[96] The peer review process can give rise to peer pressure through a combination of formal recommendations, informal dialogue, public scrutiny and comparisons, as well as the impact of all above on domestic public opinion and policy makers.[97] Apart from the Guidelines, OECD also provides several guidelines in relation to addressing issues of SOEs and investment.[98]

However, the achievements of the OECD in addressing issues of SWF investment have been less impressive than those made by the IMF. Although the OECD repeatedly emphasises these guidelines in its various documents, the trend at domestic level has moved in an opposite direction,[99] which reflects the weakness of the OECD initiatives. Firstly, since key terms such as 'public order' and 'essential security interest' have not been defined, host countries are free to interpret any meaning.[100] Secondly, the OECD's documents recognise national security as a legitimate exception for open market principles.[101] Host countries are expanding the scope of national security from traditional defence industries to including economic security or

[95] ibid
[96] Cooke (n 10) 775 in Introduction
[97] OECD, 'Peer Pressure: A Related Concept' <https://www.oecd.org/site/peerreview/peerpressurearelatedconcept.htm> accessed on 15 May 2016
[98] For example OECD General Investment Policy Principles, Freedom of Investment Process, OECD Guidelines for Corporate Governance of State Owned Enterprises (2015 version), OECD Declaration on International Investment and Multinational Enterprises, OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations.
[99] D. Drezner, 'Bric by Bric: The Emergent Regime For Sovereign Wealth Funds' (Summer Workshop on Rising States and Rising Institutions, Princeton, 2009) 16 <http://www.danieldrezner.com/research/swf1.pdf> accessed on 20 May 2016
[100] B. Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff' (2009) 85(4) Int'l Affairs 713, 725
[101] Backer (n 44) 96 in Ch.1

'critical infrastructure'.[102] Thirdly, the OECD's peer review process does not extend to national security exception. A plausible resolution would be applying national security exception with restraint. With growing concerns over sovereign investment, therefore, existing regulations in fact are inadequate to address protectionist measures and the regulatory challenge remains.

3.2 IMF guidelines regarding SWFs investment

IMF also has developed international principles in this field. But unlike the work of the OECD, the IMF's principles do not target host countries but SWFs. The International Working Group of Sovereign Wealth Funds (IWG) (which comprises 26 IMF member countries with SWFs) was established to develop a set of Generally Accepted Principles and Practices ("GAPP"), also known as the "Santiago Principles" in October 2008. GAPP, as a voluntary set of criteria, comprises twenty-four guidelines. These guidelines are subject to applicable laws of the home country and any intergovernmental agreements.[103] The IWG expected that the GAPP would guide SWF activities so that the funds would invest professionally and it could also help the institutional-related reforms. The IWG assumed that all SWFs would operate in good faith and comply with all applicable regulatory and disclosure requirements.

The IWG emphasises that the development of the GAPP helps to, e.g. ensure that the international financial market continues to benefit from SWF participation; support the 'institutional framework, governance, and investment operations of SWFs that are guided by their policy purpose and objectives and consistent with a sound macroeconomic policy framework'; and improve understanding of SWFs as economically and financially oriented entities in both the home and recipient countries.[104] This understanding aims to contribute to 'the stability of the global financial system, reduction of protectionist pressures, and maintenance of an open and stable investment climate.'[105] To achieve these goals, the IWG would rely on the

[102] Drezner (n 99)
[103] L. Gramlich, 'An International Normative Framework for Sovereign Wealth Funds?' in C. Herrmann and J. P. Terhechte (ed.) *European Yearbook of International Economic Law* (Springer 2011) 70
[104] IWG (n 19) in Ch.1
[105] ibid

cooperation from recipient countries and the OECD.[106] It seems that GAPP intends to reduce concerns of SWF investment by improving their operation, structure, accountability and transparency.

The GAPP covers three key areas: (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structures; and (iii) investment and risks management framework. The IWG explained that the principles in the first area could underpin a sound institutional framework or governance structure of SWFs, and facilitate formulation of appropriate investment strategies consistent with policy objectives stated by SWFs.[107] The second area could ensure that SWF investments are free from political influences by separating the owner, the government, and the management to create operational independence.[108] The third area could promote sound investment operation and accountability, and demonstrate operational discipline.[109]

In light of implementation and review, by recognising the evolving nature of SWFs, the different maturity level of SWFs, and their different objectives, strategies and horizons, IWG provided different time frames for adopting these principles.[110] Moreover, the GAPP may be considered as setting minimum standard for those SWFs that may already be following well-established practices. But it indeed recognised that these principles would not be applicable to every SWF.[111]

In 2009, a voluntary organisation of global SWFs was formed, which replaced the IWG, known as the International Forum of Sovereign Wealth Funds (IFSWF). It was established to enhance collaboration, to promote a deeper understanding of SWF activities and raise the industry standard for best practice and governance. It should be noticed that IFSWF currently has 32 member funds, all of which have endorsed the GAPP and conform to the definition of SWF in the GAPP. But these groups of members are less than existing SWFs included in the database of SWF Institute. Moreover, as the largest SWFs, the GPFG (Norway) has not endorsed GAPP, since it

[106] Wong (n 84) 1104
[107] IWG (n 19) in Ch.1
[108] ibid
[109] ibid
[110] Wong (n 84) 1105
[111] ibid

has its own regulatory requirements and policies with even higher transparency standards than that of other SWFs.

The GAPP provides an important and distinct example of standard setting for addressing issues of SWFs (in particular from internal perspective). It provides guidelines for legal and institutional structure, governance and management of SWFs. However, it has several flaws that affect the effectiveness in achieving these stated objectives.[112] Firstly, GAPP lacks clear or applicable criteria to measure the compliance with or implementation of the Principles. The current two-year period of self-assessment provided by SWFs members cannot guarantee the effective implementation. Yet constructive feedbacks from both SWFs and host countries are necessary to the development of international regulations/standards on SWFs. Secondly, it is argued by some scholars that GAPP focuses much more on SWFs and host countries separately but does not help to address concerns of host countries, and their relationship with recipient countries.[113] Although GAPP provides requirements on transparency and disclosure, it does not preclude SWFs from carrying out investment based on political policies, which is a main concern of host countries.[114] In addition, GAPP, as a voluntary set of principles or self-regulation, does not contain an enforcement mechanism to encourage and even guarantee the adoption of the GAPP and ensure the compliance with the GAPP.

4. Analysis and Comparison of Current International Regulatory Regime

A majority of these international instruments do not clearly mention or address issues of SWFs or the phenomenon of state capitalism while others that exclusively deal with SWFs investments are soft law regulations. Different international approaches or initiatives suggest their own focuses, and are underpinned by various theories or policy considerations. So far, how to regulate sovereign investment (including SWF investment) at international level is still under discussion due to the complexity of the choice of law and the emerging trend in international regulation.

Before considering a plausible approach to regulate SWFs investments, it is important

[112] ibid
[113] ibid 1106
[114] Bismuth (n 11) 88 in Introduction

to address key questions and compare a couples of existing choices/approaches. The couples of choices in this thesis are bilateral approaches or multilateral approaches; international hard law or soft law regulation; and the IMF, WTO or OECD, which one is appropriate to address issues of SWF investment are answered by analysing and comparing the advantages and disadvantages of each choice.

4.1 Choice between bilateral and multilateral approaches

The overseas investment of SWFs is a cross-border issue, which should be analysed at international level but not limited to domestic level. Currently, thousands of bilateral treaties dominate the operation of international investment law and address the issues of foreign investment. However, issues of SWFs are rarely clearly covered by these bilateral treaties, and the rise of state capitalism even brings about global challenges and concerns from developed countries. The increasing initiatives to negotiate regional-multilateral treaties illustrate a growing desire to address investment issues within a broader framework, and indicate an emerging trend of the multilateralism of international investment law.[115] Bilateral agreements indeed have distinct advantages for their signatories to tailor models serving for their own needs and to better reflect the unique interests of various involved parties. In addition, the enforcement mechanisms between two States can sometimes be more effective and easy.

However, not every issue raised by foreign investment could be efficiently solved on bilateral level and not every aspect of investment regulation could be assessed solely on bilateral level. If unilateral or bilateral investment regulations result in externalities or affect other countries' measures, 'there is a need for a coordination through multilateral agreement.'[116] According to economic theory, a key purpose of international trade agreement is to prevent powerful countries from creating international externalities through their unilateral policy choices,[117] which could also

[115] Both bilateralism and multilateralism are forms of international cooperation. The major differences between both forms relate to the number of parties to an international agreement and the nature of the rules governing inter-State conduct. From a purely formal perspective, bilateralism refers to ordering relations between States on a dyadic basis, whereas multilateralism concerns "the practice of coordinating national policies in groups of three of more states". Schill (n 62) 9

[116] E. Chalamish, 'The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement' (2009) 34 Brook. J. Int'l L. 303, 338

[117] B. Rigod, *Optimal Regulation and the Law of International Trade: The Interface Between the Right to Regulate and WTO Law* (CUP 2015) 101

be the case for unilateral and narrow bilateral measures on SWF investment or sovereign investment. A bilateral treaty between the home country and host country of the SWF can help to address the issues of SWFs from one country, but the whole picture of state capitalism request responses and even a consensus at a broader level.

It is argued that issues of sovereign investment, SWF investment in particular, should be addressed on a multilateral (and even international) level rather than being addressed only by unilateral or bilateral approaches. A multilateral or international instrument may have advantages over bilateral measures to the extent that a multilateral instrument could provide predictability, transparency and standardisation of treatment across a broader area. Although some studies argue that bilateral measures have low negotiation and transaction costs and have more flexibility in their application/implementation,[118] a multilateral or uniform approach could provide additional benefits, i.e. lower compliance cost and less redundancy.[119] The shortcoming of a multilateral agreement is that high standards at multilateral level might not easily be achieved since those states involved may have different levels of tolerance for investment liberalisation.[120] Nonetheless, it should be noticed that the notable differences among bilateral treaties concerning investment have gradually diminished. The US and EU models may get closer if TTIP negotiations are successful in the future. In addition, a multilateral measure would not threaten the network of existing BITs but provide a platform that helps to monitor the compliance with investment regulations by SWFs more effectively, and address the tension between host countries and SWFs more widely.

Without a multilateral or even international approach to the phenomenon of state capitalism or SWF investment, multiple problems may arise.[121] The threat of protectionism, irrational legislation, and the imbalance of investment are hazards to host countries. The uncertainty of different bilateral approaches, the undue percentage of the cost for accessing the market, and discriminatory treatment are concerns to

[118] More information about the transaction costs, see A. Thompson and D. Verdier, 'Multilateralism, Bilateralism, and Regime Design' (2014) 58 Int'l Stud. Quart. 15
[119] Wong (n 84) 1103
[120] R. Lawrence, *Regionalism, Multilateralism, and Deeper Integration* (Brookings Institution Press 2000). See also M. Chen and A. Mattoo, 'Regionalism in standards: good or bad for trade?' (2008) 41(3) Canadian J. Econ. 838
[121] Lindberg (n 122) 125 in Ch.2

SWFs. Measures between two parties (or among a small group of participants) cannot combat these problems.

Furthermore, SWF investment involves various interests from many different parties so that their interests must be met. These parties include the host and home countries, other foreign investors, portfolio companies of SWF investment, and also other relevant stakeholders. All of these parties are affected by SWFs-relevant regulations and their interests may be taken into account when formulating rules. As for host countries, they are able to reduce the cost in individually monitoring each SWF and avoid the possibility of conflicts in their different regulations. As for SWFs, they are able to predict restrictions and regulatory risks before undertaking proposed investment in host countries. In addition, potential concerns and positive effects of SWFs investments are recognised by international community.[122] The complex features of SWFs and the conflicting interests between SWFs and host countries call for multilateral (or international) approaches to clarify several important and substantial issues. It can be therefore argued that a multilateral approach at international level is necessary for changes in some way the conduct of states,[123] and behaviours of SWFs, thus building a consensus on SWFs and working out minimum standards for both SWF investment and unilateral measures of host countries. Bilateral and unilateral measures will be more effective if a mutual understanding is reached at international level with binding effects.

4.2 Choice between hard law and soft law regulation

4.2.1 General comparison of hard law and soft law

States and private actors have increasingly used a wide range of hard law or soft law instruments to advance their aims. These instruments offer particular advantages in different contexts. They are sometimes used alone and sometimes combined dynamically over time, resulting in a complex hybrid of hard-law and soft-law instruments.[124]

[122] R. Beck and M. Fidora, 'Sovereign Wealth Funds-Before and Since the Crisis' (2009) 10(3) EBOR 353
[123] J. McGinnis, 'Political Economy of Global Multilateralism' (2000) 1 Chi. J. Int'l. L. 381. 382
[124] Shaffer and Pollack (n 86) 717 in Ch.1

Hard law is featured with many advantages. Firstly, it allows states to commit themselves more credibly to international agreements, since either on account of legal sanction or reputation it would increase the cost of violation.[125] Secondly, hard law is more credible, as it can have direct legal effects on national jurisdictions. If treaty obligations are implemented by domestic legislation, it increases the 'audience costs of a violation'.[126] Thirdly, hard law can create mechanisms for the interpretation of these legal obligations over time.[127] Furthermore, it permits states to monitor and enforce their commitments via domestic court or international dispute-settlement resolution.[128] These interpretation, monitoring, and enforcement mechanisms reduce costs of subsequent interstate action.[129]

However, hard law also has several disadvantages and results in additional costs. Firstly, hard law is more difficult to adapt to changing circumstances, as it is more rigid and less flexible. Moreover, hard law is problematic, because it assumes fixed conditions while current uncertainty in many areas needs further adjustment, or it requires uniformity while in some circumstances the tolerance of national diversity is needed. It is much more difficult to meet those frequent changes.[130] Furthermore, since hard law creates formal and enforceable legal commitments/obligations, it restricts the actions of states thus infringing on national sovereignty,[131] particularly in several sensitive areas, e.g. the national security or public interest.

The supporters of soft law argue that soft law can offset the disadvantages of hard law and it provides various benefits. Firstly, soft law approaches are less costly and are easier to negotiate as well as impose lower costs on states' action in sensitive areas. Secondly, soft law provides greater flexibility for state to adapt changing circumstances, to address uncertainty and to deal with diversity. Thirdly, soft law provides a forum for various groups or relevant stakeholders (e.g. NGOs, business

[125] States are arguably particularly concerned with their reputation for compliance. Guzman claims that states' calculus over the reputational costs of noncompliance is the primary factor for explaining state compliance with international law. See A. Guzman, 'The Design of International Agreements' (2005) 16 Eur. J. Int'l. L. 579, 582
[126] Abbott and Snidal (n 86) 428 in Ch.1
[127] ibid 433
[128] ibid 427
[129] Shaffer and Pollack (n 86) 718 in Ch.1
[130] D. Trubek et al., ''Soft Law', 'Hard Law' and EU Integration' in G. de Búrca and J. Scott (eds.) *Law and New Governance in the EU and the US* (Bloomsbury Publishing, 2006) 67
[131] Shaffer and Pollack (n 86) 718-719 in Ch.1

associations, international organisations) to engage in rather than states.[132] Moreover, soft law can be used by states in the situation of increasing costs when negotiating a hard law agreement, e.g. more parties get involved, more uncertainties existed, challenges in domestic ratification.[133] Furthermore, it provides a platform for states to create a common understanding in the situation of uncertainty and helps states to tackle newly emerging, complex global challenges that cannot be addressed at national level via developing common norms and adopting effective actions.[134]

It can therefore be argued that hard law and soft law approaches offer particular advantages for different situations and in different contexts. The use of hard law and soft law approaches should be selective depending on the number of involved parties, current situations, the demand of involved parties, and particularly, the features of the issues. They can interact with and build upon each other, as complementary instruments for addressing global problems/challenges. It can be achieved in two main ways: (i) non-binding soft law instruments can direct the way to binding hard-law instruments and help to generate customary international law norms; and (ii) binding hard law instruments can be subsequently elaborated or explained by soft-law instruments (i.e. a low-cost and flexible way), and help to supplement and advance hard law.[135] In both cases, in the international rule-making process, hard law and soft law instruments act as complements to each other, thus leading to effective international coordination and cooperation.[136]

4.2.2 Application of hard law and soft law approaches to SWFs

Most bilateral treaties do not clearly cover the issues of SWFs or explicitly mention the concept of SWFs since most treaties were concluded before the emergence/development of SWFs. Furthermore, relevant WTO agreements, as international hard law instruments, do not address the general issues of foreign

[132] ibid 719. For more information about the strengths of soft law, see H. Hillgenbergy, 'A Fresh Look at Soft Law' (1999) 10 Eur. J. Int'l L. 499, 501, 504. See also F. Sindico, 'Soft Law and the Elusive Quest for Sustainable Global Governance' (2006) 19 Leiden J. Int'l L. 829, 832.
[133] K. Abbott and D. Snidal, 'Pathways to International Cooperation' in E. Benvenisti and M. Hirsch (eds.) *The Impact of International Law of International Cooperation: Theoretical Perspective* (CUP 2004) 54
[134] Shaffer and Pollack (n 86) 721 in Ch.1. See C. Brummer, *Soft Law and The Global Financial System: Rule Making in the 21st Century* (CUP 2015) 133
[135] J. Dunoff et al., *International Law: Norms, Actors, Process: A Problem-Oriented Approach (Aspen Casebook)* (Wolters Kluwer Law & Business 2015) 95
[136] Chinkin (n 45) 866

investment. So far, there is no international hard law instrument explicitly addressing issues of SWF investment. Existing regional-multilateral FTAs, although contains investment chapter, pay much attention to the competitive neutrality between SOEs and private investors, but not to SWFs (or state entities) in the context of investment, and the TPP only include the basic concept of SWFs without further requirements or clarifications.

Bilateral, regional-multilateral investment agreements and WTO agreements include general exception clause and/or security exception clause that reduce the effect of investment protection and exempt host states from their obligations to foreign investors, but these exception clauses provide states a tool to protect the national security (or maintain regulatory flexibility). Most existing hard law agreements are out-of-dated and are dominant by developed countries that cannot reflect interests of development countries or emerging economies and even issues of 'state capitalism'.[137] The conflicts of interests between open market and national security, between investment protection and state sovereignty, liberalisation and protectionism, have not been fully addressed by or reflected in existing international regulations. SWFs are mainly regulated by soft law regulation (self-regulation), i.e. the GAPP. The initial commitments of host countries regarding their unilateral measures towards SWFs are not made by treaty or hard law, instead, largely through soft law instruments (i.e. OECD guidelines) that do not impose binding legal obligations.[138]

These principle-based and self-determined soft law regulations are criticised for having too broad and vague languages to implement, lacking an enforcement or sanction mechanism to ensure compliance. It is therefore questioned that whether a multilateral investment hard law framework is necessary or whether these soft law regulations should be continually adopted and further developed.

This thesis argues that a combination of soft law and hard law instruments is appropriate to balance the interests between SWFs and host countries. To address concerns of SWFs and maintain deserved rights of SWFs, a parallel operation of hard

[137] Remarkably, FDI inflows to the developed and to the developing world have recently reached broadly coterminous levels, while the EU and the US, traditional capital exporters, and remain by far the most significant FDI destination economies. Titi (n 67) 21
[138] Brummer (n 134) 120

law and soft law regulations is plausible and necessary. The soft law instruments take the form of 'best practice' or 'code of conduct',[139] while the hard law take the form of treaties. It herein means that SWF investment could be regulated by soft law regulations while the measures taken by host countries should be constrained by international treaties but not on the soft-law level. The encouragement to comply with GAPP could be incorporated into treaties, as an obligation or quasi-obligation of SWFs or even a legal expectation (of host countries) towards home countries and also SWFs.

On one hand, the 'code of conduct' of SWFs, i.e. GAPP, offers quasi-normative rules concerning the ideal operation of SWFs and defines the necessary minimum shared standards for a healthy regulatory system. It is a good first initiative or an attempt to regulate SWFs at international level. Once the GAPP is widely adopted and implemented by an increasing number of SWFs, it will become more effective. Given that premise, it will be widely admitted by both host and home countries, and will be more easily incorporated into domestic legislation or investment treaties as hard law rules. But further improvements and more practices are needed.

On the other hand, OECD guidelines provide key principles for host countries to address issues of SWF investment and to adopt necessary national security policies. The OECD guidelines are soft law instruments; however, these guidelines need to be incorporated and clearly mentioned into relevant treaties in order to maximise their effectiveness. These guidelines can only be regarded as a mere repetition of its previous policies and also have no binding effects. Moreover, most OECD members are developed countries not developing and emerging countries so that its guidelines cannot have widespread influences. Since commitments made in treaties firstly require the approval or ratification by domestic legislatures and subsequently could become binding on all parties,[140] OECD guidelines if incorporated into treaties or guaranteed by legal commitments can help, to a certain extent, in ensuring that state

[139] The international financial law often takes form of 'best practices'. According to Brummer, the best practice 'concerns discrete issue areas, like capital adequacy, optimal disclosure rules, or due diligence techniques for preventing money laundering and terrorist financing. These practices may be promulgated by coalitions of wealthy regional bodies or even by organizations of private actors blessed by national authorities. Best practices sometimes have a broader scope, however, and deal with the general features of sound oversight in a particular financial sector.' ibid 121

[140] ibid 124

action imposed on SWFs is legitimate. This can also help to provide a stable and foreseeable legal environment for SWFs investments. 'Regulation is rarely an end in itself. Instead, the protection or advancement of societal or individual interests constitutes the aim of almost all regulatory actions.'[141] It could be argued that the government of host countries should consider trade-offs between competing interests, particularly, in the case of SWF investment, the interests between open market and national security, and between investment protection and state sovereignty.

It is suggested by this thesis that for the time being, soft law regulations are appropriate for the community or group of SWFs while hard law regulations are necessary to reduce the risk of protectionism and to guarantee that host countries and home countries comply with soft law. The GAPP, in the form of soft law (and also self-regulation), is a proper first resort to regulate SWFs. The issues of compliance and implementation could be addressed by states, and the best practice of SWFs could later be included in hard law instruments. Hard law instruments are necessary to guarantee rational and justified unilateral measures imposed on SWFs investments, since formal international obligations can create reputational pressures and sovereign costs for states. When host countries and home countries make official commitments and then renege on these, they may send a signal to future potential treaty partners that they cannot be trusted and *vice versa*. In addition, a hard law instrument can provide a platform for SWFs to claim investment protection via ISDS or relevant dispute resolution provisions introduced in treaties.

4.3 Choice among existing international institutions

Various international institutions or international standards setting bodies have existed at international level to address global issues. So far, these institutions have failed to develop a common approach towards an MAI, and investment relevant issues have been separated from the discussion on North-South economic integration, which were addressed by countries on bilateral or regional-multilateral level.[142] In terms of SWF investment, a fundamental question occurs: if a uniform international regulation is necessary, which organisation is more suitable to regulate SWFs? In terms of exiting

[141] Rigod (n 117) 7
[142] Chalamish (n 77) 32 in Ch.2

international regulatory bodies, the main debate falls in the choice among the WTO, IMF and OECD.

The argument that supports the WTO as a natural home for multilateral investment agreement and SWFs relevant issues is underpinned by two reasons. The first one is the WTO already, albeit somewhat opaquely, covers investments in the GATS, which is analysed above. The second one is the WTO dispute settlement system. Instead of taking unilateral actions based on its own judgment, the member state of WTO can provoke retaliatory protection and spiral into a trade (or investment) conflict, and it can have recourse to the WTO dispute settlement system to address disputes of SWF investment.[143] When necessary, the WTO could also offer impartial assessment concerning whether state actions conform to mutually agreed conditions, and it also offers institutionalised consultation.[144]

Several commentators have called for the establishment of a World Investment Organization (WIO) to encourage capital flows and diminish investment protectionism.[145] It would be a forum that is similar to the Dispute Settlement Body (DSB) of the WTO.[146] It is argued that the only suitable forum to discuss serious issues of international investment is a multilateral one where both developed and developing countries get involved.[147] However, if including both trade and investment in the framework of WTO, it would undermine the credibility of the WTO

[143] A. Mattoo and A. Subramanian, 'Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization' (2008) World Bank Policy Research Working Paper Series, 13 <https://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-4668> accessed September 2016

[144] ibid

[145] R. Haass, 'The Age of Nonpolarity: What will follow US dominance' (2008) 87 (3) Int'l Affairs 44, 55

[146] The DSB was founded as part of the Uruguay Round of trade negotiations in order to institutionalize and expand the dispute settlement mechanism of the GATT. See F. Sabry, The Development and Effectiveness of the WTO's Dispute Settlement Body (2001) 10 Mich. St. J. Int'l L. 521, 523-528

[147] R. Avi-Yonah, 'National Regulation of Multinational Enterprises: An Essay on Comity, Extraterritoriality, and Harmonization' (2003) 42 Colum. J. Transnat'l L.5, 31-34. The UNCTAD and the OECD suffer from a substantial bias towards various interest groups. The UNCTAD publish World Investment Report annually since 1991 and established database to provide information regarding global FDI flows, stocks, cross-border mergers and acquisitions, and investment treaties based on year and country. UNCTAD also organized World Investment Forum to address several issues related to climate change policy, including now investment can foster sustainable development, and the promotion of green FDI in light of government commitments to combat climate change. UNCTAD advances the interests of the developing world, while the OECD furthers the welfare of industrialized States.

as the principal forum for addressing world trade issues as well as the DSB.[148] Hence, the proposed WIO would benefit from a narrower mission.

Choosing the OECD as the international forum to regulate SWFs investments could be supported by two main arguments. Firstly, the above-mentioned OECD policies and guidelines consider both the interests of SWFs and of host countries. It not only provides guidelines for investors such as corporate governance of SOEs, multinational enterprises, but also provides guidelines for regulatory measures adopted by host countries. A majority of OECD policies focus on investment issues and investment-related issues. It also considers the liberalisation of capital movement and national security, which are a conflicting interest caused by SWFs investments. Secondly, among its 34 member countries, a majority of member countries are major host countries of SWF investment and several member countries are also the home countries of SWFs.[149] The 'peer-review' mechanism in the OECD can help member countries to comply with principles and requirements of these guidelines to a great extent.

IMF could be argued as a proper platform to address SWFs relevant issues for at least two reasons. On one hand, IWG and IFSWF are two important organisations established and supported by the IMF to address issues of SWFs. Currently, the most specific and exclusive international regulation on SWFs, the GAPP (or 'Santiago Principles'), is provided by the IWG and the application and compliance of these guidelines are reported to the IFSWF (and released by the IFSWF), which provide case studies on how its members observe the Santiago Principles in practice.[150] One the other hand, IFSWF is a global network of SWFs and a majority of famous SWFs and other clearly defined SWFs are members of IFSWF, within which SWFs can be self-regulated and thus making the GAPP as best practices among the SWFs groups.

The three international institutions can be compared by considering three main features (i.e. organisational members, institutional functions, existing enforcement

[148] Chalamish (n 50) 33

[149] For example, Australia, Canada, France, Germany, United Kingdom and United States etc. are major host countries of SWFs investment, which is briefly discussed in Chapter Three. Norway, United States, France, New Zealand, Australia and Ireland etc. have their own SWFs.

[150] IFSWF, 'Santiago Principles: 15 Case Study' (November 2014) <http://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf> accessed 24 May 2016

mechanisms), for the purpose of finding a plausible body to regulate SWFs investments at international level. Firstly, the WTO has 163 member states, and the OECD has 34 member states (no developing countries are included), while the IMF has 189 member states, which cover the largest groups of members including most home countries and host countries of SWFs.

Secondly, even though WTO has treaties addressing some part of investment affairs, the main function of WTO is to deal with the global rules of trade between nations and to ensure that trade flows as smoothly, predictably and freely as possible. Other developing countries (neither host countries nor home countries of SWF investment) as WTO member states may do not concern about the issues of SWFs. If WTO works as the platform for SWFs investments, it would impose additional workloads on itself and would also shift it from its main missions. The main function of the OECD is to help governments to foster prosperity and fight poverty through economic growth and financial stability. Discussions at OECD committee-level sometimes evolve into negotiations where OECD countries agree on rules of international co-operation and conclude formal agreements, standards and models, or recommendations as well as result in guidelines.[151] The IMF works to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Since a large part of SWFs portfolios have been invested in financial market or financial sectors,[152] IMF is responsible to ensure that the cross-border investment by SWFs does not undermine the financial stability.

Thirdly, under the WTO framework, informal assessment or consultation and DSB mechanism help to ensure the states' compliance with treaties and enforcement. But the DSB mechanism i.e. a state-to-state dispute settlement can easily result in the political discussion on SWF investment rather than commercial considerations, which

[151] They can culminate in formal agreement by countries, for example on combating bribery, or on the treatment of capital movements. They may produce standards, e.g. in the application of bilateral treaties on taxation, or recommendations, for example on cross-border co-operation in enforcing laws against spam. They may also result in guidelines, for example on recipient country investment policies relating to national security.

[152] KPMG, 'Sovereign Wealth Funds 2014' (2014) <https://www.kpmg.com/ES/es/ActualidadyNovedades/ArticulosyPublicaciones/Documents/sovereign-weath-funds-v2.pdf> accessed 24 May 2016

may again raise the political concern of SWF investment. As for the OECD, the above-mentioned 'peer view' process is at the heart of its effectiveness, through which the performance of individual country is monitored by its peers. As for the IMF, the adoption and compliance of the GAPP is guaranteed by good will of each SWF, which is constrained by self-regulation.

Based on analysis and comparison, in this thesis the much more proper institution to deal with SWFs investments is neither the WTO, nor IMF or OECD alone but the cooperation between the IMF and OECD. Since the SWF investment involves several couples of legal relations and various conflicting interests, it is not wise to only focus on one side (i.e. concerns of SWFs *per se* or concerns of host countries alone) but work on both sides. The IMF continues its work in developing and promoting the implementation of GAPP via IFSWF as a main platform, and mimics the 'peer review' process of the OECD. The IMF cooperates with the OECD to ensure the compliance of their guidelines and principles. They may also work together to promote the draft and negotiation of a multilateral agreement on investment among host countries and home countries of SWFs, which in turn helps to guarantee the effectiveness of those soft law regulations, and also helps to ensure the non-discriminatory treatment provided by host countries for SWFs.

Chapter conclusion

Since the issue of SWF investment is a global challenge, international solutions offer greater advantages than only relying on individual domestic actions. An international approach can bring a degree of certainty, accommodate diversity of involved parties, and consider interests of each party to a large extent. An uncoordinated series of responses would fragment the internal market, and unilateral actions may easily result in far-going protectionism. The need to address protectionism is extremely timely as global protectionism in trade and investment are increasing in times of economic recession, and in times of uncertainty (e.g. Brexit, Trump's administration) as well as in times of the rise of state capitalism. Hence, it calls for a consensus and collective efforts at broader level. Host countries of SWFs investments may already have international obligations that are constrained by international law concerning foreign investment. Recent international efforts have also produced some 'soft law' instruments. These measures have their own advantages and disadvantages.

Currently, bilateral treaties play a significant role in international investment and there is no multilateral treaty on investment. BITs and bilateral FTAs, address investment issues between contracting states. These treaties provide different level of substantive and procedural investment protections. Some of these treaties even mention SWFs or define SWFs but are only limited to very few countries that sponsor SWFs. Competitive neutrality provisions concluded in bilateral treaties aim to ensure a level playing field for SOEs and POEs. But numerous exception clauses add uncertainty to host countries' measures and reduce the protection provided for foreign investors. On the other hand, the development of regional-multilateral initiative reflects an increasing trend on investment regulations. States are inclined to participate in broader treaties negotiations. The TPP and TTIP are new attempts and they reflect the demand among signatories or negotiating countries. The TPP is the first regional-multilateral initiative that mentions the concept of SWFs and the GAPP. These regional-multilateral FTAs introduce the US model and EU model included in previous BITs and FTAs into new agreements, and these FTAs consider important and new issues in international market, the content of which will also set examples for future multilateral agreements.

The WTO framework is the only international hard law instrument involves regulations on investment issues. The most relevant treaty is the GATS, which addresses investment in service sectors through 'commercial presence' provision, while it can apply to SWFs only if SWFs hold majority shareholdings in service providers. Currently, most relevant regulatory instruments on SWF investment are in the form of soft law instruments provided by the IMF and OECD. The IWG supported by the IMF provides a code of conduct, i.e. the GAPP for SWF investment, while the OECD provides guidelines for host countries to address SWFs investments and regulatory measures concerning national security. These soft law instruments provide lower negotiation and compliance costs and higher flexibility. However, they are still concerned for the lack of an enforcement mechanism since the implementation of these soft law instruments mainly relies on good wills of individuals.

In order to find a plausible way to regulate SWFs investments, this thesis further analysed and compared these existing regulatory measures/institutions. It compared

the bilateral instruments and multilateral/international initiatives and it found that the multilateral/international approach is more appropriate to address global challenges. It compared the hard-law instruments and soft-law instruments and it found that the combination of both instruments would be an appropriate choice to regulate SWFs and to address protectionism. It also compared most relevant international organisations and it found that the proper forum to address issues of SWFs is not a particular organisation but the cooperation between the IMF and OECD. The IFSWF serves as the main platform assisted by the IMF and then works with the OECD to improve requirements and guidelines in GAPP. On the other hand, the OECD, cooperating with the IMF, take efforts to promote the drafting and negotiation of multilateral agreements, diminish the possibility of adopting irrational measures by host countries, and provide a justified framework for SWFs investment.

It is important to recognise that national legislations, bilateral and multilateral treaties, international agreements, code of conducts and guidelines are not mutually exclusive; they all play a part in the international regulatory framework on foreign investment. There is a general acknowledgement that national regulations are not totally adequate to address all aspects of global issues, thus international instruments are needed to fulfil those functions that cannot be better performed via national controls. Yet these international instruments should not replace or override national controls via domestic rules, but should seek to complement or supplement. No matter what form of a multilateral agreement or international framework is envisaged or designed, states seek to maintain their maximum sovereignty and regulatory flexibility over activities within their territories, while these should be constrained by international legal norms and accepted practices.[153] Furthermore, as investors, SWFs may seek to be granted with sufficient rights/protections and have the recourse to an appropriate dispute-settlement mechanism against undue measures adopted by host countries or the breach of obligations.

[153] C. Wallace, 'The Legal Environment for a Multilateral Framework on Investment and the Potential Role of the WTO' (2002) 3 J. World Invest. 289

CHAPTER 5 SOVEREIGN WEALTH FUNDS INVESTMENT AND ISSUES CONCERNING DISPUTE RESOLUTION

Chapter Introduction

All substantive provisions for the benefit of foreign investment would have a very light impact on national actions or regulatory measures if these substantive protections were not accompanied by procedural protections. When host countries or relevant authorities violate their legal obligations (in contracts, domestic legislations, or treaty obligations), the procedural rules provide SWFs a resort to safeguard rights and interests. When a dispute occurs between a SWF and the host country,[1] SWFs shall have recourse to certain dispute settlement mechanisms. Therefore, it is important to consider the legal standing of SWFs in dispute resolution and corresponding issues.

Generally, foreign investors may have the recourse to local remedies and/or international arbitrations. For treaty-based investment disputes, they can have recourse before an investor-state dispute settlement (ISDS) mechanism, which is incorporated into national law, or BITs (or IIAs), or investment contracts. Existing ISDS mechanism has operated for decades to address investment disputes while it is increasing criticised or doubt by several host countries or even excluded by some developing countries.[2] Questions and concerns surrounding the existing ISDS mechanism lead to a call for reform on ISDS. The EU even proposes an Investment Court System (ICS) to address investment disputes.

The hybrid feature of SWFs results in a debate on the legal standing of SWFs under dispute resolution, since it would determine which kind of dispute resolutions they can choose to against host countries i.e. state-state or investor-state, and also whether they can invoke state immunity in local court. This chapter thus discusses issues of

[1] A dispute may also occur between other private entities (e.g. target companies or portfolio companies of SWFs investment) and SWFs. But this thesis mainly focuses on the investment dispute between SWFs and host countries.

[2] ISDS is increasingly criticised for squeezing and challenging the policy space or regulatory flexibility of host countries, and some tribunals awards are even criticised for limiting or disregarding the state sovereignty of host countries. For more discussion, see Subedi (n 50) in Ch.2

SWF investment concerning dispute resolution. It firstly questions the status of SWFs with regard to treaty protection. It also discusses the legal status of SWFs in the theory and practice of state immunity in selected countries, i.e. the US, UK and China. It then analyses the role of domestic remedies and the ICSID in investment treaty protection. It questions whether it is suitable to address SWFs investment disputes via local remedies and whether SWFs investment can be effectively monitored via the ICSID as a widely adopted and used one. If SWFs are accountable in international investment arbitration, it could help to depoliticise SWFs investment. Lastly, it discusses other major dispute resolution mechanisms to address SWFs investment dispute. The application of ICC arbitration, SCC arbitration, UNCITRAL Rules, and the dispute settlement mechanism within WTO framework are roughly discussed, followed with a brief assessment of the proposed ICS.

1. The Legal Standing of SWFs and State Immunity

This section questions the relevance and implication of the identity of SWFs to the choice of dispute resolutions.

1.1 Treaty protection and the status of SWFs

A fundamental element and feature of international investment law is the role played by international arbitration (particularly treaty-based arbitration) as a means of dispute settlement between investor and host state (i.e. ISDS).[3] By resorting ISDS, investors can benefit from an international remedy when a dispute occurs with host countries. Moreover, through ISDS, the enforcement of substantive protection incorporated into IIAs could be much more effective.[4] International arbitrations may take place before various institutions, e.g. the International Chamber of Commerce (ICC), Stockholm Chamber of Commerce (SCC) or Ad hoc tribunals under UNCTRAL Rules. The most widely used one to address international investment disputes is the International Centre for Settlement of Investment Disputes (ICSID).

Before resorting to international arbitration, it should be noticed that certain BITs

[3] G. Harten and M. Loughlin, 'Investment treaty arbitration as a species of global administrative law' (2006) 17 (1) EJIL 121

[4] M. Audit, 'Is the Erecting of Barriers against Foreign Sovereign Wealth Funds Compatible with International Investment Law' (2008) 5 US-China L. Rev. 1

contain the provision of 'exhaustion of local remedies' (so-called 'Calvo Doctrine').[5] The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) itself does not require the exhaustion of local remedies (ELR) unless the member state has conditioned its consent on this matter. Most BITs provide amicable resolution of disputes through either consultation or conciliation within a specified period, prior to resorting to local remedies or international arbitration.[6]

Nonetheless, those BITs that require the ELR provide an 'opt-out' or 'exit' provision, which means that if a domestic court or administrative remedy has not made a judgment within a specified period it allows international arbitration.[7] A majority of BITs, especially those concluded recently, do not incorporate this requirement, but provide the resort to local remedies as one of many options available to investors, or include a 'fork-in-the-road' clause.[8] If a BIT incorporates this requirement, foreign investors may have little room for manoeuvre. In practice, foreign investors prefer choosing arbitration rather than local courts, thus the option of local remedies seems to be redundant.[9]

However, the discussion on the jurisdiction of arbitration will not be feasible unless a SWF can have legal standing in BITs or multilateral agreements (e.g. Energy Charter Treaty), and can qualify the jurisdictional requirements of the ICSID. Once a SWF has legal standing under international arbitration, it implies that the SWF could be considered as a separate entity from the government of its home country when undertaking commercial activities. Hence, if a SWF is seen as the government itself and SWF investment is regarded as public investment, the legal dispute arises

[5] This doctrine holds that jurisdiction in international investment disputes lie with host countries. It was proposed to prohibit diplomatic protection or armed intervention before local recourses were exhausted. This doctrine is usually advocated by Latin American countries and used primarily in concession contracts. It aims to give the local court final jurisdiction. Previously, China adopted it in its old IIAs.

[6] C. Schreuer, 'Travelling the BIT Route: of Waiting Periods, Umbrella Clauses and Forks in the Road' (2004) 5 J. World Invest. & Trade 231

[7] For more discussions, see A. Aaken, 'Perils of Success? The Case of International Investment Protection' (2008) 9 (1) EBOR 1; see also A. Aaken, 'International Investment Law between Commitment and Flexibility: A Contract Theory Analysis' (2009) 12 (2) JIEL 507

[8] This clause means that the choice of an investor to resort either to a domestic court or international arbitration for addressing disputes is regarded to be final to the exclusion of the other.

[9] M. Lippincott, 'Depoliticizing Sovereign Wealth Funds through International Arbitration' (2012) 13 Chi. J. Int'l L. 649

between two states. The fact is that although SWFs are owned or funded by foreign states, it does not preclude them from resorting international arbitration (e.g. ICSID).[10] In terms of the nature of SWFs investment, it is similar to other investment funds without governmental nature, i.e. private investment rather than public investment. It is the political motivation of a particular transaction that could raise concerns, while this is not the scope in jurisdiction.[11] Therefore, it is quite likely that an arbitration tribunal would accept jurisdiction on a case based on a BIT and the claimant is a SWF.

The jurisdiction on SWF investment dispute implies that the arbitration tribunal would assess the regulatory measures of defendant states. But before the tribunal, it should be justified whether SWFs have been granted specific standards of treatment in BITs. Moreover, the inconsistent and fragmentation of arbitration decisions or awards have been discussed widely by other scholars,[12] which may influence the host countries' willingness to provide certain treaty protection for SWFs to challenges their actions.

In the circumstance of SWFs investment, the jurisdictional debate is relevant where a SWF can rely on ISDS in BITs concluded by its home country against the host country, and where a SWF has legal standing in both BIT and ISDS. Therefore, the legal status of a SWF, as a private investor or the state, and the form/feature of SWFs investment (private or public) are decisive roles in this matter, i.e. qualified investor and qualified investment. However, if a SWF is regarded as the state performing government functions, it may be possible to invoke state immunity under domestic court and the state-state dispute settlement may apply. Otherwise, the ISDS may apply.

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[10] M. Sornarajah, 'Sovereign Wealth Funds and the Existing Structure of the Regulation of Investments' (2011) 1 (02) AsianJIL 267. See also P. Blyschak, 'State-owned Enterprises and International Investment Treaties: When are States-owned Entities and Their Investments Protection' (2010) 6 J. Int'l L & Int'l Rel. 1; L. Poulsen, 'Investment Treaties and the Globalisation of State Capitalism: Opportunities and Constraints for Host States' in R. Echandi and P. Sauvé (eds.) *Prospects in International Investment Law and Policy* (CUP 2012); S. Chen, 'Positioning Sovereign Wealth Funds as Claimants in Investor-State Arbitration' (2013) 6 Contemp. Asia Arb. J. 299

[11] Keller (n 143) in Ch.1

[12] For example, see R. Teitel and R. Howse, 'Cross-judging: Tribunalization in A Fragmented but Interconnected Global Order' (2008) 41 NYUJ Int'l L. & Pol. 959. See also C. McLachlan, 'Investment Treaties and General International Law' (2008) 57 (2) Int'l and Comp. L. Quart. 361

1.2 State immunity and SWFs investment

When state entities invest in the private market, they must comply with different rules. Under the doctrine of 'state immunity', if relevant conditions are met, sovereign investors may be protected from jurisdiction. The main point of this doctrine is that the state (or state actor) cannot be sued and its assets cannot be enforced without its consent.[13] Although this concept itself seems very simple to understand, it varies in application in different jurisdictions. Usually this doctrine could apply to a wide range of state investors, e.g. the government, other authorities or agencies, public pension funds, and even SWFs. This doctrine is most relevant to the dispute or litigation between private investors and sovereign investors (which is similar to the situation of target companies and SWFs). And it is also relevant to a situation in which an investor holds an arbitration award to execute assets of a state (and also whether assets of its SWFs could be executed). Analysing SWFs investment in the context of state immunity provides an alternative approach to understand and assess the identity of SWFs and conduct of SWFs in the market.

State immunity includes two aspects: (i) immunity from jurisdiction or adjudication,[14] and (ii) immunity from enforcement or execution.[15] Questions may arise, e.g. whether or not, and in case to what extent, SWFs can invoke state immunity, and whether there is any exception.

Since SWFs share several similarities with other sovereign investors, e.g. SOEs and FX reserve, for the purpose of state immunity, it is important to clarify whether a SWF should be treated as a SOE (that usually do not enjoy immunity) or as part of a central bank (that its immunity is generally recognised) or as a new category due to

[13] About the history of sovereign immunity doctrine, see J. Block, 'Suits against Government Officers and the Sovereign Immunity Doctrine' (1946) 59 (7) Harv. L. Rev. 1060. See also G. Pugh, 'Historical Approach to the Doctrine of Sovereign Immunity' (1953) 13 (3) La. L. Rev. 5; M. Garcia-Mora, 'The Doctrine of Sovereign Immunity of Foreign States and Its Recent Modifications' (1956) Va. L. Rev. 335; S. Timberg, 'Sovereign Immunity, State Trading, Socialism and Self-Deception' (1961) 56 Nw. UL Rev. 109

[14] G. Kahale, III and M. Vega, 'Immunity and Jurisdiction: toward a Uniform Body of Law in Action against Foreign States' (1979) 18 Colum. J. Transnat'l L. 211

[15] G. Bernini and A. Van den Berg, 'The Enforcement of Arbitral Awards against a State: The Problem of Immunity from Execution' in J. Lew (ed.) *Contemporary Problems in International Arbitration* (Springer Netherlands 1987) 359. See also A. Reinisch, 'European Court Practice Concerning State Immunity from Enforcement Measures' (2006) 17 (4) EJIL 803

their own features.[16] The nature of SWFs investment and the purpose behind such transaction should also be analysed.

1.2.1 State immunity in general theory

Although state immunity is a doctrine of international law, it is not merely a legal problem at international level but it also has impact on the access to domestic court.[17] It is the national law and national practice that firstly recognise it as absolute doctrine and then as relative term, which determines the possibility to judge an action of a state actor, or to dispose the assets of this state actor.

1.2.1.1 Absolute state immunity and relative state immunity

The state immunity, or sovereign immunity, or crown immunity, is a principle of customary international law, by which a sovereign state is exempt from jurisdiction of foreign national courts and its asset is exempt from enforcement.

Initially the absolute doctrine is the first and only approach, which is still applied in some jurisdictions (e.g. Mainland China and Hong Kong). Under the absolute doctrine, any proceedings against foreign states are inadmissible without their consent.[18] With the increasing involvement of states in commercial activities, a development from an absolute approach to a more restrictive/relative approach occurs. The distinction lies in the act of a sovereign nature and the act of a commercial nature. Under the restrictive approach, the court only recognises the immunity in respect of acts in exercise of a sovereign power but the court would deny immunity in respect of commercial nature.[19] The aim to provide a commercial exception is to protect the legitimate expectations of private entities when they do business with foreign state actors.[20] However, the restrictive approach cannot be treated as a universally

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[16] Bassan (n 6) 89 in Ch.1

[17] C. Whytock, 'Foreign State Immunity and The Right to Court Access' (2014) 93 B. U. L. Rev 2033, 2036

[18] G. Delaume, 'Sovereign Immunity and Transnational Arbitration' (1987) 3 (1) Arbitration Int'l 28. See also J. Crawford, 'Execution of Judgments and Foreign Sovereign Immunity' (1981) 75 (4) AJIL 820

[19] For more discussion, see E. Bankas, *The State Immunity Controversy in International Law: Private Suits Against Sovereign States in Domestic Courts* (Springer 2005)

[20] D. Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investors' (2010) OECD Working Papers on International Investment 2010/02 <http://www.oecd.org/investment/investment-policy/WP-2010_2.pdf> accessed 15 November 2016

recognised one, since the state immunity is still an unsettled area of international law, and the scope of recognised exceptions may vary from jurisdiction to jurisdiction.[21]

The key question of whether the investment (portfolio and direct investment) of a SWF is a commercial or sovereign act may be subject to uncertainty in all host countries. It is because national laws may define 'foreign state' differently and provide different commercial exceptions. For example, different jurisdictions may provide different approaches to a foreign SOE or a foreign central bank. Therefore, a foreign state-owned or -controlled investor may have the ability to influence the degree of state immunity it may receive, by changing its legal and governance structure, form of investment, or by choosing its target host country.[22]

1.2.1.2 Immunity from jurisdiction and immunity from execution

State immunity initially is derived from the theory of the 'sovereign equality' of states, which refers to that a state cannot judge the action of another state by the criteria in its national law.[23] It grants a state entity with immunity from jurisdiction and confers its assets with immunity from enforcement.[24] If a foreign state (or state entity) is immune from jurisdiction, it means that the court is prevented from accepting and hearing cases against this state, and from awarding a judgment against it. If a state (or state entity) is immune from enforcement or execution, it means that the court is prevented from recognising a foreign judgment or an arbitral award against it, and from enforcing orders or injunctions against it.

Generally, the commercial exception applies to both immunity from jurisdiction and immunity from enforcement under the restrictive approach. However compared with the case of immunity from jurisdiction, the commercial exception applies somewhat differently to enforcement, which is generally applied more narrowly. It can be argued that the definition of a 'foreign state' and the definition (or scope) of

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[21] ibid 5
[22] ibid
[23] H. Kelsen, 'The Principle of Sovereign Equality of States as A Basis for International Organization' (1944) 53 (2) Yale L. J. 207. See also R. Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* (Harvard University Press 2002)
[24] For more discussion on state immunity, see H. Fox and P. Webb, *The Law of State Immunity* (OUP 2013)

'commercial activities' are important elements to determine whether SWFs can be immune from jurisdiction and enforcement. Situations may differ according to national laws in different jurisdictions. Therefore, this thesis attempts to further analyse relevant national laws in selected jurisdictions, i.e. the US, UK and China.

1.2.2 State immunity in practice

1.2.2.1 Foreign Sovereign Immunities Act of United States

The Foreign Sovereign Immunity Act of 1976 (FSIA) provides rights and immunities for foreign states and state agencies. Pursuant to FSIA, foreign states are immune from both jurisdiction and enforcement in the US while it also includes exceptions that apply to these immunities. The 'foreign state' is defined broadly than sovereign state itself, but also is extended to political subdivisions, agencies and instrumentalities of foreign states.[25] The broad definition may easily lead to the inclusion of SWFs thus being entitled to immunity from jurisdiction under FSIA. A 'commercial activity' herein means 'either a regular course of commercial conduct or a particular commercial transaction or act.' The commercial characteristic of an activity is determined by 'reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.'[26]

FSIA recognises various exceptions from jurisdictions, while there are three exceptions that are particularly relevant to SWFs, i.e. waiver, commercial activity, and arbitration. As to waiver, a state entity can waive its immunity either explicitly (e.g., in a side letter) or by implication (by responding a plea in an action without raising a defence of state immunity).[27] As to commercial activity, a state entity cannot be immune from jurisdiction if the action is in connection with a commercial

[25] An agency or instrumentality of a foreign state means (1) ant separate legal person or corporate; (2) an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof; (3) any entity which is neither a citizen of a State of the US nor created under the laws of any third country. 28 U.S.C. § 1603 (b). A legislative report on FSIA gave some examples of entities that may meet the definition of an 'agency or instrumentality' such as "a state trading corporation, a mining enterprise, a transport organization such as a shipping line or airline, a steel company, a central bank, an export association, a governmental procurement agency or a department or ministry which acts and is suable in it own name." H.R.Rep. No. 94-1487 (1976) 15-16; see also E. Lauterpacht et al., *International Law Reports, Volume 107* (CUP 1998) 313

[26] 28 U.S.C. § 1603 (d)

[27] 28 U.S.C. § 1605 (a) (1)

activity with a sufficient nexus to the US.[28] As to arbitration, if a state entity has consented to the arbitration, it may not be immune from an US court action that is brought to enforce an arbitration agreement or to confirm an arbitration award.[29]

However, the scope of immunity from enforcement is slightly different from jurisdiction. The difference lies in whether the property is owned directly by a foreign state or owned by its agencies or instrumentalities. The property of a foreign state cannot be enforced unless the property at issue is 'used for a commercial activity' in US. [30] By contrast, the enforcement against the property of agencies or instrumentalities focuses on the actions of the entity rather than the use of the property. It provides the property 'engaged in commercial activity'.[31] FSIA also provides several exceptions for enforcement, and these exceptions vary relying on whether the property belongs to the foreign state or to an agency or an instrumentality. FSIA states that any property of an agency or an instrumentality engaged in commercial activity shall not be immune from enforcement, if the judgment is relevant to a claim for which this agency or instrumentality is not immune from jurisdiction, irrespective of the property used for commercial or sovereign purposes.[32]

In addition, the FSIA also provides that the property of a foreign central bank or monetary authority 'held for its own account' is immune from enforcement unless such bank or authority or its parent foreign state has explicitly waived its immunity from enforcement.[33]

It therefore can be argued that SWFs may not be immune from jurisdiction and from enforcement for following reasons. Pursuant to the definition of 'agency or instrumentality', most SWFs could be included. Hence, irrespective of whether a SWF has separate identity from its home country's government or central bank, it may enjoy no immunity from jurisdiction if it engaged in commercial activity. Moreover, if the asset of SWFs in a claim is engaged in commercial activity, this asset is subject to enforcement.

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[28] 28 U.S.C. § 1605 (a) (3)
[29] 28 U.S.C. § 1605 (a) (6)
[30] 28 U.S.C. § 1610 (a)
[31] 28 U.S.C. § 1605 (b)
[32] 28 U.S.C. § 1605 (b) (3)
[33] 28 U.S.C. § 1611 (b) (1)

Further, the FSIA also includes provisions with regard to taxation exemption in the US, some of which may affect the income of foreign government or central bank. In generally, the income of foreign government shall be exempted from taxation, if it is received from investments in stocks, bonds or domestic securities and financial instruments held in the execution of governmental financial or monetary policy; or from interest on deposits in banks in US.[34] But it also provides several exceptions, if the income is: derived from the 'conduct of any commercial activity'; or received by a controlled commercial entity or received from a controlled commercial entity; or derived from the disposition of any interest in such entity.[35] If a central bank of issue engaged in commercial activities within the US, it shall be treated as a controlled commercial entity.

Whether a SWF is treated as central bank or other controlled commercial entity, it herein enjoys no tax advantage over private POEs with respect to income generated from commercial activities. Under current US tax code, income from passive portfolio investment, e.g. portfolio interest and capital gains are generally exempt from tax for all foreign state-owned entities, and most investments of private foreign individuals and foreign corporations in such passive portfolio investment are exempt from tax.[36] But it is argued by scholars that the US rule does provide advantage to SWFs for interests from corporations in which SWFs are, 10% but no controlling, shareholder.[37]

1.2.2.2 State Immunity Act of United Kingdom

In the UK, the relevant statute provisions regarding the state immunity are set out in the State immunity Act of 1978 (SIA).[38] SIA is similar to FSIA but also contains

[34] 26 U.S.C. § 892 (a)

[35] 26 U.S.C. § 892 (a) (2) (A). The term of 'controlled commercial entity' means any entity engaged in commercial activities if the government (i) holds any interest in such entity which is at least 50 percent in such entity, or (ii) holds any other interest in such entity which provides the foreign government with effective control of such entity. 26 U.S.C. § 892 (a) (2) (B)

[36] For more discussion, see Fleischer (n 113) 449 in Ch. 2. However, portfolio interest does not include interests received by ten percent shareholders or by a controlled foreign corporation from a related person. I.R.C. § 881 (c) (3) (B)-(C) (2006). A ten percent shareholder means any person who owns at least 10% of voting powers of all classes of stock to vote, or any partner who owns at least 10% of the capital or profits interest in the partnership.

[37] M. Melone, 'Should the United States Tax Sovereign Wealth Funds?' (2008) 26 B. U. Int'l L. J. 143, 219

[38] The effect of SIA has been extended to numerous territories that follow English Law, including the

some differences in the context of investment. SIA provides that foreign states, including the sovereign, head of the state, government, and department of that government, are immune from the jurisdiction of the courts of the UK.[39] The immunity from the jurisdiction of the courts of UK is also extended to 'separate entity', if the proceedings against the entity relate to its exercise of sovereign authority and the circumstances are such that the State would have been so immune.[40]

SIA recognises several exceptions from immunity, and three exceptions that are particularly relevant to SWFs. The first one is waiver or consent. Being similar to FSIA, immunity from proceedings under SIA can be waived by the state. A state may waive its immunity by: (i) submitting to jurisdiction as a defendant in a suit, (ii) a prior written agreement, (iii) instituting proceedings without claiming immunity, and (iv) intervening in or taking any steps in the proceedings.[41] The second main exception is commercial transaction. A state is not immune as respects proceedings relating to a commercial transaction unless the parties have otherwise agreed in writing.[42] The third one is arbitration. Pursuant to SIA, where a State has agreed in writing to submit a dispute to arbitration, it is not immune from proceedings for matters related to the arbitration.[43]

Under SIA, the property of a State shall not be subject to any process for the enforcement of a judgment or arbitration award. But it also provides exceptions, which are narrower than those provided to immunity from jurisdiction. The first exception is written consent to enforcement.[44] The second one is that the property is used or intended for use for commercial purposes.[45] The SIA explicitly states that if the property of a State's central bank or other monetary authority is not in use or intended for use for commercial purposes, it cannot be enforced without consent.[46]

British Virgin Islands and the Cayman Islands.

[39] State Immunity Act 1978 s. 14 (1)

[40] State Immunity Act 1978 s. 14 (2)

[41] State Immunity Act 1978 s. 2

[42] Commercial transaction means any contract for the supply of goods or services; any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction; any other transaction or activity into which a State enters or it engages otherwise than in the exercise of sovereign authority. State Immunity Act 1978 s. 3 (3)

[43] State Immunity Act 1978 s. 9

[44] State Immunity Act 1978 s. 13 (3)

[45] State Immunity Act 1978 s. 13 (4)

[46] State Immunity Act 1978 s. 14 (4)

The SIA grants 'separate state entities' immunity from jurisdiction and enforcement only if they act in the exercise of sovereign authority, while they cannot enjoy immunity in commercial activities.

In the UK, by recognising of state immunity, a SWF can benefit from immunity from UK tax, if it is an integral part of the government of a foreign state, while the exemption is denied if it is a separate entity from the government (even if the government owns all of its share capital).[47] In this circumstance, if a SWF is organised as a branch of the government (or central bank), its investment is exempt from UK tax; nevertheless the same investment activity shall be taxed whether it is undertaken by a SWF or a SOE. However, it may result in unjustified discrimination between different SWFs, and also between SWFs and other SOEs or POEs, since it only relies on the legal status of a SWF rather than the nature of their activities.

1.2.2.3 State immunity in China

So far, in China, there is no specific state immunity law, while China has consistently claimed the absolute state immunity. In 2011, the Hong Kong Court of Final Appeal ruled that the absolute state immunity applies in Hong Kong, which is the outcome of the case *Democratic Republic of the Congo v. FG Hemisphere Associates*.[48] This case raises the issue of whether Hong Kong should follow a restrictive or absolute doctrine of state immunity. Until the final decision, Hong Kong had followed the restrictive state immunity, while the Mainland China follow the absolute approach. In practice, this absolute approach also provides protection to state-owned entities, irrespective of whether they are acting in a sovereign or commercial capacity.

In this case, the lower Court of Appeal held that Hong Kong would continue to follow the restrictive approach while the Court of Final Appeal embraced the absolute approach. The Court of Final Appeal found that as a Special Administrative Region of China, Hong Kong could not have different approach that is inconsistent with China thereby aligning Hong Kong with the approach adopted by Mainland China.[49]

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[47] House of Commons debates (28 April 2008). See Gaukrodger (n 20) 36
[48] Dem. Rep. Congo v. FG Hemisphere Assoc. LLC, [2011] H. K. C. 747 (C. F. A.)
[49] R. Hill and J. Rogers, 'Hong Kong: Decision on Immunity Not Absolutely Clear' (2011) 6 Global Arb. Rev. 4

The Ministry of Foreign Affairs clarified its own policy on sovereign immunity and its expectations of Hong Kong as follows:

> [T]he consistent position of China is that a state and its property shall, in foreign courts, enjoy absolute immunity, including absolute immunity from jurisdiction and from execution. The courts in China have no jurisdiction over any case in which a foreign state is sued as a defendant or any claim involving the property of any foreign state. China also does not accept any foreign courts having jurisdiction over cases in which the State of China is sued as a defendant, or over cases involving the property of the State of China. The regime of state immunity concerns the foreign policy and overall interests of the state, and the above-mentioned state immunity regime adopted by China uniformly applies to the whole state, including the Hong Kong Special Administrative Region.[50]

With regard to SWFs investment (transaction with private entities), this case may indicate that if a Chinese SWF is treated as a foreign state or public entity and the asset of Chinese SWF in issue is regarded as property of a foreign state, such SWF is protected from jurisdiction and enforcement.[51] Hence, the definitions of a foreign state and of property of a foreign state are important factors to be considered when invoking state immunity.

However, uncertainty remains in practice. During recent years several Chinese state-owned companies have claimed state immunity in proceedings, but the results are different. For example, Aviation Industry Corporation of China (AVIC) (a China's state-owned aerospace and defence company) and China National Building Materials Group Co (CNBM) (a state-owned building products company) have successfully claimed state immunity in the US courts.[52] But a recent case suggests that a Chinese SOEs cannot claim immunity to prevent the execution of an arbitration award against its assets in Hong Kong.

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[50] Dem. Rep. Congo, [2011] H. K. C. 747 at para. 210

[51] M. Faden, 'Improving Cross-Boarder Investment Regulation: A Case Study of China's Largest and Least Known Sovereign Wealth Fund' (2013) 7 U. Pa. East Asia L. Rev. 428, 429 & 444

[52] M. Miller and M. Martina, 'Chinese State Entities Argue They Have 'Sovereign Immunity' in U.S. Courts' *Reuters* (11 May 2016) <https://www.reuters.com/article/us-china-usa-companies-lawsuits/chinese-state-entities-argue-they-have-sovereign-immunity-in-u-s-courts-idUSKCN0Y2131> accessed 18 November 2016

In the case of *TNB Fuel Services Sdn Bhd* v *China National Coal Group Corporation*,[53] the Hong Kong Court of Frist Instance rejected an attempt by a Chinese SOE (China Coal) to assert Crown Immunity and granted a charging order against its shares in a Hong Kong company.[54] China Coal, which is a wholly owned by the Chinese government's State Asset Supervision and Administration Commission (SASAC), asserted that as a state entity it is entitled to Crown Immunity in Hong Kong. However, by applying the 'control test' and by examining relevant Chinese laws (and the role of SASAC), the court held that China Coal is an independent autonomy and its business activities are not intervened by Chinese government.

A letter of Chinese State Council further clarified that a Chinese SOE 'when carrying out commercial activities shall not be deemed as a part of the Central Government, and shall not be deemed as a body performing functions on behalf of the Central Government.'[55] This may indicate that Chinese government will generally not support a claim of immunity made by its SOE. In this circumstance, it could be argued that CIC (a Chinese SWF), established by Chinese corporate law, as a kind of SOE, thus may not invoke immunity unless Chinese government makes a reservation or carve-out arrangement. The issue of state immunity is relevant to Chinese SWFs, as Chinese state capitalism in global market is increasingly running into conflict with

[53] TNB Fuel Services SDN BHD v. China National Coal Group Corporation [2017] HKCFI 1016

[54] This case provides an example to answer the question of state immunity of sovereign investors. A 2014 arbitral award against Chinese SOE – China Coal ordered it to pay compensation to Malaysian company TNBF for breach of a coal sale contract. In an attempt to enforce the award TNBF obtained a charging order over shared held by China Coal in a Hong Kong company. In response, China Coal argued that the Hong Kong courts lacked jurisdiction over it, because as an SOE it formed part of the Chinese government and was therefore entitled in Hong Kong to assert Crown immunity. However, the Court rejected the argument. The Court heard evidence on the laws of People's Republic of China regarding the status and commercial autonomy of SOEs and the extent of government control over their activities. The Court also looked at whether the Central People's Government (CPG) has itself asserted Crown immunity or had authorised China Coal to assert it. A letter from the Hong Kong and Macao Affairs Office of the State Council of the CPG said that an SOE was an independent legal entity with no special status, the judgment said. For more information, see D. McDonald and M. Townsend, 'Hong Kong Court of First Instance Rejects Crown Immunity Claim by PRC State-Owned Enterprise' (27 June 2017) <http://arbitrationblog.kluwerarbitration.com/2017/06/27/hong-kong-court-first-instance-rejects-crown-immunity-claim-prc-state-owned-enterprise/> accessed 16 July 2017; see also 'Hong Kong High Court Rejects Claims of Crown immunity by Chinese State-Owned Enterprise' (15 June 2017) <https://www.out-law.com/en/articles/2017/june/hong-kong-high-court-rejects-claim-of-crown-immunity-by-chinese-state-owned-enterprise/> accessed 30 June 2017

[55] ibid

regulations in many western countries.

1.3 Application of state immunity toward SWFs

Different jurisdictions may adopt slight different approaches to define the foreign state notably with regard to SOEs. Many countries do not consider independent SOEs as part of foreign state and they are generally subject to the law in the same manner as POEs. Central banks are usually immune from jurisdiction and enforcement unless they are engaged in commercial activities. However, it may be complex when it comes to SWFs, as SWFs are structured in various forms (e.g. separate entities or a pool of assets without separate legal identity). It therefore could be argued that the analysis on the situation of SWFs should concern the status (or structure) of SWFs and conduct of SWFs (or the nature of investment), as they are both relevant for the purposes of immunity from jurisdiction and from execution.

It should be firstly noticed that those jurisdictions that adopt restrictive state immunity focus primarily on the nature of the conduct or activity at issue (sovereign or commercial act), not on the status or structure of such foreign entity or even purposes behind. The entity acting in exercise of sovereign power is immune, irrespectively of its status (public or private) while a foreign state is not immune if it engages in commercial transaction. When a state-owned entity is considered as an agency or instrumentality, if its activity qualifies as commercial act, and therefore is not immune.

However, the structure seems likely to be important in relation to SWFs.[56] Firstly, those jurisdictions that adopt absolute immunity consider whether the entity is a part of the foreign state, thus the definitions of foreign state and state agency or instrumentality are of great importance. To determine whether the entity is independent from or comprise the state, its structural and operational independence, its relationship with the state, and even its activities and powers should be tested. Moreover, since the foreign central bank or monetary authority can benefit from immunity advantage, the structure factor is important to those SWFs structured in central banks. In addition, although structure is less important than nature of

[56] Gaukrodger (n 20) 15

commercial act with respect to immunity from jurisdiction in proceedings, it could be a critical factor in the situation of immunity from execution.[57] Therefore, it would be important for domestic law of home countries concerning the structures and conducts of SWFs to be as clear as possible. The specialised rights and obligations of SWFs should be clarified in IIAs concluded by their home countries.

2. SWFs Investment and Treaty Protection

2.1 The role of local remedies in international investment treaty

As a rule of customary international law, in light of the successive judgments provided by the International Court of Justice (ICJ),[58] the ELR aims to safeguard state sovereignty when dealing disputes with individuals.[59] It generally requires individuals allegedly harmed by a state to resort domestic legal system until the final decision has been rendered before seeking diplomatic protection or initiating international proceedings against the state. The term "local remedies" usually refers to any redress available in host states, especially judicial relief or administrative remedies.[60]

However, in international investment law, this rule seems not to be an indispensable and mandatory means for investment dispute resolution, since in many IIAs and investment contracts states have given advance consent to international arbitration with foreign investors. It has generally led to an assumption that foreign investors could directly resort to international arbitration without exhausting the local remedies where consent has been given to ISDS or particularly to ICSID. Certain IIAs set ELR

[57] ibid

[58] These include the judgment in *Switzerland vs. United States of America (Interhadel case) and Elettronica Sicula S.p.A (United States vs. Italy)*, popularly known as the ELSI case. See Preliminary Objections, 1959 I.C.J. Rep. 6, 27; see Judgment 1989 I.C.J. Rep. 15, 28 I. L.M. 1109 (July 20)

[59] The ELR is considered by United Nations International Law Commission (ILC) as a "principles of general international law" and ILC also suggested the codification of ELR in its Draft Article on Diplomatic Protection. The ILC also recognised that IIAs prohibit or relax conditions in relation to ELR, and the draft articles states that the diplomatic protection "do not apply to the extend they are inconsistent with special rules of international law, such as treaty provisions for the protection of investments," See Text of the Draft Articles on Diplomatic Protection [2006] 2 Y. B. Int'l L. Comm'n 24, U.N. Doc. A/CN.4/SER.A/2006/Add.1 (Part 2), art. 14, cmt. 1 & art. 17, cmt. 1

[60] For more information about exhaustion of local remedies, see A. Adede, 'Survey of Treaty Provisions on the Rule of Exhaustion of Local Remedies' (1977) 18 (1) Harv. Int'l. LJ 1; W. Dodge, 'National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Elven of NAFTA' (1999) 23 Hastings Int'l & Comp. L. Rev. 357; C. Amerasinghe, *Local Remedies in International Law* (CUP 2004)

as compulsory requirements,[61] or expressly require the ELR (or require the pursuit of local remedies) for a specified period before international arbitration,[62] or provide a 'fork-in-the-road' clause. But, in fact, not many IIAs contain either express ELR requirement or waiver of this rule, and most IIAs are silent on the ELR before initiating international arbitration.[63] In terms of investment case law, although ELR is a substantive element in the claims of 'denial of justice' or 'expropriation' by certain tribunals,[64] in most ICSID and non-ICSID cases, the arbitration tribunals generally hold that the ELR requirement under international investment law is waived unless explicitly provided.[65]

Nevertheless, in recent years, many developing states have reintroduced a mandatory requirement for ELR in their IIAs, which might empower the domestic legal systems in treaty disputes.[66] Compared with these developing states, China follows an opposite trend. In many treaties and China's early BITs, China requires the exhaustion of its local 'administrative remedies' over investment dispute but not exceed required period (but China is silent on judicial remedies), while in the

[61] Several BITs concluded by the Netherlands in early 1970s provide ELR as compulsory. For example, Article 12 of Netherlands-Malaysia BIT (1971), Article XI of Netherlands-Singapore BIT (1972) and Article 6 of Netherlands-Korea BIT (1974). The Article 10 of Germany-Israel BIT (1976) also provides ELR. In some BITs, ELR is only applicable to disputes concerning the amount of compensation for expropriation, such as Article 4 of Romania -Ghana BIT (1989) and Article 4 of Romania Denmark BIT (1994). Most China's IIAs is silent on judicial remedies but requires administrative remedies, but the Article 8 of Albania-Lithuania BIT (2007) requires the exhaustion of both administrative and judicial remedies.

[62] Several IIAs require investors to pursue local remedies for a certain period or provide ELR as a condition to access ISDS but with time limit. For example, Article 10 of BLEU-Rwanda BIT (1983) and Article 8 of Jordan-Romania BIT (1992). Several BITs concluded by Argentina require to pursue local remedies fro a specified time, e.g. Argentina-UK BIT (1990), Argentina-Korea BIT (1994), and Argentina-Netherlands BIT (1992). Many China BITs requires exhaustion of administrative remedies for no longer than three months e.g. Article 9 of China-Belgium-Luexmbourg BIT (2006).

[63] The Article 26 of ICSID Convention expresses waiver the ELR in the first part, and in the final part it also provides the right to require ELR for contracting states as a condition to arbitration.

[64] For example, ATA Construction, Industrial and Trading Company v. The Hashemite Kingdom of Jordan (ICSID Case No. ARB/08/2, Award, para. 107 (18 May 2010)), Waste Management, Inc. v. United States (ICSID Case No. ARB (AF)/00/3, Award, paras. 97, 116 (30 April 2004)), and Generation Ukraine, Inc, v. Ukraine, (ICSID Case No. ARB/00/9, Award, para. 20. 30 (16 September 2003))

[65] For more discussion, see M. Brauch, 'Exhaustion of Local Remedies in International Investment Law' (January 2017) IISD Best Practices Series <https://www.iisd.org/sites/default/files/publications/best-practices-exhaustion-local-remedies-law-investment-en.pdf> accessed 30 June 2017

[66] For example, in India2016 BIT model, it requires the ELR for at least five years prior to initiate ISDS. See T. Jose, 'What is Model Bilateral Investment Treaty (BIT) 2016?' (29 July 2017) <http://www.indianeconomy.net/splclassroom/409/what-is-model-bilateral-investment-treaty-bit-2016/> accessed 30 July 2017. Other states such as the United Arab Emirates, Argentina, and Turkey have also followed this trend.

China-Australia FTA (ChAFTA), China no longer insists on this requirement and China has adopted reformed ISDS requirements. In terms of SWFs investment or the phenomenon of state capitalism, states could consider whether it is necessary to require ELR in IIAs or other measures to strengthen their domestic legal systems in response to critics of ISDS.

There might be several reasons for encouraging or requiring the pursuit (rather than exhaustion) of local remedies, which might benefit host countries. Firstly, since ISDS is increasingly criticised by certain host countries for challenging their state sovereignty, the inclusion of the need to pursue local remedies in certain claims can help to strike a balance between the right of investor to claim compensation and the right of state to regulate.[67] Secondly, using local remedies as a means to address certain claims would enhance the legitimacy of international arbitration, as it would discourage unnecessary international proceedings. It on the other hand, provides host states the opportunity to correct misconducts or errors made by lower officials, courts or agencies, particularly when investors concern appealable judicial or administrative decisions. It would encourage host states to establish effective and efficient means in domestic legal system to addressing investment claims.[68]

While local remedies in domestic system have certain weaknesses. Firstly, compared with international arbitration, the use of local remedies is a more political process for investors, particularly a state-owned investor (e.g. SWF). For SWFs, since SWFs investment is usually concerned for political motives, domestic law approach would easily run into greater issues of sovereignty than other investors. The enforcement of a ruling in favour of foreign investors may also be refused by the domestic courts or rendered by domestic legislation, [69] especially when this foreign investor is state-owned.

Secondly, foreign investors may concern the impartiality of local remedies and even

[67] Muchlinski (n 39) in Ch.2. See also G. Foster, 'Striking a Balance between Investor Protections and National Sovereignty: The Relevance of Local Remedies in Investment Treaty Arbitration' (2011) 49 (2) Colum. J. Transnat'l L. 201, 267
[68] Foster, ibid
[69] ibid 667

the domestic legal system of host states.[70] Under international arbitration, investors are allowed to select their own panellists and the dispute is judged by a group of experts, while under the domestic law system, the investment disputes are judged by randomly selected judges or juries of host states. It may easily be assumed by investors that these judges would rely on biases of their home countries. In addition, due to the legal status of SWFs, the domestic approach would result in controversial issues or uncertainty in jurisdiction issues, especially where domestic law provides immunity for foreign state or state entity as discussed before.[71]

However, it is notable that domestic law option is not sufficient and adequate to address all kinds of investment disputes, while after pursuing or exhausting of domestic remedies, it still leave open the potential for international arbitration. The local remedies are attractive when dealing with private civil litigation between SWFs and other private entities or when host states in breach of contract obligations, and even when enforcing judgements or orders. While in cases of question in relation to violation of IIAs or issues in domestic legal systems, international investment arbitration (e.g. ICSID) could play an important role. In the case of SWF investment, however, it still needs to be questioned its legal standing under investment arbitration. But it should be admitted that a politically neutral process is helpful to depoliticise it.[72]

2.2 ICSID and SWFs investment

2.2.1 The function and jurisdiction of ICSID

Usually, state-owned investors, e.g. SOEs can seek contract arbitration in other forums to address breach of obligations, or have recourse to local remedies. Where relevant contract has not been violated but the treaty obligation of host country has, they can seek treaty arbitration against host country.[73] The capacity of SWFs to seek

[70] Sornarajah (n 1) 250 in Ch.2
[71] Several countries have provided state immunity for foreign state or central banks in their domestic law. Although those countries adopted restrictive approach also provide commercial activities exception and SWFs investment may fall within this exception, a domestic law approach will result in higher procedural costs than ICSID in determining the jurisdiction. See J. Slawotsky, 'Sovereign Wealth Funds and Jurisdiction Under the FSIA' (2009) 11 U Pa J Bus L 967, 972
[72] Lippincott (n 9)
[73] M. Nolan and F. Sourgens, 'State-Controlled Entities as Claimants in International Investment

investment treaty protection against host could be a controversial issue that is receiving increased attention, since a significant and growing number of foreign investments are made by those sovereign investors. The scope of investment treaty protection is reflected in ICSID Convention and relevant BITs. It may be required to consider whether SWFs and their investments fall within the jurisdiction under ICSID convention and under BITs (or IIAs).

Moreover, the substantive protections if granted to SWFs investment in BITs (or IIAs), should have an effective and reliable mechanism to guarantee. Besides local remedies, this is where the ISDS, especially ICSID could come into play if SWFs investment constitutes invest-state rather than state-state disputes. This section further addresses the jurisdiction issue to see if the SWF could establish its standing before the tribunal against host country. It selects the ICISD (a most widely used one) as an example to analyses its benefit and limitation for addressing disputes of SWFs investment.

2.2.1.1 The establishment and function of ICSID

Normally, BITs contain arbitration clauses for an ad hoc arbitration (under UNCTRAL rules) or the submission to the ICSID (under UNCTRAL rules, ICSID Convention Arbitration Rules or ICSID Additional Facility Rules).[74] A majority of cases are settled under the ICSID framework and other arbitration systems also draw a great number of cases brought under IIAs recently.[75] The ICSID was established by the World Bank in 1965 via the ICSID Convention. Since then, many states have ratified the ICSID Convention and remained contracting parties. The enforcement of arbitral decisions of ICSID or other arbitration systems is provided by the 1958 United Nation Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

Arbitration: An Early Assessment' (2010) Colum. FDI Pers., No. 32 <http://ccsi.columbia.edu/files/2014/01/FDI_32.pdf> accessed 10 December 2016

[74] INT'L CTR. For Settlement of Inv. Disputes, Introduction to ICSID Convention, Regulations and Rules ICSID/15 (April 2006) [hereinafter ICSID Convention]

[75] As of December 31 2016, 597 cases had been registered at ICSID under the ICSID Convention and Additional Facility Rules. See World Bank, 'The ICSID Caseload Statistics (Issue 2017-1)' (2017) <https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202017-1%20(English)%20Final.pdf> accessed 30 August 2017

The ICSID provides facilities for conciliation and arbitration of investment disputes between a contracting state and 'nationals' of another contracting state. It was stated that the ICSID sought to remove 'major impediments and risks to foreign direct investments in the absence of specialized facilities for investment dispute settlement.'[76] The ICSID Convention begins with the language of considering 'the role of private international investment therein'. It fills the gap between private-private and state-state dispute settlements, which provides a platform, i.e. the ISDS for foreign investors and host states to address investment issues where the parties have executed valid consent. In the Maffezini case, the jurisdiction of ICSID over invest-to-state disputes rather than disputes between other parties was recognised.[77]

Usually, most cases registered at ICSID are brought by investors of developed countries.[78] Recently, more cases are being brought to ICSID or other forums involving investors of developing states. In light of investor-state cases that involve China (including Hong Kong), as of September 2017, there have been only three cases against China registered at ICSID (based on BITs) and 5 cases registered at ICSID that were brought by Chinese investors against host countries.[79] It implies that China and Chinese investors are getting increasingly involved in ISDS than before.

However, compared with China that gradually actively engages in ISDS, several other

[76] Y. Kryvoi, *International Centre for Settlement of Investment Disputes (ICISD)* (Kluwer Law International 2010) 21

[77] Maffezini v. Spain, Decision on Jurisdiction, January 25, 2000, 5 ICSID REP. 396, 434: 'Just as the Center has no jurisdiction to arbitrate disputes between two states, it also lacks jurisdiction between two private parties.'

[78] For example, in terms of the EU, investors from the EU member states are the largest user of ISDS. The EU member states have been challenged most frequently by EU based investors rather than investors from outside the EU. The most-often used instruments for the claims were the ECT, NAFTA and the Argentina-US BIT. See European Commision, 'Investor-to-State Dispute Settlement (ISDS): Some Facts and Figures' (12 March 2015) <http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153046.pdf> accessed 30 June 2016. In terms of all ICSID cases involving state parity, state from the South America (24%), and Eastern Europe and Central Asia (25%) have been mostly challenged. World Bank (n 75)

[79] For cases brought by Chinese investors, see Sanum Investments Limited v. Lao People's Democratic Republic (ICSID Case No. ADHOC/17/1), Standard Chartered Bank (Hong Kong) Limited v. United Republic of Tanzania (ICISD Case No. ARB/15/41), Beijing Urban Construction Group co. Ltd. v. Republic of Yemen (ICSID Case No. ARB/14/30), Ping an Life Insurance Company of China, Limited and Ping An Insurance (Group) Company of China, Limited v. Kingdom of Belgium (ICISD Case No. ARB/12/29), Tza Yap Shum v. Republic of Peru (ICSID Case No. ARB/07/6). For cases against China, see Hela Schwarz GmhH v. People's Republic of China (ICSID Case No. ARB/17/19), Ansung Housing Co., Lid. V. People's Republic of China (ICSID Case No. ARB/14/25), Ekran Berhad v. People's Republic of China (ICSID Case No. ARB/11/15).

developing countries opt out of ICISD for the concern of state sovereignty. Bolivia withdrew from ICSID in 2007,[80] while Ecuador denounced the Convention, effective in January 2010.[81] Venezuelan also withdrew from ICSID.[82] Not only have these states taken a strong stance against ICSID, but also countries such as India,[83] Indonesia[84] appear reluctant to include ISDS clauses in trade and investment agreements. Brazil has refused to sign any treaty with ISDS clauses.[85] South Africa is looking to renegotiate treaties with ISDS or considering withdrawing from such kind of treaties, as it concerns that ICSID infringes on state sovereignty and is 'beholden to US interests.'[86]

Despite the decline in contracting states and the criticism against ICSID (or even ISDS), the concern seems not to be widely shared given the rise in the number of arbitrations filed under BITs and other regional, multilateral treaties against developed countries or brought by investors of developing countries. It should be noticed that withdrawing from ICSID would increase future costs if other countries still choose to use ICSID arbitration. In addition, these countries or regions have not created many SWFs or large SWFs than other countries, so that they have less concerns of investment protection of SWFs. Moreover, the ICSID's Additional Facility Rules could enable any countries with SWFs that are not contracting parties of ICSID Convention to take advantage of ICSID arbitration. Hence, for countries

[80] One of the reasons given by Bolivia for its withdrawal from ICSID in 2007 was the alleged lack of balance between public and private interests by ICSID tribunals in delivering their ruling in investment cases. Subedi (n 50) in Ch.2

[81] P. Vasquez, 'Latin American Nations Unhappy with World Bank Arbitration Panel' (13 May 2008) 58 Oil Daily 92; see T. Yalkin, 'Ecuador Denounces ICSID: Much Ado about Nothing?' (30 July 2009) <https://www.ejiltalk.org/ecuador-denounces-icsid-much-ado-about-nothing/> accessed 26 November 2016

[82] C. Titi, 'Investment Arbitration in Latin America' (2014) 30 Arb. Int'l 357

[83] B. Dhar, 'India's Experience with BITs: Highlights from Recent ISDS Cases' (2015) South Centre Investment Policy Brief No.3 <https://www.southcentre.int/wp-content/uploads/2015/07/IPB3_India's-Experience-with-BITs_EN.pdf> accessed 28 November 2016

[84] A. Jailani, 'Indonesia's Perspective on Review of International Investment Agreements' (2015) South Centre Investment Policy Brief No.1 <https://www.southcentre.int/wp-content/uploads/2015/07/IPB1_Indonesia-Perspective-on-Review-of-Intl-Inv-Agreements_EN.pdf> accessed 28 November 2016

[85] 'Investor-State Dispute Settlement-The Arbitration Game: Governments are souring on treaties to protect foreign investors' (11 October 2014) <https://www.economist.com/news/finance-and-economics/21623756-governments-are-souring-treaties-protect-foreign-investors-arbitration> accessed 30 June 2016

[86] Lippincott (n 9) 670

with SWFs, ICSID would remain to be an attractive platform.[87]

2.2.1.2 The jurisdiction requirement of ICSID

If investors invoke ISDS under the ICSID, they must qualify the criteria not only in specific IIAs but also in ICSID Convention. The jurisdictional issue involves the determination of "investor" or "nationals" and "investment".[88] Regarding the definition of each specific BIT (or IIAs), most BITs, do not explicitly mention SWFs and deal with the issue of whether to extend treaty dispute protection to SWFs expressly.[89] Nevertheless, some of them do contain express provisions protecting state-owned or government-controlled entities, or even the government itself by incorporating them into the definition of "investors" or "nationals" of contracting parties.[90] It may imply that in IIAs the dispute resolution protection is extended to state-controlled entities. Although other BITs remain silent on the treatment to SOEs, the definition of investors or 'national' is usually ownership-neutral. The broad definition of "investors" and "investment" in many IIAs seems easily or quite likely to have SWFs falling within the scope of IIAs.

The ICSID Convention, however, introduces two considerations that may not apply to IIAs. First, it states in its Preamble that 'Considering the need for international cooperation for economic development, and the role of private international investment therein.' It indicates that ICSID Convention aims to encourage 'private international investment' as distinguished from public international investment.[91] Second, it excludes state-state disputes and private-private disputes. It is a more complicated issue when examining SWFs investment under the scope of the ICISD, as the fact that SWFs are stated-owned investment funds structured in various forms.[92] Its legal status and structure may present difficulties in considering whether SWF should be treated as a national of a State or the State under ICSID.

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[87] ibid
[88] Chen (n 10) 313
[89] See Chapter four, section 1.1.1
[90] ibid
[91] M. Feldman, 'State-Owned Enterprises as Claimants in International Investment Arbitration' (2016) 31 (1) ICSID Rev. 24, 25
[92] Chen (n 10) 314

Generally, ICSID arbitration has three jurisdictional requirements: (i) nationality of the parities, i.e. any legal dispute must occur between a Contracting State and a national of another Contracting State; (ii) consent to submit, i.e. the disputing parties must have consented in writing to the submission to ICSID; (iii) and dispute arising directly out of an investment.[93] Whether the claimant is a state or a national of a state determines whether it may file a qualified claim. If a SWF is regarded as the government itself, the legal dispute arises between two states thus the ICSID has no jurisdiction. If a SWF can effectively have its legal standing in IIAs and ICSID Convention, it could help to treat the SWF as a separate entity from its sponsoring government.

Hence, for the ICSID arbitration having jurisdiction over a dispute between a SWF and a host country, based on an IIA concluded between the home country and this host country, the SWF should not be identified as the government of its home country.[94] State-owned entities, e.g. SOEs, are usually and not necessarily excluded from treaty-based investment protection, as long as they engage in commercial activities rather than act in exercise of governmental capacity.[95] Thus, the feature of state ownership may not preclude SWFs from using the ICSID arbitration while other aspects should be considered.

As for the first requirement, ICSID only has jurisdiction if the dispute arise between a state and a national of another state. When ICSID was designed, it was assumed that state-state disputes would be sent to the International Court of Justice (ICJ) or the Permanent Court of Arbitration (PCA), investor-investor disputes would be sent to domestic courts or commercial arbitrations.[96] So far, ICSID member states cover a majority of potential host countries and home countries of SWFs. The 'national' of a contracting state includes 'any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the

[93] ICSID Convention Article 25
[94] The Broches test highlights the need to distinguish private investment from public investments and government-owned corporation should not be disqualified the jurisdiction unless it acts as a part of government. See E. Helgeson and E. Lauterpacht, *ICSID Reports: Volume 5: Reports of Cases Decided Under the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 1965* (CUP 2002) 331
[95] Dolzer and Schreuer (n 18) 46 in Ch.2
[96] C. Schreuer et al., *The ICSID Convention: A Commentary* (2nd edn, CUP 2009) 130

parties consented to submit such dispute to conciliation or arbitration.'[97]

The Convention does not define the juridical person but it may include even state-owned entities if they act in commercial capacity.[98] A problem may arise with regard to the legal and governance structure of SWFs. SWFs usually are structured into three forms: (i) a separate legal entity with full capacity governed by a specific constitutive law; (ii) a state-owned corporation governed by domestic company law or SWF-specific laws; (iii) a pool of assets without a separate legal identity owned by the State or the central bank. The first two with separate capacity could be regarded as a kind of SOEs, but the last one is deprived of any separate personality thus it is hard to meet this requirement.

The second requirement could be easily satisfied. Usually, the express consent in written form is formalised in three ways, i.e. in an investment contract, in a host country's legislation, and in IIAs.[99] Therefore, if there is an IIA containing such as dispute resolution provision between host country and home country of an SWF, or if the SWF has an investment contract with a host state that contains such provision, it would constitute the consent to ICSID arbitration.[100]

The third requirement should consider the term of 'legal dispute' and 'investment'. A 'legal dispute' must concern 'the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation.'[101] SWFs can make claim of the breach of obligation of a host country under a legally binding IIA or under an investment contract. The term 'investment' was not defined. The preamble of the ICSID Convention provides a reference to private investment.[102]

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[97] ICISD Convention Article 25 (2) (6)

[98] Cekoslovenska Obchodni Banka A S v. The Slovak Republic (decision on objection to jurisdiction, 24 May 1999), para. 16

[99] The BITs refer to the ICSID arbitration rules as just one of the possibilities to settle the dispute; the other most resorted to alternative is the UNCITRAL Rules.

[100] M. Megliani, 'Sovereign Wealth Funds and Investment Law' in N. Finch (ed.) *Emerging Market and Sovereign Risk* (Palgrave Macmillan UK 2015) 169

[101] Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

[102] The ICSID tribunal case law has accepted shareholdings in target companies as a form of investment such as minority shareholding, and indirect shareholding through an intermediate company. A qualified investment mush satisfies the form of protected investment under both IIAs and ICSID Convention. See CMS GAS Transmission Company v. The Republic of Argentina (decision on objections to jurisdiction, 17 July 2003), para 51. See also Gas Natural v. The Argentina Republic,

But the Report of the Executive Directors does recognise and respect the essential requirement of consent by the parties. Contracting states can make known in advance, 'if they so desire, the classes of disputes which they would or would not consider submitting to' ICSID.[103] Therefore, if contracting parties intend to bring disputes arising from the SWFs investment, the IIA between the host country and home country should include any SWFs related transactions by broadly defining the term 'investment' or 'covered investment'.

In terms of ICSID case law, there have been numerous investment dispute cases claimed by state-owned or controlled entities pursuant to ICSID rules. But in most cases, tribunals did not seriously address the question of state-owned investors and public investment, and respondent states did not object to a state-owned investor having access to ICSID arbitration. However, in the CSOB case (Československa obchodní banka v. Slovakia), the ICSID tribunal had addressed the matter of 'public investments' in some detail, which is a very importance case when dealing with state-owned entity.[104] In this case, the tribunal relied on the widely accepted view of Aron Broches (so-called "Broches test"), to determine whether the state-owned bank (CSOB) was a 'national' under ICSID Convention. According to the Broches test:

> [I]n today's world the classical distinction between private and public investment, based on the source of the capital, is no longer meaningful, if not out-dated. There are many companies which combine capital from private and governmental sources and corporations all of whose shares are owned by the government, but who are practically indistinguishable from the completely privately owned enterprise both in their legal characteristics and in their activities. It would seem, therefore, that for purposes of the Convention a mixed economy or government owned corporation should not be disqualified as a 'national of another Contracting State' unless it is acting as an agent for the government or is discharging an essentially governmental function.[105]

The tribunal held that the CSOB acted as an independent private entity and its

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Case No ARB/03/10 (decision on preliminary questions on jurisdiction, 17 June 2005), paras. 32-35

[103] ibid

[104] Československa obchodní banka, a.s. v. Slovakia Republic, ICSID Case No. ARB/97/4

[105] Schreuer et al. (n 96) 161 (RL-003); see also A. Broches: 'The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States' [1972] Recueil des Cours de l'Academie de Droit International, 355

activities were commercial in nature. According to the tribunal, it was the function and nature of investment rather than the ownership and purpose that determined the private-public distinction. While, it was concerned that the decision failure to consider the purpose driving the activities of state-owned claimants would increase risks in expanding ICSID jurisdiction to state-to-state disputes.[106]

Another recent case also addressed the issues of legal standing of state-owned entity, i.e. the BUCG case (which involves a Chinese claimant).[107] On May 2017, the ICSID tribunal issued a decision on jurisdiction in this case. For the first objection *Ratione Personae,* i.e. whether the BUCG is a 'national' of China, both parties accepted the Broches test, while their opinions are opposite. In this respect, the respondent cited the decision of the Maffezini v. Spain and claimed that 'the test that has been developed [to establish whether a particular entity in a state body] looks to various factors, such as ownership, control, the nature, purposes and objectives of the entity whose actions are under scrutiny, and to the character of the actions taken.'[108]

The tribunal firstly recognised that 'the Broches factors are the mirror image of the attribution rules in Article 5 and 8 of the ILC's Article on State Responsibility,'[109] and it 'lays down markets for the non-attribution of state status.'[110] It then accepted the application of Broches test in the CSOB case and agreed 'the focus on a context-specific analysis of the commercial function of the investment.'[111] The corporate controls and mechanisms in the perspective of the tribunal are usual in the context of Chinese SOEs. The tribunal held that 'the issue is not the corporate framework of the state-owned enterprise, but whether it functions as an agent of the State in the fact-specific context.'[112] The tribunal concluded that the BUCG acted as a commercial contractor rather than an agent of the Chinese Government and BUCG was not exercising Chinese governmental functions within the territory of Yemen. However, although these two cases emphasised the factor of commercial nature of

[106] Feldman (n 91)
[107] Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen, ICSID Case No. ARB/14/30
[108] Emilio Agustín Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (25 Januatry 2000) para.76
[109] ICSID Case No. ARB/14/30, Decisions and Jurisdiction (31 May 2017) para. 34
[110] ibid
[111] ibid para. 35
[112] ibid para. 39

investment to determine the state-owned entity under ICSID jurisdiction, there is no consistent decisions on this issue. And the purely financial factor of some of SWFs investment should also be considered in drafting the substantive rules and in discussing investment case law. Other relevant factors, such as ownership, purposes, and structure are likely to be considered by other tribunals in future cases.

2.2.2 The necessity for SWF to resort ISDS

According to the above analysis, it is likely for an independent SWF to qualify as a claimant under ICSID. However, although SWFs investment or the state capitalism is increasingly receiving attention in global market, SWFs has not brought any claims before investment arbitration, either ICSID or other arbitration institutes, against host states.[113] This section seeks to dig further into the question of application of ICSID to SWFs investment.

2.2.2.1 Existing Claims from SWFs

Given the possibility of SWFs to bring claims, so far few claims were brought from SWFs. Several reasons could answer this question. The first reason might be the nature of SWFs investment. Since most SWFs undertake portfolio investment, this kind of investment does not usually fall into the restriction of domestic regulations or review process. Those SWFs acquiring shares or equities, if they are prohibited/blocked by review process, it is unnecessary to increase additional costs to pursue dispute settlement.[114] Since timing could be very important for SWFs investment, pursuing ISDS seems time-consuming for SWFs. Moreover, compared to the volume of total global FDIs, SWFs investment only presents a relative small part and existing IIAs do not cover all kinds of FDI or other types of investment. The scope of covered investment depends on the definition of 'investment' in each IIA.

The second reason might be the structure of SWFs. It is the investor that usually initiates a claim before ISDS. In terms of SWFs, whether they are operated by external funds mangers or not, the board of directors of SWFs (or the controller) play an important and even essential role in decision-making. While, for SWFs with

[113] M. Burgstaller, Sovereign Wealth Funds and International Investment Law, in C. Brown and K. Miles (eds.) *Evolution in Investment Treaty Law and Arbitration* (CUP 2011) 176
[114] Chen (n 10) 317

separate identities, the board of directors may consist of governmental officials or mix with other directors. For those SWFs without separate identities, the manager/controller is usually the central bank or monetary authority. It is therefore, the government authority to decide whether to address dispute through ISDS. Home country may consider other political and diplomatic factors, and avoid involving in such dispute. Despite that, since some SWFs, especially Chinese SWFs, are actively engaging in direct investment in critical infrastructure or sensitive industries, employing ISDS may protect their investments in host countries given the increasing political backlash in many developed countries.

2.2.2.2 The advantages of employing ICSID

ISDS is usually regarded as a way to protect investors via a depoliticising mechanism. As discusses before, under customary international law, investment disputes were mostly resolved by local remedies or diplomatic protection provided by their home states. These recourses could be political-biased, and even some host countries lack sound and stable legal system, thus resulting in legal risks for foreign investors.[115] Therefore, the ICSID Convention comes into being to provide an international forum for investors with a neutral and effective mechanism.

Allowing SWFs to be protected as qualified investors under ICSID jurisdiction or other ISDS mechanisms could provide benefits to SWFs. Firstly, it could help to improve the legal and governance structure of SWFs and to depoliticise SWFs.[116] On one hand, it would encourage the home country to make clear the relation with its SWFs and separate the operation of those SWFs mannered by central bank from its governmental functions. It would reduce the possibility of SWFs to reply on the protection of home countries.

On the other hand, the purpose of regulations at both domestic and international level on SWFs investment in particular or on sovereign investment in general is to ensure SWFs to act as private investors. If host countries intend to impose same restrictions or obligations on SWFs, it is important and necessary to provide SWFs the same

[115] Schreuer et al. (n 96) 160
[116] Ibid 318

access to investment protection. It would provide the level playing field and guarantee competitive neutrality between SWFs and other investors. It indicates that SWFs act as the same like other private investors and all of them can employ ICSID or other ISDS mechanism against host states. However, it also indicates that other private investors may not bring claims against SWFs under ICSID but have to resort domestic forums or other arbitration forum, if SWFs have standing under ICSID. Besides, it would reduce the risk of having no access to recourses other than local remedies if SWFs are recognised as states and they cannot invoke either state-state or investor-state arbitration.

Secondly, it helps to guarantee the compliance with the GAPP as a voluntary code of conduct for SWFs and reduce the protective restriction imposed on SWFs. Although GAPP is endorsed by 32 funds, many other SWFs are not the member of IFSWF. Even among these endorsed funds, their levels of compliance are different. If following the suggestions in chapter four to incorporate GAPP or other similar guidelines of corporate governance into IIAs, it could make these guidelines on SWFs as elements to be considered by arbitration tribunals if SWFs claim protection. It, on one hand, encourages SWFs to adopt the GAPP to improve governance and transparency. On the other hand, good governance of SWFs would eliminate concern of host countries, thus reducing the possibility of domestic restrictions imposed on SWFs investment by host countries. SWFs would benefit from ICSID or other international arbitrations where they have faced protective restrictions due to suspicion and backlash. Host countries may also be more cautious about adopting protective measure for the fear of being challenged by SWFs before international arbitration.

Moreover, recognising SWFs under the ICSID jurisdiction could guarantee the enforcement of decisions or awards. As controversial state-owned investors, it may not be easily for SWFs to have decisions enforced in the jurisdiction of host countries, especially those host countries without sound legal system or with political prejudice.[117] The ICSID Convention makes any award enforceable in the territory of

[117] Lippincott (n 9) 673. See also C. Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties' (2011) 10 Chinese J. Int'l L 531, 536

its contracting member states.[118]

Furthermore, ICSID could provide certain predictability and confidentiality for both SWFs and host countries. As a neutral forum at international level for dispute settlement, the ICSID Convention and ICISD arbitration rules provide greater certainty than the unpredictable domestic regulations in host countries.[119] However, the inconsistent awards provided by different tribunals on the same issue would reduce the predictability of ICSID (even the ISDS). While it might be left to further ISDS reform, e.g. incorporating appellant procedures, or IIAs reform, e.g. clarifying substantive provisions, rather than limiting the access to ISDS. For confidentiality, ICSID provides parties with confidentiality for dealing with sensitive investment information, especially when SWFs investing in sensitive industries. The ICSID arbitration provides private arbitration but also accommodates public hearings depending on relevant requirements in IIAs. Providing greater transparency would make a more predictable international regime but sensitive information should be concerned.[120] It is therefore left IIAs to increase or determine the transparency of ISDS, which is also reflected in some concluded IIAs recently,[121] even IIAs concluded by China.[122]

2.2.2.3 The limitation of employing ICSID

There are, however, drawbacks of employing ICSID jurisdiction by SWFs, which particularly raise concerns for host countries. The concern mainly lies in the challenge to a state's right to regulate or the state sovereignty. Although many SWFs undertake portfolio investment, some SWFs increasingly participate in direct investment for higher returns, even in sectors that can be regarded as critical or strategic to host

[118] ICSID Convention, Article 54
[119] Lippincott (n 9) 674
[120] ibid 675
[121] For example, CETA adopts UNCITRAL Transparency Rules on information disclosure, based on which it provides a list of documents to be made available to the public. Moreover, CETA and EU-Singapore FTA (EUSFTA) require that hearings shall be open to the public, unless the Tribunal determines that it is appropriate to hold in private. See CETA art 8.36.5 and EUSFTA art 9.22 & Annex 9-G
[122] 2012 China-Canada BIT and ChAFTA contain substantive requirements for transparency of ISDS arbitration, but the disclosure of certain matters still depends on the determination of Contracting Parties. See China-Canada BIT (2012), art 28, and China-Australia FTA (2015), art 9.17

countries.[123] Providing SWFs the recourse to ICSID would be a controversial issue for host countries, since ISDS mechanism has increasingly been criticised for infringing on the regulatory flexibility of the state.[124] In some cases, the ICSID arbitration is used deliberately by investors to force the host country to change its domestic regulations.

Moreover, it would be more risky for a state party, particular when its measures or actions related to national security could be interpreted by arbitration tribunals. Due to the no precedential binding force of ISDS, it would result in inconsistent and less predictable decision and uncertainty to host countries.[125] In this regards, host countries may consider excluding SWFs from ISDS arbitration, or excluding certain disputes regarding SWFs investment from ISDS. This could also explain the reason why several countries require exhausting or pursuing local remedies before resorting to international arbitration.

However, in the perspective of SWFs, the ICSID arbitration or other ISDS mechanism is not likely to address every issue of domestic law caused by SWFs investment. For those disputes in which the state party does not violate contract or treaty obligation, or some administrative procedural requirements in domestic legal system, SWFs may have to resort to domestic courts.

It is, therefore, argued in the thesis that SWFs should be allowed to have the access to ISCID (and other international arbitrations) rather than be wholly denied as a subject-matter in jurisdiction since it is not wise to simply view every SWF as state party and treat its investment as public investment based on its state ownership. To such extent, ICSID and other ISDS mechanism provide a neutral forum, estranged

[123] After suffering loses from financial crisis, many SWFs have shifted their focus from financial market, real estate to infrastructure, energy sectors or even equity markets. Chinese SWFs also has diversified its portfolios but financial, energy, information technology are its major industry portfolio. See X. Sun et al., 'China's Sovereign Wealth Fund Investments in Overseas Energy: The Energy Security Perspective' (2014) 65 Energy Policy 654, 658. See also S. Miroudot and A. Ragoussis, 'Actors in the International Investment Scenario: Objectives, Performance and Advantages of Affiliates of State-Owned Enterprises and Sovereign Wealth Funds' in R. Echandi and P. Sauve (eds.) *Prospects in International Investment Law and Policy: World Trade Forum* (CUP 2013) 71

[124] See R. Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 Int'l L. & Pol. 953; See also C. Henckels, 'Indirect Expropriation and the Right to Regulate: Revising Proportionality Analysis and the Standard of Review in Investor-State Arbitration' (2012) 15 (1) JIEL 223

[125] Chen (n 10) 320

from political consideration and sovereign needs to address concerns of SWFs investment and issues of national security. A controversial issue involved in SWFs investment (and other sovereign investment) is national security risk, which also results in protective measures being imposed on state-owned investors in many countries. Assuming SWFs investment is more political driven than commercial-oriented may result in prejudices and biases and undermine a level playing field between SWFs in good faith and other commercial-oriented private investors. For SWFs, ICSID could serve as a resort to address protectionist measures imposed on SWFs investment.[126] Recognising SWFs under ICSID jurisdiction and receiving arbitration decisions in favour of SWFs, serve as evidences to demonstrate the commercial-oriented investment or conduct of SWFs.

For host countries, although excluding SWFs from ICSID or other ISDS may reduce the possibility to be challenged by SWFs, it may also drive away foreign capitals in their domestic market. While providing SWFs the recourse to ICISD arbitration and other international arbitration can also provide resort for host countries to indirectly encourage and require relevant obligations of SWFs or other state-owned investors in IIAs if relevant obligations or requirements of foreign investors have incorporated into IIAs. It should be noticed that the disadvantages of ICSID and criticism on ISDS, e.g. uncertainty, unpredictability, and challenging the state sovereign, are not derived from the nature of SWFs and the concern of their investment but from the mechanism itself,[127] which needs further reform and clarification in IIAs.

It should be emphasised that SWFs vary from each other and not all SWFs and all SWFs investments would raise national security or pose political risks. The SWFs claims should not wholly excluded ex ante, but adopt an ex post case-by-case investigation on legitimate national security concerns. Therefore, recognising SWFs under ICSID jurisdiction has the potential to benefit SWFs and also host countries. It helps to depoliticise SWFs, to provide a level playing field for investors to access dispute resolution, to enforce obligations of both host countries and SWFs in IIAs, and to reduce the political bias in domestic legal system. It seeks to strike an important balance in domestic and international dispute resolution forums.

[126] Burgstaller (n 113) 186
[127] Chen (n 10) 321

3. Other Dispute Resolution Mechanisms for SWFs Investment

Apart from two main mechanisms (local remedies and ICSID) to address investment dispute under IIAs, there are other dispute resolution mechanisms at international level (or in IIAs) to deal with investment dispute. Although some mechanisms are not the current main resorts to address investment issues under IIAs, they may provide a new perspective for rethinking the development or improvement of international investment dispute resolutions.

3.1 Other international arbitration institutions

While the most common international arbitration forum for investment arbitration is ICSID (under ICSID Convention, UNCITRAL rules or even under ICSID Additional Facility Rules), a substantial minority of BITs specify other dispute resolution mechanisms,[128] allowing investment disputes to be settled by other dispute resolutions.[129] Other options (selected by this thesis) mainly include the Court of Arbitration of the International Chamber of Commerce in Paris (the ICC Court), the Stockholm Chamber of Commerce (SCC) and/or ad hoc arbitration under the UNCITRAL rules.

3.1.1 The ICC and SCC arbitration

The International Chamber of Commerce (ICC) was set up in Paris in 1919 while the ICC International Court of Arbitration (the ICC Court) was established in 1923 pursuant to the ICC Rules of Arbitration adopted in 1922. According to its Statutes, the ICC Court has certain organization powers, which are conferred upon it by the parties' agreeing to submit to ICC arbitration.[130] The ICC Court and its Secretariat act as an independent body from ICC, which ensures confidentiality.[131] The ICC arbitration is usually incorporated into many contracts between private firms, between states (or state entities) and private companies. Contracting states could include

[128] R. Dolzer and M. Stevents, *Bilateral Investment Treaties* (Kluwer L Intl 1995) 146

[129] For example, the Article 8 (4) of the Egypt-Poland BIT (1995) allows investor-state disputes to be settled by a court of arbitration in accordance with the Rules Procedure of the Arbitration Institute of the SCC, the court of arbitration of ICC, ad hoc arbitration under the UNCITRAL Rules, or ICISD arbitration.

[130] For more information, see T. Webster and M. Buhler, *Handbook of ICC Arbitration: Commentary, Precedents, Materials* (Sweet & Maxwell 2014)

[131] E. Schäfer et al., *ICC Arbitration in Practice* (Kluwer Law International 2005) 13

provisions in IIAs or domestic investment laws providing for ICC administration of invest-state disputes.[132] Usually, ICC's roles in the area of investment arbitration include administration of investment treaty disputes and acting as appointing authority in accordance with the ICC Rules as Appointing Authority (under UNCITRAL Rules or ad hoc). In terms of investment treaty disputes, sometimes, ICC is one of several options available in the dispute resolution provisions.

The ICC Court is responsible for ICC Arbitration and for supervising arbitration proceedings, but it does not make formal judgements on disputed matters and its decisions are not equivalent to those of arbitration tribunal or domestic courts.[133] ICC arbitration procedure consists of the provisions in ICC Rules and practices developed by the Court and its Secretariat. With the support of the Secretariat, the ICC Court acts to ensure the appropriate application of ICC Rules of Arbitration. The decisions made on disputed matter belong to the arbitrators that are appointed by the ICC Court pursuant to ICC Rules of Arbitration.

In order to facilitate and promote the participation of a state and state entities in ICC arbitration (commercial and investment), the 2012 ICC Rules of Arbitration provides certain key changes to provisions in 1998 Rules.[134] Two of the changes are in relation to the broadening of its scope. According to the Article 1(1) of the 1998 ICC Rules, the ICC Court provides arbitration for "business disputes", while the Article 1 of the current ICC Rules refers to "disputes". This change makes it clear that the ICC Rules covers investment treaty disputes.[135] The reference to 'rules of law' in Article 21 of the ICC Rules is broad enough to include the issues of applicable law in cases

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[132] Some Spanish BITs include a reference to ICC arbitration (e.g. Spain-Latvia BIT, Spain-Pakistan BIT). Austria-Kazakhstan and several German BITs (e.g. Germany-Libya BIT, German-Oman BIT) also include ICC to administer investment disputes. See R. Digon and M. Krasula, 'The ICC's Role in Administering Investment Arbitration Disputes' in A. Rovine (ed.) *Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2014* (Brill 2015) 59

[133] The members of the ICC Court consist of over 100 individuals and most of them are lawyers specialized in international commercial arbitration.

[134] The current ICC Rules include 2012 Arbitration Rules as amended in 2017 and the 2014 Mediation Rules set clear parameters for the conduct of proceedings. See ICC, '2017 Arbitration Rules and 2014 Mediation Rules (English version)' (2017) <https://iccwbo.org/publication/arbitration-rules-and-mediation-rules/> accessed 15 July 2017

[135] ICC, 'ICC Arbitration Commission Report on Arbitration Involving States and States Entities' (2012) <https://iccwbo.org/publication/icc-arbitration-commission-report-on-arbitration-involving-states-and-state-entities-under-the-icc-rules-of-arbitration/> accessed 30 August 2016

relevant to investment treaty.[136] The ICC arbitrations involving states and states entities cover both commercial and investment disputes. But the ICC does not have comparable experience with treaty–based investment disputes. The ICC Arbitration Commission stated in its report that only some cases arise from the breach of BIT and such cases only represent a minority of ICC's caseload.[137]

Although the ICC arbitration awards are enforceable under the New York Convention, its awards are subject to scrutiny of the Court. The Article 34 of the ICC Rules provides that the Court without affecting the arbitrators' autonomy may also 'draw its attention to points of substance' and 'no award shall be rendered by the arbitral tribunal until it has been approved by the Court as to its form.' Arbitration awards involving a state or a state entity as a party, whether investment treaty or commercial, are scrutinised at a plenary session. Since the ICC Rules do not provide an appellate review of awards, it was argued that a well-scrutinised or well-reasoned award might encourage 'voluntary compliance'.[138] In addition, compared to those ICSID awards that are treated 'as if they were a final judgment of a court,'[139] ICC arbitration awards may be subject to exceptions to recognition and enforcement listed in New York Convention.[140]

The ICC Court may not be an ideal platform to address investment disputes between SWFs and host countries, especially those disputes involving political and national security concerns. But the ICC provides an advantageous forum for commercial disputes between SWFs and other private entities.

Compared with the ICC Court, the SCC arbitration also deals with investment disputes. The SCC Arbitration Institute does not have member states but is govern by the SCC Board consisting of several law experts. SCC is increasingly playing an important role as an international forum for investor-state disputes settlement. The

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[136] ibid
[137] ibid. However, it should be noticed that since the entry into force of the 2012 Rules, ICC 'received and notified more requests for arbitration in investor-state cases than it had in 14 years under the 1998 Rules,' and the ICC's administration of investment arbitration disputes 'appear to have reached a conclusion much quicker that other investment treaty disputes.' See Digon and Krasula (n 132) 62
[138] Digon and Krasula (n 132) 68
[139] ICSID Convention Article 54 (1)
[140] Lippincott (n 9) 677. See also Schreuer et al. (n 96) 1135

SCC serves as a forum for investor-state disputes in at least 120 BITs and also in the ECT. Since 1993, the SCC has administered a number of investment disputed based on these BITs and the ECT.[141] Among these BITs, some require that the SCC Arbitration Rules apply to disputes arising from the BIT, while other require SCC to act as Appointing Authority under UNCITRAL Arbitration Rules or require that the Sweden should be the legal seat of the dispute.[142]

According to the statistics of SCC, from 2007 to 2016, the SCC has administrated a steadily number of treaty-based investment disputes.[143] As of 2016, 92 treaty-based investment disputes have been administered by the SCC, of which 73% was administered under SCC Rules. While although the SCC has emerged as one of the leading international institutes for investor-state disputes resolution, a majority of cases are Swedish and other frequent nationalities to appear before the SCC are from Europe (e.g. Russia, Germany, Norway, UK).[144] It is found that seldom of involved parties are from the home countries of SWFs, especially Asia and Middle East countries.

3.1.2 The UNCITRAL rules

The UNCITRAL is an intergovernmental organisation, and the ad hoc tribunal under UNCITRAL is an investor-state dispute settlement mechanism like the ICSID. In recent years, the number of investor-state arbitrations, administrated by ICSID (ICSID Convention and Additional Facility Rules) and UNCITRAL Rules, has increased dramatically, resulting in a growing body of international investment case law. The UNCITRAL Rules was adopted by UNCITRAL and the United Nations General Assembly in 1976. It was not specifically designed to address investor-state disputes or claims for breach of treaty obligations but for 'disputes in relation to a contract'.[145] However, the UNCITRAL Rules has been incorporated into a large number of IIAs, and has also been used in investment disputes. Moreover, the use of

[141] According to Article 26 (4) (a) of the ECT, SCC is one of three optional forums for investment disputes (the other two are ICSID and UNCITRAL Arbitration).
[142] SCC, 'The Administration of Investment Disputes' <http://www.sccinstitute.com/dispute-resolution/investment-disputes/> accessed 15 October 2016
[143] SCC, 'A Great Year For Investment Treaty Disputes' (2016) <http://www.sccinstitute.com/statistics/investment-disputes-2016/> accessed 15 February 2017
[144] SCC, 'SCC Statistics 2015' (2015) <http://www.sccinstitute.com/media/181705/scc-statistics-2015.pdf> accessed 15 February 2017
[145] UNCITRAL Rules Article 1 (1)

UNCITRAL Rules is not limited to nationals of member states of the Commission, or the members of the United Nations (UN).

The Commission acts as the governing body of UNCITRAL, which consists of representatives of 60 member states selected by the UN General Assembly. The UNCITRAL provides opportunities to reform its rules, which usually is drafted and adopted by the Commission with the participation of governmental and non-governmental parties. It is applicable to a wide variety of disputes, but it does not provide administrative support for investment arbitration.[146] It is concerned by scholars that the absence of administrative function would provide less space for its institutional reform, e.g. creating an appellate mechanism in responses to criticism of ISDS.[147] Moreover, the enforcement of awards provided by ad hoc arbitral tribunal under UNCITRAL Rules is also limited by exceptions in the New York Convention.

It could be argued that although some IIAs allow investors to bring claims before ad hoc arbitration under the UNCITRAL or before ICC or SCC arbitration, the most common and experienced forum of investment treaty disputes resolution is the ICSID. The ICSID awards (as a final one) would result in less enforcement barriers than other forums pursuant to New York Convention. It should be noticed that many of these institutes have started to reform their rules or even institutional functions to facilitate dispute resolution (e.g. transparency, arbitrator independence and impartiality, and consistency and correctness of awards) and to address criticism on ISDS mechanism. Many of these issues are also considered in current IIAs reforms by contracting states.

3.2 Dispute resolution mechanism within WTO framework

Under the WTO framework, a foreign investor cannot bring a direct claim against a host state, but the home state of this foreign investor can use the dispute settlement system. It is suggested that the diplomatic intervention and state-state arbitration can work as alternative means for the protection of foreign investment and the general

[146] N. Bernasconi-Osterwalder and D. Rosert, 'Investment Treaty Arbitration: Opportunities to Reform Arbitral Rules and Processes' (January 2014) IISD Report, 8 <http://www.iisd.org/pdf/2014/investment_treaty_arbitration.pdf> accessed 15 February 2017
[147] ibid

interests of host countries,[148] as well as the interest of the home country. The WTO dispute settlement system (DSS) was suggested that it could play a role in resolving SWF related issues.[149] The competence of WTO to regulate SWFs investment could be found in its agreements, e.g. GATS, TRIMS and dispute mechanism.[150] Those home countries of SWFs as WTO members could be required to ensure that their SWFs investments were driven exclusively by commercial objectives.[151] Matto and Subramanian believe that the WTO should be the natural forum for a multilateral agreement on SWFs to address issues caused by SWFs investment since theoretically the WTO already covers investments by SWFs in GATS.[152] Apart from these substantive provisions, its DSS was also regarded as a support to address SWFs related issues/disputes.[153]

The SWF as an investor cannot play an official role under WTO DSS, as the DSS functions exclusively between member states. It was typically designed as a state-state dispute resolution. The Panel and Appellate Body proceedings are confidential and only the representatives of the parties are permitted at the hearings. Other member states would be allowed to participate in such dispute and make written submission to the panel as third parties but with certain restrictions. They should have a "substantial interests" and have notified their interests to the Dispute Settlement Body (DSB).[154] Only the government of the investor can decide whether a complaint shall be brought before WTO dispute settlement system. Individuals cannot initiate formal dispute proceedings.[155] This WTO mechanism reflects diplomatic protection provided by states under public international law.[156]

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[148] P. Acconci et al, *General Interests of Host States in International Investment Law* (CUP 2015)
[149] Reed (n 78) 120 in Ch. 1
[150] ibid
[151] M. Mathur, 'Emergence of Sovereign Wealth Funds in the Global Economy' (2012) <https://view.officeapps.live.com/op/view.aspx?src=http%3A%2F%2Fcenterforpbbefr.rutgers.edu%2F2012PBFEAM%2Fpapers%2F043-Meeta%2520Mathur-article%2520SWF%2520revised-20120322.doc> accessed 15 November 2016
[152] Matto and Subramanian (n 143) in Ch. 4
[153] ibid
[154] Understanding on rules and procedure governing the settlement of disputes Article 10
[155] J. Chaisse and M. Matsuchiota, 'Maintaining the WTO Supremacy in the International Trade Order – A Proposal to Refine and Revise the Role of the Trade Policy Review Mechanism' (2013) 16 J. Int'l Econ. L. 9, 12. See also E. Petersmann, 'The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948' (1994) 31 Common Mkt. L. Rev. 1157
[156] W. Davey, 'WTO Dispute Settlement: Segregating the Useful Political Aspects and Avoiding "Over-Legalization"' in M. Bronckers and R. Quick (eds.) I*nternational Economic Law, Essay in Honour of J. H. Jackson* (2000) 291

For disputes with regards to SWFs investment, SWFs have no standing before the DSB (panels or Appellate Body) and it would be their home countries to bring the claim of SWFs before WTO dispute settlement. Since SWFs usually are structured as state-owned entities or a pool of assets operated by central banks, the government or governmental officials in the board of directors may directly or indirectly play a role in SWFs related disputes. It was argued that if SWFs faced obstacles or were adversely affected in a host country, the home country could consider bringing the case before WTO dispute settlement.[157] But such claims can only be raised to against actions or obligations covered by GATS or other relevant WTO agreements, i.e. WTO obligations.

On the other hand, it would be also possible that the host country, as a WTO member, would have recourse to the WTO dispute settlement with institutionalised consultation and impartial assessment of conformity, since under ICSID jurisdiction the host country cannot file a claims against investors. Instead of taking unilateral protective action that may possibly result in investment or trade war, or retaliatory protection, the host country would like to bring the issue of SWFs investment to WTO and discuss it at an intergovernmental level.[158]

However, the effectiveness of the WTO dispute settlement system is limited by the relevant WTO agreements regarding SWFs and types of SWFs investment. Moreover, the WTO competency over SWFs issues is also limited by the inadequacy of the DSS itself.[159] The question may be relevant to the effective enforcement, i.e. how the WTO can enforce the disputed parties' compliance with normative values, since the reports of the DSB are not binding. Non-compliance might reduce the influence of DSS on actors at the international level.[160] In addition, the nature of DSS as a state-state dispute resolution may increase political concerns concerning SWFs investment that are already expressed by host countries. Thus, in the case of SWFs

[157] J. Chaisse, 'Assessing the Relevance of Multilateral Trade Law to Sovereign Investments: Sovereign Wealth Funds as "Investors" under the General Agreement on Trade in Services' (2015) Int'l Rev. L. <http://www.qscience.com/doi/pdf/10.5339/irl.2015.swf.9> accessed 15 November 2016
[158] Matto and Subramanian (n 143) in Ch. 4
[159] Reed (n 78) 122 in Ch. 1
[160] For more discussion, see G. Messenger, *The Development of World Trade Organization Law: Examining Change in International Law* (OUP 2016)

relevant disputes, it may be possible to turn to other forums to avoid political intervention.

3.3 Investment Court System

Recent years have witnessed emerging changes in the international investment law, i.e. reforms of IIAs and the ISDS to strike a balance between the investment protection and the state sovereignty. Apart from on-going reforms on substantive protection provisions in IIAs,[161] there are various suggestions for institutional changes to ISDS. In addition to the option of reforming existing ISDS mechanism in IIAs, or the option of requiring the exhaustion of local remedies, there is another notable approach, i.e. establishing a permanent ICS that was proposed by the EU when the EU and the US attempted to negotiate the TTIP.[162]

The proposal aims to safeguard 'the right to regulate' via necessary measures to undertake legitimate public policies. This proposal aims to create a quasi-court system, with an appellate mechanism to correct the error in applicable law and significant fact. The Court (or the Tribunal) is established with qualified judges pre-determined by Contracting Parties, and transparency proceeding, to hear submitted claims. It was argued that to allow the states to determine the composition of the court system would increase the legitimacy of such institution.[163] The tenure of judges is arguably to increase the independence and impartiality of the dispute resolvers, as they do not

[161] For example, these reforms may include clarification of definition and substantive provisions in IIAs, and the introduction of an appellate mechanism in procedural provisions, and increasing the transparency of arbitration procedure and public access to ISDS proceedings.

[162] European Commission, 'EU Finalises Proposal for Investment Protection and Court System for TTIP' (12 November 2015) <http://europa.eu/rapid/press-release_IP-15-6059_en.htm> accessed 20 June 2017. For more discussions on the EU proposal for new permanent investment court, see V. Fietta, 'The European Commission Finalises its Proposal for New Permanent Investment Court System' (24 March 2016) <http://www.volterrafietta.com/the-european-commission-finalises-its-proposal-for-new-permanent-investment-court-system/> accessed on 15 November 2016; S. Schill, 'The European Commission's Proposal of An "Investment Court System" for TTIP: Stepping Stone or Stumbling Block for Multilateralizing International Investment Law?' (22 April 22, 2016) <https://www.asil.org/insights/volume/20/issue/9/european-commissions-proposal-investment-court-system-ttip-stepping> accessed on 15 November 2016; C. Malmstrom, 'The Way ahead for An International Investment Court' (18 July 2016) <https://ec.europa.eu/commission/2014-2019/malmstrom/blog/way-ahead-international-investment-court_en> accessed on 15 November 2016

[163] S. Schill, *International Investment Law and Comparative Public Law* (OUP 2010) 8

need to cater to future potential parties.[164] Moreover, the court system would improve the consistency of the awards and increase the predictability of investment disputes resolution mechanism, thereby reducing the current fragmentation and inconsistencies of ISDS.

The ultimate objective of the EC is to set up a Multilateral Investment Court (MIC).[165] The EC aims to replace the existing ad hoc system with a 'modern, efficient, transparent and impartial system' for the resolution of international investment disputes.[166] The proposal of ICS in TTIP provides a two-layer system. The Tribunal of First Instance would utilise a randomised system in appointing three Judges to each case (one from the EU, one from the US and another one from a third country). The Appeal Tribunal would also hear appeals in divisions consisting of three Members, chosen in a similar way. The EC envisages that either the ICSID Secretariat or the Permanent Court of Arbitration would act as the Secretariat to the ICS.

On 13 September 2017, the EC issued a recommendation for a council decision to negotiate a multilateral court for the settlement of investment dispute, by which all investor-state disputes arising under the EU investment-related treaties would be resolved through this one stand-alone MIC.[167] It indicates that although the legality of the ICS provisions are under scrutiny by the CJEU due to the question on the compatibility of the ICS with the EU law,[168] the EC is expected to push ICS or the MIC in all EU's FTAs or even future BITs. Moreover, the UNCTAD has also proposed approaches to reform the ISDS mechanism, with a suggestion for the introduction of an appellate mechanism and the establishment of a permanent

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[164] ibid

[165] The CETA and EU-Vietnam FTA contain negotiated version of an ICS. Both treaties also provide provision for the ICS to be replaced by the MIC.

[166] European Commission, 'Commission Propose New International Court System for TTIP and Other EU Trade and Investment Negotiations' (16 September 2015) <http://europa.eu/rapid/press-release_IP-15-5651_en.htm> accessed 15 November 2016

[167] COM (2017) 493 final, 2017/0224 (COD).

[168] A recent CJEU's opinion on EU-Singapore FTA questioned the EU's competence to enter into agreements including ISDS clauses. This opinion clarified that the FTA areas of shared EU and Member State competence are limited to non-direct investment, investor-state dispute settlement and related issues. See J. Killick et al., 'EU Court confirms EU competence on wide range of trade areas in opinion on EU-Singapore FTA' (17 May 2017) <https://www.whitecase.com/publications/alert/eu-court-confirms-eu-competence-wide-range-trade-areas-opinion-eu-singapore-fta> accessed 30 July 2017

international investment court.[169]

However, there is no guarantee that such proposal could effectively and successfully address the claimed flaws of ISDS. This proposal is also questioned that the ICS is not different from a domestic court and would add the worst feature of ISDS system.[170] It seems that a truly multilateral investment court systems would require more fundamental reforms,[171] and integrate with domestic court or consider the role of domestic court. Moreover, the proposal reflects only the EU's view, and it would not easily to attract those countries that already incorporate existing ISDS or those countries that already take steps to reform the ISDS into their IIAs. Therefore, questions regarding whether this ICS could exist and whether the home countries of SWFs would like to adopt such proposal are still uncertain. It needs to see the further development of the EU's practices, and also to see the outcome of the EU's BIT negotiation with China (as a typical state capitalist jurisdiction with large SWFs).

Chapter Conclusion

This chapter discussed the possible dispute resolution mechanisms to address investment disputes caused by SWFs and the resort that SWFs (or even host states) can utilise to protect their interests under IIAs. Interests involved in SWFs investment are divergent, but are subject to domestic and international regulations. As important players in the market, SWFs are entitled to receive protection provided for foreign investors under domestic law and IIAs. While these substantive interests and rights cannot be maintained without an effective enforcement mechanism or procedural guarantee. Having access to dispute resolution could provide SWFs and even host countries a platform to ensure their legitimate interests. While the hybrid feature of SWFs and various available dispute settlement mechanisms make this issue more complicated.

The legal status of SWFs is a controversial issue in domestic and international regulations. Different types of legal structures may result in different treatments or

[169] UNCTAD, 'Reform of Investor-State Dispute Settlement: in Search of a Roadmap' (26 June 2016) <http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf> accessed 30 June 2017

[170] Sornarrajah M., 'an International Investment Court: Panacea or Purgatory?' (15 August 2016) Columbia FDI Perspectives No. 180 <http://ccsi.columbia.edu/files/2013/10/No-180-Sornarajah-FINAL.pdf> accessed 15 November 2016

[171] Schill (n 163)

regulations for each SWF. The legal status of the SWF is important in not only IIAs provision, but also in dispute resolution, as it determines whether SWFs can invoke state immunity in domestic court and determines which kind of dispute settlement mechanism would be a suitable forum to address investment disputes of SWFs. Those SWFs with separate legal liability may easily find their legal standing under dispute settlement mechanisms than those SWFs without separate legal liability, since the former would be treated as private investors while the latter may be treated public entities or part of the government agency.

Generally, SWFs cannot invoke state immunity since they engage in commercial activities but not execute governmental functions, and their assets are used for commercial purposes or engaged in commercial activities. However, this thesis found that situations may vary from jurisdiction to jurisdiction, e.g. in the US and UK, income of certain SWFs investments may be immune from taxation. Although China adopts absolute approach, China does not claim state immunity for its SOEs in practice. Whether host states adopt absolute or restrictive approach, and how these host states define 'foreign state', 'controlled entity' and 'commercial activities' are important factors in relation to state immunity. To well regulate SWFs investment and provide predictability, the legal and governance structure of SWFs and their specialised rights and obligations should be clarified by their home countries, or incorporated into IIAs.

In terms of investment dispute settlement, IIAs provide various options for foreign investors, from domestic to international, from intergovernmental to professional institutes. Among these, the local remedy approach as a kind of classical protection still plays an important role or even exclusive role in investment disputes before international arbitration, especially in many developing countries. Domestic legal system helps to guarantee the state sovereignty of host countries and also provide them a chance to correct errors. The WTO dispute settlement system also provide the home country and host country of SWFs an intergovernmental forum to address SWFs related disputes, but its efficiency is limited to whether SWF investment in issue is covered by WTO agreements. While international arbitrations could provide a relatively neutral forum than domestic approach and state-state dispute settlement. The ICSID, ICC arbitration, SCC arbitration and ad hoc arbitration under

UNCITRAL Rules provide effective and alternative forums for addressing treaty-based investor-state disputes or investment disputes.

Among existing international arbitrations, the ICSID is the most widely used forum and it is a logical and advantageous body for addressing claims brought by SWFs. Recognising the legal standing of SWFs under ICSID jurisdiction helps to depoliticise SWFs and to limit the political influence of both host and home states. It also helps to reduce concerns of host countries and improve the governance of SWFs. Moreover, it may help to reduce investment protectionism adopted by host country and replace complex domestic protective regulations with comprehensive international standards.

However, although ICSID arbitration would have a final award, it lacks sufficient institutional remedies against non-compliance like all other international bodies (even the WTO dispute settlement system). Moreover, even though the New York Convention provides a guarantee for the enforcement of awards of these international arbitration institutes, all of these must rely on contracting states to enforce and are limited by exceptions and reservations provided by states, and domestic laws on state immunity, as well as treaty obligations. Besides, there is also an increasing suspicion or criticism towards the ISDS mechanism (including the ICSID), which calls for a balance between investment protection and state sovereignty. States are stepping into IIAs reforms, including not only the clarification on substantive provisions but also the reform or improvement on ISDS provisions. In response to reforming ISDS, the EU even put forward an ICS proposal to replace existing ISDS by a quasi-court system, however, whether it would be successful is still uncertain and requires further efforts.

The thesis found that the domestic regulations and IIAs play a part in providing both substantive and procedural protection for SWFs investment. Both domestic legal system and international arbitration play an important role in dispute settlement of SWFs investment, and they are complements for each other. To well protect the interests of SWFs and host countries, further clarifications should be provided or incorporated into IIAs or even into domestic regulation of both host and home countries.

CHAPTER 6 PROPOSED REGULATORY APPROACH FOR SOVEREIGN WEALTH FUNDS INVESTMENT AND CHINA'S OPTION

Chapter Introduction

The shift in strategy of SWFs investment, and their recent rapid expansion have stocked fears in the Western markets. These funds arguably may pursue objectives rather than purely commercial objectives, and their close ties with the government of home countries may pose national security risks, influence market integrity and undermine fair competition with other investors etc.[1] Whereas, it should be emphasised that SWFs exist in different sorts of sizes and shapes, and it cannot be assumed that every transaction of SWFs inherently presents greater risks than other private investors, or all transactions by SWFs may contribute to concerns and all concerns may become reality. Regulation designed or provided for SWFs investment should tackle real concerns but not deal with assumptions based on discrimination or bias. Substantive and procedural protections for SWFs investment should also be provided and guaranteed.

It is important to recognise that the cross-board investments of sovereign investors, whether in the form of SWFs or other state-owned investors, should be incorporated into and reflected in international investment regime. The home states and host states of SWFs play crucial roles to create a mutual understanding and to establish a trusty framework to protect their interests and provide a healthy and long-term development of international investment.

China, as a typical state capital jurisdiction, where state-owned entities play a crucial role in domestic economy, is an important player in global market. A majority of Chinese overseas investments are dominated by these state-owned entities.[2] The

[1] These fears raised from host states during and after the financial crisis when SWFs largely and actively participate in financial market, but so far or until recent years, some of these fears still surround the investment activities of SWFs. This could be attributed to that the transparency of several SWFs (large SWFs in particular) still remains low level and also the governance structure of SWFs, while there might be other geopolitical factors.

[2] Although private investors (companies) have actively participate in overseas investment activities

expansion of Chinese overseas investments by SOEs and SWFs has raised fears and received political backlash from host states. With gradually opening up of the market, China will also face the issue of foreign sovereign investment thus it needs to consider appropriate legal responses to address relevant issues. For SWFs regulation, China cannot be ignored. China, as the home state of Chinese state-owned investors, is negotiating IIAs with the US, the EU and other countries that are host states/regions of SWFs. There are also FTAs concluded between home states of large SWFs and host states.[3] Some of these IIAs negotiations or concluded texts intended to or began to consider or address issues concerning sovereign investment.

This chapter, based on discussions in previous chapters, on one hand, provides a choice of regulatory models/treatments and proposes suggestions on existing regulatory regime from general perspective. One the other hand, it provides suggestions to regulate SWFs investment particularly for China. This chapter attempts to address the following questions: what kinds of key issues concerning SWFs (Chinese SWFs in particular) remain to be clarified? What kinds of general regulatory model/treatment could be adopted and relevant pros and cons? How to improve existing international regulations and balance conflicting interests? What kinds of models could be adopted by China with further reforms?

In order to answer these questions, this chapter firstly clarifies issues of SWFs, Chinese SWFs in particular. Certain regulatory models based on the analysis of legal status and concerns of SWFs are proposed in this section. It further provides a series of suggestions or proposals for existing international regulations from the general perspective. It then examines the regulatory concerns of SWFs in the context of Chinese regime and discusses the regulatory models that China could choose to regulate inward and outward SWFs investments by advancing domestic and external reforms. The domestic reform concerns the reform of SOEs and foreign investment regulation as well as financial regulation. The external reform is the Chinese treaty practice that incorporates the values and interest of China as the home state and also

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and their investment volumes have increased during recent years, the large and important project or transaction in critical infrastructures or manufactory factors are mainly undertaken by state-controlled investors.

[3] The EU and the US are negotiating IIAs with countries that hold SWFs or are countries with state-ownership model in their economy. For example, EU-Singapore FTA, EU-Vietnam FTA and the US-led TPP.

the host state of SWFs.

1. Proposal for General Regulatory Models on SWFs Investment

A majority of studies have analysed potential issues that might be caused by SWFs investment owing to the sovereign identity and low transparency of SWFs. Chapter one also discussed issues caused by the development and the rise of SWFs.[4] It has been controversial on whether special/additional regulations are needed and whether existing regulations are sufficient. This thesis argues that there is no need to create or provide additional regulations to tackle SWFs investment but a further reform on existing regulations is necessary.[5] Suggestion should be based on the clarification of the subject and nature of its conduct (considering both subjective and objective elements).[6] Since the level of restrictions imposed on SWFs largely depends on the concern of host states on specific issues, this section firstly analyses current concerns that still need to be addressed and clarified, and then proposes three regulatory models for further consideration.

1.1 Remaining issues to be clarified under regulatory regime

1.1.1 Issues of general SWFs investment and discussion of state ownership

Although most SWFs conduct portfolio investments, their governmental background or state ownership has raised fears from host states, let alone their direct equity investment.[7] Fears of SWFs investments in early years, when SWFs actively invested during financial crisis, are derived from an assumption but not from the recorded data

[4] See Ch. 1 s. 2.4.2

[5] It is important to note that there is no universal form or model that could be used to identify or regulate SWFs, but depends on the choice of each country or base on widely recognized agreements or conventions. Different countries may have different market economy model. The state participation in the economic activities and state-ownership model are the choice of certain countries for their national economic development. The regulation designed for SWFs or other sovereign investor alike should not be a discrimination of one country's economic system or model, but designed for addressing certain issues.

[6] The EU and US have been attempting to fill the regulatory gap of SOEs (including SWFs) while negotiating with their Asian counterparts, which has not been directly and clearly addressed by international regulations. The new treaties (FTAs) include specific chapters that develop ground-breaking rules on SOEs. While the new chapters dedicated to SOEs share similarities, the EU and the US are, in effect, promoting distinct and competing regulatory models (e.g. EU-Vietnam FTA vs. TPP).

[7] See W. Megginson, 'Privatization, State Capitalism, and State Ownership of Business in the 21st Century' (2 October 2016) Foundations and Trends in Finance (forthcoming) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2846784> accessed on 15 February 2017

(one possible explanation might be the opaque or low-transparency feature of most SWFs).[8]

The potential issues of SWFs investment have been widely discussed by many scholars and also in this thesis.[9] Risks associated with SWFs transactions are essentially two-fold: political, to the extent that SWFs could be used as political instruments of home states' foreign policy that might lead to national security threat (which, increasingly, currently, includes or even emphasises the economic security); and economic, since there is a risk of state intervention or other types of market distortions through SWFs investments that might undermine the market integrity or a level playing field. It is usually believed that these issues are derived from the state ownership of SWFs and low transparency. The state ownership is accused of being used to influence the decision-making process and governance of SWFs while the low transparency of SWFs is accused of being used to hide the political motivation behind SWFs investments.

The GAPP, which aims to increase transparency and accountability of SWFs as well as the governance structure, while due to inherent flaws, has not effectively reduced concerns from host states.[10] Host states still intend to restrict sovereign investment via tightened national security review or blocking certain investment in critical infrastructure, which may easily be used as a hidden protectionism. The OECD guidelines for host states also inherently have similar flaws like GAPP. But, it is not the action of SWFs but rather the international expansion of SOEs that draws the most scepticism. But most host states usually treat them as the same due to the state ownership. For SWFs and their home states, there is also the concern of being discriminated that arises from protective measures adopted by several host states.

It must be noted that in many ways those challenges prompted by the sovereign investment are not fundamentally different from those posed by other foreign direct investment generally.[11] It is important to clarify the factors involved in SWFs investments that may easily lead to concerns/risks and not only to blame the state

[8] Lyons (n 4) Ch. 1
[9] Ch. 1. s. 2.4.2
[10] Ch. 4. s. 3.2
[11] P. Blyschak, 'State-Owned Enterprises in International Investment' (2016) 31 (1) ICSID Rev. 5

ownership.[12] By contrast, the influence of state ownership can be neutralised through undertaking structural reform to isolate SWFs from the 'regulatory, political and policy-making functions' of home states.[13] Political or regulatory influence, and even political motivation can exist despite there being no state or public ownership, e.g. when a private investor, e.g. a multinational corporation, is powerful enough to intervene in global governance of foreign investment or to exert its bargaining power to influence regulatory measures taken by developing countries.[14]

It herein should be questioned whether it is the conduct of the private investor, as a criterion, that differentiates benign sovereign investment from those sovereign investments that require special regulation. The rise of state capitalism in the global market and the emergence of various state-owned participants are reflective of the growing blurriness of the public-private distinction, the integration of public and private actors in the market, and the interaction of public and private law. Thus, the separation of economic and political activities/motivations is hard to be identified.[15] Moreover, as long-term investors, SWFs may not intend to undermine the market, since adverse results will also spread to the global market and it in turn will influence the financial returns of SWFs and even will affect the home states of SWFs.

State ownership might be the major concern of some host states if the home state of a SWF is a political rival or an economic competitor of host states. But this is not only due to state ownership *per se* but also is due to the nationality/origin of the SWF. Normally, most countries do not distinguish investors on the basis of ownership, and WTO rules and OECD instruments are generally ownership-neutral;[16] hence it is not appropriate to discriminate investments made by SWFs only because of state ownership. As SWFs usually conduct investments in securities market or equity markets in the pursuit of financial returns, these activities should be viewed as

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[12] ibid 6

[13] W. Wolfe and A. Evans, 'China's Energy Investments and the Corporate Social Responsibility Imperative' (2011) 6 J. Intl L. & Intl Rel 83

[14] L. Backer, 'Multinational Corporations as Objects and Source of Transnational Regulation' (2007) 14 ILSA J. Int'l & Comp. L. 499; see also N. Fagre and L. Wells, 'Bargaining Power of Multinationals and Host Governments' (1982) 13 (2) J. Int'l Bus. Stud. 9

[15] Backer (n 44) in Ch.1

[16] Shima (n 14) 18; see also OECD, 'Maintaining a Level Playing Field Between Public and Private Business for Growth and Development: Background Report' (May 2013) Meeting of the OECD Council at Ministerial Level <https://www.oecd.org/mcm/C-MIN(2013)18-ENG.pdf> accessed 10 June 2017

commercially-oriented activities rather than politically-oriented activities (even though the purposes of home states to establish SWFs include both social and economic considerations as discussed in Chapter one).

However, the fear of state ownership is not only because a SWF is owned and/or even controlled by the state, but also because this control or ownership has a further impact on the conduct of such SWF. It is usually assumed that the government can easily exert influence on or intervene in the operation of its SWFs and their investment strategies, since the government is the only shareholder of its SWFs and there are political officials on the board of directors of SWFs, or these political officials may directly manage them. This concern could be attributed to the legal structure and governance structure of SWFs. Since motivation is a kind of subjective factor, which is hard to identify, it is not wise to regard this subjective factor as the most important and first factor to be considered when analysing the conduct of a SWF.[17] The legal structure and governance structure can help to analyse whether the investment activity of a SWF would be easily intervened in by the government. It is also usually assumed that the state ownership would provide SWFs or other sovereign investors regulatory advantages or preferential treatment over private investors, e.g. through public subsidies, tax exemption and/or state immunity,[18] which might undermine a level playing field for private investors.[19]

The fear of political motivation and political influence can also be attributed to the unknown characteristics of SWFs.[20] The low level of transparency of many SWFs results in a call for increasing transparency and disclosure of information (and providing for public access to such information/data). Low transparency is also one of the reasons why the GAPP exists. Although the GAPP could be regarded as a useful

[17] Al-Hassan (n 12) in Ch.1

[18] The regulatory advantages may include lighter regulatory restrictions, under enforcement of restrictive laws; preferential treatment with regards to disclosure requirements or complying with other requirements; sovereign immunity laws, bankruptcy laws and preferential access to land etc. See M. Field, 'Competitive Neutrality: Maintaining A Level Playing Field between Public and Private Business' (2012) OECD Working Paper, 66 <http://www.oecd.org/corporate/50302961.pdf> accessed 16 April 2017

[19] J. Bird-Pollan, 'The Unjustified Subsidy: Sovereign Wealth Funds and the Foreign Sovereign Tax Exemption' (2012) 17 Fordham J. Corp. & Fin. L. 987

[20] A. Bagnall and E. Truman, 'Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard' (2013) Peterson Institute for International Economic Policy Brief No.13-19 <https://piie.com/publications/pb/pb13-19.pdf> accessed 16 April 2017

soft-law regulation to address the relationship between fund manager and owners, it is inadequate to address national security concerns of host countries caused by SWF investment or to ensure investment transparency of SWFs.[21] Moreover, even though several SWFs have implemented the GAPP and have disclosed some information, others are still below the average level and have not endorsed the GAPP.

Another fear generated by state ownership is national security risk. Host states usually worry that SWFs might take control over the strategic assets or critical infrastructure/technology of host states, steal knowhow and military intelligence,[22] and would threaten economic security, e.g. market stability. However, it cannot be assumed that any particular SWF or state-owned investor inherently poses greater national security risks than other investment instruments/investors.[23] It should be noted that the national security concern is not generated by the state ownership of investors, but is caused due to the foreign control over industries that are regarded as sensitive or critical assets of host states. Many countries have established national security review mechanisms or similar mechanisms to tackle national security risks, and there is even an increasing trend of adopting tightened protective measures to ensure the broad national security.[24] The general exception clause and security exception clause in IIAs are already more than sufficiently broad to provide the state with the necessary discretion to protect its security or public interests.[25] But the definition of national security and the wording of treaty provisions should be clarified.

Apart from these concerns caused by SWFs, it is important to acknowledge the conflicting interests between SWFs and host states and to reflect these in international investment regimes. It might require the avoidance of protectionism adopted by host states and the maintenance of protection for SWFs as investors. It should be highlighted that regulation of SWFs should not focus on the political motivation of

[21] Bismuth (n 11) 79 in Introduction
[22] See P. Rose, 'The Foreign Investment and National Security Act of 2007: An Assessment of Its Impact on Sovereign Wealth Funds and State-Owned Enterprises' in F. Bassan (ed.) *Research Handbook on Sovereign Wealth Funds and International Investment Law* (Edward Elgar Publishing 2015) 150
[23] J. Mendenhall, 'Assessing Security Risks Posed by State-Owned Enterprises in the Context of International Investment Agreement' (2016) 31 (1) ICSID Rev. 36
[24] See Ch. 3 s. 1.1
[25] M. Barbieri, 'Sovereign Wealth Funds as Protected Investors under BITs and the Safeguard of the National Security of Host States' in G. Sacerdoti et al. (eds.) *General Interests of Host states in International Investment Law* (CUP 2014) 130

SWFs, but the specific concerns generated by their conduct/actions, since the market is inherently political throughout the history and process of capitalism.[26] The state has played a critical role in monitoring the market, explicitly or implicitly, via making rules and regulations and providing public goods.[27]

Moreover, since the political system and legal system of each state are not the same, states and their polities do not always share the same values or have the same political traditions, e.g. views on openness and transparency. Hence, legal regulations for SWF investment should respect the legitimate interests of both host states and home states. Currently, there are many regulations to tackle each concern at the domestic and international levels. There is no need to introduce particular rules to restrict SWF investment.[28] It is not wise for host states to treat all SWFs and their investments as entirely different from other private investors/investments only based on the fear of state ownership. Regulations should focus on those transactions and those investors (and/or SWFs) that might indeed cause particular issues.

From the perspective of home states, they may have the need and intention to protect their overseas investments under the existing international regime. Whether the law is impartial and effective mainly depends on the balance of rights and obligations. Therefore, a consensus, reached by a large group of participants or between host states and home states, could fulfil this goal and enhance the effectiveness of existing regulations. Achieving this, in this thesis, relies on a combination of soft law (self-regulation) and hard-law treaty obligations. When regulating SWF investment, two questions should be emphasised. The first is how to balance the rights and obligations of SWFs. The second is how to strike a balance between attracting foreign investment and maintaining the regulatory flexibility of host states.

1.1.2 Issues of Chinese SWFs investment

Chinese overseas investments, especially those undertaken by SOEs and SWFs, are always suspected by host states for pursuing political motivation and creating uneven

[26] A. Dixon, 'Enhancing the Transparency Dialogue in the "Santiago Principles" for Sovereign Wealth Funds' (2014) 37 Seattle U. L. Rev. 581, 593
[27] ibid
[28] A. Pauwels, 'A Justified Defiance towards Sovereign Wealth Funds? A Tentative Defense Manual for the Wary Host State' (2016) 16 U.C. Davis Bus. L. J. 103

playing field. Compared with liberal capital jurisdiction, where private institutional investors play a controlling role, China is a typical state capital jurisdiction where the government is the controlling shareholder of state-owned entities that play a crucial role in China's domestic economy. The political dimension associated with Chinese SWFs induces political sensitivities and public concern from host countries.

Specific concerns regarding Chinese SWFs investments are as follows. The first one, which is similar to many other SWFs, is the issue of low transparency. According to Linburg-Maduell Transparency Index,[29] most Chinese SWFs are below the recommended rating of 8 (maximum 10) so that they are not considered as adequate transparent.[30] This is arguably for concealing the real motivation of Chinese SWFs investments. Although increasing transparency could be considered as a solution to many concerns, e.g. maintaining financial stability, SWFs should not be subject to higher transparency requirements than those of other investors (as competitors).[31] The principle of competitive neutrality is relevant here to both state-owned and private-owner actors in the market, which provides that 'no business entity is advantaged (or disadvantaged) solely because of its ownership.'[32]

The second one is that the governance structure of Chinese SWFs is blamed of helping Chinese government to exert political influence since Chinese governmental officials serve on the board of directors.[33] Investments of Chinese SWFs also raise national security concern. Apart from investments made in financial sectors, real estate and natural resources, Chinese SWFs also prefer to invest in energy and materials sectors and they even conduct in a similar way to Chinese SOEs, which are blamed for serving China's national development policies or strategies.[34] They also

[29] This index was developed at the Sovereign Wealth Fund Institute by Carl Linaburg and Michael Maduell. It is a method of rating transparency in respect to sovereign wealth funds.
[30] CIC scored 8, SAFE scored 5, China-Africa Development Fund (CAD Fund) scored 5 and National Social Security Fund (NSSF) scored 4. See SWFI, 'Linburg-Maduell Transparency Index' (updated 2017) <https://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/> accessed 15 June 2017
[31] Kratsas and Truby (n 10) 18 in Introduction
[32] A. Capobianco and H. Christiansen, 'Competitive Neutrality and State-owned Enterprises: Challenges and Policy Options' (2011) OECD Corporate Governance Working Papers No.1, 3 <http://www.oecd-ilibrary.org/docserver/download/5kg9xfgjdhg6-en.pdf?expires=1509582962&id=id&accname=guest&checksum=557649A894C41FA2665C7FB5C3BA8EB2> accessed 20 April 2017
[33] For discussion, see M. Zhang and F He, 'China's Sovereign Wealth Fund: Weakness and Challenges' (2009) 17(1) China & World Econ. 101; see also Backer (n 44) in Ch.1
[34] M. Keller, 'The Role of SWFs in Shaping the Neo-polar World: The Asia-Europe Perspective' in L.

embrace their role in executing national policies.[35] Compared with CIC, the SAFE Investment Company Limited (SIC), a subsidiary of the State Administration of Foreign Exchange (SAFE) in Hong Kong, is much more active in pursuing stakes in leading resource companies.[36] SAFE also invests directly on foreign stock exchanges. It arguably leads to the concern of taking control over strategic or critical infrastructure. Moreover, due to low transparency of some Chinese SWFs, especially the SIC, it is difficult to make a conclusion on whether these funds are purely financial investors or strategic investors.

The third concern is that Chinese SWFs may receive preferential treatment or regulatory advantages over other private investors thus undermining the level playing field, owing to the state ownership.[37] The issue of fair competition does not only exist in the market of host states but also in Chinese market. The EU and the US concern that their investors cannot have a level playing field in China, and cannot compete with Chinese state-owned entities; their investors have limited access to crucial sectors of China, which are dominated by Chinese SOEs or controlled by Chinese SWFs (e.g. telecommunication, financial sectors).[38] Thus, market access has been a key point in China-EU and China-US BIT negotiations. The EU even concerns that its openness to Chinese investments is not reciprocated by China.[39] It was suggested that unless China reduces limits in market access for foreign investments, protective measures against Chinese investments would become more stringent, and suspicions on the intention of Chinese state-owned investors would continue to rise.[40]

Oxelheim (ed.) *EU-Asia and the Re-polarization of the Global Economic Arena* (World Scientific 2012) 522

[35] L. Adamson, 'What's Behind China's Sovereign Wealth Fund Executive Changes?' (3 March 2015) <http://www.sovereignwealthcenter.com/Article/3432447/Whats-Behind-Chinas-Sovereign-Wealth-Fund-Executive-Changes.html#.WfbpghTtvhg> accessed 10 July 2017

[36] T. Kamiński, 'Sovereign Wealth Fund Investments in Europe as An Instrument of Chinese Energy Policy' (2017) 101 Energy Policy 733, 735

[37] Backer (n 44) 62 in Ch.1

[38] R. Held, 'China: Why Reciprocity in Market Access is Pivotal' (29 June 2016) <http://www.atimes.com/article/china-why-reciprocity-in-market-access-is-pivotal/> accessed 15 June 2017

[39] W. Wu, 'EU to Seek Reciprocity from China at Top-level Talks This Week' (31 May 2017) <http://www.scmp.com/news/china/diplomacy-defence/article/2096069/eu-seek-reciprocity-china-top-level-talks-week> accessed 30 June 2017

[40] Held (n 38); see also T. Hanemann and M. Huotari, 'Record Flows and Growing Imbalances: Chinese Investment in Europe in 2016' (January 2017) <http://rhg.com/wp-content/uploads/2017/01/RHG_Merics_COFDI_EU_2016.pdf> accessed 15 July 2017

1.2 Consideration of regulatory models

Normally, the treatment granted to foreign investment is at the discretion of each state, which is only constrained by international obligations or when those international rules are transferred into domestic legislation. From the perspective of host states, measures adopted would consider the balance between their regulatory power to safeguard public interests and the need to attract capital inflows. From the perspective of home states, efforts would consider the protection of their overseas investors/investments and ensure legitimate rights of their investors. Hence, in this thesis the plausible way to balance those interests is to embed these values into IIAs (BITs, investment chapter of FTAs or even a multilateral investment treaty) and clarify concerns that need to be addressed. Before proposing specific improvement or suggestions for IIAs, it is reasonably to think about certain general models to regulate SWFs.

1.2.1 Model one: treat all SWFs as the same like other private investors

In this model, host states could choose to treat all SWFs as the same like other general private investors and do not apply different requirements to different SWFs. Investments of SWFs and other private investment comply with same requirements (e.g. same transparency requirement, same shareholding threshold for investment review, same requirement for corporate governance and same access to dispute resolution), which is a reflection of the principles of competitive neutrality and non-discrimination.[41] This model is based on investment behaviours of SWFs but not depends on the analysis of their motivations behind or the state ownership. According to this, SWFs are treated as private investors and hence they are entitled to treaty protection.[42] Under this model, host states regulate SWFs via the same rules imposed on private investors. Portfolio investment of SWFs does not have particular restrictions under existing regime and does not trigger special investment restrictions, e.g. national security review for foreign direct investment or controlled investment.

This model treats SWFs as large private institutional investors in a similar fashion

[41] For more discussion on competitive neutrality and sovereign investors, see Capobianco and Christiansen (n 32)
[42] Sornarajah (n 10) in Ch.5

such as mutual funds, pension funds, or hedge funds and private equity funds.[43] But for the concern of financial stability, certain disclosure requirements might apply to these investment funds, and also to hedge funds and private equity funds. This model assumes that SWFs do not give rise to particular concerns and the state ownership of SWFs does not necessarily influence the operation of SWFs. SWFs and other private investment funds are likely to have the potential to bring about same problems, but these cannot be attributed to the ownership for granted; the nature of investment should be considered and analysed. It can be argued that the basis of this model is that SWFs' conducts are similar to those of normal private investment funds, which follow the same kind of operation structure, i.e. modern governance structure and commercial-oriented strategy. Under this model, at domestic level, rules concerning general foreign investment apply to SWFs, and at international level, substantive rules and procedural rules in IIAs apply to SWFs investment. Any measures taken by host states on SWFs would be constrained by those treaty provisions.

However, this model has its advantages and disadvantages. In terms of advantages, under this model, host states trust investment activities of SWFs and do not introduce specific regulations on SWFs. It helps to encourage the commercial operation of SWFs. It keeps regulations for foreign investors and foreign investments as simple as possible and makes these rules easily to apply. SWFs investments during market access phase follow foreign investment regulations for general investment. SWFs investments in different industries follow the same rules concerning restriction and disclosure requirement.

The disadvantage is that the governance structure of SWFs, the transparency of SWFs and concerns related to political motivations cannot be addressed by host states alone but depend on measures of home states or self-regulation of SWFs, i.e. the GAPP. Host states might still concern the political influence of SWFs. Moreover, if being treated like private investors, SWFs can enjoy substantive and procedural protections in IIAs. SWFs can use ISDS mechanism to challenge the right to regulate of host states even if they pursue political strategy rather than financial returns (but SWFs cannot revoke state immunity as they are private investors and they undertake private

[43] Li (n 6) 417 in Introduction

investment).

It can be argued that the guarantee of this model falls into the reform of SWFs to be independent market participants and the improvement of their governance. On one hand, home states of SWFs may have to undertake necessary domestic reform on all SOEs including SWFs. On the other hand, it could be an effective approach to promote the code of conduct of SWFs or other international principles via international coordination between the IMF and OECD, and incorporating these soft-law requirements into IIAs. The host countries can continue utilise industry-specific rules to regulated SWFs investments in certain sectors, especially critical or sensitive industries.

1.2.2 Model two: treat all SWFs as the same but different from private investors

This model treats SWFs as public entities, functionally like private investors, i.e. having the public-private feature. It is based on the ownership or funding source that differentiates SWFs from private investors. SWFs and other government-controlled entities are treated like SOEs or state-controlled entities, or state-holding companies. In terms of national security review mechanism in several host states, all foreign government controlled transactions should be reviewed, or all FDI of SOEs or investments even below certain threshold but having substantial influence should face scrutiny.[44] Hence, even though portfolio investment or minority investment of SWFs is below or outside required shareholding threshold, if they can exert substantial influence on target companies via special arrangement or contract or if they involve in critical infrastructure or strategic assets, concerns might arise. As regulations on foreign investment mainly focus on the FDI, portfolio investment of SWFs needs additional regulations, if host states concern the political influence of SWFs investment. Under this model, SWFs may receive higher level of restriction than private investors but receive same restrictions imposed on SOEs. If SWFs and their investments were covered by the definitions of 'investor' and 'investment' in many IIAs but no special requirements or clarifications were made on SWFs, host states, in order to address concerns of sovereign background of SWFs, might intend to introduce special regulations or high-level threshold for SWFs investment.

[44] P. Rose, 'U.S. Regulation of Investment by State-Controlled Entities' (2016) 31 (1) ICSID Review 77. See also Bath (n 8) in Introduction

The advantage of this model is that it is more likely to reduce concerns of SWFs to the utmost extent and to protect national security and public interest of host states. This model grants and maintains the regulatory power of host states to a large extent. However, this model might result in discriminating SWFs due to state ownership or origins/nationality of SWFs but not nature of their investments. These protective or discriminatory measures imposed on SWFs by host states might give rise to protectionism or be regarded as the violation of treaty provisions or soft law regulations, e.g. OECD guidelines for host states of SWFs.

An over-focus on state ownership or political motivation of SWFs cannot help to encourage commercial behaviours of SWFs but results in divestment or even conflicts. Those modernised or independent SWFs cannot receive sufficient/deserved protection under this model. Possible measure to address drawbacks of this model is to avoid measures adopted by host states to be a political response but a legitimate approach, e.g. avoiding protectionism of host states by limiting the right to regulate of host states to legitimate and real national security concerns via due process with transparency and proportionality.

1.2.3 Model three: treat different kinds of SWFs differently and tackle specific issues

This model, which depends on legal structure and governance structure of SWFs and activities of SWFs, relies on an assumption that not every SWF might result in concerns and some SWFs act as independent private investors. Those SWFs that have separate legal identities are different from those SWFs that have no separate identities but are controlled by central banks or monetary authorities.[45] The former is more like a private investor while the latter is a kind of public entity.

However, both private and public entity can raise concerns if they exert political influence on host states' regulatory power, and if they lack modern corporate governance, or if they invest in sensitive industries for political objectives.[46] If SWFs are private entities, undertaking commercial activities, portfolio investments of SWFs do not have to comply with additional requirements under this model while their FDIs

[45] See Bassan (n 6) in Ch.1
[46] See Cooke (n 10) in Introduction

receive the same treatment like other private investors. If they are public entities, their portfolio investment might not receive additional restrictions if they undertake commercial activities, while if they undertake political activities, they might receive special restrictions and cannot resort to ISDS mechanism to challenge those measures adopted by host states but resort to state-to-state dispute resolution, consultation and conciliation, and they can even invoke immunity under this circumstance. Besides, host states can utilise national security review to screen direct investment of SWFs in sensitive industries or those may pose real national security (including economic security) risks.

Under this model, more pertinent measures and actions can be taken. Regulations focus on SWFs and specific behaviours that might lead to concerns. It helps to reduce the concern in relation to the uncertainty of SWFs. However, it might cause the problem of complexity, as SWFs might change their investment policies over time and they can be also structured in a more advantageous form thus making host states hard to identify which SWFs or which kinds of SWFs investments might result in questions. Moreover, no matter public or private one, when they conduct commercial activities or engage in commercial activities, under international law, these activities are treated as private investments rather than public investments and cannot invoke immunity. It is hard to identify which SWF is driven by political motivation.

Therefore, to offset the flaws of this model, regulations should not focus on every aspect of SWFs investment but focus on interests that host states concern, while other fields could leave a space for SWFs investment without additional restrictions. Those SWFs, which have modern governance structure and invest in non-sensitive industries, comply with general requirements in specific industries and general requirements for all foreign investors. Those SWFs, without modern governance structure and invest in sensitive industries, might be reviewed by national security review authorities or constrained by other relevant regulations.

Based on the analysis of three proposed models, it is found that the regulation is not introduced or improved to restrict all SWFs and their investments but to protect national security, legitimate interests, and provide a level playing field for private investors. Concerns and questions may occur in any forms but not just in the form of

SWFs investment. Whether restricting SWFs investment or not, SWFs are and will still be an important part of international investment that cannot be ignored, thus they should be entitled to receive protection under international investment law. The choice of regulatory models depends on the discretion of and also concerns from host states, while the crucial point is how to balance and guarantee legitimate interests of both sides. As important participants in international market, SWFs relevant issues should be reflected and addressed between host states and home states via IIAs but not limited to unilateral actions.

2. Suggestions for Regulating SWFs Investment in International Investment Treaties

Since domestic approaches to regulate SWFs may be various depending on the interests and values of each state, host states are left with much more discretion in implementing local SWF-specific regulatory measures.[47] At both pre-establishment and pro-establishment stages, host states are free to impose discretionary barriers on SWFs investment, but are nonetheless constrained by explicit IIAs provisions in this respect.

This section thus argues that the plausible way to address issues of SWFs investment and to balance the conflicting interests would be incorporating issues surrounding SWFs investment and investment of other sovereign investors into IIAs. It should be highlighted that although large SWFs come from emerging economies or developing countries, many developed countries have also established SWFs or intend to establish SWFs,[48] and therefore home states of SWFs would also be the host states of other foreign SWFs and *vice versa*. It could also be the reason why host states and home states should address these issues via IIAs and consider the balance of interests of both sides.

[47] Pauwels (n 28)

[48] The UK government intends to establish a series of SWFs to support infrastructure spending. See M. Khan, 'Tory manifesto promises UK' sovereign wealth funds'' *Financial Times* (18 May 2017) <https://www.ft.com/content/132b90ad-1d21-3d8b-b4c0-8a8fbf605d05?mhq5j=e1> accessed 29 June 2017

2.1 Suggestions for treaty protection in IIAs

2.1.1 Substantive rules

2.1.1.1 Market access and national treatment

Usually, before entering the market of a host state, investors would encounter a denial of market access based on the status and feature of investors and/or the type of industry that investors seek to invest in.[49] It consists of investment screening (or national security review) and selective carve-out of certain industries or even certain investors/investment. For both SWFs and host countries, the market access and investment treatment during this phase are of great importance. Currently, national treatment (NT) has not been widely granted during the market access phase by many countries. The US and Canada routinely include it as an mandatory right of entry and establishment in their IIAs while many Asian countries and also EU member states do not usually embrace investment liberalisation provisions in their IIAs. However, there is a growing trend that several countries also intend to adopt this US model via pre-establishment NT plus negative list approach.[50] The negative list usually contains prohibited or restrictive industries for foreign investment.

Treaties containing pre-establishment NT usually provide foreign investment treatment no less favourable than its own investment made by local investors, but some treaties limit this to 'in like circumstance.'[51] It may be assumed that if the home state has an IIA with host state that guarantees the market access and provides NT for SWFs investment, SWFs investment could not be denied entry except sectors in negative list. Once SWFs and their investments are covered by this IIA, they are entitled to treaty protection. However, there might be two barriers that prevent SWFs

[49] Pauwels (n 28) 118

[50] For example, because EU and China are negotiating IIAs with U.S., they are discussing the 'national treatment plus negative lists' model in market access. Usually, the EU style BITs or FTAs do not extend the national treatment to pre-entry phase. In term of 'negative lists', usually any listed sectors can be assumed as exceptions to liberalisation. 'Positive lists' means any listed sectors can be assumed as commitments to open market. See S. Golub, 'Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries' (2003) OECD Economics Department Working Papers No. 357, 10 <http://www.oecd-ilibrary.org/docserver/download/335043060125.pdf?expires=1509583291&id=id&accname=guest&checksum=1CDBC815A921B678D88DB6B4E31AA4DD> accessed 29 June 2017

[51] For example, NAFTA art. 1405, US Model BIT 2012 art. 3. Those treaties that grant national treatment in pro-establishment phrase also including the wording of 'in like circumstances' e.g. the Article 4 of Singapore-Korea BIT (2008)

from claiming NT.

The first one is where there was the wording of "like circumstances", which requires a comparison by identifying a national "comparator" in host states.[52] It is hard to find a comparator that is similar to SWFs in many host states, but it is easy when a host state is also the home state of SWFs. For those countries do not have a similar investor conducting similarly to SWFs, it is difficult for SWFs to prove the host state's violation of national treatment standard. In this regard, it may depend on whether the nationals of host state receive the same treatment in 'like circumstances'.[53] However, to reduce uncertainty and provide predictability for SWFs, it would be plausible to incorporate certain specifications on NT 'in like circumstance', which helps to facilitate the application and interpretation of this standard. Examples can be learnt from the provisions in Morocco-Nigeria BIT (2016) but it could consider other relevant factors in light of state-owned investors.[54]

The second one is exception provision clauses in many IIAs concerning the application of the pre- and pro-establishment NT.[55] If a host state concerns the national security risk brought by SWFs investment, they can exclude SWFs from receiving certain treatments. However, the host state cannot restrict or discriminate SWFs only due to the state ownership but should depend on a case-by-case investigation. For invoking exceptions, the host state should clarify elements or factors that are used to assess the nature of SWFs investment, while these elements not only target state-owned investors but all foreign investors. For concern of national security during market access phase, the host state should clarify the concept of national security (only limit to military or defence, or extend to economic security or even broad notion of security) with legitimate reasons. If the host state concerns foreign control over critical infrastructure or strategic assets, it can list these areas into its negative list.

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[52] Sornarajah (n 10) 283 in Ch.5

[53] D. Wallace and D. Bailey, 'The Inevitability of National Treatment of Foreign Direct Investment with Increasingly Few and Narrow Exceptions' (1998) 31 Cornell Int'l L.J. 615, 620-623

[54] It provides the application of national treatment standards with the list of specifications. See Morocco-Nigeria BIT (2016) art. 6 (3). For more discussion, see T. Gazzini, 'Nigeria and Morocco Move Towards a "New Generation" of Bilateral Investment Treaties' (8 May 2017) <https://www.ejiltalk.org/nigeria-and-morocco-move-towards-a-new-generation-of-bilateral-investment-treaties/> accessed 15 July 2017

[55] Ch. 4 s. 1.1.4

In order to avoid unnecessary disputes and conflicts, it would be wise to treat all foreign investors as the same at the market access phase (applying the suggested model one). For those IIAs without investment liberalisation provision, investment protection provisions usually provide standards of treatment for investment during pro-establishment phrase. Host states can also use exceptions or even incorporate investors' obligations into IIAs (herein could be the GAPP for SWFs) to protect their public interests rather than setting unilateral protective barriers.

2.1.1.2 National security concern

For the concern of national security, the question is whether additional provisions or restrictions are needed to address risks associated specifically with investments made by state-owned or state-backed investors. In this thesis, the answer is no. Several questions should be considered in this respect. Does the investor have malicious motivation, and is it able to act on that motivation? Does the investor take control over a particularly strategic assets or sensitive company via its investment? It should be noticed that these questions could be caused by any investor in bad faith whether it is a private-owned or state-owned.

Exception provisions in many IIAs are already broad enough to include any national security concerns that might arise with respect to sovereign or private investments.[56] Currently, the national security concern is not limited to military or defence but the concern of foreign control over strategic assets or critical infrastructure or critical technology, which means the vulnerability of the asset being acquired.[57] It is argued that this vulnerability is affected by the nature of an investment and the level of control hold by the foreign investor but is not due to the investor being a state-owned investor.[58] If an investor has ill intention, it only indicates that it may pose threats but

[56] See Ch. 4 s. 1.1.4

[57] When assessing the national security risk, the CFIUS looks "(1) at the threat, which involves an assessment of the intent and capabilities of the acquirer, (2) at the vulnerability, which involves an assessment of the aspects of the U.S. business that could impact national security, and (3) at the potential national security consequences if the vulnerabilities were to be exploited." See US Treasury, 'Remarks by Treasury Deputy Assistant Secretary for Investment Security Aimen Mir at the Council on Foreign Relations, Washingto, D.C.' (1 April 2016) <https://www.treasury.gov/press-center/press-releases/Pages/jl0401.aspx> accessed 17 July 2017

[58] Mendenhall (n 23) 41

does not mean vulnerability. If an investor presents a unique national security risk, the host state could treat it differently without violate its obligation. But with regard to sovereign investment the host state should prove that SWFs or other state-owned investors would lead to specific risks.

It should be admitted that the scope of security or public interest would change over time and the type of investments or investors that might pose threats to such security might be different over time (the rise of state capitalism is an example). The host state could include special provisions in the IIA with regard to the protection of national security or general interest it believes that easily and possibly to be threatened by the involvement of SWFs and other state-owned investors in its market. But it would easily lead to an assumption that SWFs always and naturally tend to endanger the national security and even those SWFs that are political and economically independent from the home state are not immune from this.

A provision could seek to determine whether the investor has a legitimate commercial purpose. But in practice, purposes or motivations as subjective factors, are hard to be investigated. Moreover, SWFs are inherently established with purposes rather than purely commercial considerations, but they operate for higher profits.[59] There are a number of other investors (including SWFs), especially many public pension funds, undertaking investments other than purely commercial considerations, e.g. engaging in socially responsible investment (SRI), which is not restricted by regulators.[60] Sustainable development is increasingly becoming a mainstream concept on the international political agenda, and the international investment law cannot be immune to.[61] It is also arguably that even many IIAs do not include the requirement of

[59] Ch.1 s. 1.2.1

[60] C. Woods and R. Urwin, 'Putting Sustainable Investing into Practice: A Governance Framework for Pension Funds' in Tessa Hebb (ed.) T*he Next Generation of Responsible Investing* (Springer 2012) 27; see also B. Richardson, 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand' (2011) 2 Nordic J. Com. L. 1; see W. Yin, 'Sovereign Wealth Fund Investments and the Need to Undertake Socially Responsible Investment' (2017) 1 Int'l R. L. <http://www.qscience.com/doi/full/10.5339/irl.2017.9> accessed 29 June 2017

[61] For example, China-Korea FTA (2015), China-Canada BIT (2012), and China-Switzerland FTA (2013) provide sustainable development in the preamble. CETA and EUSFTA include comprehensive obligations to respect labour and environmental standards. In addition, some host states even emphasize the responsible business conduct of investors. See T. Berry and J. Junkus, 'Socially Responsible Investing: An Investor Perspective' (2013) 112 (4) J. Bus. Ethics 707

'investment for profit'.[62] Furthermore, investment case law, e.g. the CSOB and BUCG cases by applying the Broches test emphasise that the focus should be put on the nature and function of the investment rather than the purpose and ownership.[63] Thus, in terms of national security concern, the focus should be put on the nature of a particular investment and involved industries or assets but not only rely on the purpose/motivation.

It is possible to incorporate a provision to determine whether a particular transaction of SWFs is influenced by political intervention or motivation, which could be assessed according to various relevant factors. However, it is not necessary and practicable to incorporate every aspect into IIAs, and as already discussed the exception provision in IIAs is broad enough to protect the legitimate national security of host countries. Nevertheless, it could give a reference to relevant international guidelines (e.g. GAPP) for SWFs or other state-owned investor (which also provide elements for arbitral tribunal to consider). The host states can also choose to exclude those SWFs that do not act in good faith or are controlled for political objectives from treaty protection. The political influence on investments herein is mainly through the influence on governance and operation of SWFs.

2.1.1.3 Governance structure concern

It is true that the fear of political motivation of SWFs investment is because of their governance structure and low-transparency that cannot ensure their independent operation and decision-making from the influence of their government. The legal and governance structure of SWFs, nature of investment, and even investment objectives, purposes, transparency etc. are sorts of elements that the host state would consider in examining whether a SWF present a threat via national security review.[64] Tribunals

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[62] Poulsen (n 10) 86 in Ch.5

[63] See Ch. 5 s. 2.2.1.2

[64] For example, if a investment is controlled by a foreign government, the CFIUS would considers following relevant facts: "the extent to which the basic investment management policies of the investor require investment decisions to be based solely on commercial grounds; the degree to which, in practice the investor's management and investment decisions are exercised independently from the controlling government, including whether governance structure are in place to ensure independence; the degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements and financial information of the investor; and the degree to which the investor complies with applicable regulatory and disclosure requirements of the countries in which they invest." See US Treasury, 'Guidance Concerning the National Security Review Conducted by the Committee on

may also rely on these factors to assess whether a host state is justified in determining this. These factors may be also considered by tribunals to determine whether a SWF is a qualified claimant in ISDS and whether its investment falls within the jurisdiction of ISDS.[65] Although host states may impose regulations on state-owned investor via domestic measures, substantive protections with regard to governance structure concern should be clarified in IIAs thus ensuring that legitimate interests and state sovereignty would not be challenged or undermined by tribunals.[66]

To ensure the commercial operation of SWFs, besides home states' effort to improve governance structure, (public and private) accountability, even transparency of their SWFs, host states could also choose to incorporate their requirements into treaty provisions as a part of 'legitimate expectation' of SWFs thus establishing obligations and duties of investor and investment.[67] Treaty drafters could choose from two approaches to make references to internationally accepted standards of corporate governance by applying suggested model one or model two.

The first choice is to set their required 'expectations' for all foreign investors (model one). Treaty drafters could generally refer to 'international recognised standards or principles of corporate governance, inspired from the Article 9.7 of TPP and the Article 15 of Model International Agreement on Investment for Sustainable Development of the International Institute for Sustainable Development (IISD) (IISD Model treaty).[68] They could also specifically refer to the OECD Guidelines for Multinational Corporations, inspired from the Article 16 of IISD Model treaty.[69] The

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Foreign Investment in the United States' (2008) <https://www.treasury.gov/resource-center/international/foreign-investment/Documents/GuidanceFinal_12012008.pdf> accessed 19 July 2017

[65] See the case of Maffezini v. Spain, in Ch. 5 s. 2.2.1.2

[66] Poulsen (n 10) in Ch.5

[67] The doctrine of legitimate expectations presupposes that a promise or an agreement would generate a level of trust or expectations. It is usually used in domestic jurisdictions concerning the issues of judicial review in England and Australia. In the context of investment arbitration, it is the stability and predictability of the legal regime in host states. See Y. Ngangjoh-Hodu, 'A Critique of the Legitimate Expectations Doctrine in Investment Treaty Arbitration' (16 September 2013) <https://www.ejiltalk.org/a-critique-of-the-legitimate-expectations-doctrine-in-investment-treaty-arbitration/> accessed 10 July 2017. For more discussion on legitimate expectations, see M. Potesta, 'Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept' (2013) 28 ICSID Rev. 88

[68] H. Mann et al., *IISD Model International Agreement on Investment for Sustainable Development: Negotiators' Handbook* (2ed. IISD 2015)

[69] ibid

second choice is to set requirements only for state-owned investors or SWFs (model two). Treaty drafters could make references to the OECD Guidelines for Corporate Governance of SOEs, since according to the definition of 'SOEs' in the Guidelines those SWFs formed as an enterprise could be regarded as SOEs.[70] Or they could refer to the GAPP, inspired by the Article 17.1 of TPP.[71]

2.1.2 Procedural Rules

Unilateral protective measures, or regulatory barriers in market access in domestic jurisdiction to tackle state-owned investors may easily result in far going protectionism or even discrimination. In this case, if SWFs are covered by IIAs with granted protection, an arbitration claim under relevant IIAs could be theoretically initiated by SWFs to challenge actions of host states. The SWF as a claimant would firstly have its legal standing before the ISDS (or ICSID as an example) and then would have to demonstrate that the SWF-specific entry barrier has violated the treaty obligations of the host state. The host state as respondent would have to demonstrate its legitimate legal reasons for its actions. However, as discussed in Chapter five, the legal standing of SWFs in ICSID or even other ISDS is still a controversial issue. Thus, for greater certainty for both sides, substantive and procedural rights and obligations should be clarified in IIAs, which also seeks to limit the flexibility of arbitrators to challenge the legitimate right to regulate or the legal response to state capitalism,[72] and to balance conflicting interests.

There are three options for treaty drafters to apply suggested models. Firstly, for those host states hesitant to provide SWFs and other state-owned investors the same recourse to ISDS (or ICSID) as private investors, treaty drafters could consider to exclude them as qualified investors to file a treaty claim via 'denial of benefit' clause or a specific provision (model two). Or they can exclude certain types of SWFs investments from treaty protection or exclude claims of SWFs in relation to national security (model three). Under this circumstance, the treaty could provide state-state arbitration or diplomatic negotiations for these claims or via consultation and conciliation.

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[70] OECD (n 45) in Ch. 1
[71] See Ch. 4 s. 2.2.2.1
[72] Poulsen (n 10) in Ch.5

Secondly, host states could allow all SWFs (model one) or allow certain SWFs (model three) access to ISDS as other private investors and provide other specifications on all investors in order to ensure the legitimate interest and national security of host states. As discussed before, to ensure commercial purposes, requirements concerning governance could be incorporated into or encouraged in IIAs. Treaty drafters could choose to exclude investors (whether state-owned or private-owned) from ISDS and from a claim regarding national security measures, if they do not comply with these requirements. Or they could choose to exclude those SWFs that do not observe SWF-specific requirements (model three).

In addition, in terms of national security relevant claims, host states could choose from the following options to guarantee their state sovereignty over legitimate interests. The first option, discussed before, is to rely on exception provisions with a clarification that adopted measures should not be a disguised restriction or protectionism. Or they can choose to incorporate the wording of 'self-judging' (e.g. 'it considers') into the exception clause.[73] They can also choose to exclude entire claims regarding national security related measures, while under this circumstance, the tribunal could be allowed to review whether these protective measures are in good or bad faith for the interest of investors. Alternatively, those host states concerns being challenged by SWFs via ISDS, they can adopt the emerging trend in several developing countries (e.g. India) to insist pursuing or exhausting local remedies before resorting ISDS.

2.2 Improvement of soft law for SWFs

In light of suggestions discussed above, it could be noticed that internationally accepted guidelines for foreign investors generally, or for SOE or SWFs particularly, play an important role in addressing issues of SWFs investment. These guidelines help in part to ensure the commercial purpose or transactions of SWFs by improving the governance, transparency and accountability of SWFs thus further eliminating

[73] For example, Article 18 (4) (b) of Canadian Model BIT (2012), Article IX (5) (b) of Canada-Slovakia BIT (2010), Article 10 (4) (b) Canada-Peru BIT (2006). For more discussion, see C. Titi, *The Right to Regulate in International Investment Law* (Bloomsbury Publishing 2014) 195-198

concerns of host states. If incorporated into IIAs, it also helps tribunals to assess the necessity of host states' measures to restrict SWFs and to investigate whether SWFs meet the legitimate expectation set by host states. It can, to certain extent, overcome flaws of these guidelines, e.g. the lack of an enforcement mechanism or insufficient compliance.

The GAPP (or the so-called 'Santiago Principles'), prima facie, is an example of international institute building and a kind of standard setting, which aims to promote transparency, accountability and more generally, the good governance of SWFs. However, it was argued that the GAPP could only be regarded as a form of self-regulation (and soft law) rather than a genuine international standard,[74] since the process of setting and developing an international standard (whether legally binding or not) shall ideally involve the equitable participation of all stakeholders.[75] The membership of an international standard should not be limited to a small number of states.[76] For the process of developing the GAPP, host states only act as a passive role, and the focus arguably is only put on interests of SWFs and the relation between fund managers and SWFs.[77]

Moreover, it should be admitted that the GAPP is a small group participated self-regulation for SWFs, as the IFSWF only consist of 32 SWFs (endorsed the GAPP),[78] which is less than existing SWFs worldwide, so that it cannot represent the interests of all SWFs. For concerns of political influence (not the political motivation, as the motivation is hard to determine), the GAPP focuses more on disclosure requirements of SWFs rather than the independent structure/operation of SWFs.[79] In addition, although as discussed pursuing other than purely commercial considerations cannot be blamed since other investors also consider interests more than financial

[74] Bismuth (n 11) in Introduction
[75] L. Koechlin and R. Calland, 'Standard Setting at the Cutting Edge: an Evidence-Based Typology for Multi-Stakeholder Initiatives', in A. Peters et al. (eds.) *Non-States Actors as Standard Setter* (CUP 2009) 84
[76] ibid. According to GATS, international standards are adopted by relevant international organizations, which refer to "international bodies whose membership is open to the relevant bodies of at least all Members of the WTO." See GATS art. VI (5) (b) note 3.
[77] Bismuth (n 11) in Introduction
[78] See Ch.4 s. 3.2
[79] According to GAPP 1, GAPP 2, and GAPP 18, the GAPP provides that the legal stricture, legal relationship between SWFs and other state bodies, the policy purpose and the investment policy should be publicly disclosed.

return (e.g. SRI), the GAPP may confuse the identity of SWFs as private investors.[80]

It is therefore necessary to revise and improve the GAPP to reduce the uncertainty and confusion concerning the status of SWFs and SWFs investment. This could not be done by the IFSWF alone or only with the assist of the IMF, but require the coordination between the IMF and OECD (as suggested in Chapter four),[81]as well as efforts of host and home countries, thus considering interests of both sides. Compared with the IMF, OECD, with abundant experience, has provided various guidelines for host states, and for private as well as public entities, which indicates that the OECD considers the interests of host states and also of foreign investors.[82]

To improve the GAPP as an international standard for SWFs, experiences can be learnt from OECD Guidelines for SOEs (2015 version). The SOE Guidelines have been adopted in several regimes of global governance, e.g. international economic law and human rights, especially the role of SOEs and the state shareholders in responsible business and human rights-based CSR.[83] It seeks to provide a model or instrument for Good State Shareholders. This Guideline might inspire what the GAPP can do to deal with the relationship between SWFs and home states, and reduce the concern of host states. In addition, the OECD and the IMF, as well as the IFSWF can work together to provide a plausible answer to state capitalism based on their existing guidelines concerning state-owned entities.

3. China's Approach to Regulate Inward and Outward SWFs Investment

Apart from the rise of state capitalism in global market, the Chinese state capitalism has generated a significant debate and has attracted wide attention. With the support

[80] The GAPP requires SWFs to comply with domestic law, but a footnote of GAPP 20 mentions, "However, recipient countries may grant to SWFs certain privileges based on their governmental status, such as sovereign immunity and sovereign tax treatment." It may indicate that although SWFs are required to be guided by financial motives and should be independent from government authorities, SWFs may still receive regulatory advantages i.e. state immunity.

[81] See Ch.4 s. 4.3

[82] See Ch.4 s. 3.1. The OECD also provide national treatment instrument for host states i.e. national treatment for foreign-controlled enterprise. It consist of a declaration of principle (which forms part of the Declaration on International Investment and Multinational Enterprises) and a procedural OECD Council Decision.

[83] M. Rajavuori, 'Governing the Good State Shareholder: The Case of the OECD Guidelines on Corporate Governance of State-Owned Enterprises' (2017) E.B.L.R., 6 (forthcoming) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2900799> accessed 29 June 2017

of 'go global' policy, Chinese enterprises have undertaken overseas investments driven by various motives.[84] The 'One-Belt and One-Road' (OBOR) Initiative provides opportunities for a new round of the expansion of Chinese investment, especially along the OBOR countries. Among these Chinese enterprises, sovereign investors (including SWFs and SOEs) play an important role, to support the development of domestic economy, to pursue higher financial returns and even to support the OBOR initiative.

The increase of Chinese overseas investment and the active role played by Chinese sovereign investors would require China to pursue sufficient investment protection, which is covered by investment treaties and fair or non-discriminatory treatment under domestic law of host states. However, although China currently holds the most bilateral investment treaties in the world, these treaties do not reflect its new practices and interests. The overseas expansion of Chinese sovereign investors also has created anxieties from host states, due to the state ownership and state control.[85]

Since China is negotiating IIAs with western economies (which are major destinations of Chinese overseas investment), it is the right time to protect its overseas investment via these treaties. It is also an opportunity for China and contracting parties to include or address issues of state capitalism via these treaties. On the other hand, the treaty negotiation will promote and advance a further domestic reforms in China to incorporate international standards into domestic governance and to further open up its domestic market, which are undergoing in China (e.g. SOE reforms, legislative reform concerning foreign investment rules and financial regulation).

In particular, China-EU and China-US BIT negotiations would set examples for the wide communities to address the issues of sovereign investors. Moreover, the domestic SOEs reform could in part help to enhance the trust and mutual

[84] Despite 'market seeking' is invariably the major motive, other motivations stand out in different industries and different recipient economies. 'Resource seeking' would be an important motivation for Chinese firms, especially state-owned enterprises (SOEs), since China has high demand for nature resources. Many multinational enterprises (MNEs) motivated by 'strategic asset seeking' through cross-border M&A tend to increase their competitiveness (such as controlling or acquiring technological resources, advanced management and widely recognized brands). Trade related FDI is also a usual motivation.

[85] L. Xing and T. Shaw, 'The Political Economy of Chinese State Capitalism' (2013) 1 (1) JCIR 88, 99

understanding between the home state and host states of SWFs. It is also important to notice that for China, a better way to protect its overseas investment and reduce political backlash in host states would be the achievement of its domestic reforms. This section therefore would like to assess the suggested regulatory models in China's context and put forward specific suggestions for relevant reforms.

3.1 The choice of proposed regulatory models by China

By recognising state sovereignty over economic activities in the territory of a state, regulatory models proposed by this thesis aim to provide a choice of regulatory suggestions that different states could adopt for addressing their own concerns and considerations towards SWFs investment. It should be noticed that these models could only reflect a general attitude from legal perspective in each country towards SWFs investment but not provide the specific and the final resort. The choice for China should rely on the current situation of China, and current need of China (according to the national economy and policy of China).

It should be noticed that so far foreign SWFs investment has not raised concerns or backlash in China, which on one hand might be attributed to the high level of restriction in Chinese market access, and on the other hand might result from the limited volume of capital inflows brought by foreign SWFs in China. Compared to the fierce resistance or suspicion that Chinese sovereign investors received in host states, SWFs investment seems more acceptable in China.[86] Although, China does not intend to implement over-reacted protectionist measures, for the purpose of legitimate national security, certain regulation and supervision are needed, especially in sensitive sectors. However, the option of China for general regulatory model on

[86] At present, we cannot find media news or official releases that state or express the concern of SWFs investment in China or any resistance on foreign SWFs investment from China. However, since SWFs have become important institutional investors and SWFs investment has become normal in global market, some Chinese scholars suggest that China should undertake legislative reform to cope with risks of foreign SWFs investment. In addition, since China continues to open up its market, it is important for China to reinforce its regulatory regime to attract foreign investment in terms of quality but not quantity and to enhance the national security review mechanism in China. See Y. Liu, 'Research on the regulation of sovereign wealth funds' (2009) 2 Anhui University Law Review (Chinese) 41, 52 [刘郁，《主权财富基金的法律规制问题研究》，《安徽大学法律评论》2009 年第 2 辑第 52 页]. See also Y. Zhang, 'China's Sovereign Wealth Funds under the Perceptive of Legal Adjustment' (2008) 6 Academics 85 [章毅，《法律调整视野下的中国主权财富基金》，《学术界》2008 年第 6 期第 85 页]

SWFs should not ignore the principle of proportionality, non-discrimination and reciprocity required in OECD guidelines,[87] as it is beneficial to both foreign SWFs and Chinese SWFs.

For model one, this is the model that China currently implements on most foreign investors and investments. Current foreign investment regime does not treat SWFs or other sovereign investors as special investors but as normal foreign investors.[88] Generally, SWFs investments (direct investment) in the phase of establishment, operation etc., follow the same rules that apply to investments made by other private investors. This might result from the list of exhibited and limited sectors in China's Industry Catalogue (or China's current negative list).

For the concern of national security, the national security review of China does not differentiate sovereign investors from other private investors thus SWFs comply with the same requirements and restrictions imposed on other foreign investors.[89] The state ownership or governmental background is not a substantial element to be considered. For concerns of transparency and corporate governance, apart from general disclosure requirements for private investors, China can also use national security review to investigate the motivation and nature of investment of each SWFs based on the level of transparency and the corporate governance of SWFs. These elements are also used to examine transactions made by other private investors since other private investors may also possibly give rise to national security concerns or exert political influence.

The national security review could be used in pre-establishment and also pro-establishment phases and it could cooperate with sector-specific measure or restrictions (or the use of negative list for critical or sensitive industries). Other regulations, e.g. competition law, corporate law, financial regulation apply to the operation of foreign SWFs investment in China. Therefore, it can be seen from current situation in China that there is no need to introduce additional or special rules on SWFs investment but reform existing rules in terms of investment in industrial

[87] Ch. 4 s. 3.1
[88] Ch. 4 s. 4.1
[89] Ch. 4 s. 4.1.2

sectors.

For model two, this is the way that China treats SWFs investment in stock market and bond market as well as inter-bank market. China treats SWFs slightly different from other private investors and even other institutional investors in securities market.[90] But this treatment is not a discriminatory stance but preferential treatment compared with other investors. As China continues to open up its market to foreign investors (and even domestic private investors) via reducing the content of negative list, China intends to attract more foreign capital into domestic market, especially long-term institutional investors. The QFII policy provides SWFs a channel to access China's A-share market and bond market,[91] and SWFs receive higher investment quota than other QFII institutions.[92] Under this circumstance, SWFs are treated as the same like central banks and monetary authorities of foreign countries, but different from other private investors.

Offshore investors are not legally allowed to invest directly in Chinese capital markets due to longstanding capital controls. Moreover, in order to facilitate overseas institutional investors' investment in inter-bank bond market and attract more qualified investors, China has changed the QFII by eliminating the need for licence holders to seek individual approval for investment quota,[93] thus SWFs (and central banks or monetary authorities and international financial organisations) can invest without an official quota restriction according to new filling system but not the approval system.[94] The main reason behind relaxing restriction on one hand is to

[90] Ch.3 s. 4.1.1.2
[91] ibid
[92] As two of the world largest SWFs, Norway's Government Pension Fund Global (GPFG) and UAE's Abu Dhabi Investment Authority (ADIA) have invested in China via QFII. In 2014, GPFG invested to China $ 1.53 billion and invested $ 3.3 billion in fixed-income. In 2015, ADIA invested in China's stock market $ 1.5 billion with approval, before which ADIA had already received four times QFII investment quota. For more information see L. Chen, 'Reveal the world's most richest wealth fund' [陈琳，"揭秘那些全球最土豪的财富基金"] (23 December 2015) <http://www.laohucaijing.com/news/112946/> accessed 27 June 2017
[93] It was argued that QFII changes may well have brought forward the timetable for the inclusion of China A-shares and it is a clear a China's official signal that they certainly are "open for business" in terms of capital inflows, even if they are wary of speculative capital outflows. See J. Sedgwick, 'QFII reforms: Chance to rethink China investments' (15 February 2016) <http://www.arendt.com/publications/documents/pressroom/2016.02.15%20-%20qfii%20reforms%20chance%20to%20rethink%20china%20investments%20-%20ignites%20asia%20-%20s.karolczuk.pdf> accessed 27 June 2017
[94] See 'China's SAFE relaxes QFII quota and funds flow restrictions' (Linklaters 6 February 2016)

support its currency and equity prices; on the other hand is to increase China's allocations in the cross-border investment scheme and to stem capital flight and attract offsetting inflows.[95] It can be seen from the scheme that China welcomes SWFs' portfolio investment or investment in capital market, and China treats SWFs as long-term institutional investors.

For model three, currently China does not treat different SWFs differently based on their different governance structures and investment objectives. It can be seen from the analysis on model one and two that generally China treats SWFs as the same, even the same as other foreign private investors (except in securities and bond market). Model three, to certain extent, is not a suitable one for China relying on both economic and political considerations. Firstly, it is complex and hard to identify which kind of SWFs should be treated differently from other SWFs. Not only because it is time consuming but also because it is hard to simply set a criteria. Although SWFs are established for different purposes and exist in various governance structures as well as legal frameworks, these are not the reasons to treat them differently, and SWFs can change their objectives and strategies over time. It is not easy to identify transactions led by certain SWFs *ex ante* that might lead to higher risks than other SWFs. New SWFs might be established in the future in different forms, but the main characteristics of them are the same, i.e. investment funds created by government for various macroeconomic and social purpose investing surplus or national wealth in domestic and overseas market for financial returns.

<http://www.linklaters.com/Insights/AsiaNews/LinkstoChina/Pages/Chinas-SAFE-relaxes-QFII-quota-funds-flow-restrictions.aspx> accessed 27 June 2017; see also 'China asset management: Recent developments in QFII and RQFII regimes' (November 2016) <http://www.nortonrosefulbright.com/knowledge/publications/144846/china-asset-management-recent-developments-in-qfii-and-rqfii-regimes> accessed 27 June 2017. On 21 June 2017, the People's Bank of China (PBOC) promulgated the *Interim Measures for the Administration of Mutual Bond Market Access between Mainland China and Hong Kong* (Decree No. 1 [2017])(Interim Measures)[《内地与香港债券市场互联互通合作管理暂行办法》(中国人民银行令[2017]第 1 号)]. The scope of eligible investors is the same at the specified in PBIC's Circular of 2016 on the direct access regime (the DAR). This includes (i) foreign central banks or monetary authorizes, sovereign wealth funds, international financial organisations; (ii) QFII and RQFII; and (iii) foreign commercial banks, insurance companies, securities companies, fund management companies and other asset management institutions that lawfully registered and incorporated outsider the China and investment products issued by such institutions. See Y. Shen and B. Zhang, 'Mainland China briefing: Bond Connect' (18 July 2017), <http://www.lexology.com/library/detail.aspx?g=d2801d9e-8bfb-4c7d-8271-b58522ad94e4> accessed 19 July 2017

[95] See D. Weinland et al., 'Foreign funds cut quotas in China investment scheme' *Financial Times* (4 February 2016) <https://www.ft.com/content/fcacb912-ca1a-11e5-a8ef-ea66e967dd44> accessed 27 June 2017

Moreover, different treatments granted for SWFs might lead to the claim of discrimination. If China treats certain SWFs differently due to their legal status or governance structure (which is in relation to legal, economic culture and democratic system of each country), it will be accused of discrimination in terms of nationality thus leading to political conflicts. Although some SWFs are in low transparency or are with less modern corporate governance (that would lead to higher concerns than other transparent and modern SWFs), potential concerns could be reduced by setting minimum standards or incorporating the GAPP. However, in some cases or to certain extent, China could choose to treat different SWFs differently, i.e. providing preferential treatment for certain SWFs that are endorsed the GAPP. For those SWFs, no other special restriction or requirements should be imposed on them and they are treated as other commercial-oriented private investors.

It can be seen from above analysis that China does not treat SWFs and SWFs investment as threats but treats them like private investors or even provide certain preferential treatment for SWFs over other foreign investors. Generally, all three regulatory models can be adopted by China to certain extent or partially used by China. However, China should consider its dual role as home country and host country of SWFs investment and balance conflicting interests, which also depends on China's economic and legislative reforms, and serves for its policy. In the short term, since China needs to attract foreign capital and China still controls over capital flows as well as certain industries related to the people's livelihood,[96] the state capital brought by foreign SWFs cannot raise particular concerns that China's current regulations cannot address. Hence, in short term, China could still choose to treat SWFs as other private investors in terms of direct investment and treat SWFs different from private investors in terms of investment in securities markets, i.e. a combination of the model one and model two.

[96] In August 2017, the National Development and Reform Commission (NDRC), Ministry of Commerce (MOFCOM) and PBOC jointly released official guidelines on outbound direct investments, approved by the State Council, which clarifies the regulatory requirements to seek approval and classified overseas investment into prohibited, restricted and encouraged transactions. *See Notice of the State Council Forwarding the on Guiding Opinions of the National Development and Reform Commission, the Ministry of Commerce and the Peoples' Bank of China on Further Guide and Standardize Overseas Investment Direction* [2017/74] [国务院办公厅转发国家发展改革委商务部人民银行外交部关于进一步引导和规范境外投资方向指导意见的通知, 国办发［2017］74 号]

In the long term, if China continues to open up its market and to relax control or restriction on foreign investment in various sectors, and if a large amount of state capitals led by foreign SWFs flow into China, China should consider relevant risks and issues. Therefore, China could choose to combine the model two and model three. Sovereign investors (SWFs and SOEs) could be treated differently from private investors, especially in national security review mechanism, which is the current situation Chinese SWFs and SOEs have encountered in the U.S. and in other developed countries.

If foreign SWFs have endorsed GAPP or have built sound modern governance, they will be reviewed as normal. If not, they will follow different requirements. However, if we consider the reciprocity, when Chinese sovereign investors intend to reduce concerns or backlash from host states, the plausible way is, at general level, to treat all SWFs as private investors, but these should be based on their commercial/private activities/conducts. Special treatments or restrictions should be in place to tackle those investments for public purpose or in executing the function of government either in the form of sovereign investor or other private investors.

However, these regulatory models are mainly adopted to identify foreign SWFs and other foreign investors but not to differentiate foreign investors from Chinese sovereign investors. The regulatory advantages and preferential treatments granted to Chinese SWFs and SOEs by Chinese regulator is the main concern from foreign investors and their governments, as they concern that their investors cannot receive fair treatment or have a level playing field.[97] Compared with Chinese SWFs and SOEs (that may have less restrictions on their investments in Chinese domestic market), foreign SWFs can only access to limited sectors. But this is also the problem and situation that Chinese private investors have encountered in China. Nevertheless, things might be changed if the on-going SOEs reform and foreign investment regulation reform can effectively be advanced and implemented. These reforms aim

[97] Here should be clarified that the situation for Chinese SOEs might different from the situation for Chinese SWFs. In terms of direct investment, most sensitive sectors are dominated by Chinese SOEs in which foreign investors cannot step in. Chinese SWFs hold shares of important institutes in banking sectors. But in terms of portfolio investment and investment in securities and bond market, foreign SWFs can invest in but still have restrictions in A-share market and bond market but without particular restrictions in inter-bank bond market.

to relax restrictions in Chinese market and to provide fair and healthy competition and opportunities for both foreign investor and domestic investors (whether they are private or public). It is also the way that China tries to address concern of its SOEs in host states (i.e. market-oriented or commercial-oriented investment).

3.2 Domestic reform in relation to SWFs investment in China

This section focuses on relevant domestic economic and regulatory reforms in China and provides suggestions for further reform. These efforts can help to recognise China's option to address competition neutrality between private investors and sovereign investors (either foreign investor or domestic investors), and help to understand China's attitude towards foreign investors and the operation of its SWFs.

3.2.1 SOEs reforms

The SOEs reform in China has travelled for a long journey and is still on going.[98] The structure of SOEs, the productivity of SOEs, and the preferential treatment received by SOEs, have been questioned by many scholars.[99] Issues of SOEs, especially competitive neutrality, are not only discussed within China or focus on Chinese SOEs, but also are discussed by international communities and other countries.[100] Recent years have seen China's attempt to reform inefficient SOEs through mixed ownership models. The last few years have seen China establishing state capital funds to support M&A activity and reform among its SOEs. China has determined that its SOEs must become more market-oriented entities; the prevailing focus is on facilitating higher level of mixed, or partially private, ownership.[101]

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[98] For discussion on the rationale to reform in China, see C. Bai et al., 'The Multitask Theory of State Enterprise Reform: Empirical Evidence from China' (2006) 96 (2) Am. Econ. Rev. 353

[99] It was suggested that the restructuring of SOEs was limited and the productivity of SOEs lagged private companies. See D. Berkowitz et al., 'Recasting the Iron Rice Bowl: The Reform of China's State Owned Enterprises' (2017) 99 (4) Rev. Econ. Statistics 735

[100] Not only China has its SOEs, other developing countries even developed countries (e.g. Europe countries or US) also have their own SOEs. The issue of SOEs is widely discussed within WTO for subsides, OECD for SOEs guidelines and competitive neutrality. It is also discussed and being an important part in most FTAs.

[101] In November 2013, the Third Plenary Session of 18th CPC Central Committee set the agenda for reforming SOEs. In September 2015, the State Council and Communist Party of China Central Committee issued the guidelines on deepening the reform of SOEs. See《中共中央国务院关于深化国有企业改革的指导意见》[Guiding Opinions of the Communist Party of China Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises], Communist Party of China Central Committee and State Council of the People's Republic of China (PRC) (Beijing, September 13, 2015).

The mixed ownership reform is firstly to monitor SOEs in classification.[102] SOEs can be classified by function into two main types, i.e. public-oriented SOEs that provide public goods, and commercial-oriented SOEs that achieve commercial objectives.[103] The public-oriented SOEs could be further classified into two types, i.e. SOEs with monopolies and SOEs with public welfare aims. Whether being public-oriented or commercial-oriented SOEs, both are market participants that must engage in market competition and must establish modern corporate governance with diverse shareholding structure. The mixed ownership reform is first implemented in commercial-oriented SOEs in fully competitive sectors.[104] The reform would also be implemented in public-oriented SOEs but should maintain their social service functions due to their important status in Chinese economic system.

Although China may encounter many difficulties when implementing mixed ownership reform, the success of SOEs reform could be guaranteed by progress in broader financial and legislative reform,[105] and external approaches (i.e. incorporating international standards), to reduce governmental interference in decision-making and entrench commercial orientation. Firstly, China should provide a clear governance framework for SOEs (including SWFs) and increase the transparency of their operations. Secondly, regarding a level playing field, China could consider introducing exceptions to the application of NT via the negative list, i.e. open fully competitive sectors to private (domestic and foreign) investors, but retain majority control over industries in natural monopoly, national security and economic lifelines.

Thirdly, as the home country of SOEs and SWFs, China could consider incorporating international principles or code of conducts (e.g. OECD Guidelines for SOEs, OECD

[102] See J. Zhang, 'Mixed Ownership Reform Must First Classify SOEs' (6 February 2017) <http://charhar.china.org.cn/2017-02/06/content_40229098.htm> accessed 20 February 2017
[103] ibid
[104] The first round of SOE pilot reforms includes China Unicom, Harbin Electric Cooperation, China Eastern Airlines, China Nuclear Engineering and Construction Corporation, China Southern Power Grid and China Shipbuilding Industry Corporation. See 'Central SOE Mixed Ownership Reform to Get Green Light Soon' China Daily (25 April 2017) <http://www.chinadaily.com.cn/business/2017-04/25/content_29077222.htm> accessed 1 August 2017
[105] G. Jefferson, 'State-Owned Enterprise in China: Reform, Performance, and Prospects' (2016) Brandeis University Working Paper Series 2016/109, 19 <http://www.brandeis.edu/economics/RePEc/brd/doc/Brandeis_WP109.pdf> accessed 1 August 2017

Guidelines for Multinational Corporations and GAPP for SWFs) into its domestic regulations and treaty negotiations. This is not only to encourage the conduct of foreign SOEs and SWFs in China, but also to modernise the corporate governance of Chinese SOEs, increase the transparency of Chinese SWFs thus improving their images/reputations in the process of making overseas investments. Apart from these, coordinated reforms outside the state-owned sectors could also help to achieve the goal of reforms, such as protecting minority shareholders and providing the access to finance for small and medium-sized enterprises.[106]

The SOE reform suggests that China intends to improve SOEs to be more commercial-oriented market participants, except those SOEs in reserved sectors. In this regard, China remains control over sectors that are of great importance to national security and public interest but opens other sectors for competition, which is in line with the Catalogue and negative list reform. Most SOEs would compete with private investors and a majority of sectors open to domestic private investors even foreign investors. But it is important to recognise that China would not change the state ownership character of SOEs but mix public and private ownership, which means that the reform does not aims to change state-ownership system but to provide fair competition among different investors. The reform shows that China treats different SOEs differently, which indicates a same approach as the suggested model three for SWFs. China intends to treat commercial-oriented SOEs the same like private investors based on nature of investment but not from ownership perspective, which is similar to suggested model one for SWFs. While at current stage, public-oriented SOEs are supposed to be treated differently from normal private investors, which can be assumed as the same like suggested model two.

It can be seen from the analysis that China's current options to regulate its SOEs and to regulate foreign SWFs indicate a combination of proposed models in practice. Situations widely vary and are based on a case-by-case consideration. A flexible approach is what China always chooses to adopt and implement in its policies. This is also reflected in treaty negotiation and conclusion practices of China, since there is no typical China Model BIT compared to the US one but relying on different situations

[106] ibid

with particular contracting partner.[107]

3.2.2 Regulating the operation of Chinese SWFs

It is usually suggested that China has two large SWFs, i.e. CIC and SIC, while the CIC is the only official SWF admitted by Chinese government.[108] In terms of the SIC, according to the Memorandum of Association of SIC, the main objectives of SIC is 'to undertake the management of state foreign exchange reserves or other business authorised by central banks' and 'to undertake the management of investment funds of all types on a worldwide basis.'[109] Since there are very little information about the operation and investment strategies of SIC,[110] this section only select CIC as a typical Chinese SWFs to discuss.

CIC was created as a wholly state-owned company incorporated in accord with China's Company Law in 2007. It invests a portion of China's massive foreign currency reserves and pursues maximum returns within acceptable risk tolerance, serving for the need of national economic development and deepening the financial system reform.[111] CIC was funded by fiscal revenue (special treasury bonds) issued by the Minister of Finance.[112] The bonds were used by the Ministry of Finance to

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[107] It can be found that China's approach is different from other host states, especially the UK and US discussed in chapter three. The US, Australia and Canada treat foreign sovereign investors or government-background investors differently in their national security review mechanism. While although the UK and also the EU so far have not established particular national security review mechanism or set additional requirement or restrictions for foreign investors (including foreign sovereign investors), they are seeking to tightened regime for foreign investment in critical infrastructure or strategic assets. For China, its national security review is designed for direct investment by foreign investors ignoring the ownership difference, while it provides certain preferential treatment for foreign SWFs concerning investment in securities and bond market.

[108] According to SWF Institute, there are five funds (including Hong Kong) that can be treated as China's SWFs. The other three are NSSF, CAD fund and HK Monetary Authority Investment Portfolio. SIC, which was opened in 1997, is organised as a privately held firm, which is primarily funded by foreign currency reserve from SAFE. The SAFE officials serve on its board of director. It has undertaken foreign equity investment and fixed income securities. See SWFI, 'SAFE Investment Company' <https://www.swfinstitute.org/swfs/safe-investment-company/> accessed 16 July 2017

[109] *Memorandum and Articles of Association of SAFE Investment Company Limited*, CYBER SEARCH CENTRE OF THE INTEGRATED COMPANIES REGISTRY INFORMATION SYSTEM (27 May 1997) <http://www.icris.cr.gov.hk/csci/cns_basic_comp.do *for a nominal fee*> accessed 30 July 2017

[110] For discussion about the necessity to regulate SIC, see Faden (n 51) in Ch.5

[111] See CIC, 'Annual Report 2016' (11 July 2017) <http://www.china-inv.cn/wps/wcm/connect/229a8953-b221-4538-90d3-c8f22a24144e/中投公司2016年年度报告.pdf?MOD=AJPERES&CACHEID=229a8953-b221-4538-90d3-c8f22a24144e> accessed 30 July 2017

[112] This arrangement is to avoid the violation of Article 29 of the Act of People's Bank of China (PBOCA), which explicitly prohibits the PBOC from "provideoverdraft for government or directly

purchase foreign reserves (purchase 100% of Central Huijin from the People's Bank of China-PBOC) as the registered equity capital of CIC.[113] To cover the cost of the bonds, CIC has to pay dividends to the State Council as its owner.[114]

CIC has three subsidiaries, i.e. CIC International Co., Ltd. (CIC International), CIC Capital Corporation (CIC Capital) and Central Huijin Investment Ltd. (Central Huijin). The overseas investment and management activities of CIC are undertaken by CIC International and CIC Capital (both are market-oriented commercial entities),[115] while Central Huijin is responsible to undertake equity investments in key state-owned financial institutions in China.[116] The portfolios of CIC mainly consist of public equity (equity investment in listed companies), fixed income (bonds), alternative assets,[117] and cash. As of December 2016, the assets of CIC are mainly distributed in financial sectors (19.01%), information technology (16.22%), consumer discretionary (12.39%) and industrials (10.68%).[118] A majority of its assets are externally managed in its portfolio, accounting for 66.11 %.[119]

The governing boards of CIC consist of the Board of Director and Board of Supervisors while the daily operation is delegated to an Executive Committee. Three functional committees (the International Advisory Council, the Investment Committee, and the Risks Management Committee) are responsible to report to the Executive Committee. Apart from these management committees, there are a number of

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subscribe to or underwrite treasury bonds another government securities."

[113] ibid 433; see also IWG (n 19) in Ch. 1

[114] IWG (n 19) in Ch.1

[115] The CIC Capital, incorporated in 2015, is responsible to make direct investments. CIC International, established in 2011, conducts bond and policy equity investments, alternative investments (hedge fund, real estate, and private equity fund), co-investments, and minority investments as a financial investor.

[116] Central Huijin does not interfere with the daily operation of its investee institutions but exercises it shareholder rights. More information about business and structure of CIC available at <http://www.china-inv.cn/wps/portal/!ut/p/a1/jZFBc4IwEIX_Sj14pFkgEDxSQMCW1lEchEsmaEBmMDDgePDXF7BXYnPKZr63L7sPZeiIMsHuVcluVSNYPdaZSb_BBNXZwwYiew22BV70o2_CT88cgHQW0HysSfVr_Kd3fDvA5AsAsKVB6H4ELllFAKH5Pz3MHBte_T8d9GQOcEBHe5ShLHEiug1Rqo6FEw-mSzhdKsGUStzf2qa7sXoJl-bKKRdLiDw3tKfbtuN9T3e85qzn_fA0NhA9lXrSyY6V_F0nJ5LnWqEYeq4qmGBNyTHhim6dLYOsLLUwCUo1lIxtJYM6RA74sRx4JjkBsqgmQJJF8mrZScfFmXeovR4Ox0fM80fRervAKO3F4herM56I/dl5/d5/L3dHQSEvUUtRZy9nQSEh/> accessed 30 July 2017

[117] The alternative assets in CIC's portfolio include hedge funds, real estate, infrastructure, industry-wide private equity, industry-wide direct investments and multi-asset investments. As of the end of 2016, these alternative assets accounted for 37.24% of CIC's overall portfolio. See CIC (n 111)

[118] The energy sectors account for 6.3%, the telecommunication services and utilities account for 3.17% and for 2.70% respectively. ibid

[119] ibid

functional departments.[120]

In the context of China, CIC could be seen as a special ministry-level SOE.[121] According to its funding and legal status, CIC is separate from PBOC and is out of the supervision of SASAC (usually Chinese central SOEs are supervised by SASAC) while CIC is a corporation owned and directly supervised by the State Council. It herein means that the CIC may enjoy a higher status than SOEs while the same political status as SASAC, PBOC, Minister of Finance or even other authorities, which may prevent its operation from the political interference from these authorities.

However, this special status and the structure of CIC may result in several concerns. The first one is that CIC is only accountable to the State Council but its operation lacks legal accountability or legal mandates, which cannot guarantee its commercial and professional operation.[122] This could easily result in the concern from the public opinion in China concerning its capacity to make profits, and also the concern with regard to its commercial-oriented and independent investment from Chinese government. The second one is the mix public and private functions. The role of Central Huijin played in state-owned banks makes CIC functionally like the SASAC for SOEs. In this respect, the CIC acts the role as quasi-governmental entity. Moreover, CIC has the mission to support Chinese enterprises going global and support OBOR Initiative via its investment activities.[123] Nevertheless, the ambiguity concerning CIC could be addressed by providing specifications in domestic legislations.

It should be noted that the three subsidiaries of CIC have different functions and mandates, and they are treated differently from each other. Despite the hybrid function of CIC, as discussed before, when undertaking overseas investment, the focus might be put on the nature of particular investment made by CIC International

[120] For more information, see Backer (n 44) 110-112 in Ch. 1

[121] Zhang and He (n 33) 103. They argue that CIC have some internal weakness, including a vague orientation, mixed investment strategies and an inefficient bureaucratic style.

[122] Li (n 6) in Introduction

[123] The Chair man of CIC, Guangshao Tu, expressed the main tasks of CIC. See 'CIC: Exploring the Investment Opportunities from China's Perspective' (中投公司：从中国视角挖掘投资机会) (28 September 2017) <http://news.xinhuanet.com/fortune/2017-09/28/c_129713637.htm> accessed 30 September 2017

or CIC Capital rather than on Central Huijin (only invest in China). However, Chinese government (and also other home states) should recognise that concerns on its SWFs from host states are not entirely unreasonable and irrational. It is usually the opaqueness of SWF's internal structure that creates the controversy on the nature of investment. Therefore, home states should take efforts to depoliticise SWFs and eliminate concerns.

For China, further clarifications on its SWFs should be provided. Firstly, the legal status of CIC, and even all Chinese SWFs that conform to the definition in the GAPP should be illustrated via a special SWF Act or National Investment Company Act or a special Provision provided by the State Council. It aims to separate the governmental function from commercial operation, to clarify the relationship between the Chinese SWFs and other administrative agencies or authorities. Secondly, to further abate concerns about the motivation and investment objectives, the transparency of Chinese SWFs should be improved, which is also for the consideration of legal accountability. Although CIC receive a rate of 8 in Linburg-Maduell Transparency Index, other Chinese (non-official) SWFs are below recommended rate and in low transparency. A periodic *ex post* disclosure requirement would be a resort while the plausible benchmark might be the GAPP (not the current one but an improved and reformed version).

Although according to the current situation China treats foreign SWFs slightly different from other foreign investors, and CIC is formed as a special entity among other Chinese sovereign investors, China does not impose biased regulations on SWFs based on definition or state ownership. It would be wise for China not to treat SWFs specially or pick out SWFs, since it is likely to be counter-productive in requiring the commercial-oriented and professional investment of SWFs. As a host state, China has legitimate right to regulate the market participants and avoid any investors from distorting the market, and China also has the intent to promote capital flow. Potential concerns and risks of SWFs investment could be prevented or eliminated to a large extent via existing regulations in a neutral manner, e.g. national security review, negative list and other industry-specialised requirements/restrictions, and competition law.

At a broader level, SWFs and other sovereign investors should be encouraged to participate, as stakeholders, in on-going negotiation concerning global governance of investment, whether it is in the form of IIAs or soft law principles.[124] If host states and home states could reach a consensus, there will be no need to create new or additional restrictions on SWFs and on other sovereign investors. Overall, in the long term, the proposed model one would be China's plausible option to regulate SWFs.

3.2.3 Reform in foreign investment regulation

The on-going reform in foreign investment regime aims to meet China's economic development needs, to reflect new treaty practices and to adapt to on-going treaty negotiations. Relevant departments of the State Council (e.g. MOFCOM and NDRC) have taken actions to relax investment rules and facilitate investment. All these current steps are going to support the introduction of a new foreign investment law, based on the draft version.

For the concern of competitive neutrality in China, apart from SOEs reform, the on-going negative list plus pre-establishment approach could be treated as a response to host states that receive Chinese investment, and it is a reflection of China's attitude toward the notion of 'reciprocity'. The establishment of Pilot Free Trade Zone (FTZ) in China, Shanghai FTZ in particular, is a significant move by Chinese government to attract foreign capital inflows and to test the 'pre-establishment national treatment plus negative list' model for investment liberalisation reform. It herein means that when investing into Shanghai FTZ, foreign investors are treated no less favourably than Chinese investor except for sectors in negative list.[125] After being tested in Shanghai FTZ, these reform initiatives will finally become national policies and operate national wide. At the 19th National Congress of the Communist Party of China, Jinping Xi delivered a report and stated that China will fully 'implement the system of pre-establishment national treatment plus a negative list across the board' and 'will significantly ease market access and protect the legitimate rights and interests of foreign investors.'[126] The negative list for market access is introduced not

[124] See generally De Meester (n 111) in Ch. 3
[125] Circular of the State Council on the Framework Plan for the China (Shanghai) Pilot Free Trade Zone, Guo Fa [2013] No. 38
[126] ZD, 'Highlights of Xi's Report to 19th CPC National Congress' *Xinhua* (18 October 2017) <http://news.xinhuanet.com/english/2017-10/18/c_136688994.htm> accessed 19 October 2017

only for foreign investors but also for private businesses in China that impede the development of a unified market and fair competition.[127]

Apart from the role of FTZ played in investment liberalisation reform, the Catalogue is another crucial role in further reforming negative list (reducing number of sectors in the list). The 2017 Catalogue includes a section listing industries in which foreign investment is encouraged (the 'Encouraged Category') and a section listing special administrative measures on access for foreign investments (the 'Negative List'). The negative list is further divided into two categories, i.e. the 'restricted category' and the 'prohibited category'.[128] But this revised Catalogue cannot meet the expectations of western economies, which is criticised that the release of this new catalogue means that a fundamental distinction remains between domestically-invested and foreign-invested enterprises with respect to market entry and approval requirements.[129]

However, this step has reflected a trend that China seeks to open its market firstly to domestic private investors and then expands it to all foreign investors, which is also a flexible approach and a combination of suggested regulatory models as discussed before. This is a short-term option and a gradual opening up process. By realising the change of its dual-role in global international investment, China will continue to open its market in an active, prudent manner with the support of sound legal system and

[127] Y. Liang, 'Xi Says China to Introduce Negative List for Market Access Nationwide' *Xinhua* (18 October 2017) <http://news.xinhuanet.com/english/2017-10/18/c_136688807.htm> accessed 19 October 2017

[128] The Restricted Category includes some industries where foreign investment will be subject to shareholding restrictions, administrative approvals and other special administrative measures. A few industries included in the Restricted Category also fall within the Encouraged Category, meaning that foreign investment in these industries will also benefit from the preferential policies for encouraged projects. The Prohibited Category lists the industries in which foreign investment is not allowed. All other industries that are not included within the Encouraged Category or the Negative List fall within the "Permitted Category", meaning that foreign investors will not be subject to special restrictions or administrative measures compared with domestic investors. See 'China publishes the Foreign Investment Industrial Guidance Catalogue (2017)' (30 June 2017) <http://www.cms-lawnow.com/ealerts/2017/06/china-publishes-the-foreign-investment-industrial-guidance-catalogue-(2017)?sc_lang=en> accessed 30 June 2017

[129] It is expected by European Chamber that a national negative list is needed to replace the catalogue altogether, in order to create a level playing field in the Chinese marketplace. Reciprocal treatment is essential, not only for European business investing in China, but also for Chinese investment overseas. See 'European Chamber: China's revised foreign investment catalog falls short of expectations' (18 July 2017) <https://www.cfoinnovation.com/story/13320/european-chamber-china's-revised-foreign-investment-catalog-falls-short-expectations> accessed 17 July 2017

coherent regulations, and to strike the balance of interests between inbound and outbound investment. China has already agreed in BIT negotiations to further open up banking, securities and many other sectors.[130]

3.3 China's interest and choice in international regulations on SWFs

3.3.1 The issue of sovereign investor in treaty negotiation

Recently, owing to the global penetration of sovereign investors, many western countries have proposed the 'competitive neutrality' policy or clause concerning SOEs in IIAs negotiations.[131] For example, EU-Canada FTA (CETA) and EU-Vietnam FTA provide a special chapter on SOEs and the released TPP text provides an entire chapter on SOEs.[132] These SOEs specified chapters mainly focus on addressing non-commercial assistant of sovereign investors. It is believed that concerning market competition, SOEs and POEs should be equally treated, and SOEs should not enjoy privileges and advantages from unfair competition. Competitive neutrality aims to address the unfair advantage of SOEs on tax, subsidies, loan and regulatory treatment etc. because of the ownership or preferential treatment.[133] The increasing amount of investments made by sovereign investors has attracted wide attention, especially Chinese SOEs and its SWFs, while China's current BITs do not include this kind of provision.

As a state capital jurisdiction, it is necessary for China to answer two questions, i.e. how to understand the different natures and functions of Chinese enterprises, and how to balance the interests of protecting Chinese enterprises and reducing concerns from host states. China and its treaty negotiators need to make a compromise on both sides. The EU may seek to have a level playing field for Chinese sovereign investors and

[130] 'China committed to further improving environment for foreign investors: Chinese vice premier' *Xinhua* (19 July 2017) <http://news.xinhuanet.com/english/2017-07/19/c_136455649.htm> accessed 19 July 2017

[131] For more discussion on the issue of SOEs in trade and investment, see a special issue of ICSID Review. See L. Wang and N. Gallagher, 'Introduction to the Special Focus Issue on State-Owned Enterprises' (2016) 31 (1) ICSID Rev. 1

[132] The purpose of this chapter is to ensure the commercial considerations of SOEs investment, prevent SOEs from receiving unfair non-commercial assistance and financing or subsidies etc. thus achieving a level playing field. See M. Du, 'Explaining China's Tripartite Strategy Toward the Trans-Pacific Partnership Agreement' (2015) JIEL 1, 23

[133] Capobianco and Christiansen (n 32)

other private investors via a BIT and to enhance the regulation on behaviours of SOEs as well as the transparency of SWFs.[134] Overall, the requirement for SOEs in a BIT is largely in line with the objective and direction of China's policy to deepen economic reform.[135]

The current SOE reform in China aims to reduce the governmental intervention in allocation of resources, to modernise SOEs, to improve the efficiency of SOEs, and to clearly define divergent functions of SOEs, thus finally turning SOEs to fully independent market entities. It can be therefore argued that the response to this question, not only influences China's IIAs negotiation, but also affects China's further economic, even corresponding regulatory reforms on SOEs. SWFs, which could be seen as a kind of special SOE, should be also clarified along with SOEs in certain treaties for providing certainty, which helps to avoid unnecessary conflicts and avoid being broadly interpreted by arbitrators.

3.3.2 China's choice to regulate SWFs investment via international approach

An increasing number of countries have been aware of national security concern, which is not limited to defence but also including economic security, financial security etc. Hence, how to strike a balance between protecting national security and attracting foreign investment is an important question to be considered by each host country. The claim of striking a balance has been discussed in the realm of international investment law, which usually focuses on the protection of investment and thus on investors' rights, to consider public interests. As an important player in global market, China should take these issues into consideration in term of its domestic and external policies. General suggestions for addressing issues of SWFs investment at international have been discussed in this thesis, while China is supposed to choose its own approach to regulate SWFs at a broader level.

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[134] Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Towards a Comprehensive European International Investment Policy' COM (2010) 0343 final

[135] See 'State Council to Deepen Economic Reform in 2015' (18 May 2015) <http://english.gov.cn/policies/latest_releases/2015/05/18/content_281475109998933.htm> accessed 15 January 2017. See also 'China Issues Guideline to Deepen SOE Reforms' *Xinhua* (13 Sep 2015) <http://english.gov.cn/policies/latest_releases/2015/09/13/content_281475189210840.htm> accessed 15 January 2017

Firstly, it is important to consider whether SWFs and SWFs investments could be protected via treaty protection. This is relevant to definitions of 'covered investment' and qualified 'investors'. Although China does not clearly mention SWFs relevant definitions in most IIAs, generally, SWFs and SWFs investments are covered by these definitions thus SWFs are entitled to receive treaty protection unless explicitly excluded. However, explicitly incorporating SWFs and SWFs investments into IIAs helps to reduce confusion when applying certain substantive and procedural protections.

It would be possible to clarify whether some Chinese SWFs and their investments would enjoy certain exemption in interim period (before the accomplishment of Chinese domestic reform). This exemption might apply to those Chinese SWFs (may be some new ones in the future) undertaking non-commercial activities or providing non-commercial assistance, inspired from TPP.[136] Once they are clearly included in these definitions, it may indicate that they receive the same treatment and protection (substantive and procedural) like other private investors unless there are certain exemptions or reservations.

Secondly, in terms of protecting its own national security (which is not limited to SWFs investment but to all foreign investment), China, at domestic level, can apply its existing or further improved national security review with some constrains (e.g. due process, transparency, and non-discrimination requirements in OECD guidelines) to protect legitimate public interests. At international level, China via treaties could insist certain exceptions for protecting its national security and public interest in order to ensure that its legitimate right to regulate would not be easily challenged by foreign investors and also by arbitrators. However, more specific elements rather than vague concepts should be provided in the exception clause, e.g. using enumerative method with procedural requirements and criteria. China could choose to include in its IIA a clause on the protection of general interests that it deems to be possibly endangered by SWFs or sovereign investors in its market. But as discussed before, particular concerns are not caused due to the ownership but the vulnerability of target industries, the nature of investment and corporate governance of investors etc. These concerns

[136] See Ch. 4 s. 2.2.2.1

can be generated by other influential or ill-intended private investors. A particular clause designed for SWFs is not necessary but the exception in certain sectors seems to be acceptable. Nevertheless, this could be done via industry-specific restrictions or negative list for all foreign investors.

Thirdly, in light of concerns of corporate governance, transparency and even regulatory advantages of SWFs, China could choose to make a reservation or a side-agreement in its IIAs for certain sovereign investors (non-commercial SWFs and public-oriented SOEs), and encourage or introduce the GAPP in its IIAs. The GAPP is used to define covered SWFs and SWFs investments that could receive treaty protection, which means that those SWFs that have accept or have endorsed the GAPP, or implemented other internationally-accepted code of conducts would be covered by treaty protection.

It could be a signal that apart from the legitimate expectation of investors, the widely recognised standards on SWFs (or on sovereign investors) would be part of the legitimate expectation of the host country. Sovereign investors are supposed to follow these standards and to act as commercial-oriented investors if they intend to seek treaty protection like other private investors. The incorporation of guidelines into IIAs would also be a signal that emerging and new IIAs would consider and even impose obligations for investors thus balancing the interests between the host countries' legitimate right to regulate and investment protection.

Fourthly, for dispute settlement, if China intends to treat SWFs as private investors, investments made by them (private investment) cannot enjoy state immunity in domestic court after a analysis on the legal status and commercial autonomy of SWFs. SWFs can access to ISDS included in IIAs but only if they undertook private investment. Whether SWFs conduct private investment or public investment, and whether SWFs investment poses a national security threat might depend on a case-by-case investigation and an analysis by domestic authorities or arbitral tribunals. It is important to notice that treating SWFs as private investors and granting private investment of SWFs the access to ISDS could on one hand encourage SWFs' commercial operation and on the other hand, could provide SWFs deserved rights.

Since China is the home country and host country of SWFs investment, if China treats foreign SWFs and its own SWFs as private investors, it may help Chinese SWFs to receive sufficient protection and non-discriminatory treatment in host countries and may help to provide the trust and confidence for foreign SWFs to invest in China. Clarified substantive provisions adopted in IIAs could reduce the concern of existing ISDS to challenge China's legitimate right to regulate. Or if China is afraid of being arbitrarily interpreted by arbitrator, it can choose to exclude disputes concerning regulatory measures related to national security from ISDS mechanism since China at present has very limited number of ISDS claims raised by foreign investors. But in the future, with the opening up of Chinese market, and a successive high-standardised IIAs concluded by China, there will be more investment dispute claims brought by foreign investors against Chinese government, while Chinese SWFs can benefit from this and receive treaty protection with these high level treaties. This may require the improvement of Chinese regulatory regime to tackle potential issues and protect its national security.

Last but not the least, as the member of the IMF, WTO and G20, it is important for China to participate in international rule-making process (soft law and hard law). In terms of soft law regulation, as CIC is the member of IFSWF, Chinese government should support Chinese SWFs to implement the GAPP and improve requirements concerning governance, transparency, and even accountability in it. CIC should actively participate in SWFs Standard Setting via IFSWF. In terms of hard law regulation, i.e. investment treaties, China is negotiating BITs with the EU and US, which contain high-standards concerning liberalisation, SOEs relevant issues, and public interest issues (i.e. sustainable investment) as well as the reform of ISDS mechanism. It is reasonably argued that these high standards included in IIAs are important for China's involvement in emerging trend of international investment law and provide protection for Chinese overseas investment either in the form of SWFs or others. In the future, China will renew or negotiate IIAs with other emerging countries, developing countries, especially countries along OBOR, some of which may lack sufficient legal protection for foreign investors thus investment protection in IIAs is necessary to help protecting Chinese overseas investment (including SWFs investment).

Chapter conclusion

This chapter proposed a choice of regulatory models for SWFs investment from general perspective (which are not provided for any particular jurisdiction) and provided suggestions from Chinese perspective. These proposals are not only based on discussions in previous chapters but also on the analysis of remaining issues of SWFs (and Chinese SWFs investment) in this chapter. Discrimination on the state ownership of SWFs (and other sovereign investors) cannot well address potential issues but raise additional conflicts. In terms of national security, both sovereign and private investors can raise this concern, while existing national security review mechanism or exception clauses in IIAs can help to reduce this concern to a certain extent. Other regulations after market access phase, e.g. the competition law can make a difference. Measures should focus more on a level playing field (regarding competitive neutrality) between sovereign investors and private investors, between domestic investors and foreign investors. The elements concerning legal and governance structure, transparency and/or even objectives are necessary to be considered.

This chapter proposed three general regulatory models (or we can say 'treatment') for regulating SWFs, i.e. (i) treat all SWFs the same as private investors; (ii) treat all SWFs the same but different from private investors; (iii) treat different SWFs differently. These models could be adopted by different jurisdictions since granting treatment for foreign and domestic investors is the sovereignty of each state. It should be noticed that each model inherently has its advantages and disadvantages, while the disadvantage can be offset by relevant regulatory supports to tackle particular concerns. Moreover, the choice of each state seems to satisfy and support the need of its domestic economic development and policies. This chapter provided suggestions for regulating SWFs investment via IIAs and GAPP. Improvement on IIAs focuses on maintaining the host states' legitimate right to regulate by incorporating clear substantive provisions and providing SWFs the access to ISDS.

The thesis has assessed these proposed regulatory models in the context of China to regulate foreign SWF investment, based on its current regime. It found that in terms of SWFs' direct investment, general foreign investment rules (and national security

review) apply to both SWFs and other private investors without significant differences, and regarding investment in the securities market, China provides preferential treatment for SWFs over other institutional investors. China's current approach suggests that China adopts a flexible approach and uses combined models to regulate SWFs. It indicates that these three models can be used and combined by China in different sectors. In the short term, the combined regulatory models could serve for China's policy and are in line with the current approach in China's on-going domestic reforms (e.g. SOE reform). While, in the long term, regulatory model one would be a more plausible choice to maintain a level playing field. Relevant concerns could be addressed by a improved national security review in a neutral manner, or industry-specialised regulations or restrictions.

The adoption of three models has been reflected in SOEs reform, in regulations regarding Chinese SWFs, and in the reform of the foreign investment legal system. China usually takes a case-by-case/flexible view to address problems. During the process of reforms, China's progressive opening-up of its market requires the combination of proposed models under the current circumstances, while in the long-term, being consistent with the final goal of China's reform (market-oriented economy), the model one could be a more plausible choice (i.e. reform SOEs as commercial-oriented market players and provide a level playing field for investors). Compared to Chinese SOEs, SWFs, as investment funds and institutional investors, raise less concerns, thus treating SWFs as other private investors helps to attract long-term capital inflows and enables the financial market to flourish. The GAPP is in place to guide the investment behaviour of SWFs and improve the governance structure, transparency and accountability of SWFs, while the pledge to implement the GAPP by SWFs could be the government's recognition in the domestic rules and even in IIAs.

Providing investors the access to China's market (via pre-establishment national treatment with negative list approach) and transferring the high standards in its IIAs into domestic governance, concerns of SWFs (and even other sovereign investors) could be eliminated to a large extent and Chinese overseas investment could also receive better protection from host states or a good reputation/image. Regulation for SWFs, and even sovereign investors like SOEs, is not designed to change the state

ownership system (and should not be a form of discrimination of this system). The state that intends to provide regulations should accept this system first and then it can find a better way to address potential and existing issues. It can be seen from the SOEs reform in China that the mix ownership and classification of SOEs reflect the approach of proving different treatments to different SOEs (in the short term), while this is not the case when it turns to SWFs. SWFs can be treated as the same, or be treated differently in different sectors for security reasons.

The thesis found that any proposed models and suggestions for regulating SWFs investment at both domestic and international level should address the concerns resulting from the governance of SWFs. Concerns in relation to state ownership, political motivation and political influence are all derived from the governance structure. The final goal of each model and regulatory suggestion is to provide a level playing field and to strike a balance between protecting/attracting investment and protecting the legitimate right to regulate in relation to national security. All proposed suggestions are put forward for the macro behaviour (external issue), i.e. general investment in market access, but not the micro behaviour (internal issue) of SWF investment, i.e. particular transactions in targeted companies.

The internal issues, such as SWFs' influence on target companies as their shareholders (shareholder activism), the financial returns of each investment transaction, and the risk tolerance, are interesting questions and aspects related to the regulation of SWFs, but these issues are expected to be discussed or analysed in future studies. The proposals in this thesis intend to provide options at the general policy level to regulate SWF investment and help China to find a plausible way to cope with the issue of SWFs (its own SWFs and foreign SWFs) investments.

CONCLUSION AND WAY FORWARD

1. Conclusion

The main purposes of this thesis are to explore and to assess existing regulations that apply to SWFs investment, and to propose regulatory models and suggestions to regulate and protect SWFs investment in general and the plausible option for China in particular. In pursuit of these aims, the thesis seeks to provide answers for main research question and sub-questions specified in the Introduction. It answered these questions based on analyses from theoretical and practical perspectives. It argued that no additional and special regulation is necessary or urgently needed to tackle SWFs investment, but a reform or improvement on existing hard law and soft law regulatory frameworks. It suggested that a flexible combination of them seems to be a plausible approach, with further clarifications in relevant provisions of IIAs and in domestic law. By way of conclusion, it is desirable to review how and what the thesis has achieved in response to these questions.

SWFs are heterogeneous groups with various legal and institutional structures, funding resources, and operational models. As state-owned investment instruments engaging in financial market, SWFs have brought political, economic and regulatory challenges and also opportunities for the global and national economies. The SWFs groups had played a positive role during 2008 financial crisis, while the nature of SWFs and their investments had raised fears from host states, especially from developed economies, over security and market stability risks, thus a call for legal responses and even additional restrictions occurs.

However, questions concerning why and how SWFs need to be regulated (and even whether additional restrictions are needed) should not ignore the features of SWFs and the nature of SWF investment, as well as relevant rationales and conflicting interests behind them. The phenomenon of SWFs requires that legal responses for SWF investment cannot be limited to practical and unilateral considerations but both theoretical and practical considerations under a broader framework are necessary. The thesis highlighted that the regulatory approach towards SWFs investments cannot only put an over-emphasis on restrictions but does not provide sufficient protections

for them.

By analysing the features of SWFs and their investment activities, the thesis found that although both subjective and objective elements of SWFs matter, proposed regulatory measures should firstly focus on the nature of SWF investment and then take other factors into account in order to conduct a further case-by-case investigation. The necessity to regulate SWF investment could be underpinned by two main reasons. Firstly, from a theoretical perspective, as market participants and foreign investors, SWFs need to be regulated due to the state's demand to maintain market stability via regulatory intervention, and the state sovereignty to regulate economic activities within its jurisdiction on account of interests of national security and the domestic economy. Secondly, from a practical perspective, the potential political influence of SWFs, the strategic investment made by SWFs (with regard to national security) and the low transparency of SWFs, result in political and economic concerns. For China, the thesis provided that the dual role of China in the global market and the need for China to strike a balance between conflicting interests would require China to adopt regulatory measures.

The conflicting interests that were considered and discussed in the thesis are interests of investment protection and state sovereignty, interests of open market (liberalization) and national security. In the thesis, the question concerning whether SWF investment could be regulated under a justified framework (which means that legitimate concerns generated by SWF investment could be addressed while SWFs could receive sufficient protection without being implemented by protectionist-minded actions) depends on the way that the host country reacts to aforementioned conflicting interests. Striking a balance between these conflicting interests could not be achieved within a narrow framework, since the phenomenon of SWF investment, as a new round of 'state capitalism', is a global challenge. But, after assessing the proposed regulations in the literature, it was found that these proposals fail to consider the interests of both sides. The proposed self-regulation that has come into reality, lacks an enforcement mechanism and binding effect, the implementation of which needs to be guaranteed by other mechanisms. Therefore, the thesis turns to analyse existing relevant national and international regulations to find out an answer.

However, it was found that several issues exist in these existing regulations. National regulations vary from country to country. This may easily lead to the rise of protectionism, if the host country cannot balance conflicting interests and even takes a discriminatory position on the state ownership and origins of SWFs rather than directing its attentions to the nature of a particular investment or the conduct of a SWF in a particular case. A mutual understanding should be achieved on a broader level. But, the thesis found that regulations at international level also have several weaknesses or pose potential risks. International hard law (i.e. substantive and procedural provisions in treaties) has not explicitly addressed or included SWF investment. Without certain hard law regulation, international soft law (i.e. GAPP and relevant OECD guidelines) alone cannot guarantee the individual compliance.

By comparing the pros and cons of the hard law and soft law regulations, the thesis found that although the bilateral approach could provide the home country and host country with more flexibility to deal with specific concerns and interests in relation to SWF investment, a multilateral or international solution is more plausible to regulate such kind of 'state capitalism' in the global market and to address investment protectionism. The combination of hard law and soft law (self-regulation) approaches seems to be a more appropriate choice, i.e. introducing soft law into IIAs. In terms of the guarantee of treaty-based protection, clarifying SWFs' legal standing under ISDS (or ICSID) and providing SWFs with the recourse to ISDS help to limit the political influence exerted by home states and to depoliticise investments of SWFs.

Apart from recognising the engagement of host countries and home countries in domestic measures and international treaties, the thesis attributed an important role to the IMF and OECD in promoting a plausible regulatory framework for SWF investment. This role played by them is that the IMF helps the IFSWF to continually work as the main international platform for SWFs and coordinates with the OECD to improve the soft law for SWFs (i.e. the GAPP) and for host countries, and these two institutions work together to help create a platform for host and home countries to negotiate a multilateral/international investment agreement with the involvement of relevant stakeholders. The thesis emphasised that national and international regulations are not mutually exclusive. They all play a part in the regulatory landscape for SWF investment. International instruments for SWF investment aim to

fulfil those functions that cannot be better performed at the national level (i.e. striking a balance between conflicting interests).

In the view of the thesis, providing a plausible regulation for SWFs and creating predictability can be better achieved by clarifying the identity of SWFs, and their specialised rights and obligations in IIA provisions, which should be done by the side of home countries. It argued that the reform of existing regulations should focus on the remaining issues (i.e. national security and competitive neutrality or a level playing field) surrounding SWF investment at present and in the future. It is the sovereignty of the state to regulate economic activities within its jurisdiction. Although the thesis suggested striking a balance between conflicting interests, between SWFs and host countries, it provided three different regulatory models to deal with SWF investment from the general perspective. Without focusing on any particular jurisdictions, these models could be adopted at the discretion of the host state based on its own policy and economic considerations.

Each regulatory model inherently has its advantages and disadvantages in solving issues of SWFs investment (and even sovereign investment as a whole), while the disadvantages in each model can be offset by adopting other measures, thus helping to achieve an equilibrium of the aforementioned conflicting interests. If incorporating these regulatory choices respectively into IIAs, further clarifications on the identity, level of protection, exceptions or reservations, and even on certain obligations (whether hard or soft law) are needed. Existing national security review mechanism at national level, or general or security exception clauses in IIAs, can help to reduce concern to a certain extent, but measures should put more focus on how to provide a level playing field between sovereign investors and private investors, between domestic investors and foreign investors.

2. Way Forward

The thesis takes the view that existing regulations are enough to address the potential issues of SWFs investment (either portfolio investment or direct equity investment) but the efficient application of these regulations and sufficient protection provided for SWFs need a further clarification, an enhanced cooperation and a balance between the conflicting interests. These three proposed regulatory models (or the treatment of the

status of SWFs) could be used by different jurisdictions or could be adopted in IIAs, depending on a consensus reached between the home country and the host country. The thesis argued that a two-layer approach of 'incorporating soft law regulation into IIAs' would be more plausible, with further clarifications.

Since China is a typical state capitalist jurisdiction, and China is now a capital exporter and importer, the question of how to regulate SWFs investment is indeed relevant to China. The test and analysis of proposed regulatory models in the context of China suggested that so far, existing regulatory regime in China does not treat foreign sovereign investors differently from private investors (except the QFII programme). China currently adopts a flexible approach, i.e. the combined regulatory models to regulate SWF investment. These three models can be used and combined by China in different sectors.

In the short term, the combined regulatory models could serve China's policy and could be in line with the approach that China adopted in its on-going domestic reforms (e.g. treat different SOEs differently, treat foreign SWFs preferentially from other foreign investors, and further opening up domestic market). But in the long term, regulatory model one would be a more plausible choice to maintain a level playing field for China and other countries concerning sovereign investors (i.e. treat them the same as private investors undertaking commercial activities). Compared to Chinese SOEs, SWFs as investment funds and institutional investors, raise less concerns, thus treating SWFs as other private investors helps to attract the long-term, high-quality capital inflows and to promote the flourish of the financial market.

Based on this, the focus should not be put on the state ownership but the modern corporate governance and transparency of sovereign investors. For China, the market access, and the role of market, and the fair treatment of foreign investors would be the key fields for both foreign SWFs and Chinese SWFs to be considered by China. Other relevant rules, e.g. financial regulation and foreign investment regulation should be also improved or even reformed to strike a balance between open market and protecting its legitimate security and public interest, i.e. to provide sufficient protection for inbound foreign investment and to maintain its sufficient capacity to protect its economic security.

This requires China to pay attention to the quality of foreign investment rather than the quantity of foreign investment, and also to incorporate international widely recognised standards/principles into its domestic regulatory regime. When China further advances/promotes its domestic economic and legislative reforms, the concerns of SWFs investment (and even other sovereign investment) could be eliminated to a large extent and Chinese overseas investments made by sovereign investors could also receive better protection or a good reputation from host states. Regulation of SWFs, and even of sovereign investors like SOEs, should not be a form of discrimination against the state-owned economy system, but should accept this system first and then find a better way to address the potential and existing issues.

Indeed, the analysis of this thesis and the three regulatory models developed in the thesis attempt to provide the theoretical and practical approaches for the future study of sovereign investment in general and SWF investment in particular. Apart from the arguments and suggestions made by this thesis, a number of further works could be done in the future.

First, conclusions on the Chinese part and on general SWFs investment could be yet more compelling if greater empirical evidence and data regarding the current trend of SWFs investments (including Chinese SWFs investments) were available. It helps to determine whether SWF investment could result in certain special risks or concerns of host countries. A much more extensive empirical evidence survey could be envisaged, which could in the future provide more robust Chinese data and SWFs statistics, and help to analyse whether Chinese SWFs could lead to particular concerns than other top/large SWFs.

The second approach of study is relevant to the influence of or the role of SWFs in the corporate governance of target companies (institutional ownership, shareholder activism). This could help to analyse whether SWFs investment is driven by commercial motivation or political motivation, to see whether the financial return or corporate performance of target companies is influenced by SWF investment. This could provide the evidence or the support to determine the nature of SWFs investment, thus further clarifying their status. As stated in Chapter 2, the thesis mainly focuses on

the legal relation between SWFs and host country (i.e. the restriction and protection provided by host country) while the thesis argued that other legal relations might also influence this relation, e.g. relations between SWFs and target companies, between target companies and host country.

Thirdly, studies from the perspective of home countries are also necessary for the research of SWF investment and the regulations of SWF investment. Further research could be done by comparing regulations of home countries on SWFs in selected jurisdictions (especially top SWFs, or selecting SWFs in different legal forms), or by deeply analysing regulations in China on its existing SWFs (e.g. CIC and SIC). This kind of research could help to further understand the role of SWFs in the home country, and clarify their legal status and the links between SWFs and the government of the home country.

Last but not least, although the thesis compared differences between SWFs and other different sovereign investment instruments (e.g. SOEs, FX reserves and public pension funds), the thesis also argued that they share several similarities. When participating or investing in the global market, these sovereign background investors should be regarded as normal investors and they should be able to compete fairly with other private investors. Hence, further research could be conducted to analyse those sovereign investors (and institutional investors) as a whole in the international investment framework. This could help to identify whether sovereign investors should be treated differently from private investors and whether different sovereign investors should be treated differently, as well as whether sovereign investors can be treated as the same and be required to comply with the same commercial operation and transparency requirements as private investors. It can also help to assess how to deal with the state capitalism (Chinese state capitalism in particular) under the existing international framework.

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