

TRANSNATIONAL
LAW &
CONTEMPORARY
PROBLEMS

Sovereign Investing in
Times of Crisis: Global
Regulation of Sovereign
Wealth Funds, State-
Owned Enterprises, and
the Chinese Experience

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Volume 19, Number 1

Winter 2010

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ABSTRACT

The financial crisis of 2007 has brought into sharper focus a set of rising global financial actors—the *sovereign investors*. In the form of sovereign wealth funds ("SWFs"), sovereigns have become an important player in the global financial market and its stability. Over the last decade, SWFs became more visible and more aggressive in the scope and form of their interventions in global finance. State-owned enterprises began to operate indirectly

through subordinate legal persons that operate like privately held multinational corporations. In this new form, sovereigns are becoming a more significant presence in global markets, as owners as well as investors. More importantly, sovereign owners have begun to coordinate their economic activities for economic and sovereign goals. Consequently, the crisis has produced a dynamic element in the evolution of the global economic system.

The evolution of the state-owned industry clarifies issues of law and policy that stretch current systemic conceptions into new and uncharted territory. If sovereign investors are understood as private actors participating in markets, then this might suggest the best case for the equal treatment of states as private entities. On the other hand, if sovereign investors and their instrumentalities are understood as state instrumentalities, then these entities can be understood as instruments projecting state power into the territory of other states, making a political solution more likely.

Yet, while governmental responses were at first wary, criticizing these funds as potentially dangerous to the sovereignty and independence of national markets, the increasing needs of national economic sectors quickly altered attitudes. Responses have focused on law and policy to protect the integrity and workings of the domestic and international markets themselves by decentering the sovereign element of sovereign investment. However, this approach is without much of a plausible conceptual center.

I. INTRODUCTION

“We plant everything.”¹

A century ago, the guardians of public power in the United States articulated a widely held fear of *private* aggregations of power. An influential member of the American judiciary at the time expressed that fear in comprehensive terms, stating, “Through size, corporations, once merely an efficient tool employed by individuals in the conduct of private business have become an institution—an institution which has brought such concentration of economic power that so-called private corporations are sometimes able to dominate the state.”² The threat, then, was understood not merely as a challenge to the welfare and power of the community of individual economic

¹ Interview by Alan Freidman, *World Business*, with Gao Xiqing, Vice Chairman, President, & CIO of China Inv. Corp. (July 14, 2009), *available at* <http://www.youtube.com/watch?v=PFazgevnIos> [hereinafter Gao Xiqing Interview] (interviewing Mr. Gao about China’s investment strategy). The quote subtly references a famous suggestion of Deng Xiaoping: “Plant trees everywhere and make our country green in the interest of future generations.” Deng Xiaoping, Remarks at a Conference Held by the People’s Liberation Army to Review the Experience in Afforestation and to Honor Outstanding Units and Individuals for Their Work (Nov.–Dec. 1982), *available at* <http://english.peopledaily.com.cn/dengxp/vol3/text/c1070.html> (last visited Jan. 20, 2010).

² *Louis K. Liggett Co. v. Comptroller*, 288 U.S. 517, 565 (1933) (Brandeis, J., dissenting in part).

actors functioning through markets in the private sphere. More importantly, such aggregations of *private power* appeared to challenge the effectiveness of the *public power* itself. It suggested the nature of the threat as not merely economic, but also conceptual. Large corporate aggregations threatened the hierarchy of legal authority, at the top of which stood the state and its apparatus. Such private concentrations of economic power also threatened the role of the state and its law-based regulatory framework as the only legitimate source of public regulation, within which everything else was meant to occupy the space reserved for the objects of that regulation.

This understanding of the danger posed by private aggregations of power was grounded in a set of simple conceptions about the world order. At its core was the belief that the power to regulate could only derive from law enacted through public bodies legitimately vested with the authority to command every member of the community it controlled.³ While it was acceptable to argue about the arrangement of hierarchies of public regulatory regimes,⁴ or

³ See CARL SCHMITT, *LEGALITY AND LEGITIMACY* 18 (Jeffrey Seitzer trans., Duke Univ. Press 2004) (1932). Schmitt elaborated:

[T]he images of legal science and legal practice were (and still certainly are) mastered by a series of simple equivalences. Law = statute; statute = the state regulation that comes about with the participation of the representative assembly. Practically speaking, that is what is meant by law when one demanded the "rule of law" and the "principle of the legality of all state action" as the defining characteristic of the Rechtsstaat.

Id. Thus, the distinction between public and private spheres, the notion that regulation was a political act, and that such political acts ought to be confined to political (rather than non-governmental) institutions to which all other bodies are subject, have been well established among people across a wide spectrum of political ideology. Carl Schmitt, of course, ironically is quoted here as a once discredited and now increasingly popular and influential critic of the purely legal state.

⁴ See ALBERT VENN DICEY, *INTRODUCTION TO THE STUDY OF THE LAW OF THE CONSTITUTION* 73-74 (MacMillan & Co., Ltd. 8th ed. 1915) (1885). Dicey explained:

The plain truth is that as a matter of law Parliament is the sovereign power in the state. . . . As to the actual limitations on the sovereign power of Parliament. . . . The actual exercise of authority by any sovereign whatever, and notably by Parliament, is bounded or controlled by two limitations. Of these the one is an external, the other is an internal limitation. The external limit to the real power of a sovereign consists in the possibility or certainty that his subjects, or a large number of them, will disobey or resist his laws.

Id. at 73; See also Neil Duxbury, *Kelsen's Endgame*, 67 CAMBRIDGE L.J. 51, 51-52 (2008).

Roughly speaking, Kelsen, for most of his professional life, conceived of the basic norm—that citizens ought to obey legal norms validly created in accordance with the historically first constitution—as a presupposition. That all the norms of a legal system derive ultimately from the basic norm has to be presupposed, he argued, because without this assumption that which we know to exist could not exist: positive law *qua* the object of cognitive legal science would not be possible.

Id.

the unruliness of customary law in a new rational and “scientific” age,⁵ it was accepted that regulatory authority had to be confined to the apparatus of the government. This was the classical age of *Rechtsstaat*.⁶ Beyond the state, little was legitimately regulatory in the political sphere.

All other forms of regulation might be coercive within the communities of stakeholders in such enterprises, but such regulatory activity was neither public (a matter affecting the governance of the political community) nor legal. Everything from the compulsion of religious codes of behavior to the contractual agreements between finite parties, which cover only very limited sets of behaviors, was tolerated as long as it did not challenge a state’s ultimate authority to regulate such activity.⁷ Because no power greater than the state could exist, all activity was subject to and flowed from it. In other words, the state was the only legitimate source of public regulatory power.⁸ Within this normative framework, large corporate organizations that might regulate conduct effectively, by their sheer size and control, generally

⁵ See JOHN AUSTIN, *THE PROVINCE OF JURISPRUDENCE DETERMINED* 118–19 (Oxford Univ. Digitized 2006) (1861), available at <http://books.google.com/books?id=k4YDAAAQAAJ>. Austen articulated the relationship between positive law and the sovereign:

Every positive law, or every law simply and strictly so called, is set by a sovereign person, or a sovereign body of persons, to a member or members of the independent political society wherein that person or body is sovereign or supreme. Or (changing the phrase) it is set by a monarch, or sovereign number, to a person or persons in a state of subjection to its author.

Id. See also Ralf Michaels, *Globalizing Savigny? The State in Savigny’s Private International Law and the Challenge of Europeanization and Globalization* 12 (Duke Law Sch., Legal Studies Research Paper No. 74, 2005), available at <http://ssrn.com/abstract=796228> (“[B]ecause Savigny sees the state as the organizing form of the people, consequently legislation emanates from, and therefore reflects, both customary and scientific law.”).

⁶ See RUPERT EMERSON, *STATE AND SOVEREIGNTY IN MODERN GERMANY* 35–39, 60–77 (1928).

While it is true that in the modern *Rechtsstaat* the sovereign cannot act otherwise than in compliance with law, it is equally true that he sets the law in accordance with which he is to act. The law lays down the formal procedure by means of which it can be changed, but the power which formulates and brings about the change is not the law itself.

Id. at 267. See also Michel Rosenfeld, *The Rule of Law and the Legitimacy of Constitutional Democracy*, 74 CAL. L. REV. 1307, 1318–19 (2001).

⁷ This move by the state to usurp the power of cataloguing reality is mocked in Gioacchino Rossini’s wonderful comic opera, *La Cenerentola*, in which the existence of and the death of a daughter was disputed solely on the basis of the appearance of her name in the registry of deaths and births. See JACOPO FERRETTI, *LA CENERENTOLA*, act I, sc. 6 (music by Gioacchino Rossini) (first presented Teatro Valle in Rome, Italy, Jan. 25, 1817).

⁸ This was the age of the German Civil Code, the *Bürgerlichen Gesetzbuch* (1900), and the rise of the common law organizations, like the American Law Institute, devoted to the systematization of Anglo-American law on “sounder” positive law-like principles. See generally *Bürgerlichen Gesetzbuches*, Aug. 18, 1896, available at http://www.gesetze-im-internet.de/englisch_bgb/index.html; See, e.g., Larry Catá Backer, *Reifying Law—Government, Law, and the Rule of Law in Governance Systems*, 26 PENN. ST. INT’L L. REV. 521 (2008).

threatened established hierarchies of power. More specifically, large corporations threatened the authority of the state as traditionally asserted through its legislative, police, and administrative powers. Despite the challenge, states and corporations appeared to reach a rough understanding. This understanding, memorialized in domestic law and policy, was grounded in the idea that the state asserted a paramount power to regulate markets and economic activity, but that private actors were free to order their affairs and participate in these state regulated markets.⁹

A generation ago, the guardians of public power, now situated on a global stage, raised a similar alarm about the threat to public power by private economic collectives.¹⁰ This time, however, private aggregations of economic power, in the form of multinational corporations, appeared to threaten all states.¹¹ The belief grew among states that these large aggregations of private power could overwhelm the more limited and territoriality-based public power, especially (but not exclusively) that of small states.¹² These private entities, now spread beyond any one state, might subvert not only the traditional hierarchy with the state at the top, but might also subvert the *global* monopoly of political power exercised by the state system through institutionalized supranational systems of public actors.

Yet, the threat to the monopolies of power, whose borders are protected by the conceptual division of law into public and private spheres, has not come solely from multinational corporations and other economic entities. The growth of transnational civil society actors—including civil rights, human rights, and other groups representing non-state communities of actors—and their incorporation within the emerging framework of global trade and

⁹ In its most pristine form, these ideas were expressed by what became known in the United States as the Chicago School. See, e.g., MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* (2002). The outer boundaries of these notions, of course, remain highly contested. For a strong criticism of Friedman's position, see, e.g., NAOMI KLEIN, *THE SHOCK DOCTRINE* (2007). But see JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* (1936) (a softer alternative to Klein's stronger criticism).

¹⁰ For a short history, see, e.g., PETER MUCHLINSKI, *MULTINATIONAL ENTERPRISES AND THE LAW* (2nd ed. 2007). See also The Special Representative of the Secretary-General, *Business and Human Rights: Mapping International Standards of Responsibility and Accountability for Corporate Acts, Delivered to the General Assembly*, U.N. Doc. A/HRC/4/035 (Feb. 9, 2007), available at <http://www.business-humanrights.org/documents/srsg-report-human-rights-council-19-feb-2007.pdf>; RICHARD FALK, *PREDATORY GLOBALIZATION: A CRITIQUE* (1999).

¹¹ See, e.g., DAVID KORTEN, *WHEN CORPORATIONS RULE THE WORLD* (2nd ed. 2001); Phillip Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605 (2005); Jan Wouters & Leen Chanut, *Corporate Human Rights Responsibility: A European Perspective*, 6 NW. U. J. INT'L HUM. RTS. 262 (2008); But cf. JENNIFER A. ZERK, *MULTINATIONALS AND CORPORATE SOCIAL RESPONSIBILITY: LIMITATIONS AND OPPORTUNITIES IN INTERNATIONAL LAW* (2006).

¹² See Larry Catá Backer, *Economic Globalization Ascendant and the Crisis of the State: Four Perspectives on the Emerging Ideology of the State in the New Global Order*, 17 BERKELEY LA RAZA L.J. 141 (2006).

politics¹³ suggest that other non-state actors are also challenging the divisions between public and private spheres and threatening the state's monopoly on regulatory, political, and even military power.¹⁴

Yet, state actors have not been passive in the face of these challenges. One important response by state and other public power actors has focused on efforts to domesticate private transnational power to an aggregate morality of public power, expressed at the international level and transposed into the law of all public actors. The United Nations' Global Compact project¹⁵ represents one attempt to put into operation such a system of internalized morality.¹⁶ Likewise, the Organization for Economic Cooperation and Development ("OECD")¹⁷ developed a cluster of principles and guidelines for corporate governance, multinational corporations, and state-owned enterprises, which sought to provide another framework to domesticate international corporations within legal systems.¹⁸ These guidelines are meant to supplement national regulation and harmonize national legal orders—a strength in numbers approach to meeting the challenge of transnational enterprise power.¹⁹ The alternative to these soft law systems of transnational

¹³ See NON-STATE ACTORS IN INTERNATIONAL RELATIONS (Bas Arts, Math Noortmann & Bob Reinalda eds., 2001); see also NON-STATE ACTORS IN WORLD POLITICS (Daphne Josselin & William Wallace eds., 2001).

¹⁴ See, e.g., Ann M. Florini, *Who Does What?: Collective Action and the Changing Nature of Authority*, in NON-STATE ACTORS AND AUTHORITY IN THE GLOBAL SYSTEM 15, 15–31 (Richard A. Higgott, Geoffrey R.D. Underhill & Andreas Bieler eds., 1999); see John Agnew, *Democracy and Human Rights After the Cold War*, in GEOGRAPHIES OF GLOBAL CHANGE: REMAPPING THE WORLD (R.J. Johnston, Peter J. Taylor, & Michael J. Watts eds., 2002) (criticizing civil society as a threat to the framework of the conventional political order).

¹⁵ See United Nations, Global Compact, <http://www.unglobalcompact.org/> (last visited Jan. 20, 2010) (listing the primary sources on the United Nations' Global Compact project); see also Jean-Philippe Therien & Vincent Pouliot, *The Global Compact: Shifting the Politics of International Development?*, 12 GLOBAL GOVERNANCE 55 (2006).

¹⁶ See The Secretary-General, *Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, Delivered to the Human Rights Council*, U.N. Doc. A/HRC/8/5 (Apr. 7, 2008), available at http://www.unglobalcompact.org/docs/issues_doc/human_rights/Human_Rights_Working_Group/29Apr08_7_Report_of_SRSG_to_HRC.pdf.

¹⁷ ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2001), available at http://www.oecd.org/document/28/0,3343,en_2649_34889_2397532_1_1_1_1,00.html [hereinafter OECD, MULTINATIONAL ENTERPRISES] (listing the OECD guidelines).

¹⁸ See OECD, PRINCIPLES OF CORPORATE GOVERNANCE (2004), available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [hereinafter OECD, PRINCIPLES OF CORPORATE GOVERNANCE]; OECD, MULTINATIONAL ENTERPRISES, *supra* note 17; OECD, GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED INDUSTRIES (2005), available at <http://www.oecd.org/dataoecd/46/51/34803211.pdf> [hereinafter OECD, STATE-OWNED INDUSTRIES].

¹⁹ For example, the "OECD Principles of Corporate Governance were endorsed by OECD Ministers in 1999 and have since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide." OECD, PRINCIPLES OF CORPORATE

harmonizing guidelines, and less accepted responses, at least within the community of public actors, relies on public actors' willingness to acknowledge the public power of these private institutions and to bring them within the regulatory framework that binds and preserves the superior status of public political actors.²⁰ In effect, this alternative has sought, still unsuccessfully, to acknowledge the public power of private enterprises and to force them to undertake the obligations of states when they engaged in activity with public or regulatory effects.²¹

Still, the subversion of the classical notion of the public order, when that subversion can be affected to the advantage of the *primi inter pares*²² of the global state community, might be a tempting alternative. Today, the guardians of public power have succumbed to the lessons of a century. If the old field boundaries between public and private actors are ineffective in preserving local or global monopolies of public power controlled by governments, then those monopolies must adjust to fit themselves to the newer realities. Consequently, states have now sought to extend their market share in all markets for power. States are no longer content to wield the traditional (and traditionally limited) forms of public power. Instead, states have begun to refashion themselves as major players in markets for economic power.

This participation of states directly in markets (production, ownership, finance and the like) is not merely in the old and now fairly tame form of public, central planning-based, political regimes, or the sort of ownership that traditionally constituted state enterprises, i.e. mercantilist/Marxist-Leninist

GOVERNANCE, *supra* note 18, at 3. Likewise, the Guidelines for Multinational Enterprises are understood as "the only multilaterally endorsed and comprehensive code that governments are committed to promoting." OECD, POLICY BRIEF: THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES 8 (2001), available at <http://www.oecd.org/dataoecd/12/21/1903291.pdf>.

²⁰ See Larry Catá Backer, *Multinational Corporations, Transnational Law: The United Nation's Norms on the Responsibilities of Transnational Corporations as Harbinger of Corporate Responsibility in International Law*, 37 COLUM. HUM. RTS. L. REV. 287 (2006) (discussing the opposition of states to imposing state-based duties on multinational corporations); *id.* Part IV.

²¹ *Id.*

²² "First among equals" is a not-so-veiled reference to both the idea of vertical relationships within formally horizontal systems of power sharing, and a reminder that such systems mask rather than reveal real shifts in governance hierarchies. That was certainly the case within Rome during the late Republic and early Empire periods, when the term was meant to anchor government within Republican forms even as the state apparatus strongly shifted toward monarchy. Thomas O. Hueglin, *Johannes Althusius: Medieval Constitutionalist or Modern Federalist?*, 9 PUBLIUS J. FEDERALISM 9, 12 (1979). Within the international system, this reference points to the unequal relations between developed and developing states, and the use of the forms of equality inherent in international law to mask the realities of power disparities in the operation of the international system. See, e.g., ANTONY ANGHIE, *IMPERIALISM, SOVEREIGNTY AND THE MAKING OF INTERNATIONAL LAW* (2004) (on the relationship between imperialism and modern internationalism).

undertakings with a long and well understood history and purpose.²³ What distinguishes this sovereign activity from its mid-20th Century form is the willingness of states not only to limit their control of internal economies, but also to invest their financial wealth outside their national borders. In this respect, states assume the very role of the private economic actors that they once feared so much. The 21st Century is witnessing a dramatic rise in the willingness of states to project economic power both at home and in host states through the same economic vehicles that threatened the states' power in the 20th Century. The facilitating cause of this change in approach is the creation of the very system that frees economic actors from the constraints of territory and more closely binds public actors thereto.²⁴ Just as private economic entities may now cross borders to affect transactions that maximize their wealth, so states are now discovering that they might do the same thing. Economic globalization does not exclude private market participants from its system of freely moving capital. Just as private actors are subject to the regulation and control of the sovereign in whose territories they act, states acting outside their borders as participants in local economic activity assume a similar character. Consequently, some states seem to have become, to some extent, pools of national economic wealth, the power of which matches or exceeds their traditional sovereign power.

In the form of sovereign wealth funds ("SWF"s)²⁵ and the investment activities of reconstituted state-owned enterprises,²⁶ the state is now

²³ Larry Catá Backer, *The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law*, 82 TUL. L. REV. 1801, 1863 (2008).

²⁴ See Paul Rose, *Sovereigns as Shareholders*, 87 N.C. L. REV. 83, 83–149 (2008) (an exposition of the cheery views among elites); Robert M. Kimmitt, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, 87 FOREIGN AFF. 119, 126–28 (2008).

²⁵ The term refers to official sector assets that are regarded as something different than traditional central bank reserves. Andrew Rozanov, *Who Holds the Wealth of Nations*, 15 CENT. BANKING 52–57 (2005), available at <http://www.docstoc.com/docs/8086792/Who-Holds-The-Wealth>. "However, increasingly, a different type of public-sector player has started to register on the radar screen—we shall refer to them as sovereign wealth managers. These are neither traditional public-pension funds nor reserve assets supporting national currencies, but a different type of entity altogether." *Id.* at 54.

²⁶ See, e.g., H. Stephen Harris, *Legal Implications of a Rising China: The Making of an Antitrust Law: The Pending Anti-Monopoly Law of the People's Republic of China*, 7 CHI. J. INT'L L. 169, 173 (2006) (explaining the resurgence of state-owned enterprises as a vehicle of economic activity); Ruilong Yang & Youngsheng Zhang, *Globalisation and China's SOEs Reform* (Paper for the Int'l Conf., "Sharing the Prosperity of Globalization," U.N. Univ./ World Inst. for Dev. Econ. Research 2003), available at <http://website1.wider.unu.edu/conference/conference-2003-3/conference-2003-3-papers/Yang-Zhang-3108.pdf> (arguing that China's SOEs were compatible with central planning but not with globalization). But see Larry Catá Backer, *Cuban Corporate Governance at the Crossroads: Cuban Marxism, Private Economic Collectives, and Free Market Globalism*, 14 TRANSNAT'L L. & CONTEMP. PROBS. 337 (2004). For a discussion of SWFs in the popular press and opinion-making among the electorate, see, e.g., Austin Ramzy, *Why China's*

becoming the very thing that states feared almost a century ago. That is, they have begun to take on the characteristics of large aggregations of *private* economic power. Now over a generation old in their current form, financial entities identified as SWFs have become important factors in global financial stability.²⁷ Starting slowly after the Second World War, SWFs have become major players in financial markets.²⁸ Over the last decade, SWFs became more visible and more aggressive in the scope and form of their interventions in global finance.²⁹ The rise of these sovereign vehicles reflects more than an attempt to expand state power through participation in the new regimes of free movement of capital and its consequential opening of national territories to inbound foreign investment. Sovereign investment, the active participation of states in markets, especially in markets outside their national borders, also reflects the difficulty of separating what is effectively a close connection between the economic activities of states and their legal systems. This

State-Owned Companies Are Making a Comeback, TIME, Apr. 29, 2009, available at <http://www.time.com/time/world/article/0,8599,1894565,00.html>.

²⁷ Rob Kellogg, *The Rise of Sovereign Wealth Funds—Part I*, GLOBAL INVESTMENT WATCH, Oct. 17, 2008, available at <http://globalinvestmentwatch.com/2008/10/17/the-rise-of-sovereign-wealth-funds-part-i/> ("Because Sovereign Wealth Funds have long term investment horizons and generally have no commercial liabilities, they are better placed than most private investors to withstand market pressures in times of crisis. For this reason, Sovereign Wealth Funds have been a stabilising force during the current financial turmoil."); Joaquin Almunia, Eur. Comm'r for Econ. & Monetary Policy, *The EU Response to the Rise of Sovereign Wealth Funds*, Address at the Crass Montana Forum (Apr. 2, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/165&format=HTML&aged=0&language=EN&guiLanguage=en>.

²⁸ John Lipsky, First Deputy Managing Director of the International Monetary Fund, added:

Of course, the formation of SWFs is not a new phenomenon. However, almost two thirds of the existing Funds were established in the past decade. As a result, the importance of Sovereign Wealth Funds has grown not only within their own countries, but their relevance also has increased for the international financial system.

John Lipsky, First Deputy Managing Dir. of the Int'l Monetary Fund, International Monetary Fund [IMF], *Sovereign Funds: Their Role and Significance*, Address at the Seminar: Sovereign Funds, Responsibility with Our Future (Sept. 3, 2008), available at <http://www.imf.org/external/np/speeches/2008/090308.htm>.

²⁹ Simon Johnson, *The Rise of Sovereign Wealth Funds*, FIN. & DEV., Sept. 2007, at 56–57, available at <http://www.imf.org/external/pubs/ft/fandd/2007/09/pdf/straight.pdf>; Steven R. Weisman, *Oil Producers See the World and Buy It*, N.Y. TIMES, Nov. 28, 2007, available at http://www.nytimes.com/2007/11/28/business/worldbusiness/28petrodollars.html?_r=2. Weisman aptly described the situation:

Though oil-producing countries have been looking at investments in the West since the 1970s, their strategies back then were largely confined to safe assets with a low return, like United States Treasury debt. By 2001, with the collapse in oil prices, many of the oil exporters had depleted their dollar reserves, economists say. But the boom in oil prices in the last five years has changed all that. It has persuaded oil producers to set up or expand "sovereign wealth funds" as vehicles to invest far more aggressively in the West, in their own economies and in emerging markets.

Id.

connection is important and also suggests a tension in the basic idea that states regulate and everyone else participates. It also demonstrates the possibility of a state's dual role as simultaneously sovereign and "corporate," depending on the character of its actions. The connection has not only a descriptive element, suggesting origins, but also a normative one, suggesting a framework for conceptualization that has a significant legal effect. In the case of SWFs, it serves as the basis for treating the fund as a sovereign vehicle (and thus subject to tax and sovereign immunity treatment on that basis) rather than as an investment fund, the owner of which is a sovereign (and thus subject to tax treatment as a private entity and no sovereign immunity to it).³⁰

However, sovereign investing abroad is not limited to nor accomplished solely through SWFs. State-owned enterprises ("SOE"s), newly reconceived and no longer necessarily the corporate expressions of public control economic activity, now can function like privately held enterprises in virtually all respects.³¹

At the outset it is critical to be clear that SWFs are not SOEs. There is little difference in functionality between the two and they are easily mistaken for each other, but the distinction is relevant where the bulk of the controversy regarding foreign direct investment centers on SOEs and not SWFs.³²

The SOE activity, especially beyond the borders of its public owner, can serve as a basis for privatizing the sovereign activities of states through surrogates that function like other private actors, but whose shareholders do not behave like individual or corporate shareholders. Like SWFs, SOEs have begun to invest in economic markets abroad. But unlike SWFs, whose activities do not generally seek controlling interests in investment targets, SOE investments more often may have as their object the acquisition of

³⁰ See, e.g., Foreign Sovereign Immunity Act of 1976, 28 U.S.C. § 1604 (1976), available at <http://uscode.house.gov/download/pls/28C97.txt>. Of course, sovereign immunity and the exceptions written into the domestic law of the relevant state would still apply to the sovereign owner—though not to the non-sovereign fund. The difference is conceptually important. The traditional conflation implies that such funds are irrevocably instrumentalities of the state. For discussion, see, e.g., Matthew Melone, *Should the United States Tax Sovereign Wealth Funds?*, 26 B.U. INT'L L.J. 143, 176–217 (2008).

³¹ See, e.g., NICHOLAS R. LARDY, CHINA'S UNFINISHED ECONOMIC REVOLUTION 22–24 (1998); SHAHID YUSUF ET AL., UNDER NEW OWNERSHIP: PRIVATIZING CHINA'S STATE-OWNED ENTERPRISES (Int'l Bank for Reconstruction & Dev./ World Bank 2006); Lawrence Sáez & Joy Yang, *The Deregulation of State-Owned Enterprises in India and China*, 43 COMP. ECON. STUD. 69, 76 (2001).

³² Brenden J. Reed, *Sovereign Wealth Funds: The New Barbarians at the Gate? An Analysis of the Legal and Business Implications of Their Ascendancy*, 4 VA. L. & BUS. REV. 97, 110 (2009). But this distinction may be purely technical. Others have argued that SOEs are a form of sovereign investing and thus a form of SWF. See Edward F. Greene & Brian A. Yeager, *Sovereign Wealth Funds—A Measured Assessment*, 3 CAP. MARKETS L. J. 247 (2009).

control of a private economic entity operating or based abroad. This has raised some significant concerns regarding SOE interventions in foreign economies and the activities of SWFs.³³

Developing states continue to innovate in the areas of the form, function, and activities of SWFs and SOEs.³⁴ Developing states have also begun to coordinate the activities of their sovereign investment activities and economic operations through SWFs and SOEs for the purpose of harmonizing and maximizing the utility of these efforts to aid national development and other policy objectives.³⁵ Coordinated deployment of SWF and SOE investment activities abroad is an especially potent tool because it targets investments that maximize the economic and sovereign aims of their owner.

These innovations in SWFs and SOEs were brought into sharp focus in the course of events leading up to the acknowledged collapse of the global economic system after September 2008.³⁶ One of the most dramatic events of the financial crisis was the rescue of several American financial institutions by foreign sovereigns willing to invest in them.³⁷ Those investments were

³³ The classic recent case was the controversy in the United States in 2006 when a multinational enterprise controlled by a Persian Gulf state sought to acquire the right to administer ports in the United States. See David E. Sanger, *Under Pressure, Dubai Company Drops Port Deal*, N.Y. TIMES, Mar. 10, 2006, available at <http://www.nytimes.com/2006/03/10/politics/10ports.html>.

³⁴ See, e.g., Rachel Ziemba, *Sovereign Wealth Funds as Development Funders*, RGE MONITOR, Feb. 25, 2008, available at http://www.rgemonitor.com/econo-monitor/245844/sovereign_wealth_funds_as_development_funders (discussing aspects of this innovation).

³⁵ This has affected not only traditional operators of SWFs and SOEs, but also developed countries like the United States. See Benjamin A. Templin, *State Entrepreneurism* (Thomas Jefferson Sch. of Law, Working Paper No. 1428108, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1428108.

³⁶ Currently, experts place the start of the current economic turmoil sometime in 2007. See Int'l Monetary Fund, *IMF Urges G-20 States to Take More Decisive Action to Combat Crisis*, IMF SURV. MAG., Feb. 5, 2009, available at <http://www.imf.org/external/pubs/ft/survey/so/2009/NEW020509A.htm>. But see Henry M. Paulson, Jr., U.S. Sec'y of Treasury, *Financial Rescue Package and Economic Update, Remarks to the American People from the U.S. Dep't of Treasury Press Room* (Nov. 12, 2008), available at <http://www.ustreas.gov/press/releases/hp1265.htm> (the determination of the 2007 start date was put off until the time of the 2008 U.S. Presidential Election).

³⁷ Yale Global Online, *World Rides to Wall Street's Rescue*, Jan. 17, 2008, <http://yale.global.yale.edu/content/world-rides-wall-streets-rescue> (last visited Jan. 20, 2010). Foreign governments rescued troubled American financial institutions facing near collapse due to the acute subprime crisis during the second part of 2007 and early 2008 as noted by David Cho:

The nation's biggest financial firms, battered by huge losses in their mortgage businesses, are relying on an enigmatic source for cash: foreign governments in the Middle East and Asia. Citigroup announced yesterday that it had sold a 7.8 percent stake in the company worth \$14.5 billion to a group of investors, including the government of Singapore and Saudi Prince Alwaleed bin Talal, as it revealed a colossal \$10 billion loss for the fourth quarter. Merrill Lynch, which is expected to report a massive loss tomorrow, said that it sold a special class of stock worth \$6.6 billion to funds managed

accomplished through a variety of entities. Some of those entities were sovereign wealth funds.³⁸ The OECD Investment Committee noted, “[SWFs] have much to offer. [SWFs]’ recent injections of capital into several OECD financial institutions were stabilizing because they came at a critical time when risk-taking capital was scarce and market sentiment was pessimistic.”³⁹ Other sovereign entities important to the efforts to stabilize global markets, or at least the institutions of such markets suffering in the developed world, were SOEs that purchased some of the operating assets of ailing corporations in the United States and elsewhere.⁴⁰ Moreover, the financial crisis reversed a longstanding American reluctance to create and maintain SOEs. The United States and other developed states moved quickly to convert failing private businesses into SOEs on new governance models suited to the tastes of the purchasing state.⁴¹

by South Korea and Kuwait. This is the second time in recent months that the two banks have sought help from foreign government investment pools, known as sovereign wealth funds.

David Cho, *A Growing Foreign Stake in U.S. Banks*, WASH. POST, Jan. 16, 2008, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/01/15/AR2008011503664.html>.

³⁸ *America’s Bailout Plan: The Doctor’s Bill*, ECONOMIST, Sep. 5, 2008, available at http://www.economist.com/finance/displaystory.cfm?story_id=12305746; see also MARK JICKLING, AVERTING FINANCIAL CRISIS 12 (Cong. Research Serv., CRS Report for Congress Order Code RL34412, Mar. 21, 2008), available at <http://fpc.state.gov/documents/organization/103688.pdf>. Jickling explains how foreign SWFs helped save U.S. financial institutions:

In fact, troubled U.S. institutions were able to raise significant amounts of new capital. Much of this money—over \$30 billion by one estimate—has come from government sources, but not the American government. Instead, sovereign wealth funds operated by China, Singapore, Abu Dhabi, and other countries have taken large equity stakes in Citigroup, Merrill Lynch, Morgan Stanley, and other firms, including leading European financial institutions.

Id. at 15.

³⁹ OECD, INV. COMM., REPORT ON SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES 2 (2008), available at <http://www.oecd.org/dataoecd/34/9/40408735.pdf> [hereinafter OECD, INV. COMM.].

⁴⁰ See Rachel Ziemba, *Sovereign Wealth Funds as Development Funders*, RGE MONITOR, Feb. 25, 2008, available at http://www.rgemonitor.com/economonitor/245844/sovereign_wealth_funds_as_development_funders.

⁴¹ In the United States, the economic and financial crisis produced new forms of state-owned enterprises in AIG and General Motors. See Press Release, U.S. Dep’t of the Treasury, U.S. Treasury and Federal Reserve Board Announce Participation in AIG Restructuring Plan (Mar. 2, 2009), available at <http://www.ustreas.gov/press/releases/tg44.htm> (discussing AIG); see Press Release, General Motors, The New General Motors Company Launches Today (July 10, 2009), available at <http://media.gm.com/servlet/GatewayServlet?target=http://image.emerald.gm.com/gmnews/viewmonthlyreleasedetail.do?domain=74&docid=55577> (discussing General Motors new government arrangements). For a discussion in the popular press of the U.S. transaction with General Motors, see, e.g., *A Not So Happy Birthday for General Motors*, FIN. TIMES, Aug. 1, 2008, available at http://www.ft.com/cms/s/0/4b080fdc-5fbc-11dd-805e-000077b07658.html?nclink_check=1; *Hedge Funds Protest Against Delphi Sale Plan*, FIN. TIMES, June 24, 2009, available at <http://www.ft.com/cms/s/0/97b6e0dc-60e0-11de-aa12-00144feabdc0.html>; Neil King Jr. & Sharon

These actions reinforce the trend to confound what had been the conventional premise of political and economic organization. That premise—that state actors regulate markets in which non-state actors participate—is now challenged by the activities of states that participate in markets and non-state actors that seek to regulate. This has become particularly apparent in the operation of SWFs. When used by states as vehicles through which they held their reserves and protected their financial security, the practice could be understood as a limited and acceptable extension of governmental power.⁴² Additionally, the direct state ownership of certain sectors of a national economy, deemed tied to public policy and national welfare, could also be understood as another acceptable form of asserting regulatory power. The move toward using public wealth to intervene in the financial markets of other states, or toward operating economic enterprises abroad, however, suggests activities that were reserved to private actors. When exercised by states in the territories of other states, the actions become threatening to the power-order on which the state system is based. The threat was inherent in the traditionally constructed hierarchies of power in which economic entities were subordinate to states, and only one state could be the dominant authority within a territory. Those hierarchies become difficult to apply when a state actor operates within the borders of another state actor. Adjustment, then, is necessary:

[This] is often the case, when new actors emerge on the international financial scene, the players need to become better acquainted. The growing role of SWFs raises issues regarding the smooth functioning of financial markets and they raise investment policy questions, including legitimate concerns in recipient countries about protecting national security.⁴³

Terlep, *GM Collapses into Government's Arms*, WALL ST. J., June 2, 2009, available at <http://online.wsj.com/article/SB124385428627671889.html>.

⁴² Rozanov, *supra* note 25. Rozanov articulates the importance of SWFs to state security:

These days one often hears a question posed with regard to huge foreign exchange reserves accumulated by these countries along the lines of: "Do they really need so much?" In terms of intervening to support their currencies, the answer is a resounding no. But frame the question differently: "How much sovereign wealth do these countries need to provide economic, political and social security—be it through faster development or dependable insurance against the huge risks they run?" and the answer may well be different. One example may best illustrate the point: Kuwait managed to regain its independence and rebuild the country after the Iraqi invasion in large part thanks to the large pool of assets accumulated and managed by KIA [Kuwait Investment Authority].

Id. at 4.

⁴³ Carolyn Ervin, *Sovereign Wealth Funds: Should Sovereign Wealth Funds Be Treated Differently Than Other Investors? An OECD Project Has Set Out to Answer This Question*, OECD

Consequently, even as developed states welcomed the infusion of funds to prevent greater financial collapse, these states also began to challenge the innovations in sovereign investing that were used to ameliorate the effects of financial collapse. Thus, just as large aggregations of private wealth frightened public authorities in the 20th Century, large aggregations of public wealth seeking an offshore home now produce a similar kind of fear in the same public actors.⁴⁴ While governmental responses were at first wary, criticizing these funds as potentially dangerous to the sovereignty and independence of their national markets,⁴⁵ the increasing needs of national economies quickly altered attitudes.⁴⁶ Still, even these responses have been mild, careful efforts to avoid adversely affecting capital markets and the

OBSERVER, May–June 2008, *available at* http://www.oecdobserver.org/news/fullstory.php/aid/2610/Sovereign_wealth_funds.html.

⁴⁴ See LEE HUDSON TESLIK, COUNCIL ON FOREIGN RELATIONS [CFR], SOVEREIGN WEALTH FUNDS (2009), *available at* <http://www.cfr.org/publication/15251/#10> (discussing concerns about SWFs). The major looming factor is how SWFs will be used in practice. Will governments use them simply as financial tools and eye investments from a purely financial standpoint, or will SWFs emerge as an implement of political muscle? See BRAD W. SETSER, CFR, SOVEREIGN WEALTH AND SOVEREIGN POWER 17 (2008), *available at* <http://www.cfr.org/publication/17074> (“The longer the United States relies on central banks and sovereign funds to support large external deficits, the greater the risk that the United States’ need for external credit will constrain its policy options.”).

⁴⁵ *The Rise of Sovereign Wealth Funds: Impacts on US Foreign Policy and Economic Interests: Hearing Before the H. Comm. on Foreign Affairs*, 110th Cong. (2008) (statement of Edwin M. Truman, Senior Fellow, Peterson Inst.), *available at* <http://foreignaffairs.house.gov/110/42480.pdf> Oxford Analytica, *West Approaches Opaque SWFs with Caution*, FORBES, Sept. 30, 2008, *available at* http://www.forbes.com/2008/09/29/sovereign-wealth-funds-cx_0930oxford.html. As Analytica explains:

During the second half of 2007 and early 2008, some SWFs made high-profile investments in major U.S. and European companies. Amid growing unease about some SWFs’ governance structures and investment objectives, U.S. and European policymakers aired a mix of divergent points of view. French President Nicolas Sarkozy made hawkish statements, as did many politicians in Germany. The U.K. government took a more welcoming stance toward SWFs. The U.S. Treasury was the most proactive, agreeing to a set of investment principles with two of the largest SWFs.

Id.

⁴⁶ Angel Gurría, OECD Secretary-General, Briefing With the United States Council for International Business, Washington, D.C. (Oct. 13, 2008), *available at* http://www.oecd.org/document/9/0,3343,en_2649_34863_41492169_1_1_1_1,00.html.

OECD member countries have come out strongly in this debate in welcoming Sovereign Wealth Funds and have given us a mandate to develop guidance for recipient countries. And we came out first. . . . We can congratulate ourselves on an outcome where SWFs, working with the support of the IMF, and the OECD were able to create a positive interaction—a real synergy—that has delivered something important to the global economy.

Id.

needs of states for infusions of inbound investment, whatever its source.⁴⁷ Indeed, rather than attack SWF projections into their domestic economies, most developed states have sought to work indirectly, through international organizations, to develop an initially voluntary regulatory framework for SWFs.⁴⁸ The resulting frameworks mimic those being developed for the transnational regulation of multinational enterprises—including guidelines and other soft law instruments grounded in transparency and benchmarking principles of good behaviors.⁴⁹ These soft law efforts initially ranged from the OECD,⁵⁰ the European Union,⁵¹ and various states.⁵²

By the end of 2008, the group of leading sovereign owners of SWFs, with the participation of leading host states under the auspices of the International Monetary Fund (“IMF”), developed a set of self-governing mechanisms that would continue to make available to sovereign capital the same easy access to global markets enjoyed by non-sovereign capital. The product of those efforts, the Santiago Principles, now serves as a benchmark for sovereign investment behavior, at least when undertaken through SWFs—so denominated.

Several years earlier, other international actors, representing the bulk of SOE host state acquisition activity in the developed world, also sought to implement a set of framework guidelines for the activities of SOEs that mimicked the standards developed under the Santiago Principles.⁵³ The

⁴⁷ But see Mathias Audit, *Is the Erecting of Barriers Against Foreign Sovereign Wealth Funds Compatible With International Investment Law?* (Soc’y of Int’l Econ. Law, Working Paper Series, Paper No. 29/08, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1154601.

⁴⁸ Thus, for example, the “EU common approach should serve as a contribution to the IMF efforts to set up a code of conduct for SWFs and for their owners and to the OECD work to define principles applied by recipient countries when dealing with SWFs.” *Communication From the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Common European Approach to Sovereign Wealth Funds*, at 10, COM (2008) 115 final (Feb. 27, 2008), available at http://ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf [hereinafter *Common European Approach*].

⁴⁹ See discussion *infra* at Part IV.

⁵⁰ The OECD developed a set of SWF governance principles. See OECD, INV. COMM., *supra* note 39 (containing investment policy guidance from the Freedom of Investment Project).

⁵¹ Simone Mezzacapo, *The So-Called ‘Sovereign Wealth Funds’: Regulatory Issues, Financial Stability, and Prudential Supervision* (Eur. Comm. Econ. Papers, Paper No. 378, 2009), available at http://ec.europa.eu/economy_finance/publications/publication15064_en.pdf. For a discussion of the EU engagement with this project, see discussion *infra*, at Part IV.B.1.

⁵² Prominent among these has been the United States. See Press Release, U.S. Dep’t of the Treasury, Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment With Singapore and Abu Dhabi (Mar. 20, 2008), available at <http://www.ustreas.gov/press/releases/hp881.htm> [hereinafter *Treasury Reaches Agreement*].

⁵³ See OECD, STATE-OWNED INDUSTRIES, *supra* note 18. The OECD Guidelines on Corporate Governance of State-Owned Enterprises were adopted by the OECD Council in April 2005. The OECD Guidelines on Corporate Governance of State-Owned Enterprises aim to give concrete advice to countries on how to manage their responsibilities as company owners more effectively,

object was simple. The SOE host states wanted to impose a minimum amount of transparency in SOE operations, but more importantly, they wanted to minimize the connection between the sovereign owner and the economic enterprise.⁵⁴ By reducing the likelihood of the use of SOEs as instruments of sovereign policy, the host states hoped to forestall protectionist measures in a way that mimicked the SWF framework.⁵⁵

Thus today, like their ancestors nearly a century ago, the guardians of public power articulate a growing fear of *private* aggregations of power, which threaten their power to control affairs within their national territory. Like their ancestors, they worry about large economic aggregations that threaten the viability of the traditional state system and the preservation of distinctions between public and private power. But, unlike the perceived danger confronting their ancestors, the challenges today do not arise from the usurpation of public power by private enterprises; instead it arises from the usurpation of *private* power by *foreign public* actors that *reach across borders*.⁵⁶ This usurpation, taking the form of sovereign investing through instruments of private commerce in direct competition with private actors, inverts the logic of traditional hierarchies, distinctions, and confrontations between public and private power. Indeed, in the face of this inversion, realized through sovereign investing activity, traditional regulatory

thus helping to make state-owned enterprises more competitive, efficient, and transparent. *Id.* at 11.

⁵⁴ *Id.* at 13. "The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives." *Id.* at 14.

⁵⁵ See INT'L WORKING GROUP OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GENERALLY ACCEPTED PRINCIPLES AND PRACTICES: "SANTIAGO PRINCIPLES" (2008), available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf> [hereinafter SANTIAGO PRINCIPLES]; see also *Corporate Governance Updates*, Nat'l Found. for Corp. Governance (NFCG, New Delhi, India), Oct.-Dec. 2008, available at http://www.adia.ae/ADIA_AE_press.asp. A section of the newsletter states:

The International Working Group of Sovereign Wealth Funds (IWG) presented the *Generally Accepted Principles and Practices (GAPP)—Santiago Principles* to the International Monetary Fund's policy-guiding International Monetary and Financial Committee on October 11, 2008. The IWG made public the set of 24 voluntary Principles and related explanatory material and announced it has established a Formation Committee to explore the creation of a Standing Group of Sovereign Wealth Funds.

Id. The principles are meant to be transposed into the municipal law of its adherents. SANTIAGO PRINCIPLES, *supra*, at 14. "In furtherance of the 'Objective and Purpose,' the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, each of which is subject to home country laws, regulations, requirements and obligations. This paragraph is an integral part of the GAPP." *Id.*

⁵⁶ Kimmitt, *supra* note 24, at 123 ("The most obvious consideration is national security. As with any form of foreign investment, countries on the receiving end of SWF investment need to ensure that national security concerns are addressed, without unnecessarily limiting the benefits of an open economy.") (Mr. Kimmitt was a Deputy Treasury Secretary under former President George W. Bush).

approaches and the policy assumptions that underlie them add to confusion, rather than reduce it, and thus further muddle policy approaches. If sovereign investing is understood as private actors participating in markets, then this might suggest the best case for similar treatment of states and private entities. This is because, as far as any transaction is concerned, the state stands in the same shoes as a private investor. On the other hand, if sovereign investing is understood as the assertion of public sovereign authority through private markets, then these activities can be understood as instruments that project sovereign power into the territory of other states.⁵⁷ While the conceptual movement concerning this paradigm within the European Union had been toward a public law conception of all assertions of state power,⁵⁸ regardless of whether the state power comes from within the nation or outside the national territory, the view of other states and international regulators has taken a more ambiguous position.⁵⁹

This article considers sovereign investing—the use of state-owned investment entities, principally SWFs and SOEs—as a catalyst to change policy and regulation. The focus of analysis is regulatory policy and its fundamentally dissonant character. This dissonance is grounded in the oppositional forces driving interaction with sovereign investment. These forces are both suspicious of investments as potentially dangerous to the sovereignty and independence of national markets, and solicitous of the investments themselves as a consequence of the needs of national economic sectors. These oppositional forces became more pronounced in the face of the global financial crisis. Responses to sovereign investment have focused on law and policy to protect the integrity and workings of domestic and international markets by decentering the sovereign element of sovereign investment. However, this response lacks much of a plausible conceptual center.

The effectiveness of this approach raises important questions about the relation between public and private law and the role of sovereigns pretending to be non-sovereign in their participation in global private economic markets. More basically, the discussion centers around the issue of continued viability of status-based distinctions in the law and regulatory frameworks as they apply to public and private actors, regardless of the nature of the activity in which they engage and irrespective of the character of the acts subject to law.

⁵⁷ See JAVIER SANTISO, OECD DEV. CTR., POLICY INSIGHTS NO. 58: SOVEREIGN DEVELOPMENT FUNDS (2008), available at <http://www.oecd.org/dataoecd/17/57/40040692.pdf> (“[F]inancial actors from developing countries are playing with other OECD financial giants as equals through their [SWFs].”).

⁵⁸ Backer, *The Private Law of Public Law*, *supra* note 23, at 1845–63.

⁵⁹ See SANTIAGO PRINCIPLES, *supra* note 55; see Rose, *supra* note 24, at 127–41; see also Jason Buhi, *Negocio de China: Building Upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation*, 39 H.K. J.L. 197 (2009) (discussing Chinese sovereign investing in the Santiago context).

Still more dangerous, the current approaches to regulation insist on the system of hyper taxonomy that treats distinct aspects of sovereign investing separately, and posits that for every form of sovereign investing, there ought to be a separate regulatory system. This Article attempts to challenge that conception of law and regulatory framework that is grounded on formalism and categorical segregation. It suggests that governance systems ought to be grounded in regulatory and participatory action irrespective of the status of the actor as either sovereign or private. As such, the current distinction between the public or private character of the actor will be subsumed to the question of the regulatory or participatory character of the action. It also suggests that the aggregation of sovereign investment indicates the need to abandon a piecemeal approach to regulation.

After an introduction contextualizing the problem as a function of the character and control of large aggregations of wealth, Part II focuses on SWFs as projections of public economic power in private form. It focuses on issues of the conceptual dissonance in the definition and operation of SWFs. Part II ends by connecting those issues to policy debates about sovereign investing, especially in the form of SWF activity. Part III then considers SOEs as another vehicle for sovereign investment abroad. It considers SOEs as a fundamental component of innovative multi-vehicle deployments of sovereign wealth outside the national territory as part of the implementation of coordinated national development goals. Part IV then considers sovereign investing in its regulatory context by considering the expression of the conceptual dissonance of sovereign investment regulation and examining national and supranational approaches to regulation and regulatory reform. Part V examines the sufficiency and relevance of sovereign investing in the context of one of the great, cutting edge systems of sovereign investing now in development. "Beijing's economic reforms (and broader foreign policy) reflect both a relatively coherent grand strategy for building China into a wealthy and powerful state and a domestic strategy for ensuring the continued rule of the Chinese Communist Party."⁶⁰

The Chinese "Go Global" strategies, in which China coordinates important aspects of sovereign investing to achieve both commercial and political aims that maximize the welfare of the Chinese state,⁶¹ suggest a new and powerful methodology of sovereign projection into private markets outside national borders. China is seeking to refine a national system of sovereign investment, harmonizing and bending inbound and outbound features to the private ideal of welfare maximization, while furthering the political objectives of the state. This is the context around which this Article

⁶⁰ Philip C. Saunders, *China's Global Activism: Strategy, Drivers, and Tools*, 4 INST. FOR NAT'L STRATEGIC STUD. 1, 3 (2006).

⁶¹ 走出去。Zǒuchūqū and its connection to Chinese SWF and SOE investment strategies is discussed *infra* at Part V.

will examine China's approach to the use of state wealth through SWFs and SOEs. The focus will be on the construction of a unified outbound investment strategy by the Chinese state, affected through complex arrangements between and within its sovereign wealth fund instrument, the China Investment Corporation, ("CIC") that is both a sovereign wealth fund and state-owned enterprise.⁶² The CIC is a relatively young SWF.⁶³ The CIC invests directly in domestic and foreign assets, and through its subsidiaries,⁶⁴ invests in other Chinese SOEs, which may also invest abroad.

While the CIC's investment strategy did not change in the course of the financial crisis, the portfolio mix of the CIC's foreign and domestic investments changed to favor domestic over foreign investments after 2008. As a result, the aggregate of the CIC's domestic investments appeared to favor SOEs strongly. But the real consequence might have been movement from direct financial investment to indirect investment through the activities of its subsidiaries and client SOEs, which increased their foreign acquisitions in the course of the crisis. One reason for these changes might have been to alter the quality of the investment from small holdings in many foreign companies to control of a few key foreign enterprises. But another reason might have been to avoid the limits and norms of the Santiago Principles.

⁶² China Inv. Corp., Overview, http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html (last visited Jan. 20, 2010) [hereinafter CIC Overview] ("[CIC] is an investment institution established as a wholly state-owned company under the Company Law of the People's Republic of China and headquartered in Beijing." CIC's mission "... is to make long-term investments that maximize risk adjusted financial returns for the benefit of its shareholder.").

⁶³ *Id.* "CIC was established on September 29th 2007 with the issuance of special bonds worth RMB 1.55 trillion by the Ministry of Finance. These were, in turn, used to acquire approximately USD 200 billion of China's foreign exchange reserves and formed the foundation of its registered capital." *Id.* In addition, "[B]ecause its financing is grounded in financial instruments and subject to commercial obligations, CIC maintains a strict commercial orientation and is driven by purely economic and financial interests." *Id.*

⁶⁴ China Inv. Corp., Articles of Association (Abstract), <http://www.china-inv.cn/cicen/governance/articles.html> (last visited Jan. 20, 2010) [hereinafter CIC Abstract]. Central Huijin Investment Ltd. ("Central Huijin") is a wholly owned subsidiary of CIC with its own Board of Directors and Board of Supervisors. It was established to invest in key state-owned financial institutions in China; it does not conduct any other commercial activities and is not involved in day-to-day issues within the institutions in which it invests. *Id.* The CIC explains:

To the extent of its capital contribution, Huijin shall, on behalf of the State and in accordance with applicable laws, exercise the rights and perform the obligations as an investor in state-owned major financial enterprises, such as the Industrial and Commercial Bank of China, Bank of China and China Construction Bank, represent the State's controlling position in large-scale financial institutions and achieve value preservation and enhancement of state-owned financial assets.

Id.; *China's CIC Unit Jianyin Investment 2007 Opg Profit Over 10 Bln Yuan—Xinhua*, FORBES, Feb. 26, 2008, available at <http://www.forbes.com/feeds/afx/2008/02/26/afx4700518.html>. Jianyin Investment, Ltd., a wholly owned subsidiary of Huijin Investment was acquired in 2004 and is in the business of subsidizing Chinese brokerage firms or taking them over. *Id.*

From a host country perspective, such an investment strategy may be aggressive, for it suggests an attempt to disguise the projection of foreign political power as private investment. From an investing country perspective, such an investment strategy may be defensive, as it seeks to minimize investment risk. This investment strategy suggests a number of consequences that this Part explores. These include the relationship between SOE investment activities funded by SWFs and the application of the Santiago Principles, as well as the relationship between internal and external investment by governmental instrumentalities. The CIC evidences a change from the traditional model of the SWF to a multipurpose entity with blended public and private objectives. It serves as both sovereign investor in markets and domestic investor in SOEs, which, in turn invest in companies abroad. To the extent that the CIC retains some oversight of SOE indirect activity, the sovereign investor can control the method of its projection of economic power in domestic and cross-border markets.

The Chinese efforts to coordinate sovereign investment present a potentially substantial advance in the integration of programs of sovereign investing, public policy, and private markets.⁶⁵ This integration suggests that it may not make sense to segregate SWF regulation from other investment vehicles. Instead, it may be possible for a state to employ a policy of politically motivated interventions in foreign markets and markets for control that is, simultaneously, financially motivated. It follows that sovereign investing may not be regulated adequately through frameworks that pretend sovereigns can detach pieces of themselves and operate them as if they had no connection or interest. At the same time, this integration suggests that sovereign investing is, to some extent, a captive of the markets in which they operate—sovereign investment entities abroad will be subject to those host state regulatory regimes that affect, in equal measure, all economic organs and the markets in which they operate. Yet, the measure of that success, actualized in conventional terms, may continue to reflect a public and sovereign purpose effectuated within the territory of competitor sovereigns. The rise of sovereign market participatory entities, operating as a coordinated network of both sovereign and private actors, will require a responsive regulatory framework substantially different from those currently in gestation.

⁶⁵ See Xie Ping & Chao Chen, *Sovereign Wealth Funds, Macroeconomic Policy Alignment and Financial Stability* 3 (China Inv. Corp. Working Paper Series, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420614 (suggesting a sovereign investment strategy that coordinates all elements of public and private power, and to some extent, private actors, to project state power abroad in a coordinated and directed way). "It is possible for size and behavior of investments by SWFs to affect a country's financial market, monetary policy, balance of international payments, and fiscal policy, even wealth allocation in public sector and investment behaviors in private sector." *Id.* at 3.

II. PROJECTIONS OF PUBLIC ECONOMIC POWER IN PRIVATE FORM: CONTEXTUALIZING SWFs IN FORM, FUNCTION, AND POLICY

The SWFs represent a new form of an ancient type of traditional state activity—the management of public funds. Jason Buhi nicely summarizes this history:

Between 1945 and 2001, the world's preferred investment instruments were United States Treasury Bonds. Underwritten by the then overwhelming strength of the American economy and liquid enough to be sold in time to prevent a currency crisis, these bonds were rightly considered a safe investment vehicle. Most central banks were content to settle for their security and liquidity. The exceptions were a few Middle Eastern emirates with more petrodollars than they knew what to do with. Realizing that oil wealth is not eternal and unsatisfied with the relatively low rate of return on bonds, these nations began innovating new investment vehicles and formed the first major SWFs. The desire for diversification spread in the early years of the 21st century with an increasingly negative prognosis of the U.S. economy.⁶⁶

For nearly half a century, these funds were not of much interest to the scholarly or policy community. It was considered to be merely another method available to states for the management of their reserves, especially for developing states with substantial assets from natural resources exploitation.⁶⁷ Conventional scholarship tends to adhere to the view that SWFs are primarily a special form of the traditional sovereign activity of managing reserves, rather than a commonplace commercial activity.⁶⁸ But SWFs have become noteworthy not merely because they have grown larger, but also because they have begun to invest more aggressively.⁶⁹ “SWFs

⁶⁶ Buhi, *supra* note 59, at 199.

⁶⁷ Kimmitt, *supra* note 24, at 119 (“In 1953, eight years before its independence from the United Kingdom, Kuwait established the Kuwait Investment Board to invest its surplus oil revenue. That was perhaps the first-ever ‘sovereign wealth fund’ (SWF), although the term would not exist for another 50 years.”).

⁶⁸ N.Y. STATE BAR ASS'N TAX SECTION, REPORT ON THE TAX EXEMPTION FOR FOREIGN SOVEREIGNS UNDER SECTION 892 OF THE INTERNAL REVENUE CODE 10–16 (2008), available at <http://www.ny.sba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1157Report.pdf> [hereinafter N.Y. TAX SECTION].

⁶⁹ On the growth and size of aggregate SWF investment, see *Asset Backed Insecurity*, ECONOMIST, Jan. 17, 2008, available at http://www.economist.com/finance/displaystory.cfm?story_id=10533428; LEE HUDSON TESLIK, COUNCIL ON FOREIGN RELATIONS, SOVEREIGN WEALTH FUNDS (2009), available at <http://www.cfr.org/publication/15251/#8>. Experts say the emergence of sovereign wealth funds represents a fundamental shift in the reasons governments invest money. “To the extent governments have traditionally held investment assets, it was to protect

recently have chosen to invest instead in long-term equity positions and in other more risky financial assets not traditionally associated with foreign exchange investments of central banks in order to seek higher long term returns and thereby establish greater fiscal revenue stability and intergenerational savings.”⁷⁰

The new SWF form also represents a substantial departure from traditional currency reserve models, precisely because the sovereign seeks to assert a historically public activity in a manner normally used by private actors. The SWFs effectively embody a new form of state engagement in markets beyond their individual regulatory control. Sovereigns created a global framework for private activity through markets in which they had a primarily regulatory role. They now seek to participate in these markets, although none of them can individually control the markets through sovereign regulatory power. The difference between currency regulation and active private industry investment is substantial enough to produce regulatory contradiction. If sovereigns invoke private frameworks to defend the actions of SWFs, do the SWFs’ activity lose their sovereign character? If SWFs never lose their sovereign character, what regulatory framework ought to apply to SWFs? More importantly, what are the political consequences when the SWFs’ activities extend the reach of sovereign power from their own territory into the territory of other sovereigns? The standard histories of SWFs suggest that the assumption that such funds must be tied to the context from which they originated, rather than to the forms through which they undertake their activities.⁷¹ This assumption suggests that the public character of the fund’s ownership, rather than its form and operation, is privileged in the conceptualization of the SWF,⁷² but not as strongly in the

domestic currencies and banks from crisis,’ writes the *Economist*. Modern sovereign wealth funds go well beyond this basic agenda.” *Id.*; see also ANNA L. PAULSON, CHI. FED. RESERVE BANK, *RAISING CAPITAL: THE ROLE OF SOVEREIGN WEALTH FUNDS* (2009), available at http://www.chicagofed.org/publications/fedletter/cfljanuary2009_258.pdf. Paulson states:

One reason that SWFs have received a lot of attention in the popular press is because of their recent high-profile investments in developed countries’ financial institutions. . . . These investments have helped a number of systemically important financial institutions raise critical new capital. They have also heightened the scrutiny of SWFs and raised concerns about the desirability of these investments.

Id. at 2.

⁷⁰ Kimmitt, *supra* note 24, at 122.

⁷¹ *Id.* at 120 (discussing SWFs in the context of the forms of sovereign investment, which are international reserves, public pension funds, state-owned enterprises, and sovereign wealth funds); Greene & Yeager, *supra* note 32, at 249 (listing different forms of SWFs, namely central banks, stabilizations funds, public pension funds, government investment companies, and state-owned enterprises).

⁷² Kimmitt, *supra* note 24, at 122 (“[S]ince SWFs are an outgrowth of domestic and international financial policies, it makes sense to consider them in terms of their potential impact on financial security.”).

conceptualization of the regulatory framework through which it may operate in host states.

Unstated assumptions color much of the discussion about the character of SWFs. The self-referential character of the study produced more ambiguity than clarity. Those who are suspicious of sovereign participation in markets oppose their growth and tend to privilege their public aspects—principally that states own SWFs—adopting a formalist approach to their analysis. Legal responses consequently have a public law flavor. Formalists tend to stress the importance of treating sovereign investments as political actions and subject to the same restrictions as political actions by states. Others, who are less suspicious of SWFs, tend to privilege their private aspects—that they operate like and are subject to regulation outside their home jurisdictions by public regulators—adopting a functionalist approach to regulation. For functionalists, legal frameworks that vest states exercising regulatory power with authority to reach all forms of vehicles that seek to invest in domestic economic markets ought to be sufficient regardless of the character of the investor.

Like some judges' definition of pornography in the United States, it appears that many commentators are content with a definition of SWFs that relies on their power to "know it when they see it" rather than on something less technically arbitrary.⁷³ But a lack of consensus about the definition of SWFs actually reveals two sources of dissonance. The first, discussed briefly in Part A, is focused on efforts to define SWFs as distinct from other sovereign interventions in economic markets. The second, discussed in Part B, is focused on the forms that sovereign interventions may take. The first source of dissonance tends to privilege the sovereign element of the fund, and the second tends to concentrate on both the forms through which these funds operate and the objects of their activities. The differences are important; definitions tend to serve as the place where regulatory coverage is determined.⁷⁴ Narrowing definitions can be an effective means to reduce the

⁷³ *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring). Justice Stewart's opinion stated:

I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.

Id.

⁷⁴ Oxford Analytica, *International: SWF Definition Focuses Debate*, Dec. 29, 2008, <http://www.oxan.com/display.aspx?ItemID=DB147874> (last visited Jan. 20, 2010). The Analytical states:

The possibility of new rules for SWFs in certain jurisdictions raises the question of which funds will be subject to these rules. To date, there has been considerable confusion as to what actually constitutes a SWF: While many public pension funds are adamant that they are not SWFs, Benn Steil of the Council on Foreign Relations and Edwin Truman of the Peterson

effects and substantive burdens of those regulations. Thus, SWF host and home states' laws and policies reflect a balance between coverage and substantive regulation. Part C discusses how elaborations of both views shape the policy discourse in significant ways.

A. *The Formalist Definition of the Operations of SWFs*⁷⁵

Formal definitions of sovereign funds by governmental or international organizations tend to focus on their ownership element.⁷⁶ Large private actors with significant stakes in global financial markets take a similar approach.⁷⁷ This focus on the sovereign aspect of ownership produces an important policy consequence. It is possible that sovereigns might disguise the projection of their political power abroad by means of a private investment strategy in ways that would be more difficult if done directly as a

Institute have both argued that funds such as CalPERS should be considered SWFs; The US Treasury defines SWFs as investment vehicles funded by foreign exchange assets and managed separately from official reserves, which would exclude Singapore's Temasek. . . . ; [Some academics have argued that] that stabilisation funds and SWFs are distinctly different entities. The IMF disagrees and contends that stabilisation funds are SWFs. Clearly, the disparity among even the most respected academics and institutions presents a serious question for policymakers of what is a SWF exactly.

Id.

⁷⁵ The materials considered in this subsection were explored in more detail in Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 GEO. J. INT'L L. (forthcoming 2010).

⁷⁶ Clay Lower, Under Sec'y for Int'l Affairs, U.S. Dep't of the Treasury, Remarks by Acting Under Secretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System (June 21, 2007), available at <https://ustreas.gov/press/releases/hp471.htm> [hereinafter U.S. Dep't of the Treasury, SWFs]. The Americans have sought to define these entities by emphasizing their public nature of these investment instruments. *Id.* A SWF has been understood to include "a government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from official reserves." *Id.*; but see IMF, *Sovereign Wealth Funds—A Work Agenda*, at 4 (Feb. 29, 2008) [hereinafter IMF, SWFs] (prepared by the Monetary and Capital Markets and Policy Dev. and Review Dep'ts and approved by Mark Allen and Jaime Caruana) ("SWFs are government-owned investment funds, set up for a variety of macroeconomic purposes. They are commonly funded by the transfer of foreign exchange assets that are invested long term, overseas."); HELMUT REISEN, OECD POLICY BRIEF NO. 38, HOW TO SPEND IT: COMMODITY AND NON-COMMODITY SOVEREIGN WEALTH FUNDS 12–16 (2008), available at <http://www.oecd.org/dataoecd/41/3/41412391.pdf> (stating that SWFs are pools of assets owned and managed directly or indirectly by governments to achieve national objectives); see also Adrian Blundell-Wignall, Yu-Wei Hu & Juan Yermo, *Sovereign Wealth and Pension Fund Issues*, 94 FIN. MKT. TRENDS 117, 129–31 (2008), available at <http://www.oecd.org/dataoecd/27/49/40196131.pdf>.

⁷⁷ IMF, SWFs, *supra* note 76, at 37. Deutsche Bank suggested that sovereign investment entities could be defined as "financial vehicles owned by states which hold, manage, or administer public funds and invest them in a wide range of assets," and Morgan Stanley, "[a] SWF needs to have five ingredients: sovereign; high foreign currency exposure; no explicit liabilities; high-risk tolerance; and long-term investment horizon." *Id.*

sovereign political actor.⁷⁸ The focus on the sovereign element is important because of the disguise element of the vehicle, that is, an entity or operation that appears to be one thing, but is actually quite another, and one that uses private markets for sovereign aims. The sovereign aims might not be objectionable in themselves. The element of disguise inherent in the activity, however, this is another matter.

Among states that operate SWFs, the conceptual framework is not much different. Fund operators have advanced a self-conception that emphasizes both the tie between the sovereign and the fund, and the connection between the macroeconomic objectives of the fund owners and fund operations.⁷⁹ The Santiago Principles⁸⁰ trumpet a general rule that appears to limit the objectives of the fund "to maximize risk adjusted financial returns in a manner consistent with its investment policy and based on economic and financial grounds."⁸¹ However, the Santiago Principles make clear that this principle is not so much a restriction as a trigger for the application of transparency rules. For example, the Santiago Principles do not limit the use of SWFs for any purpose, from application of political embargoes to national policy projected abroad, as long as these policies are disclosed.⁸²

The focus on the character of the ownership of these investment vehicles produces an identity between the sovereign and the investment vehicle. Because the state is the owner, the fund is the state. "SWFs are, by

⁷⁸ Sanjiv Shankaran, *Norway Fund to Put \$2 Bn in India*, LIVEMINT.COM, Oct. 22, 2008, available at <http://www.livemint.com/swf.htm> ("A SWF is a global investment fund owned by a government. Unlike a private international investment fund, which is governed by profit motives, SWFs might have national strategic objectives that have made them controversial investment vehicles.").

⁷⁹ SANTIAGO PRINCIPLES, *supra* note 55, at 27 (defining SWFs).

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

Id. at 34. The elaboration of macroeconomic purposes as financial objectives does little to suggest limitations of sovereign objectives, precisely because the use of investment funds necessarily must have financial objectives. *Id.* at 27.

⁸⁰ *Id.*

⁸¹ *Id.* at 22 (relating to GAPP 19 Principle).

⁸² SANTIAGO PRINCIPLES, *supra* note 55, at 29 ("Some SWFs may exclude certain investments for various reasons, including legally binding international sanctions and social, ethical or religious reasons (e.g., Kuwait, New Zealand and Norway). More broadly, some SWFs may address social, environmental, or other factors in their investment policy. If so, these factors should be publicly disclosed.").

definition, extensions of the state. They are therefore viewed as maximizing their country's long-term strategic interests rather than as profit-maximizing actors."⁸³ This objective produces a willingness to assume away the autonomy among juridical persons, even where the SWF is both a separately constituted, conflating investment vehicle and the political apparatus of the state without any meaningful separation.⁸⁴ Norway has been particularly explicit about this conflation in the construction and operation of its fund.⁸⁵

The possibility of conflation also suggests that, assuming sovereigns do not act like private entities or individuals,⁸⁶ their funds might be presumed to serve as flow-through entities, at least with respect to fund objectives.⁸⁷ In the case of SWFs, the critical assumption is that, unlike private actors, the owners of SWFs are not *constrained* by a "profit" motive, though sovereigns might agree to such commercial purpose limits to the extent that those limits would suit them.⁸⁸ The Santiago Principles, in particular, serve as a

⁸³ Daniel W. Dezner, *Sovereign Wealth Funds and the (In)security of Global Finance*, 62 J. INT'L AFF. 115, 117 (2008).

⁸⁴ See, e.g., Henry Hansmann & Reiner Kraakman, *The Essential Role of Organizational Law*, 110 YALE L. J. 387 (2000). This presents a perversity of sorts. *Id.* The notion of the autonomy of separately constituted entities has served as a bedrock principle of modern corporate law in much of the West. *Id.*

⁸⁵ See Nor. Ministry of Fin., *Report No. 20 to the Storting (2008–2009): On the Management of the Government Pension Fund in 2008*, at 12 (2009), available at http://www.regjeringen.no/pages/2185603/PDFS/STM200820090020000EN_PDFS.pdf [hereinafter Norway, *Report No. 20*]. "The Government requires that responsible management of the Fund is arranged in such a way that support is ensured among the population of Norway and legitimacy among market players." *Id.* As a consequence, "[t]o meet these goals, the Ministry wants to integrate the goals of good corporate governance and consideration of environmental and social aspects into all parts of the management to a greater extent than they are at present." *Id.* at 47.

⁸⁶ Dezner, *supra* note 83, at 117. Dezner explains:

Even defenders of sovereign wealth funds as responsible financial actors acknowledge that some SWFs might have strategic objectives in their pattern of acquisitions. The funds themselves have repeatedly insisted that they merely seek to maximize their rate of return. Nevertheless, the perception among financial actors diverges from the self-perception of SWFs.

Id.; see also N.Y. TAX SECTION, *supra* note 68.

⁸⁷ See, e.g., Lee C. Hodge & Andrew B. Sachs, *Piercing the Mist: Bringing the Thompson Study into the 1990s*, 43 WAKE FOREST L. REV. 341 (2008) (discussing the idea of flow-through activity with respect to legal consequences such as piercing the corporate veil); but see Larry Catá Backer, *Small Steps Toward an Autonomous Transnational Legal System for the Regulation of Multinational Corporations*, 10 MELBOURNE J. INT'L L. 258 (2009) (discussing the idea of conflation of purpose that attaches to understandings of the operations of SWFs, and increasingly to multinational corporations under transnational soft law systems).

⁸⁸ INT'L FIN. SERVS. LONDON, SOVEREIGN WEALTH FUNDS 2008 7 (2008), available at http://www.ifsl.org.uk/upload/CBS_Sovereign_Wealth_Funds_2008.pdf. The International financial Services London describes such conflation of the purposes and operations of SWFs:

Some governments however have expressed reservations about SWFs because of the limited disclosure and transparency of some SWFs. Concerns

conscious effort to excise sovereign investing from other forms of sovereign activity and, in return for the adoption of mild restrictions on the sovereign element of these funds, to avoid restrictions on flows of sovereign capital in global markets.⁸⁹

The perception of the close ties between state's sovereign activity and the investment of its assets through a variety of vehicles—including SWFs—fuels the understanding of the taxation and sovereign immunity effects of SWFs in host states. The American approach is instructive. For a long time, the United States treated all investors on an equal footing, whatever the character of the investor, in accordance with a framework geared to private investment.⁹⁰ The means used by the United States to arrive at this equivalence is sourced in two different approaches to regulation. One approach assumes the legitimacy of regulatory power for private enterprises. The other assumes the illegitimacy of regulatory power for public sources activity. The former is based on an applied regulatory framework that seeks exemptions and exceptions.⁹¹ The latter is based on a framework in which the sovereign is exempt from regulation unless an exception applies.⁹²

Consistent with a broad understanding of sovereign power and its unique character, some states view exceptions as inherently grounded in the objectives of the sovereign. This grounding is an important factor when determining the character of the activity.⁹³ Yet, the American Foreign

have also been expressed about their multiplicity of objectives, making it difficult to assess the SWFs' activities and their impact on global capital markets. Another concern expressed by some governments is that SWFs may invest to secure control of strategically important businesses or sectors for political rather than commercial reasons, and could use these investments to advance their own national interests.

Id.

⁸⁹ See Backer, *Regulatory Chameleons*, *supra* note 75.

⁹⁰ See *Sovereign Wealth Funds: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. (2008) [hereinafter *SWF Hearing*] (statement of Scott G. Alvarez, General Counsel, Bd. of Governors of the Fed. Reserve Sys.) ("As a general matter, the same statutory and regulatory thresholds for review by the federal banking agencies apply to investments by SWFs as apply to investments by other domestic and foreign investors in U.S. banks and bank holding companies."); see also Melone, *supra* note 30, at 176–217 (discussion in the context of SWFs).

⁹¹ See Securities Act of 1933, 15 U.S.C. § 77(c) (2006) (assuming application unless an exemption or exception applies). The framework of the Securities Act of 1933 is instructive. *Id.*

⁹² That is substantially the framework of statutory codifications of American relations with foreign states affecting or occurring in its territory. See, e.g., Foreign Sovereign Immunities Act of 1976, 28 U.S.C. § 1605(a)(2) (2008).

⁹³ See Lee M. Caplan, *State Immunity, Human Rights, and Jus Cogens: A Critique of the Normative Hierarchy*, 97 AM. J. INT'L L. 741, 761 (2003). There is a relationship between this approach and that of the now abandoned American approach to the protection of the sovereign power of states under constitutionally extracted principles of federalism. *Id.* See, e.g., *Nat'l League of Cities v. Usery*, 426 U.S. 833 (1976).

Sovereign Immunities Act, which is the most useful exception for commercial activities,⁹⁴ defines commercial activity by reference to the activity rather than to the identity or objectives of the public actor.⁹⁵ Courts have become increasingly proficient in sorting through the character of an activity for purposes of applying the commercial activities exception.⁹⁶

Mirroring the formula for foreign sovereign immunity, the American regulatory approach under the Bank Holding Company Act ("BHC")⁹⁷ distinguishes between states and corporations through which states operate based on the character of the activity rather than the objectives of the ultimate sovereign owner.⁹⁸ The BHC respects foreign rather than domestic sovereigns. With respect to the BHC, for example, then-General Counsel to the Board of Governors of the Federal Reserve System Scott G. Alvarez has noted:

The BHC Act specifically excludes from its coverage a corporation controlled by the United States or by a state government. Thus, investment companies controlled by the states of Alaska and New Jersey, for example, are specifically

⁹⁴ See Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1330, 1332, 1391, 1605–11 (2008).

⁹⁵ See, e.g., *Guevara v. Republic of Perú*, 468 F.3d 1289, 1298–99 (11th Cir. 2006); Timothy G. Nelson, *Peruvian Bounty, Argentine Sanctuary: Latin American Encounters With the U.S. Foreign Sovereign Immunities Act*, 6 LATIN LAW. MAG. (June 2007), available at <http://www.arbitralwomen.org/files/publication/4210231249364.pdf>.

⁹⁶ See *Youming Jin v. Ministry of State Sec.*, 335 F.Supp.2d 72 (D.D.C. 2004), available at https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2002cv0627-91; *Chen v. China Cent. Television*, 2007 WL 2298360, at *5 (S.D.N.Y. Aug. 9, 2007) (citing *Bryks v. Canadian Broad. Corp.*, 906 F.Supp. 204, 207–08 (S.D.N.Y. 1995)). *Chen* concluded that CCTV's general activities were 'commercial,' despite its ownership by the government, but that the basis of the plaintiff's claims against CCTV—that CCTV engaged in a 'campaign of propaganda'—were not. *Chen*, 2007 WL 2298360, at *17.

⁹⁷ Bank Holding Company Act of 1956, 12 U.S.C. § 1841 (2008), available at <http://www.fdic.gov/regulations/laws/rules/6000-300.html>. The Act states:

"Company" means any corporation, partnership, business trust, association, or similar organization, or any other trust unless by its terms it must terminate within twenty-five years or not later than twenty-one years and ten months after the death of individuals living on the effective date of the trust, but shall not include any corporation the majority of the shares of which are owned by the United States or by any State, and shall not include a qualified family partnership. "Company covered in 1970" means a company which becomes a bank holding company as a result of the enactment of the Bank Holding Company Act Amendments of 1970 and which would have been a bank holding company on June 30, 1968, if those amendments had been enacted on that date.

Id.

⁹⁸ See Joseph Coyne et al., *Banca Commerciale Italiana*, 68 FED. RES. BULL. 423 (1982); Michael Gruson & Uwe H. Schneider, *The German Landsbanken*, 1995 COLUM. BUS. L. REV. 337, 428–30 (1995).

excluded from the requirements of the BHC Act. The exclusion does not, on its face, apply to companies controlled by foreign governments and . . . the Board has not extended this exclusion to companies controlled by foreign governments that make investments in U.S. banks and bank holding companies. Foreign governments to date have primarily invested through sovereign wealth funds that are companies controlled by the foreign government.⁹⁹

The consequences of this approach are instructive for reviewing the way that other countries treat SWFs. Where a government permits all actors to participate in private economic markets, the government essentially presumes that all actors participating within those markets are private actors. Therefore, even SWFs are treated as such, irrespective of the sovereign or non-sovereign character of their ultimate owners. Where states seek direct entry into private markets, regulatory frameworks change. In essence, U.S. law distinguishes between private and public actors according to their participation.¹⁰⁰

American tax rules follow a similar path.¹⁰¹ Sovereigns are treated as a special category in their sovereign capacities.¹⁰² Their investments, to the extent that they represent the sovereigns' actions, are not considered income by their nature.¹⁰³ But commercial activities are treated differently.¹⁰⁴ For sovereigns operating SWFs, this means that SWFs can have it both ways. If they use their funds for sovereign purposes, which entitle them to the protection of reserves and other traditionally sovereign activities, then the American tax rules treat them as sovereigns, with all the benefits and

⁹⁹ *SWF Hearing*, *supra* note 90.

¹⁰⁰ *Id.* Mr. Alvarez stated:

The effect of the Board's long-standing interpretation is that a sovereign wealth fund that seeks to make an investment in a U.S. bank or bank holding company that exceeds the thresholds in the BHC Act would be required to obtain Board approval prior to making the investment and would become subject to the other provisions of the BHC Act, but its parent foreign government would not.

Id.

¹⁰¹ See, e.g., Gregory May, *Special Report: The Foreign Sovereign Tax Exemption*, TAX NOTES, Jan. 19, 2009, available at <http://www.freshfields.com/publications/pdfs/2009/jan09/Sovereign%20exemption-Tax%20Notes.pdf>.

¹⁰² See, e.g., I.R.C. § 895 (1986) (central banks); N.Y. TAX SECTION, *supra* note 68.

¹⁰³ I.R.C. § 892 (1986); see, e.g., Victor Fleischer, *Should We Tax Sovereign Wealth Funds?*, 118 YALE L.J. (POCKET PART) 93 (2008), available at <http://yalelawjournal.org/2008/11/17/fleischer.html>.

¹⁰⁴ I.R.C. § 892(a)(2)(A)(A) (1986). The touchstone is governmental financial or monetary policy. For a discussion, see, e.g., Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440 (2009).

detriments.¹⁰⁵ Otherwise, the sovereign might choose to be treated as a private actor by changing the behavior of its fund.

These approaches amplify a certain amount of dissonance. Yet, if sovereigns are to be treated as market participants when they invest on an equal footing with individuals, whether or not they operate directly or indirectly (through a corporation or other entity), they should be treated not as a public sovereign entity, but as a private sovereign entity. Moreover, the character of the activity and the constitution of the actor, rather than the objectives of the ultimate owner, ought to determine whether the investment is categorized as public or private. For that purpose, regulatory frameworks might abandon the distinction between private sovereign entities and other juridical persons, and instead focus on the legal actor and the character of the activity. The fact that sovereign owners present political or other risks because of their unique nature justifies regulation, rather than approaching activity conducted in form and through markets as open to both public and private actors.

The distinction between public and private activities of sovereign entities would not be hard to figure out. The guidelines governing public and private activities are already fairly well established in the Foreign Sovereign Immunities Act ("FSIA") and the jurisprudence it has generated.¹⁰⁶ The Federal Reserve Board has essentially taken this position, though in a more roundabout and formal manner:

The Board has long taken the position that while foreign governments themselves are not companies subject to the BHC Act, foreign government-owned corporations such as SWFs are companies. Thus any proposed controlling investment in a U.S. bank or bank holding company by a SWF would be subject to Federal Reserve approval.¹⁰⁷

Yet, with respect to the objects of SWF activities, regulators continue to fall back on the sovereign character of the SWF's ultimate owners and the sovereign's objectives. In a sense, this approach rejects the "commercial activities" approach of the courts when implementing FSIA. The FSIA substitutes an approach assuming that such funds are necessarily regulatory in character on the basis of the connection between these funds (and SOEs to some extent) and the presumption that they exist principally for the sovereign purpose of managing reserves, or otherwise as instruments of public policy projected outside the national territory.

¹⁰⁵ See, e.g., May, *supra* note 101.

¹⁰⁶ See Rose, *supra* note 24.

¹⁰⁷ SWF Hearing, *supra* note 90.

B. *Function in Sovereign Investing*

While SWFs have been defined by reference to their sovereign character, there has been some effort to distinguish among them by reference to their functional elements. Functional elements that tend to serve this purpose include a SWF's organization and the source of its funding from its sovereign owners. By focusing on organization or source of funding, the definition of an SWF tends to de-emphasize the sovereign character of the vehicle and turn attention to the characteristics SWFs share in common with similar non-sovereign entities. The IMF trend is to identify funds by reference to their function and objectives.¹⁰⁸ For example, an IMF study distinguished among these funds on the basis of their objectives.¹⁰⁹ These objectives included stabilization funds,¹¹⁰ savings funds,¹¹¹ reserve investment corporations,¹¹² development funds,¹¹³ and contingent pension reserve funds.¹¹⁴ Others have suggested broader categories, for example, distinguishing between "(i) central banks, (ii) stabilization funds, (iii) public pension funds, (iv) government investment companies and (v) state-owned enterprises."¹¹⁵ These categories also tend to emphasize funding sources.¹¹⁶ The World Bank sometimes

¹⁰⁸ Jukka Pihlman, *Sovereign Funds Set Up Permanent Representative Forum*, IMF SURV. MAG., May 6, 2009, available at <http://www.imf.org/external/pubs/ft/survey/so/2009/NEW050609A.htm>. Pihlman states:

SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets. These exclude, among other elements, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.

Id.

¹⁰⁹ IMF, SWFs, *supra* note 76, at 5.

¹¹⁰ *Id.* ("where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings").

¹¹¹ *Id.*

¹¹² *Id.* ("which aim to convert nonrenewable assets into a more diversified portfolio of assets and mitigate the effects of Dutch disease").

¹¹³ *Id.* ("which typically help fund socio-economic projects or promote industrial policies that might raise a country's potential output growth").

¹¹⁴ IMF, SOVEREIGN WEALTH FUNDS—A WORK AGENDA 5 (Feb. 29, 2008), <http://www.imf.org/external/np/pp/eng/2008/022908.pdf> ("which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet").

¹¹⁵ See, e.g., Greene & Yeager, *supra* note 32, at 249.

¹¹⁶ *Id.* at 248 (defining such entities as "a state-owned or influenced fund that obtains its funding from foreign-currency reserves or commodity export revenues, though in certain instances, government budget surpluses and pension surpluses have also been transferred to SWFs."); U.S.

emphasizes investment strategy rather than the form through which SWFs make investments. The World Bank has suggested that SWFs are “long-term investment fund[s], typically for both income and intergenerational wealth transfer. . . .”¹¹⁷ Others distinguish among foreign exchange reserve funds, SWFs, and public pension funds.¹¹⁸

This focus on the functional tends to minimize the connection between the state and the fund. It emphasizes the similarities between these funds, however operated, and private investment vehicles organized and operated in a similar fashion. Formal organization is meant to serve as a structural impediment to the assertion of the sovereign and sovereign governance in entities organized along conventional commercial lines. Regulators assume that function will follow organizational form.¹¹⁹

The activities of SWFs suggest a dissonance between regulatory systems and the reality of SWF performance. This Part briefly considers the operations of some of the more financially significant SWFs in the context of investment decisions during the financial downturn of 2007–08.

1. Libya

The Libyan SWF (“LSWF”) is relatively new.¹²⁰ The LSWF is a product of the reengagement of Libya with the world in 2007.¹²¹ Libya invested small

Dep’t of the Treasury, SWFs, *supra* note 76 (distinguishing between the two large categories of SWFs, commodity and non-commodity funds).

¹¹⁷ See World Bank Treasury, Services for Sovereign Wealth and Commodity Fund Managers, <http://treasury.worldbank.org/Services/Asset+Management/Reserves+Advisory+and+Management+Program/ServicesForSovereignWelth.html> (last visited Nov. 13, 2009); see also ECON. & SOC. COMM’N FOR ASIA & THE PACIFIC, KEY ECONOMIC DEVELOPMENTS AND PROSPECTS IN THE ASIA-PACIFIC REGION, at 24, U.N. Sales No. E.07.II.F.28 (2008), available at <http://www.unescap.org/pdd/publications/key2008/key2008.pdf>. Most broad, perhaps, is the approach of the United Nations: “[SWFs] seek to diversify foreign exchange assets and earn a higher return by investing in a broad range of asset classes. Typical asset classes are longer-term government bonds, asset backed securities, corporate bonds, equities, commodities, real estate, derivatives, alternative investments, and foreign direct investment.” *Id.*

¹¹⁸ See Olivia S. Mitchell et al., *Managing Public Investment Funds: Best Practices and New Challenges* (Nat’l Bureau of Econ. Research, Working Paper No. 14078, 2008). Mitchell states:

[A]pplying insights from the pension and corporate governance literature to comparing these three investment vehicles in the context of the objectives of “secur[ing] prudent and economically sound public fund management practices in these funds, as well as . . . evaluat[ing] their governance and investment policies and how to better protect the assets from political interference.

Id. Abstract.

¹¹⁹ This is the essence of the approach of the OECD in its Guidelines for sovereign wealth funds as well as for state-owned enterprises. See discussion *infra* at Part IV.B.2.

¹²⁰ SWF Inst., Libyan Investment Authority, <http://www.swfinstitute.org/fund/libya.php> (last visited Jan. 20, 2010). The Libyan Investment Authority was established in 2006 as a product of the consolidation of the Libyan Arab Foreign Investment Corp., the Libyan African Investment

portions of its funds through portfolio managers but suffered significant losses during the economic downturn.¹²² The LSWF maintained a more liquid position than other SWFs.¹²³ “The fund is mainly seeking fair returns for its investments over the long term but will take board seats in companies when entitled because of the size of their shareholding,” said Zlitni, who also is Libya’s planning minister.¹²⁴ The LSWF does not focus primarily on the developed world. Instead, the LSWF’s focus is regional.¹²⁵ In addition, “\$155 billion of [LSWF funds] would be spent in Libya on projects related to housing, energy, and telecoms reminiscent of the days when Libya was a primary state sponsor of terror.”¹²⁶ In response to growing concerns about its lack of transparency, the Libyan fund announced in early 2009 that it will provide limited disclosure about its investment strategy.¹²⁷ Libya’s announced move toward financial transparency signals that it is also moving closer to accepting the forms of the ideal private investor model for SWFs. “By laying out its investment philosophy in some form, the [LSWF] wants to assure lawmakers in foreign countries its intentions are purely commercial and not for political advantage, said Layas, a former chairman of the Libyan

Portfolio, along with contributions of revenues derived from the exploitation of Libya’s petroleum resources. *Id.* “The fund invests through a number of external managers. LIA may make investments locally.” *Id.*

¹²¹ Sam Hopkins, *Libya’s Hundred Billion Dollar Diplomacy*, ENERGY & CAP., Dec. 12, 2007, available at <http://www.energyandcapital.com/articles/libya-sovereign-wealth/574>. Hopkins reported:

Yesterday, December 11, Libya’s Prime Minister (Qaddafi is still the Leader and Guide of the Revolution, since 1969) Baghdadi Mahmudi told Bloomberg news that Libya is set to sling \$255 billion in petrodollars around the world. . . . However, Mahmudi added, “We are now preparing to invest more than \$100 billion outside Libya, in different fields.

Id.

¹²² *Libyan Wealth Fund to Increase Investment in Equities*, BUS. INTELLIGENCE MIDDLE EAST, Oct. 23, 2008, <http://www.bi-me.com/main.php?id=26307&t=1> (“The Libyan Investment Authority had a portfolio of \$300 million managed by Lehman Brothers Holdings Inc., of which it plans to retrieve between 60 percent and 70 percent, Bengdara said.”) [hereinafter *Libyan Wealth Fund*].

¹²³ *Libyan Wealth Fund Has Up to 23 Pct of Cash Invested*, REUTERS, Feb. 13, 2009, <http://uk.reuters.com/article/oilRpt/idUKLD30914720090213>.

¹²⁴ *Id.*

¹²⁵ *Libya’s Income from Sovereign Fund \$2.2 Billion: Report*, REUTERS, Feb. 18, 2009, <http://af.reuters.com/article/investingNews/idAFJJOE51H0L32009021> (“The fund’s long-term investment share was more than \$8.0 billion spread into stocks of 107 firms, 65 percent of which are located in North Africa, 20 percent in Asia, with the remaining 15 percent in companies in Europe and North and South America.”).

¹²⁶ Hopkins, *supra* note 121.

¹²⁷ Spencer Swartz, *Libya Wealth Fund to Disclose Details on Invest-Fund Head*, EASYBOURSE, Jan. 11, 2009, <http://www.easybourse.com/bourse-actualite/marches/libya-wealth-fund-to-disclose-details-on-invest-fund-head-594174>.

Arab Foreign Bank.”¹²⁸ The purpose of the increased transparency is to permit greater access to investments in equities in developed state enterprises without intervention by host states.¹²⁹ Yet, Libya remains slow to do more than make announcements.¹³⁰ Even with increased transparency, an identity remains between the state ownership and state direction, as well as between the family of the leader of Libya and the fund itself.¹³¹

2. Singapore

Singapore operates two SWFs. One of them is the Government of Singapore Investment Corporation (“GIC”).¹³² “GIC’s mandate is to enhance the international purchasing power of Singapore’s reserves. To achieve this, GIC invests globally through systematic diversification across multiple asset classes. This requires a robust and coherent investment process, comprising three levels of decisions.”¹³³ GIC Special Investments (“GIC-SI”) undertakes equity investment.¹³⁴ The object is to invest both for return on investment¹³⁵

¹²⁸ *Id.*

¹²⁹ *Libyan Wealth Fund*, *supra* note 122. Business Intelligence Middle East reports:

“We’re thinking about telecommunication, pharmaceutical, retailers, utility companies,” Libya’s Central Bank governor Farhagt Bengdara, who also sits on the board of the Libyan Investment Authority, said at a meeting of African central bank governors today in Cairo. . . . “We want to increase our investment in equities, which is currently 10 percent, by 2 percent or 3 percent in less than six months,” said Bengdara. “We are targeting companies less affected by the recession.”

Id.

¹³⁰ The websites of the Libyan Arab Foreign Investment Company (<http://www.lafico-libya.com/construction.htm>) and the Libyan Investment Authority (<http://www.lia.ly/>), for example, remain under construction as of October 27, 2009.

¹³¹ See AFSHIN MEHRPOUYA ET AL., INVESTOR RESPONSIBILITY RESEARCH CTR. INST., AN ANALYSIS OF PROXY VOTING AND ENGAGEMENT POLICIES AND PRACTICES OF THE SOVEREIGN WEALTH FUNDS 113–16 (2009), available at http://www.irrcinstitute.org/pdf/Sovereign_Wealth_Funds_Report-October_2009.pdf. “LIA operates as a government agency and as such has independence from the country’s central bank and ministry of finance.” *Id.* at 114.

¹³² Government of Singapore Inv. Corp. [GIC], Story, http://www.gic.com.sg/aboutus_story.htm (last visited Jan. 20, 2010) (“The GIC was incorporated on 22 May 1981 as a private company. It is wholly owned by the Singapore government. This arrangement allows GIC to operate as a global fund manager, while allowing the government to have oversight over the management of the country’s reserves.”).

¹³³ GIC, Investment Process, http://www.gic.com.sg/aboutus_invest.htm (last visited Jan. 20, 2010); see also GIC, GIC (About Us), http://www.gic.com.sg/ourbiz_overview.htm (last visited Jan. 20, 2010) (“The investment portfolio is managed by three subsidiaries—GIC Asset Management Pte. Ltd., GIC Real Estate Pte. Ltd., and GIC Special Investments Pte. Ltd., which are responsible for public markets, real estate and private equity investments respectively.”).

¹³⁴ GIC, Special Investments, http://www.gic.com.sg/ourbiz_si.htm (last visited Jan. 20, 2010). GIC’s website describes the portfolio:

and to operate a diversified group of entities with respect to the funds that GIC-SI participates in managing.¹³⁶ The other fund is operated through Temasek Holdings Pte.¹³⁷ “Governed by the Singapore Companies Act, and also designated a Fifth Schedule Company under the Singapore Constitution in 1991, Temasek is an autonomously managed and professional investment house guided by an independent board.”¹³⁸ The company describes itself as “an active shareholder and investor in diverse industries covering banking & financial services, real estate, transportation & logistics, infrastructure, telecommunications & media, bioscience & healthcare, education, consumer & lifestyle, energy & resources, engineering as well as technology.”¹³⁹ Temasek emphasizes its autonomy from its state shareholder, stating, “While we are state-owned, we are not state directed in our investment, divestment or other business decisions.”¹⁴⁰ The focus is on responsible investing and corporate social responsibility in the context of maximizing wealth creation. To protect their assets, both GIC and Temasek “reduced equity holdings amid the global downturn last year ‘early in the crisis,’ helping the funds to post smaller losses than the MSCI World Index, Finance Minister Tharman

GIC Special Investments (GIC SI) was started in 1982 as the private equity investment arm of GIC. We aim to provide significant added returns and risk diversification to GIC's total portfolio through investing in private equity. Our investment covers a wide spectrum which includes leveraged buyouts, venture capital, growth capital, mezzanine financing, distressed situations, infrastructure and other special situation investments.

Id.

¹³⁵ GIC, Investment Approach, http://www.gic.com.sg/ourbiz_si_invest.htm (last visited Jan. 20, 2010). (“We are invested in many of the top private equity and venture capital funds in the US, Europe and Asia, and are among the largest investors in many of them.”).

¹³⁶ *Id.* (“We see our role as complementing and adding value, through counsel and assistance, to the company's management team. Companies can also leverage on our global network of business relationships with top-tier private equity funds and the portfolio companies of these funds.”).

¹³⁷ See Temasek Holdings, Corporate Profile, http://www.temasekholdings.com.sg/about_us.htm (last visited Jan. 20, 2010).

¹³⁸ Temasek Holdings, Temasek Review 2008: Investment Approach, <http://www.temasekholdings.com.sg/TemasekReview/2008/Investment-Approach.html> (last visited Jan. 20, 2010); see also Temasek Holdings, About Us, http://www.temasekholdings.com.sg/about_us.htm (last visited Jan. 20, 2010) (describing this entity as an investment house organized to “create and maximise long-term shareholder value as an active investor and shareholder of successful enterprises.”) [hereinafter Temasek Review].

¹³⁹ TEMASEK HOLDINGS, RISK & OPPORTUNITIES 4 (2009), available at <http://www.temasek.com.sg/TemasekReview/2008/pdf/Investments.pdf>.

¹⁴⁰ See Temasek Review, *supra* note 138; see also Temasek Holdings, Institutionalising Sound Governance, <http://www.temasekholdings.com.sg/TemasekReview/2008/Institutionalising-Sound-Governance.html> (last visited Jan. 20, 2010) (stating that Temasek's shareholder is the government of Singapore through the Minister of Finance).

Shanmugaratnam said on Jan. 19.”¹⁴¹ Temasek was one of the global SWFs that invested in the American sector at the time of the initial implosion in September 2008, a move that has produced financial losses.¹⁴²

3. Norway

The Government Pension Fund of Norway is the second largest SWF in the world and the largest in Europe.¹⁴³ Norges Bank Investment Management (“NBIM”), a division of the Norwegian Central Bank, administers the SWFs.¹⁴⁴ Norges Bank is also responsible for the publication of quarterly and annual reports on the fund, which are then made public.¹⁴⁵ Up to 50 percent of the fund’s assets may be invested in shares, primary capital certificates, bonds, commercial paper, and deposits in commercial and savings banks.¹⁴⁶ The fund is also subject to regional investment restrictions, with the majority of both fixed income and equity investments confined to Europe.¹⁴⁷ Additionally, Norwegian law and fund regulation restricts the

¹⁴¹ Andrea Tan & Chris Peterson, *Singapore’s GIC Loses \$33 Billion as Assets Tumble*, WSJ Says, BLOOMBERG, Feb. 17, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=adldZ5kLXIjw>.

¹⁴² Bei Hu & Yoolim Lee, *Temasek CEO Ho Ching to Leave; Goodyear to Take Over (Update2)*, BLOOMBERG, Feb. 6, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=anBvGhDTLqn8>. Hu and Lee state:

[The] credit crisis ravages the value of Temasek’s investments in Barclays Plc, Merrill Lynch & Co. and Bank of China Ltd. The MSCI World/Financials Index slumped 60 percent in the past year. “In hindsight, Temasek came in too early but it would be unfair to say Temasek made the wrong call to invest in American banks,” Francis Lun, general manager at Fulbright Securities in Hong Kong, said “At that time it was seen as a good opportunity to invest in U.S. banks on the cheap so it would be unfair to criticize the investment officers for the decision.”

Id.

¹⁴³ See Sovereign Wealth Fund Inst., Norway Summary, <http://www.swfinstitute.org/fund/norway.php> (last visited Jan. 20, 2010). The fund operates as two accounts. *Id.* One, the Government Pension Fund-Global, targets investments abroad in debt and equity securities. *Id.* The other is targeted to domestic investment. *Id.*

¹⁴⁴ See Norway, *Report No. 20*, *supra* note 85.

¹⁴⁵ *Id.* The annual reports of Norges Bank and Folketrygdfondet are appended by reference. See <http://www.norges-bank.no>; see also Ministry of Nor., *On the Management of the Government Pension Fund in 2008*, § 1 [hereinafter *Management of the Government*], available at <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/the-guidelines-for-the-management-of-the.html?id=434605> (“Norges Bank shall prepare an annual report and quarterly reports for the Fund. The reports shall be public.”).

¹⁴⁶ *Management of the Government*, *supra* note 145, § 4.

¹⁴⁷ *Id.*; See Norway, *Report No. 20*, *supra* note 85 (“The Ministry of Finance has formulated a long-term investment strategy based on the assumption that the portions to be invested in various asset classes and geographical regions can be determined on the basis of assessments of expected long-term returns and risks.”).

fund to no larger than a 5 percent equity stake in an invested company or to exercise voting rights in excess of 5 percent of the total voting rights in a single company.¹⁴⁸

On November 19, 2004, Royal Decree established the Ethics Council.¹⁴⁹ The Council's primary function is to evaluate companies in which the fund might invest to determine whether those companies meet certain ethical standards.¹⁵⁰ In December 2005, the Council released ethical guidelines to evaluate companies.¹⁵¹ Based on the guidelines, the Fund excluded a number of companies,¹⁵² prompting other states, principally the United States, to complain that the Fund was motivated by politics rather than investment goals.¹⁵³ The Council has also shown its willingness to exclude companies

¹⁴⁸ See Press Release, Ministry of Fin., Nor., Prudent and Long-Term Asset Management, No. 16/2008 (Apr. 4, 2008), <http://www.regjeringen.no/en/dep/fin/press-center/Press-releases/2008/prudent-and-long-term-asset-management.html?id=506651> (stating that on the verge of the economic downturn, the fund manager sought to increase the equity share restriction from 5 percent to 10 percent); see also John Acher, *Norway Seeks to Up Wealth Fund's Ownership Cap*, REUTERS, Apr. 4, 2008, <http://in.reuters.com/article/asiaCompanyAndMarkets/idINOSO00117120080404> ("Finance Minister Kristin Halvorsen stressed to a news conference that the fund was 'clearly a financial investor and not a strategic investor.'").

¹⁴⁹ Ministry of Fin. (Nor.), The Council on Ethics for the Government Pension Fund Global, <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/ethical-guidelines-for-the-government-pe/the-council-on-ethics-for-the-government.html?id=447010> (last visited Jan. 20, 2010).

¹⁵⁰ See COUNCIL OF ETHICS (NOR.), RECOMMENDATION TO REVERSE THE EXCLUSION OF THALES SA, available at http://www.regjeringen.no/pages/2236625/Thales_2009eng.pdf. The Council makes recommendations to the Ministry of Finance, who then has the power to exclude companies from the fund's portfolio. *Id.* Subsequently, the Council is obligated to periodically evaluate excluded companies in the event that a company has ceased to engage in actions which are contrary to the ethical guidelines. *Id.* "The Council shall review on a regular basis whether the reasons for exclusion still apply and may against the background of new information recommend that the Ministry of Finance revoke a decision to exclude a company." *Id.* at 2.

¹⁵¹ STYRER RAD OG UTVALG, ETHICAL GUIDELINES, NORWEGIAN GOVERNMENT PENSION FUND-GLOBAL, available at http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277. The guidelines state two principal aims. *Id.* First, because the fund is concerned with long term stability and solvency, it should seek to invest in companies who promote sustainability in the "economic, environmental, and social sense." *Id.* Second, the fund should abstain from investments "that constitute an unacceptable risk of contributing" to violations of "fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages." *Id.*

¹⁵² Styrer Rad Og Utvalg, Recommendations, http://www.regjeringen.no/en/sub/Styrer-rad-utvalg/ethics_council/Recommendations/Recommendations.html?id=458700 (last visited Jan. 20, 2010) (listing excluded companies).

¹⁵³ See Mark Landler, *Norway Keeps Nest Egg from Some U.S. Companies*, N.Y. TIMES, May 4, 2007, available at <http://www.nytimes.com/2007/05/04/business/worldbusiness/04norway.html?ex=1335931200&en=bf2bff622406f256&ei=5088&partner=rssnyt&emc=rss>. The American response occurred on the heels of the Norwegian exclusion of Wal-Mart. "The fund sold off more than \$400 million worth of Wal-Mart shares. That drew a sharp protest from the American ambassador to Norway, Benson K. Whitney, who accused the government of a sloppy screening process that unfairly singled out American companies." *Id.*

that deal with governments that have poor human rights records,¹⁵⁴ to use the Government Pension Fund-Global's available investment objectives to make political statements, or to put pressure on foreign states to further the interests of Norwegian national policy.¹⁵⁵

Norway used its finances more proactively than other countries. By May 2008, the Government Pension Fund-Global managers announced an increased commitment to equity purchases, emphasizing that all equity purchases must thereafter comply with the ethical and other guidelines of the Government Pension Fund-Global.¹⁵⁶ Its investment head stated, "We regard volatile markets as . . . an opportunity."¹⁵⁷ Norway's SWF, like others,

¹⁵⁴ For example, the Total SA was considered for exclusion for doing business with the ruling military junta in Burma. See Letter from The Advisory Council on Ethics for the Gov't Petroleum Fund to the Ministry of Fin., Recommendation of 14 November 2005 (May 1, 2006), available at <http://www.regjeringen.no/en/dep/fin/Selected-topics/The-Government-Pension-Fund/Ethical-Guidelines-for-the-Government-Pension-Fund---Global/Recommendations-and-Letters-from-the-Advisory-Council-on-Ethics/Recommendation-of-14-November-2005.html?id=419590> (discussing whether investments in Total SA, due to the company's operations in Burma, were contrary to the Fund's ethical guidelines).

¹⁵⁵ For example, the Council began considering the exclusion of certain investments related to Israel as a consequence of the Israeli incursions into the Gaza Strip at the end of 2008. See John Acher, *Norway Oil Fund's Israel Holdings Under Scrutiny*, REUTERS, Jan. 6, 2009, <http://www.reuters.com/article/Deflation/idUSL6437690>. Archer suggests that Norway intended to make investment decisions based on political decisions concerning its sense of the legal effects of Israeli and Palestinian actions, but only with respect to Israeli companies:

Finance Minister Kristin Halvorsen on Monday asked the fund's ethics council to assess whether companies in which the fund is invested and which operate in the Palestinian territories are in compliance with the guidelines. "In light of the increased conflict level in the Palestinian areas, I will ask the Council on Ethics for an account of the council's work on matters related to companies that have operations in these areas," Halvorsen said in a statement. The ethical guidelines prohibit the fund from investing in companies where there is an unacceptable risk of contributing to serious or systematic abuses of human rights or serious violations of individuals' rights in war or conflict. "Investment in companies that contribute to an occupation against international law or oppression in occupied areas could be affected by both of these considerations," Halvorsen said.

Id.

¹⁵⁶ John Acher & Wojciech Moskwa, *Norway Oil Fund Buyer of Stocks, Eyes New Deals*, REUTERS, May 29, 2008, <http://www.reuters.com/article/reutersEdge/idUSL2967976620080529>. Reuters reports:

Yngve Slyngstad said on Thursday that the world's second largest sovereign wealth fund was a "huge buyer" of stocks over the first quarter in a planned shift towards more equities. "We are just weeks away from crossing 1 percent ownership on average in Europe (in equities), and our ownership in the rest of the world is months, not weeks, away from crossing half a percent," Slyngstad said in an interview.

Id.

¹⁵⁷ *Id.* Reuters also reported:

suffered losses in connection with the collapse of U.S. bank values as well as those in Europe.¹⁵⁸ Despite their losses, NBIM has taken the position that because they are long-term investors, these short-term downturns do not concern them.¹⁵⁹ Still, the economic downturn forced the Norwegian government to dip into its SWF for domestic matters.¹⁶⁰ In addition to using its SWF, the "Norwegian government . . . unveiled a 100 billion kroner (\$14.8 billion) plan to inject capital into the country's banks and lend directly to banks and other businesses by buying corporate bonds."¹⁶¹

Though it had its poorest quarter in its 10-year history in January-March this year, the fund took advantage of lower equity prices, volatility and uncertainty over the period, [Slyngstad] said.

Id. The fund shrank by \$15 billion in the first quarter, despite new transfers, hit by a 12.7 percent negative return on its stock holdings amid a global selloff. *Id.*

¹⁵⁸ Richard Tomlinson & Vibeke Laroi, *Norway Oil Fund Lehman Losses Exacerbates Kingdom's Worst Return*, BLOOMBERG, Feb. 3, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aBMkhtkUBEds&refer=home>. Tomlinson and Laroi reported that:

In 2008, they compounded their losses in plunging global stock markets by putting out \$1 billion to refinance six U.S. and European banks, including the now defunct Lehman Brothers Holdings Inc. Those bets cost about \$500 million. Slyngstad also held on to U.S. mortgage-backed securities, including about \$16 billion of bonds issued by Fannie Mae and Freddie Mac, the home lenders U.S. taxpayers bailed out last September.

Id.

¹⁵⁹ *Norway's Oil Fund Faces Losses in 2008—Finmin*, FORBES, Nov. 10, 2008, available at <http://www.forbes.com/feeds/afx/2008/11/10/afx5670828.html>. Forbes reported that:

"This will be a hard year for the fund... this will be a year of losses, especially in the equity markets," [Finance Minister Kristin Halvorsen] said in an interview posted on the BBC's website on Monday. "Because we are very long term investors, we are not panicking, even if this is going to be a year of losses.

Id.

¹⁶⁰ David Ibison, *Norway Dips Into Oil Fund for Nkr20bn Stimulus*, FIN. TIMES, Jan. 26, 2009, available at http://www.ft.com/cms/s/5cd3812a-ebbd-11dd-8838-0000779fd2ac.Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F0%2F5cd3812a-ebbd-11dd-88380000779fd2ac.html%3Fnclick_check%3D1&_i_referer=http%3A%2F%2Fwww.swfinstitute.org%2Ffund%2Fnorway.php&nclick_check=1 ("Norway on Monday unveiled a Nkr 20bn (\$3 billion, €2.25 billion) fiscal stimulus package as it starts to use its massive oil wealth to boost growth and employment in its struggling economy.").

¹⁶¹ Paul Hannon, *Norway Unveils Bank Aid Package*, WALL ST. J., Feb. 9, 2009, available at http://online.wsj.com/article/SB123411883915260951.html?mod=googlenews_wsj (stating that the programs will impose conditions on Bank borrowers, limiting executive compensation and dividends).

4. United Arab Emirates¹⁶²

"The [United Arab Emirates ("UAE")] is home to the world's biggest [SWF] as the Gulf nation has kept massive oil windfall revenues to preserve wealth for the future generation. Analysts estimates [sic] assets at the Abu Dhabi Investment Authority [("ADIA")] are worth around \$500 billion."¹⁶³ The Government of the Emirate of Abu Dhabi established the ADIA in 1976 as an independent government investment institution.¹⁶⁴ According to its official website, ADIA's mission is to secure and maintain the current and future prosperity of the Emirate of Abu Dhabi through the prudent management of the Emirate's investment assets.¹⁶⁵ As much as 75 percent of ADIA's assets are administered by external managers, "which includes around 60 percent that is passively managed through tracking indexed funds."¹⁶⁶ The investments made by the ADIA are diversified over a broad spectrum of industries in foreign, direct, public, and private investments. Some reports include the following sovereign wealth enterprises under ADIA: Abu Dhabi Investment Company, Tasameem, Procific, and Tamweelview European Holdings SA.¹⁶⁷

ADIA is the largest shareholder in two of UAE's largest banks, National Bank of Abu Dhabi and Abu Dhabi Commercial Bank.¹⁶⁸ ADIA says that because it has a "long tradition of prudent investing, ADIA's decisions are based solely on its economic objectives of delivering sustained long-term financial returns. ADIA does not seek active management of the companies it invests in."¹⁶⁹ Amid some international pressure for transparency, Abu Dhabi, historically secretive regarding its investments, sent a letter to U.S. Treasury Secretary Henry Paulson in early 2008, including the set of

¹⁶² See VICTORIA BARBARY & EDWARD CHIN, MONITOR, TESTING TIME: SOVEREIGN WEALTH FUNDS IN THE MIDDLE EAST AND NORTH AMERICA AND THE GLOBAL FINANCIAL CRISIS 53-87 (2009), available at http://www.monitor.com/Portals/0/MonitorContent/imported/MonitorUnitedStates/Articles/PDFs/Monitor_Testing_Time_SWF_MENA_May_2009.pdf (examining the Qatar Investment Authority, Kuwait Investment Authority, Istithmar (subsidiary of Dubai World), and Mubadala Investment Co. (Abu Dhabi)).

¹⁶³ Natsuko Waki, *UAE Should Spend SWF to Revive Economy-Advisory Chief*, REUTERS, Jan. 31, 2009, <http://uk.reuters.com/article/gc08/idUKTRE50U0S920090131>.

¹⁶⁴ See Sovereign Wealth Fund Inst., UAE Summary, <http://www.swfinstitute.org/fund/adia.php> (last visited Jan. 20, 2010).

¹⁶⁵ Abu Dhabi Investment Authority, History, http://www.adia.ae/ADIA_AE_history.asp?navLoc=history (last visited Jan. 20, 2010).

¹⁶⁶ Abu Dhabi Investment Authority, Sovereign Wealth Fund Inst., <http://www.swfinstitute.org/fund/adia.php> (last visited Jan. 20, 2010).

¹⁶⁷ FACTBOX: *The World's Largest Sovereign Wealth Funds*, REUTERS, July 8, 2008, <http://www.reuters.com/article/ousivMolt/idUSSIN3837620080708?sp=true>.

¹⁶⁸ *Id.*

¹⁶⁹ EMPEA, Abu Dhabi Investment Authority, <http://www.empea.net/Member-Profile/Abu-Dhabi-Investment-Authority.aspx> (last visited Jan. 20, 2010).

principles that guide ADIA's investments.¹⁷⁰ Though not viewed as a guarantee or official commitment, the letter was a major development for SWFs.

At the turn of the global financial crisis in 2007, ADIA was one of the first sovereign investors that assisted a major U.S. financial institution in raising capital.¹⁷¹ However, ADIA is now rethinking its investment strategies.¹⁷² However, it is not entirely clear what kind of changes it will make. The UAE funds might be used to shore up the domestic banking sector.¹⁷³ Also, ADIA "may depart from its long-standing tradition and begin investing in the local market by buying bonds planned by the UAE Government and other institutions"¹⁷⁴ following investment strategies increasingly aimed at

¹⁷⁰ For a discussion of transparency standards, see Aamir A. Rehman, *ADIA's Letter: Transparency on Its Own Terms*, <http://rehmaninstitute.wordpress.com/2008/03/20/adia%E2%80%99s-letter-transparency-on-its-own-terms/> (last visited Jan. 20, 2010); see also Tom Barkley, Code Set for State Run Funds, WALL. ST. J., Mar. 21, 2008, available at <http://online.wsj.com/article/SB120604168933252597.html>.

¹⁷¹ Eric Dash & Andrew Ross Sorkin, *Escalating Losses Force Citigroup to Seek More Foreign Investment*, N.Y. TIMES, Jan. 12, 2008, available at <http://www.nytimes.com/2008/01/12/business/12citi.html?ex=1357794000&en=2b92fc2277fba775&ei=5088&partner=rssnyt&emc=rss>. Dash and Sorkin reported:

Citigroup is turning to cash-rich foreign investors for a second time as it confronts mounting losses on mortgage-related investments. In November, the company sold a \$7.5 billion stake to a Middle Eastern fund, Abu Dhabi Investment Authority, underscoring its deteriorating capital position. That purchase gave Abu Dhabi a 5 percent stake.

Id.

¹⁷² See *Abu Dhabi SWF Says Reviewing Long Term Strategy*, REUTERS UK, June 1, 2009, <http://uk.reuters.com/articleidUKLNE5502720090601>. Reuters reported:

Abu Dhabi Investment Authority ADIA, one of the world's largest sovereign wealth funds, said it was reviewing its long-term strategy for possible changes in the wake of the global financial crisis. "ADIA is currently reviewing its long-term strategy of assets . . . and assess whether changes are warranted," Obaid Murad Al Suwaidi, director of the Equities for Far East Department of ADIA, said in a speech at a business seminar in Tokyo. He did not elaborate on what changes might be made. He said ADIA tried to "look beyond the cycle" and that it remained committed to investing for the long term across different types of assets. "ADIA will continue to look at ways of capturing major market trends across all markets and asset classes, for example equities, fixed income and real estate."

Id.

¹⁷³ *UAE's Emirates WBD Nears Bond Sale Planes-CFO*, REUTERS, Sept. 1, 2009, <http://www.reuters.com/article/rbssfinancialservicesAndRealEstateNews/idUSL162855520090901> ("The UAE central bank and finance ministry have together launched 120 billion UAE dirhams (\$32.67 billion) of emergency funding since September to help banks cope with tight credit conditions.").

¹⁷⁴ *Adia May Invest in UAE Bonds, Says Saudi Bank*, BUS. 24/7, July 19, 2009, http://www.business24-7.ae/Articles/2009/7/Pages/18072009/07192009_6aaa3adf7f72484997d9ce7d43f5e9b8.aspx. Business 24/7 reported:

domestic markets as other SWFs have done in the aftermath of the global financial crisis.

5. Russia

The Russian state established the National Welfare Fund ("NWF") in 2008 as part of the reorganization of the predecessor Oil Stabilization Fund ("OSF").¹⁷⁵ The OSF fund was split into a fund to manage official reserves and the NWF.¹⁷⁶ The OSF only invests in foreign government bonds.¹⁷⁷ "[W]hile the main purpose of the NWF is to guarantee the voluntary pensions of the citizens" and to help balance the budget of the Pension Fund for Russia, the NWF has authority to lend money to Russian banks and serves to absorb excess liquidity.¹⁷⁸ Since NWF's inception, there seems to be some disagreement as to the type of investments it should make.¹⁷⁹ Russia received some criticism for its investments in purchasing gas pipelines and storage facilities in Europe.¹⁸⁰ In the wake of the global financial crisis, it has become clear that Russia is reshaping its foreign investment strategies,¹⁸¹ and it may soon be forced to tap into the NWF to alleviate its budget deficit.¹⁸²

In response to the still-strained financing conditions, the authorities are introducing measures to facilitate development of bond markets for local companies and banks. Having passed new legislation regulating the issuance of government debt, the authorities now plan to issue federal government bonds, both in international and local markets, for the first time.

Id.

¹⁷⁵ See Sovereign Wealth Fund Inst., Russia, <http://www.swfinstitute.org/fund/russia.php> (last visited Jan. 20, 2010).

¹⁷⁶ See *id.*

¹⁷⁷ See *id.*

¹⁷⁸ See *id.*

¹⁷⁹ See Andrew E. Krammer, *Russia Creates a \$32 Billion Sovereign Wealth Fund*, N.Y. TIMES, Feb. 1, 2008, available at <http://www.nytimes.com/2008/02/01/business/worldbusiness/01fund.html>. Krammer reported:

"The law allows us wider possibilities for investment," Mr. Pankin [Russia's Deputy Finance Minister] said. "But for now, we don't use these possibilities. A more aggressive investment strategy is being held up, he said, by a lack of agreement within the government on the fund's investment horizon—when the money will be withdrawn for use in the budget. By September, he said, the cabinet can be expected to approve a strategy, opening the door for possible overseas investments."

Id.

¹⁸⁰ *Id.*

¹⁸¹ *Update 2-Russia SWFs Banned from Fannie/Freddie Investment*, REUTERS INDIA, Mar. 5, 2009, <http://in.reuters.com/article/asiaCompanyAndMarkets/idINL523110320090305?sp=true>. Reuters reports:

Russia banned investment of its \$220 billion [SWF] in bonds of agencies such as Fannie Mae and Freddie Mac saying it needed more liquid assets to meet

6. Brazil

The Brazilian government established the Fundo Soberano do Brasil ("FSB") in January 2009 by issuing bonds totaling 14.2 billion Reals (\$5.9 billion), a sum equivalent to a half percent of Brazil's GDP.¹⁸³ The government created the FSB to safeguard Brazil from "future financial crisis and to assist Brazilian firms in increasing trade and expanding abroad."¹⁸⁴ The fund also helps investments in Brazil by "act[ing] as an anti-cyclical mechanism."¹⁸⁵ Despite the decrease in government revenues due to the continued effects of the global financial crisis, Brazil decided not to use its SWF, though it is possible that the fund may be used in the future.¹⁸⁶ More likely, Brazil's SWF fund efforts may suggest that it saw more political value in threatening the creation of a SWF than in actually implementing a SWF fund.¹⁸⁷

7. Form and Function of SWFs

This short review of the activities of the largest SWFs suggests the ambiguities of the fund instrument. In the hands of some states, sovereign funds retain their essentially private character. In the hands of others, sovereign owners exerted stronger shareholder pressure to change the

the needs of its own budget. The Finance Ministry said it needs to shift the portfolios in favour of more liquid assets such as sovereign bonds as Russia plans to tap the funds to cover budget and pension fund deficits this year.

Id.

¹⁸² *UPDATE 1-Russia Could Halve 2010 Borrowing Plans-Report*, REUTERS, July 23, 2009, <http://www.forbes.com/feeds/afx/2009/07/23/afx6693518.html>.

¹⁸³ See Sovereign Wealth Fund Inst., Brazil, Summary, <http://www.swfinstitute.org/fund/brazil.php> (last visited Feb. 15, 2010).

¹⁸⁴ See *id.*

¹⁸⁵ See *id.*

¹⁸⁶ *Brazil Plans to Keep Sovereign Wealth Fund-Mantega*, REUTERS, Apr. 27, 2009, <http://www.reuters.com/article/marketsNews/idUSN279020090427>.

¹⁸⁷ Riva Froymovich, *UPDATE: Brazil Sovereign Wealth Fund Idea More a Pipe Dream*, WALL ST. J., Oct. 16, 2009, available at <http://online.wsj.com/article/BT-CO-20091016-713078.html>. Froymovich reported:

Brazil's government may be floating the idea of a wealth fund for the prestige it carries. This may also be the government's way to tell the central bank to intervene more, according to Affonso Pastore, former Brazil Central Bank President and adviser for GlobalSource Partners. But, analysts say the country must reinvest in itself to fund development, rather than try to turn profits with money abroad. Brazil already tried to launch an outside-looking sovereign wealth fund last year, but had to change plans when the financial crisis struck. Monetary authorities realized they needed to use those dollar reserves for their originally intended purpose, selling dollars in order to stabilize the market.

Id.

investment mix of funds to satisfy political needs. In either case, the fund operation was grounded in principles of welfare maximization; however, in the later cases, the welfare-maximizing behavior deviated substantially from what might have been expected from an ideal private investor.¹⁸⁸ Moreover, the global financial crisis appeared to create a stronger inbound investment pressure.¹⁸⁹ This appears to be especially acute in the Middle East,¹⁹⁰ where the activities of SWFs become merged with state-owned enterprises.¹⁹¹ The form, then, does not appear to follow function. Yet, as I have suggested elsewhere, the inclusion of indirectly commercial profit maximization objectives is not unique to sovereign investment.¹⁹² Private investment vehicles have shown an increasing tendency to invest using long-term, principle-based investing strategies which, like their sovereign counterparts, are also meant to project their power to affect behavior.¹⁹³ This might suggest a regulatory framework that is distinguishable based on the regulatory or commercial objectives of investment, irrespective of the ownership of the investment vehicle.¹⁹⁴

¹⁸⁸ Andrew England, *Sovereign Wealth Funds Lose Their Gloss*, FIN. TIMES, Jan. 29, 2009, <http://www.ft.com/cms/s/0/9d0c9ff2-ed5b-11dd-88f3-0000779fd2ac.html> ("Just as their performances have come under scrutiny, a local liquidity squeeze and sharp corrections in regional stock markets have led to debate about whether SWFs should, or will, focus more on their home markets.")

¹⁸⁹ *Id.*

¹⁹⁰ Waki, *supra* note 163 ("The United Arab Emirates should spend part of its sovereign wealth fund to revive the economy and must delay property projects as demand vanishes, the head of its advisory council said on Saturday."); *see also* England, *supra* note 188. England reported:

Some funds have already acted at home. Late last year, the Qatar Investment Authority said it would raise its stakes in local listed banks to between 10 and 20 percent to shore up their balance sheets. The Kuwait Investment Authority (KIA) has taken steps to support that country's beleaguered stock market and is reported to be investing up to KD1.5bn (\$5.2bn) as part of a government fund to prop up the bourse.

Id.

¹⁹¹ *See* England, *supra* note 188. England continued:

Though he is more famous as a leading shareholder of UK bank Barclays and owner of English football club Manchester City, Sheikh Mansour Bin Zayed Al Nahyan, the crown prince's full brother, also controls the federal Emirates Investment Authority. The EIA, established in November 2007, is the custodian of government stakes in federal companies such as Etisalat and Du, the telecommunications operators, and Gulf International Bank and Gulf Investment Corporation, another bank.

Id.

¹⁹² *See* Backer, *The Private Law of Public Law*, *supra* note 23.

¹⁹³ *See* Backer, *Regulatory Chameleons*, *supra* note 75.

¹⁹⁴ *See supra* Part IV.

C. *The Policy Context of SWF Form and Function on the Eve of Financial Crisis*

The focus on the sovereign element of SWFs necessarily affects regulatory policy debates profoundly. Influential political, media, and academic stakeholders view SWFs as another factor in international financial politics, even though there is not yet a developed method for treating them like commercial enterprises. This Article now considers those profound effects on regulatory policy. Yoichi Funabashi, the Editor in Chief of the *Asahi Shimbun*, published in Tokyo, Japan, notes:

Compounding the effects of its diplomatic fumbling, Washington is also losing economic clout in Asia. With the dramatic growth of [SWFs] in recent years, Western economies have had a rude awakening to the rapidly shifting balance of global economic power: the line between political and financial power is becoming increasingly blurred.¹⁹⁵

For all that, the complexity of the issues relating to SWFs requires an analysis that spans beyond both the fear of SWFs in scope and the longing for their economic power.¹⁹⁶ This fear and loathing of sovereign investing in general, and SWFs in particular, exploded onto the media stage at the start of the financial crisis as leaders sought to both manage the crisis and use it to control a potential instrument of their rescue. These observations are particularly important because they reflect the thinking of people who are most likely to fashion both the regulatory responses and the cultural understanding of the sovereign investing phenomenon.¹⁹⁷ More significantly, these actors are likely to exercise their authority to translate assumptions into practice.¹⁹⁸ As I stated in another Article:

The political response has run the gamut from fearful protectionism, to welcoming the funds as a source of stabilizing cash for businesses caught in a downturn. Most adept politicians are taking a 'wait and see' approach, while

¹⁹⁵ See Yoichi Funabashi, *Keeping Up With Asia: America and the New Balance of Power*, 87 FOREIGN AFF. 110 (2008).

¹⁹⁶ *Sovereign Wealth Funds and Hungry States: Adjusting the Borders of Public and Sovereign Activity Across Borders*, <http://lcbackerblog.blogspot.com/2008/08sovereign-wealth-funds-smatter-ing-of.html> (June 6, 2008, 3:42 EST).

¹⁹⁷ In that sense, indeed, their views will be more important than those of academics. Cf. PIERRE BOURDIEU, *THE FIELD OF CULTURAL PRODUCTION* (Randal Johnson ed. & trans., 1993).

¹⁹⁸ Cf. ERIC A. NORDLINGER, *ON THE AUTONOMY OF THE DEMOCRATIC STATE* 7 (1981).

financial insiders tend to stress the importance of keeping markets open and welcoming the inflow.¹⁹⁹

For all the discussion, the interventions are instructive, and will inform the debate about the regulatory future of SWFs. Those sources of authoritative or legitimate opinion, described above, suggest fear, caution and enthusiasm. None seek to attack SWFs or their activities directly. All seek some sort of control over those activities consonant with the level of their fear, caution, or enthusiasm. And, of course, those reactions can be tied to the way in which these actors think about SWFs.

Many influential members of the political class in the United States and Europe expressed fear of the SWFs' power, and suggested that the cure for that fear lay in regulation. For example, Hillary Rodham Clinton, then a U.S. Senator (D-NY) stated, "We need to have a lot more control over what [SWFs] do and how they do it."²⁰⁰ The combination of state power and private power used to intervene indirectly in the affairs of other states caused a great deal of fear in the current political elite.²⁰¹

This discomfort reflects the notion that wealth maximization may be more complex than a narrow vision of short-term monetary wealth maximization. It also reflects the notion that states are somehow special when they participate in markets they cannot directly control. For example, Senator Jim Webb (D-VA) expressed a fear of mixed-motive activity when China invested in Blackstone.²⁰² The U.S. politicians seem fearful that China

¹⁹⁹ See *Sovereign Wealth Funds: A Smattering of Opinions that Count But Perhaps Ought Not*, <http://lbackerblog.blogspot.com/2008/08/sovereign-wealth-funds-smattering-of.html> (Aug. 22, 2008, 10:43 EST).

²⁰⁰ Hillary Rodham Clinton, *The Invasion of the Sovereign-Wealth Funds*, *ECONOMIST*, Jan. 17, 2008. Senate Banking Committee Chairman Chris Dodd has noted that "[SWFs] have been and will continue to be a high priority for the Committee." *OECD, IMF Guidelines on Sovereign Wealth Expected this Spring*, *INSIDE US TRADE*, Jan. 18, 2008, available at 2008 WLNR 1031593.

²⁰¹ See Evan Bayh, *Time for Sovereign Wealth Fund Rules*, *WALL ST. J.*, Feb. 13, 2008, available at <http://online.wsj.com/article/0,,SB120286960358864245,00.html>. Bayh reported:

Senate Banking Subcommittee on Security and International Trade and Finance Chairman Evan Bayh, "Sovereign nations have interests other than maximizing profits and can be expected to pursue them with every tool at their disposal, including financial power. For this reason, Congress must establish standards for transparency and behavior now to prevent unwarranted interference in our economy by foreign governments."

Id.

²⁰² Sebastian Mallaby, *The Next Globalization Backlash*, *WASH. POST*, June 25, 2007, available at <http://www.cfr.org/publication/13668/>; see also Lawrence Summers, *Sovereign Funds Shake the Logic of Capitalism*, *FIN. TIMES*, July 30, 2007, available at <http://blogs.ft.com/economistsforum/2007/07/sovereign-funds.html/> ("The logic of the capitalist system depends on shareholders causing companies to act so as to maximize the value of their shares. . . . It is far from obvious that this will over time be the only motivation of government as shareholders.").

and other countries will use their shareholder power to remove corporate officers or shape corporate policy.²⁰³

Yet, it is unclear why this constitutes a special fear. Politicians would appear to have little problem, were he a shareholder, with using his own shareholder power to oust a CEO merely because labor unions detested him, for example, as long as the politician could clothe the move in the appropriate language of commerce. He might do this, for example, by suggesting that the ousted CEO's relationships with shareholders was detrimental to the company's long-term growth. Still, a sovereign shareholder might have strong feelings about the value of a particular CEO, or of labor unions, and other corporate activities, and seek to act on them. Those strong feelings may reflect that CEO's actions and their effects on the interests of the sovereign investor, including but not limited to the investment in that particular enterprise.²⁰⁴

Still, there are differences between sovereign and individual shareholders. An individual shareholder can regulate only herself. A sovereign shareholder, on the other hand, can legislate. Sovereign shareholders do not legislate effectively outside the territory under their control. Likewise, sovereign shareholders directly participate in governance in their role as shareholders. In that role, sovereign shareholders are in a substantially similar position as individual shareholders. In these roles, both would seek to act *through* rather than *on* the entity. Both individual and sovereign shareholders have been known to invest and assert shareholder power within the corporation and divest their holdings to maximize their respective welfares as shareholders, including their values and in the context of their aggregate positions.²⁰⁵

Individuals would make value maximizing policy determinations by debating among themselves. On the other hand, the sovereign shareholder, like the corporate shareholder, would arrive at its value maximizing decision by applying principles of either fiduciary duties (as corporate shareholder),

²⁰³ *Id.*

²⁰⁴ See Christopher Balding, *Framing Sovereign Wealth Funds: What We Know and Need to Know* (Univ. of Cal., Irvine Working Paper Series, 2009), available at <http://ssrn.com/abstract=1335556> (documenting the politics of SWFs).

²⁰⁵ See Backer, *Regulatory Chameleons*, *supra* note 75. I write in a forthcoming article:

Suppose that a large institutional shareholder embraced the same public policy notions and attachment for the Norwegian corporate code and used its institutional shareholder power to advance those objectives within the corporation? That, certainly, would not be viewed as either political or regulatory—and could be easily justified on traditional grounds (maximization of long term corporate welfare). This is the context in which many socially conscious investment funds operate, for example.

Id.

democratic accountability, or its functional equivalent (as sovereign shareholders). In that sense, shareholder actions are regulatory. A state translates its political will through its activist activities as a shareholder, either by buying and selling shares or by actively participating in the company governance. Still, viewing sovereign objectives as distinct from private objectives—even if the latter are not entirely commercial in character—inevitably leads to a regulatory crossroads, which is grounded in a fundamental assumption that states can act as private market participants. If the assumption has value, then SWFs would have to forego their own wealth maximizing behavior in favor of some mythological construct. Host states construct this myth, that is, of the reasonable private investor, on the notion that private investment behavior is purely commercial.

In sovereign investing, the crux of the assumptions underlying regulatory policy is that it is possible to neutralize the sovereign element.²⁰⁶ Former Treasury Secretary Lawrence Summers, an American economist now heading the White House National Economic Council for President Barack Obama, echoed these themes:²⁰⁷

The logic of the capitalist system depends on shareholders causing companies to act so as to maximize the value of their shares. It is far from obvious that this will over time be the only motivation of governments as shareholders. They may want to see their national companies compete effectively, or to extract technology or to achieve influence.²⁰⁸

Imagine that a SWF invests in a major bank of a nation that fails. Can anybody in the world assert that, with billions of dollars on the line, the nation's head of state and foreign minister are not going to get involved in the negotiations? Others have echoed this national security concern as well,²⁰⁹

²⁰⁶ See Benjamin A. Templin, *State Entrepreneurism* (Thomas Jefferson Sch. of Law Research Paper Series, Paper No. 1428108, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1428108.

²⁰⁷ See Whitehouse.gov, Lawrence H. Summers, <http://www.whitehouse.gov/administration/eop/nec/chair/> (last visited Jan. 20, 2010).

²⁰⁸ Summers, *supra* note 202.

²⁰⁹ See *Do Sovereign Wealth Funds Make the U.S. Economy Stronger or Pose National Security Risks?: Hearing Before the J. Economic Comm.*, 110th Cong. 1 (2008) (opening statement of Charles E. Schumer, Chairman, J. Economic Comm.), available at <http://jec.senate.gov/archive/Hearings/02.13.08%20SWF/Eizenstat%20JEC%20Testimony.pdf>. Schumer stated:

Because sovereign wealth funds, by definition, are potentially susceptible to noneconomic interests, the closer they come to exercising control and influence, the greater concerns we have. The question of the day is whether these huge pools of investment dollars, known as sovereign wealth funds, make the U.S. economy stronger or pose serious national security risks.

Id.; see also Press Release, U.S. Dep't of the Treasury, Under Secretary for International Affairs David H. McCormick Testimony Before the Senate Committee on Banking, Housing, and Urban

including President Obama during his presidential campaign.²¹⁰ Thus, that fear is grounded both in the idea that SWFs are both the instrumentalities of the states that own them, even if they are operated as separate legal persons, and in the presumption that states act in their regulatory capacity when they engage in investment activities, irrespective of their form and the place of the investment.²¹¹ Others have been more cautious,²¹² sometimes suggesting a heightened application of American regulatory models based on disclosure and transparency, but now aiming at the investing entities.²¹³

Affairs (Sept. 14, 2007), available at <https://ustreas.gov/press/releases/hp681.htm> ("[T]ransactions involving investment by sovereign wealth funds, as with other types of foreign investment, may raise legitimate national security concerns."); Kimmitt, *supra* note 24, at 123.

²¹⁰ See *Obama Says Concerned About Sovereign Wealth Funds*, REUTERS, Feb. 7, 2007, <http://www.reuters.com/article/politicsNews/idUSN0742347120080208>. President Obama stated:

I am concerned if these . . . [SWFs] are motivated by more than just market considerations, and that's obviously a possibility. If they are buying big chunks of financial institutions and their boards of directors influence how credit flows in this country and they may be swayed by political considerations or foreign policy considerations, I think that is . . . a concern.

Id.

²¹¹ See David Cho & Thomas Heath, *Oil and Trade Gains Make Major Investors of Developing Nations*, WASH. POST, Oct. 30, 2007, available at <http://www.washingtonpost/wp-dn/content/article/2007/10/29/AR2007102902130.html>. Securities and Exchange Commission Chairman Christopher Cox:

[The emergence of sovereign funds] challenges us to ask whether these many benefits of markets and private ownership will be threatened if government ownership in the economy . . . becomes more significant. When the regulator and the regulated are one and the same, deference to [SWFs] can all too easily trump vigorous and neutral enforcement. When individuals with government power also possess enormous commercial power and exercise control over large amounts of investable assets, the risk of misuse of those assets, and of their conversion for personal gain, rises markedly. Unchecked, this would be the ultimate insider trading tool.

Id.

²¹² Ron Orol, *Congress Probes Sovereign Wealth Funds*, LAW.COM, Jan. 15, 2008, <http://www.law.com/jsp/article.jsp?id=1200305128255> ("Spokesman for House Financial Services Chairman Barney Frank suggested that 'We are going to look at the big picture of this phenomenon and try to gauge what are the policy implications for these funds in the U.S.'"); see also *A Closer Look at Sovereign Wealth Funds: Secretive, Powerful, Unregulated and Huge*, KNOWLEDGE@WHARTON.COM, Dec. 12, 2007, available at <http://knowledge.wharton.upenn.edu/articlepdf/1868.pdf?CFID=15903878&CFTOKEN=73881071&jsessionid=a830d2f8e760812a2873275a64159241ae7e> (quoting Wharton finance professor Franklin Allen as saying, "I think [the threat of SWFs being used to exert political] pressure is a legitimate worry, but I'm not sure we have seen signs of that yet.").

²¹³ Christopher Rugaber, *Ahead of the Bell: Congress and Foreign Government Funds*, INT'L BUS. TIMES, June 5, 2008, <http://www.ibtimes.com/articles/20080605/ahead-of-the-bell-congress-and-foreign-govt-funds.htm>. As such, there is a basis for permitting sovereigns to invest in the economies of other sovereigns as long as their funds and activities are transparent. *Id.* "Moran said he urged government officials in the region to be more transparent about the funds' operations, which some analysts have said could help alleviate such concerns." *Id.*

There is a certain intuitive appeal to the argument that not all shareholder objectives are equally valid. The argument might be even more appealing when the shareholder is a state. Two important cases from the ancient history of American law provide a good starting point to consider the limits of shareholder interests. *Dodge v. Ford Motor Co.* suggests the limits of director discretion when acting in the name of the entity—looking to institutional welfare maximization for the benefit of its constituent community.²¹⁴ *Gamble v. Queens County Water Co.* suggests similar, though more broadly stated, limits on a shareholder's discretion to exercise her rights as represented by her stake in the entity.²¹⁵ Both essentially point to limitations based on duties of loyalty to the entity. These duties can at times sound like they are extracted from the German constitutional conception of *Bundestreue*.²¹⁶ According to this conception, states cannot act like private investors because that role would require them to maximize welfare, but public welfare maximization has different goals than private welfare maximization. The argument suggests that this conflict is not rooted merely in the implausibility of converging public and private law where entities seek to participate in markets. Instead, the real objective is to privilege a single view of those factors that together constitute appropriate considerations for welfare maximizing behavior by shareholders. For that purpose, the desires of popular sovereigns, expressed through their SWFs, are re-categorized as illegitimate because they seek to maximize welfare for the purpose of asserting their rights as shareholders.

Thus recast, these ideas provide insight into the conception of SWFs that may be emerging from one strand of potentially applicable jurisprudence of the European Union,²¹⁷ which is one I have criticized before.²¹⁸ In the form of

²¹⁴ See *Dodge v. Ford Motor Co.* 170 N.W. 668, 684 (Mich. 1919). When discussing directors' discretion, the court held:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. . . . There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business. . . . The judges are not business experts. It is recognized that plans often must be made for a long future, for expected competition, for a continuing as well as an immediately profitable venture.

Id.

²¹⁵ *Gamble v. Queens County Water Co.*, 25 N.E. 201, 201 (N.Y. 1890).

²¹⁶ See Larry Catá Backer, *Restraining Power from Below: The European's Constitution Text and the Effectiveness of Protection of Member State Power Within the EU Framework* (Fed. Trust Constitutional, Online Paper No. 14/04, 2004), available at http://papers.SSRN.com/5013/papers/cm?abstract_id=581341.

²¹⁷ See Backer, *The Private Law of Public Law*, *supra* note 23, at 1801.

²¹⁸ See *State Subsidies and the Character of the Market Transactions of Sovereigns: The Case of EADS*, <http://lbackerblog.blogspot.com/2008/05/state-subsidies-and-character-of-market.html>, (May 29, 2009, 16:30 EST); see also *Brazil Builds a Sovereign Wealth Fund and Norway Flexes*

the Santiago Principles, of course, this position also suggests the illegitimacy of sovereign welfare maximization as an objective of SWFs.²¹⁹ The consequences are a greater toleration of direct regulation of sovereign investing that projects sovereign economic power into host states. Thus, for example, the French Finance Minister has suggested that SWFs are welcome to invest in France, while the French President suggests that SWFs are in need of substantial control.²²⁰ French President Nicolas Sarkozy explained, "In the face of the increasing power of extremely aggressive speculative funds and sovereign funds which do not obey economic logic France is taking the political and strategic choice to protect its companies, to give them the means to defend and develop themselves."²²¹ He also suggested that domestic corporations could not compete against privately deployed state power.²²²

Similarly, the German leadership suggested a law to regulate SWFs, while the German finance minister tried to lessen the implications of regulation by saying, "[N]obody wants to block investment, that would be crazy."²²³ European Commissioner for Economic and Monetary Policy, Joaquín Almunia, stated, "There are situations that are quite striking when the investor is a sovereign fund, a foreign state. This requires transparency. We need to set out European principles because we can't fulfill the internal market and its roles if each member state has different principles."²²⁴

Yet, political elites are mindful of the importance of inbound investment, especially in hard times. David Lewis, Lord Mayor of the City of London, noted, "We open our arms to hug them. If they wish to conduct acquisitions in London, there will be no problem if the acquisitions are in accordance with

Its Muscles: Private Participation in the Market or Regulation By Other Means, <http://lcbackerblog.blogspot.com/2008/05/brazil-builds-sovereign-wealth-fund-and.html> (May 24, 2008, 18:40 EST).

²¹⁹ See Backer, *Regulatory Chameleons*, *supra* note 75.

²²⁰ Grant Clelland, *Government Split Over Sovereign Wealth Funds*, FIN. NEWS, May 23, 2008, <http://www.efinancialnews.com/privateequity/index/content/2350748411>; Steven R. Weisman, *A Fear of Foreign Investment*, N.Y. TIMES, Aug. 20, 2007, available at <http://www.nytimes.com/2007/08/21/business/worldbusiness/21wealth.html> (quoting German Chancellor Angela Merkel as saying, "How do we actually deal with funds in state hands? This is a phenomenon which until now has not existed on such a scale.").

²²¹ *Sarkozy to Use CDC to Defend French COS Against 'Aggressive' Speculators*, REUTERS, Jan. 8, 2008, <http://www.forbes.com/feeds/afx/2008/01/08/afx4505120.html>.

²²² Clelland, *supra* note 220.

²²³ *Id.*

²²⁴ *EC to Rule on Sovereign Wealth Funds*, TELEGRAPH, Nov. 29, 2007, available at <http://www.telegraph.co.uk/finance/markets/2820342/EC-to-rule-on-sovereign-wealth-funds.html> (last visited Jan. 20, 2010); Weisman, *A Fear of Foreign Investment*, *supra* note 220 (quoting Günter Verheugen, Vice President of the European Commission for Enterprise & Industry, as saying, "[T]he question that must be discussed is how we can defend our strategic interests without violating our most important principles of the freedom of movement of capital in the internal market. I think it is an important issue.").

British supervisory laws.”²²⁵ Germany’s Finance Minister Peer Steinbrueck previously described the German plans to defend domestic firms as modest compared to those of other countries, including Britain, France, and the United States.²²⁶ By the middle of June 2008, Peter Mandelson declared, “A state acting like a business—throwing the resources of government behind a company that competes with others—is a different proposition from a state looking to invest its surplus capital in the most commercially advantageous way.”²²⁷ Mandelson suggests that copying private funds by adopting an appropriately formulated, voluntary code of conduct would provide a mechanism by which such funds might remain above suspicion.²²⁸ Mandelson

²²⁵ Zhou Jiangong, *Chinese Companies Preferring London to New York City*, CHINA STAKES, June 19, 2008, <http://www.chinastakes.com/2008/6/chinese-companies-preferring-london-to-new-york-city.html>; see also *EU in Sovereign Wealth Fund Call*, BBC NEWS, Feb. 27, 2008, <http://news.bbc.co.uk/1/hi/business/7267506.stm>. BBC reports:

Speaking at a joint press conference in Brussels, EU Internal Market Commissioner Charlie McCreevy added that sovereign wealth funds needed to improve their quality of financial information. ‘Let us be brutally frank about this: sovereign wealth funds have been positive and long-term investors. There is, as far as I know, no instance of sovereign wealth funds acting in any manner other than responsibly up until now.’

Id.

²²⁶ “Sovereign Funds Welcome in Germany,” *Finmin Says*, REUTERS INDIA, May 9, 2008, <http://in.reuters.com/article/asiaCompanyAndMarkets/idINL0991456920080509>. Finance Minister Peer Steinbrueck stated:

“Sovereign wealth funds are welcome in Germany,” he said in the text of a speech for delivery in Bonn. “Their commitment contributes to value creation and employment in Germany, and also to stabilisation in times of financial market turbulence, as we are currently experiencing.” Steinbrueck has previously described the German plans to defend domestic firms as modest compared to those of other countries, including Britain, France and the United States.

Id.

²²⁷ Peter Mandelson, *Sovereign Wealth and Politics*, WALL ST. J., June 6, 2008, available at <http://online.wsj.com/article/SB121270281191850007.html>. Mandelson, the EU Trade Commissioner, faulted the sovereign wealth funds for “getting the facts right and the politics wrong.” *Id.* He then raised the usual fear that states cannot resist acting like sovereigns even when they (pretend) to act as private actors in the market: “The possibility that a state might seek to use its investments for political leverage is very slim, but because recipients are not quite sure of the rules of the game, they can’t exclude it entirely.” *Id.*

²²⁸ *Id.* Mandelson suggested:

The smart move from the funds would be to confound the suspicions. If sovereign wealth funds want to manage the politics of their dramatic rise, they should study the experience of the hedge-fund and private-equity industries in Britain. When rising public anxiety about their intentions and business models put them on the defensive, hedge funds and private equity moved quickly to reassure with voluntary codes of conduct. Sovereign wealth funds should do the same.

Id.

appeared willing to accept the proposition that sovereigns might act like, and be treated as, private investors under circumstances involving conformity to OECD or IMF transparency rules. "So long as its capital is invested for no other goal than a good commercial return, a sovereign wealth fund is not different from a pension fund, and its investments are likely to be much longer-term."²²⁹

However, when one moves beyond political actors, the policy context becomes more ambiguous. Western financial managers, for example, are more enthusiastic, emphasizing the participatory aspects of SWF operation. Peter Weinberg, former CEO of Goldman Sachs, explained that:

It is hard to see why these investments have harmed Americans. . . . In each case, the entities receiving the capital decided that the price and terms were superior to what they could secure elsewhere. More important, this is how the markets are supposed to work . . . it is only a matter of time before SWFs are represented on boards of companies in which they invest—and they should be.²³⁰

Weinberg also emphasized the circularity of monetary flows and the SWF's place in the recycling of wealth.²³¹

²²⁹ *Id.*

²³⁰ Peter Weinberg, *Sovereign Funds Offer a Wealth of Benefits*, FIN. TIMES, May 22, 2008, available at <http://www.ft.com/cms/s/0/171c7bf0-280e-11dd-8f1e-000077b07658.html> ("SWFs have invested most actively in the US: approximately \$85bn (€54bn, £43bn) or 0.5 percent of the total value of the US equity market. . . . All shareholders would benefit from a large, important SWF in the boardroom."); see also Megan Davis, *UPDATE 2-Blackstone CEO Says SWF Scrutiny Causing Chills*, REUTERS, Apr. 14, 2008, <http://uk.reuters.com/article/idUKN1437840020080414>. Merrill Lynch, who has especially benefited from an inflow of cash from Singapore's Temasek and Korea's investment fund during the downturn, praised SWFs in a recent press release: "Investors should rejoice in the more balanced global economy and the impetus that SWFs will provide to continued growth and development of global asset markets," said Alex Patelis, head of international economics at Merrill Lynch." Press Release, Merrill Lynch, Merrill Lynch Economists Expect Sovereign Wealth Fund Assets to Quadruple by 2011 (Oct. 12, 2007), available at http://www.ml.com/index.asp?id=7695_7696_8149_74412_82725_83576. It is well known that Citigroup has aggressively sought funding abroad, beginning with a large sale to ADIA in the 1990s, and recently courting the funds of China, Kuwait, and Singapore simultaneously. See Andrew Dash & Andrew Ross Sorkin, *Escalating Losses Force Citigroup to Seek More Foreign Investment*, N.Y. TIMES, Jan. 12, 2008, available at <http://www.nytimes.com/2008/01/12/business/12citi.html>. Dash and Sorkin commented:

If the deal goes through, it would be the second instance in less than two months of Citigroup's being forced to turn to foreign investors to shore up its weakening finances. In November, the company sold a \$7.5 billion stake to a Middle Eastern fund, Abu Dhabi Investment Authority, underscoring its deteriorating capital position.

Id.

The responses to SWFs by private industry reflect the importance of the market participatory aspects of their business. Minimizing the sovereign element, private industry responses also suggest the growing importance of SWFs for the operation of global financial and credit markets. However, it often comes down to threats and hurt feelings. According to Mohamed Al-Jasser, Vice Governor of the Saudi Arabian Monetary Agency, "It's like the SWFs are guilty until proven innocent."²³² In a similar vein, Sultan Ahmed Bin Sulayem, chairman of Dubai World, believes:

If somebody comes with regulations that make it difficult for someone from certain geographical locations to invest in Europe or the west, people will take their investment somewhere else. If you put a politician in charge of an investment, believe me, that investment fund will not last for a very long time.²³³

In addition, the Chinese were skeptical of even a voluntary code of conduct regime.²³⁴ This was a view reflected by other SWF sovereigns as well.²³⁵

²³¹ See Cho & Heath, *supra* note 211; see also Winter Casey, *Opening the Door to Foreign Investment: Sovereign Wealth Funds Enjoy Tax Breaks in the U.S.*, NAT'L J., June 20, 2008, available at http://www.nationaljournal.com/njonline/no_20080620_6012.php. Casey stated:

The [IMF Joint Committee Report] argues that "unencumbered trade in goods and services and cross border investment creates the greatest opportunity for growth both in the United States and abroad," while "policies that impede cross border investment can lead to inefficient decisions and potentially reduce aggregate investment." Putting greater restrictions on SWFs "may be interpreted by other potential investors as an indication that the United States is inhospitable to foreign investors."

Id.

²³² Yoolim Lee & A. Craig Copetas, *Wealth Funds Hear Disclosure Warning in Davos Meeting (Update4)*, BLOOMBERG, Jan. 24, 2008, <http://www.bloomberg.com/apps/news?pid=2060187&sid=aTUOBfzqkOoE&dlbjk>.

²³³ *Dubai Fund Hits Back at Criticism*, BBC NEWS, Feb. 29, 2008, <https://www.news.bbc.co.uk/1/hi/business/7271007.stm>.

²³⁴ See Thomas H. Wilkins, *A Code of Conduct for Sovereign Wealth Funds "Stupid", Says CIC*, CHINA STAKES, Apr. 8, 2008, available at <http://www.chinastakes.com/2008/4/a-code-of-conduct-for-sovereign-wealth-fund-studied-says-cic.html> (commenting that Gao Xiqing, president of the CIC, said a code of conduct for SWF would only "hurt feelings" and "it's stupid").

²³⁵ See Suwaidi *Critical of IMF Attempt to Monitor SWF Investments in West*, BUS. 24/7, May 9, 2008, <http://www.business24-7.ae/articles/2008/5/pages/05092008a08c25c7336442e78cefedaeb74ce408.aspx>. [UAE] Central Bank Governor, Sultan bin Nassir Al Suwaidi, said the IMF lacks sufficient experience in such issues and its involvement following Western pressure could discourage further SWF investment in the United States. Al Suwaidi said at a meeting of the IMF and its Financial Committee in Washington that "[w]e reiterate our misgivings regarding the Fund's involvement in setting best practices for Sovereign Wealth Funds . . . the IMF does not have the requisite expertise in the areas of governance and transparency to take the lead in producing a set of best practices for SWFs." *Id.* The states Al Suwaidi represented included Bahrain, Egypt, Qatar, Jordan, Kuwait, Iraq, Lebanon, Libya, Oman, Syria, and Yemen. *Id.*

It seems clear that the efforts to produce a cultural consensus about outbound sovereign investing remain rooted in uneasiness about the character of the instruments through which such investing is affected. The problem is that in a conventional context, where politics and economics are in separate spheres, SWFs and SOEs appear as wolves in sheep's clothing. If states are inherently regulators, their participation in markets might not merely create unfairness in transactions against private interests, they may also destabilize the markets themselves.

It is clear that these older nostrums about the division of economics and politics, as well as the effects on the construction of laws, are no longer reflective of any reality "on the ground."²³⁶ A subtler analysis suggests that the difference is not behavioral, as states easily mimic the behavior of other legal persons. Rather, the difference is that the motivations, objectives, and value structures of sovereign and non-sovereign investors tend to diverge, as do their respective power, *over* rather than *in*, markets.²³⁷ Just as there is a convergence of public and private law, there is a convergence between law as a formal and institutionalized set of tools over which public entities exercised a monopoly power, and governance as a private, contractual, and informal method of controlling or regulating behavior available to any community with sufficient power to assert it.²³⁸ Law, like the state, might be harder to detect within the globalized institutional environment of soft and hard multilevel and multi-contextual regulation.²³⁹ The real problem remains. It is not a fear of xenophobia that informs the discussion about SWF regulation, as

²³⁶ See Katsuhito Iwai, *Persons, Things and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583, 590 (1999). This results from the mixing of two once-distinct spheres of activity, though it has been foolish to consider them distinct. Just as corporations might consider cross-holdings hostile (except perhaps among certain industries following certain rules in states like Japan), so states might consider hostile attempts by other states to invest in domestic economic enterprises for precisely the same reason. *Id.*

²³⁷ See DAVID A. WESTBROOK, *BETWEEN CITIZEN AND STATE* (2008) (discussing the virtual person as a postmodern actor). Westbrook states that:

As shareholders, both corporate and states each seek to maximize their own welfare (including the values—economic, political, moral, social, religious, etc.) that contributes to that maximization. But corporate shareholders have a more limited range of objectives than states, and states regulate as well as participate in markets in ways that are unavailable to other legal persons or individuals.

Id.

²³⁸ See MICHEL FOUCAULT, *DISCIPLINE AND PUNISH: THE BIRTH OF THE PRISON* (Alan Sheridan trans., Vintage Books 2d ed. 1995) (1977).

²³⁹ See *Democracy Part XI: Mass Democracy and Shareholder Democracy Converge*, <http://lbackerblog.blogspot.com/2008/06/democracy-part-xi-on-perception-of.html> (June 30, 2008, 11:54 EST).

Lawrence Summers suggests.²⁴⁰ Rather, the SWF regulation discussion reveals the need to confront the changing landscape of power and regulation on the supranational plane. The next Part addresses the complexities that arise in sovereign investing as a result of the introduction of multiple instruments and prevailing regulatory shortsightedness.

III. COMPLEXITY AND COORDINATION IN SOVEREIGN INVESTING: THE STATE-OWNED ENTERPRISE AS A SOVEREIGN INVESTMENT VEHICLE

It is clear that SWFs represent a multifaceted nexus point for the convergence of public and private law.²⁴¹ On the one hand, SWFs encompass attempts by states to participate in global markets like private individuals. On the other hand, SWFs may govern by other means. SWFs potentially allow states to convert private markets into public arenas through which they might project political and regulatory power abroad. The projection of sovereign authority through sovereign investing, in both senses, also deepens a long-term trend toward the privatization of regulation and its diffusion within surveillance and monitoring frameworks. In this last sense, sovereign investing contributes to the use of markets as another vector for governance, because of the way that privatization of surveillance and monitoring regimes—emphasizing financial transparency—has increasingly been used.²⁴² As such, there is more to the SWF debate than issues of classification and character. Sovereign investing, as a visible convergence point of public and private power, has the potential to expand politics through economic means. In this way, sovereign investing suggests that the participation of public entities as private participants possibly will subvert the private element of the global economic order.

This Article explains that sovereign investment vehicles embrace a large and protean class of organs, entities, and actions, whose principal point of commonality is the ownership, control, or management by a sovereign.²⁴³ A SWF can serve as the single investment entity, organized as a corporation or similar enterprise under the general law of its sovereign owner,²⁴⁴ or more

²⁴⁰ Summers, *supra* note 202.

²⁴¹ Backer, *The Private Law of Public Law*, *supra* note 23, at 1801.

²⁴² See Larry Catá Backer, *Global Panopticism: States, Corporations and the Governance Effects of Monitoring Regimes*, 15 IND. J. GLOBAL LEGAL STUD. 101, 103 (2008).

²⁴³ See Daniel Drezner, *Sovereign Wealth Funds and the (In)Security of Global Finance*, J. INT'L AFF., Oct. 1, 2008, available at <http://www.allbusiness.com/government/public-policy/11706749-1.html> ("Sovereign wealth funds are simply the latest manifestation of the explosive growth in official assets ranging from currency reserves to state-owned enterprises.").

²⁴⁴ See Qatar Investment Authority, FAQ, <http://www.qia.qa/qia/faq.html> (last visited Jan. 20, 2010). The Qatar Investment Authority (QIA) was incorporated in 2005 as the primary vehicle for strategic and direct investments by the State of Qatar. *Id.*; see also Sovereign Wealth Funds Institute, Qatar, <http://www.swfinstitute.org/fund/qatar.php> (last visited Jan. 20, 2010). According to its constitutive instrument, QIA's objectives are to develop, invest, and manage the

typically, organized pursuant to special legislation.²⁴⁵ A SWF can also serve as the holding company for any number of vertically or horizontally organized sub-funds that affect entities through their actual operations.²⁴⁶

These sovereign wealth enterprises can include any form of economic enterprise, from investment to operating entities.²⁴⁷ Indeed, as conventionally defined, "sovereign wealth funds are not the only vector through which sovereign entities make foreign private investments. Another way through which countries invest in foreign entities is through purchases by state-owned enterprises. . . ." ²⁴⁸ "Additionally, governments can make foreign private investments directly through their existing foreign exchange stocks."²⁴⁹ In their various forms, these investment vehicles operate individually and in tandem with other financial entities to influence the

state reserve funds and other property assigned to it by the Government via the Supreme Council of Economic Affairs and Investments. *Id.*

²⁴⁵ Both the Norwegian and the two Singapore funds were created in this manner. *See, e.g., supra* Part II.B.

²⁴⁶ *See infra* Part V.B (discussing the organization of Chinese sovereign investing through a SWF umbrella).

²⁴⁷ Media Release, KPMG, Sovereign Wealth Funds—The New Global Investors (Oct. 1, 2008), available at <http://www.kpmg.ch/mediareleases/12704.htm> (identifying the China National Offshore Oil Corporation and the Dubai DP World as sovereign wealth enterprises); *see also* Sovereign Wealth Institute, Sovereign Wealth Enterprise, <http://www.swfinstitute.org/research/swe.php> (last visited Jan. 20, 2010). The website states:

A SWF could have a strict investment mandate in place; however, the sovereign wealth enterprise has its own rules. For instance, many public pension funds are unable to short stocks. To get around this they can hire an external manager to manage a portfolio that could have a long-short strategy. A second reason could be transparency. If a sovereign wealth fund has hundreds of sovereign wealth enterprises, it is harder to track their holdings. Lastly, is to avoid being lumped into the same category as a sovereign wealth fund and avoid the public spotlight.

Id. *See also* China National Offshore Oil Corp., <http://www.cnooc.com.cn/yyww/default.shtml> (last visited Jan. 20, 2010).

²⁴⁸ Bryan J. Balin, *Sovereign Wealth Funds: A Critical Analysis*, Johns Hopkins Univ. Sch. of Advanced Int'l Studies 1, 1 (2008), available at [https://jscholarship.library.jhu.edu/bitstream/handle/1774.2/32826/Sovereign Wealth Funds A Critical Analysis 032008.pdf?sequence=3](https://jscholarship.library.jhu.edu/bitstream/handle/1774.2/32826/Sovereign%20Wealth%20Funds%20A%20Critical%20Analysis%20032008.pdf?sequence=3).

²⁴⁹ *Id.* at 2. Balin explains:

Examples of this method [investment through state-owned enterprises] include the attempted acquisition of the Peninsular and Oriental Steam Navigation Company (P&O) by the state-owned Dubai Ports World Corporation, and the purchase of IBM's computing business by the Chinese government-controlled Lenovo Group. . . . [E]xamples [of purchases through foreign exchange stocks include that of] the governments of India, Thailand, and Indonesia [which] have either investigated or implemented plans to diversify their foreign exchange holdings into private fixed income products or liquid international equity securities.

Id.

financial markets. "These new power brokers are here to stay, and they are increasingly venturing into each other's territory. Hedge funds are buying up companies. Asian central banks are starting to replicate the SWFs of oil exporters. Oil exporters are creating more-sophisticated investment vehicles such as private-equity funds."²⁵⁰ It is in this context that the nature of the state-owned enterprise becomes more relevant and interesting.

A. *The SOE as a Sovereign Investment Vehicle*

The assumptions about sovereign investing derived from recent engagement with SWFs also apply to SOEs in some important respects. In many critical ways, SOEs are no longer merely the outward projection of state power in centrally planned economies. That understanding of SOEs was the hallmark of Marxist-Leninist state based economic organizations in the years before the fall of the Soviet Union.²⁵¹ But those sorts of SOEs were substantially abandoned in the 1990s as post-Soviet states rushed to privatize old socialist and Marxist-Leninist SOEs in favor of wholly more privatized economic sectors. Likewise, non-Soviet states with significant public economic sectors also sought to privatize their industries as they adjusted their economies to participate better in implementing the current phase of the project to construct private, global economic markets.²⁵² "Over the last few decades however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have called for readjustment and restructuring of the state-owned sector."²⁵³ Today, state-owned enterprises no longer resemble the remnants of socialist experimentation that marked much of Europe before the 1990s²⁵⁴ and still appears in Latin America and Asia today.²⁵⁵

²⁵⁰ Diana Farrell & Susan Lund, *Power Brokers*, NEWSWEEK INT'L, Oct. 20, 2007, available at <http://www.mckinsey.com/mgi/mginews/powerbrokers.asp>.

²⁵¹ See Bernard Fensterwald, Jr., *Sovereign Immunity and Soviet Trading*, 63 HARV. L. REV. 614 (1950); see also *Sovereign Immunity of States Engaged in Commercial Activities*, 65 COLUM. L. REV. 1086 (1965).

²⁵² On Eastern European privatization, once the focus of a tremendous amount of academic consideration, see, e.g., George Bogdan, *The Economic and Political Logic of Mass Privatization in Czechoslovakia and Poland*, 4 CARDOZO J. INT'L & COMP. L. 43 (1996).

²⁵³ OECD, STATE-OWNED INDUSTRIES, *supra* note 18, at 11.

²⁵⁴ For a discussion of state-owned enterprises in Western Europe, and their critique, see, e.g., Carol M. Rose, *Privatization—The Road to Democracy?*, 50 ST. LOUIS U. L.J. 691 (2006); see also John N. Drobak, *A Comment on Privatization and Democratization*, 50 ST. LOUIS U. L.J. 783 (2006).

²⁵⁵ For a discussion of state-owned enterprises outside of Western Europe, and their critique, see, e.g., Amy L. Chua, *The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries*, 95 COLUM. L. REV. 223 (1995); Lawrence Sáez & Joy Yang, *The Deregulation of State-Owned Enterprises in India and China*, 43 COMP. ECON. STUD. 69, 76 (2001).

The most dynamic development of the SOEs that are being integrated into the modern global economy has been occurring in China since the 1990s.²⁵⁶ Chinese SOEs are sovereign in the sense that their ownership vests, directly or indirectly, in the state. Despite state ownership, direct state oversight of SOEs has been considerably reduced. This reduction in state oversight parallels the development in the organization and operation of SWFs. "Since the 1980s, the Chinese government and the ruling party have followed a policy of *zhengqi fenkai*, which formally separates government functions from business operations."²⁵⁷ State authorities view the distinction as a good means of disciplining the state owned economic sector.²⁵⁸ However, as with SWFs, ownership oversight has not been reduced. The SOEs and SWFs both operate to maximize benefits to their owners. However, where the owner is the state, there is a conflation between "private" welfare maximization and public policy.²⁵⁹ In places like China, that separation must be contextualized within an economic system in which the factors of production are never entirely free of state oversight.²⁶⁰

In fact, the government's pervasiveness in society gives China's state-owned enterprises freer rein to confront these issues than their counterparts in more open societies enjoy:

²⁵⁶ See, e.g., George Steven Swan, *The Political Economy of the Rule of Law in China*, 5 HASTINGS BUS. L.J. 309 (2009); H. Stephen Harris, Jr., *Legal Implications of a Rising China: The Making of an Antitrust Law: The Pending Anti-Monopoly Law of the People's Republic of China*, 7 CHI. J. INT'L L. 169, 173 (2006); Deborah Kay Johns, *Reforming the State-Enterprise Property Relationship in the People's Republic of China: The Corporatization of State-Owned Enterprises*, 16 MICH. J. INT'L L. 911, 923-27 (1995); Xinqiang Sun, *Reform of China's State-Owned Enterprises: A Legal Perspective*, 31 ST. MARY'S L.J. 19, 21 (1999). For a history of the transformation of Chinese SOEs, see, e.g., DONALD HAY ET AL., *ECONOMIC REFORM AND STATE-OWNED ENTERPRISES IN CHINA 1979-87* 5 (1994).

²⁵⁷ Jonathan R Woetzel, *Reassessing China's State-Owned Enterprises*, MCKINSEY Q., July 2008, available at <http://www.mckinsey.it/storage/first/uploadfile/attach/140418/file/retho8/pdf>.

²⁵⁸ For an interesting internal perspective, see, e.g., ZHANG WENKUI, DEV. RESEARCH CTR. OF THE STATE COUNCIL, P.R.C., *THE ROLE OF CHINA'S SECURITIES MARKET IN SOE REFORM AND PRIVATE SECTOR DEVELOPMENT 1* (2002), available at http://www.tcf.or.jp/data/20020307-08_Wengkui_Zhang.pdf.

²⁵⁹ As one commentator recently noted, "Because the central or local government perform[s] contributor's duties, and enjoy[s] the owner's rights and interests in Chinese SOEs, the government's role should never be neglected or underestimated." Catherine (Xiaoying) Zhang, *Business Negotiation Between Westerners and Chinese State-Owned Enterprises*, 42 INT'L L. 1303, 1306 (2008).

²⁶⁰ *Id.* at 1308. Chinese SOEs have much more complicated incentive systems, combined with the government's significant role in Chinese SOEs, as mentioned above. *Id.* at 1305. The motivations of Chinese SOEs' executives in business negotiations are far greater than merely profit-making. *Id.* at 1308. Other factors, such as the overall political environment, compliance with policy guidelines, and even the deal's impact on the executive's personal political career path, will have an inevitable impact on the Chinese SOEs' business negotiations with Western firms. Zhang, *supra* note 259, at 1315-16. Furthermore, these various motivations are generally interlinked. *Id.*

the Communist Party controls both labor and management, eliminating the overt tensions that make public-sector reform difficult elsewhere. Over the past decade, tens of millions of workers have been laid off by state-owned companies striving to become leaner organizations.²⁶¹

Moreover, as SOEs continue to evolve, the issues of governance and reassurance for participation in private markets begin to look substantially like those of SWFs, with transparency being the principal issue.²⁶² In a sense, the issue isn't so much ownership in China, but control. In the case of economic enterprises, control, especially over outbound investment, is still strictly a matter of state policies.²⁶³ When that control relationship spills over borders, then SOEs, like SWFs, begin to blur the boundaries between public and private, and between sovereign and commercial purposes.²⁶⁴

²⁶¹ Woetzel, *supra* note 257, at 2.

²⁶² See *id.* Thus, a recent analysis in the popular business press has rightly suggested that:

As the Chinese economy evolves, it is no longer so easy or desirable to pigeonhole state-owned enterprises. The line between them and private-sector companies has blurred considerably. Over the next five years, as the economy and business climate continue to shift, the ownership structure of state-owned companies will matter much less than the degree of openness they show in their business practices and management—that is, their transparency and receptiveness to new ideas.

Id. at 1.

²⁶³ *Id.* at 2.

As the distinction between a state-owned and private enterprise blurs, the challenges that both face are converging. Chinese companies, in the public or private sector, must gain approval from government officials for cross-border M&A and other global activities. Even the top-tier state-owned companies—those reporting directly to the central government—struggle with many of the same problems confronting their private-sector counterparts as they move beyond China's borders.

Id.

²⁶⁴ See *China Outward FDI Faces Challenges as it Continues to Expand*, OECD INVESTMENT NEWS (OECD (Paris, Fr.), June 2009, available at <http://www.oecd.org/dataoecd/53/24/43143597.pdf>). Specifically, the OECD reports that:

In recent years, several major acquisitions by Chinese MNEs of target companies in developed countries have been discontinued in the face of strong opposition from host country publics, in some cases after having been approved by the authorities. Because these MNEs are often closely held or listed state-owned enterprises (SOEs), concerns have been voiced about acquisitions that might be politically-motivated perhaps even a representing a potential threat to the national security of host countries. Another priority in host countries has been maintaining a level playing field among foreign SOEs and privately owned companies—not least in respect of their access to, and cost of, financing. Much of the public criticism of Chinese-led takeover bids has focused on the perception that the bids were facilitated by subsidized government financing. A key step that Chinese authorities might take to

B. *Differentiating Between SOEs and SWFs*

The distinct but parallel issues of sovereign investing reflected in the constitution and operation of SOEs and SWFs are in turn reflected in recent academic and industry attempts to distinguish between SWFs and SOEs. Such distinctions are for the most part marked by an emphasis on a small group of distinguishing factors. One basis for distinguishing between SWFs and SOEs is the source of their funding. This would suggest that SWFs and SOEs could engage in the same business, but their relationship to their owner and the owner's funding source would be different. For example, Ping Xie of Central Huijin Investment Company Limited²⁶⁵ and Chao Chen of China Investment Corporation,²⁶⁶ suggest that, because of their common state ownership, "SWFs are often confused with government pension funds, monetary authorities and state-owned enterprises."²⁶⁷ This view is shared, in part, by other bank analysts.²⁶⁸ Yet, there is nothing that suggests that this

alleviate such fears is the upgrading of corporate governance standards in SOEs in order to entrench the commercial orientation of these enterprises and strengthen governance mechanisms to raise the credibility of the commercial orientation.

Id. at 7.

²⁶⁵ This entity is a subsidiary of the Chinese SWF, the CIC. *See infra* Part V.C.1.

²⁶⁶ The CIC is the entity through which China engages in SWF activity. *See infra* Part V.B.

²⁶⁷ Ping Xie & Chao Chen, *The Theoretical Logic of Sovereign Wealth Funds* 6 (China Inv. Corp., Working Paper Series, 2009), available at <http://ssrn.com/abstract=1420618>. Xie & Chen explain the organizational references in the following manner:

In terms of legal structures, 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.

Id. They also note differences in organizational form and finding reflecting a functional understanding of differences between these forms of governmental economic activity: "SWF vs. SOE: the former is held by the central government and is funded by Forex reserves and export revenues; the latter is held by the central or local government and is funded by the government grants and corporate profits." *Id.*

²⁶⁸ *See* DEUTSCHE BANK RESEARCH, SWFs AND FOREIGN INVESTMENT POLICIES—AN UPDATE (2008), available at http://www.expeditiondeutschland.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000232851.pdf. In establishing the difference between SWFs and SOEs, an October 2008 research paper by the Deutsche Bank puts in perspective the role of SWFs with respect to SOEs:

SWFs are government-owned investment funds which are commonly funded by the transfer of foreign exchange assets, and which are set up to serve the objectives of a stabilisation fund, a savings fund for future generations, a reserve investment corporation, a development fund, or a contingent pension reserve fund by investing the funds on a long term basis, often overseas.

Id. at 2.

distinction is invariably true, or that funding SOEs from Forex reserves and SWFs from the profits of its activities would necessarily reconstitute either.

Others participating in this debate favor distinguishing between SWFs and SOEs based on organization. For example, some suggest SWFs are asset pools owned by governments and operated to meet national policy objectives, while SOEs are separate legal persons established to engage in commercial activities.²⁶⁹ Yet again, this definition seeks too much. The Chinese SWF is itself constituted as a separate legal personality under generally applicable Chinese corporate law, yet such a constitution does not have the effect of converting the Chinese fund from a SWF to a SOE.²⁷⁰ Moreover, as the Santiago Principles' efforts suggest, governments increasingly see SWFs as grounded in commercial objectives.²⁷¹

What these efforts suggest is that formal distinctions between SOEs and SWFs can mask effective convergences of function. Thus, there is much to commend in the insight that:

[On a] superficial level, the difference between SWFs and SOEs is obvious: It is the same as that between any type of investment fund and any type of company. But in reality the difference is not that obvious, and is to some extent misleading, since there are SOEs that are used as a conduit for their respective state's sovereign wealth, as part either of a longer channel involving a SWF or of a shorter channel

²⁶⁹ See ADRIEN BLUNDELL-WIGNALL & GERT WEHINGER, OPEN CAPITAL MARKETS AND SOVEREIGN WEALTH FUNDS, PENSION FUNDS AND STATE-OWNED ENTERPRISES, 25–26 (2008), available at http://cama.anu.edu.au/Events/swf2008/swf2008_papers/Blundell-Wignall_SWF_paper.pdf. Blundell-Wignall and Wehinger explain the differences between SWFs and SOEs in their text. They define SWFs as “pools of assets owned by governments to achieve broader national objectives—to diversify and improve the return on exchange reserves or oil revenue, to shield the domestic economy from commodity price fluctuations, or unspecified other objectives.” *Id.* at 3. By contrast, they define SOEs as:

[E]ntities (separate from public administration) that have a commercial activity where the government has a controlling interest (full, majority or significant minority) whether listed or not on the stock exchange. The rationale is often industrial/regional policy and/or the supply of public goods (often in utilities and infrastructure—such as energy, transport and telecommunications). . . . SOE's are not pools of investable capital as such, but they may finance investments via their earnings, fiscal appropriations from the government, or from debt markets at a (possibly) distorted low cost of capital. In some sense there is greater scope for financially less-constrained investment, and with strategic objectives very much in mind.

Id.

²⁷⁰ Philippe Gugler & Julien Chaisse, *Sovereign Wealth Funds in the European Union: General Trust Despite Concerns* (Swiss Nat'l Ctr. for Competence in Research, Working Paper No. 2009/4, 2009), available at <http://ssrn.com/abstract=1372014>.

²⁷¹ See SANTIAGO PRINCIPLES, *supra* note 55, at 75.

between the foreign reserve manager and the target company.²⁷²

At the same time, it is clear that at the edges, SWFs and SOEs can be very different vehicles. The difference is tied to function. SWFs are creatures whose ordinary course of business is investment. The SOEs are not necessarily constituted to engage in the ordinary course of investment. Yet, SOEs can invest, and SWFs can acquire controlling interests in operating entities, and thus become, at least indirectly, SOEs.

C. *Investment and Regulatory Consequences: SOEs versus SWFs*

The regulatory issues raised by the activities of SOEs, whose business is not primarily investment like SWFs, nonetheless present issues similar to those of the typical SWF, at least from a functional perspective. Yet, such approaches to SOEs retain potentially significant differences from those affecting SWFs when one adopts a formal or constitutive perspective. From a functional perspective, centered on the state as ultimate owner, there may be little difference between a state-owned hotel corporation purchasing another large hotel corporation with principle offices in Chicago and incorporated in Delaware, and a SWF purchasing a controlling interest in the same firm. In both cases, the target company is controlled by an enterprise whose ultimate owner is a state. In both cases, the state as ultimate shareholder can assert a power of control over the entity that may or may not reflect the sort of values a private shareholder might be expected to assert. Thus, states might be tempted to use their ownership for a political purpose, to maximize their national interests through their ownership of foreign entities, even if those entities suffer financially as a result. For example, if the state-owned hotel corporation of State A wanted to ruin the competing hotel business of State B, it might cause State A Hotel Corp. to purchase State B Hotel Corp. for the purpose of either shutting it down or causing State B to make concessions that would preserve the business of State A hotels, or it might cause State A's SWF to acquire a controlling interest in State B Hotel Corp., and then cause that entity to sell its business to State A Hotel Corp. There are, of course, other ways of achieving the same result.

But this scenario is not necessarily logical, realistic, or unique to public entities. First, unless the target entity is wholly owned, the public shareholder would be subject to suit for breaches of duty or abuse of power by the minority shareholders in many jurisdictions (but not all to be sure). Second, all shareholders seek to maximize their personal interest in their investments. Yet, it stands to reason that a public shareholder would characterize its interests (and the measure of its maximization) on a scale distinct from that of an individual or legal person that is not a state. Third, the sort of predatory behavior suggested by the example is usually actionable

²⁷² Gugler & Chaisse, *supra* note 270, at 6.

under the domestic law of the state where it occurs, whether the ultimate owner is private or a foreign public entity. The evil or disruptive potential of such behavior is only troublesome to the extent that states, as owners of entities that invest in foreign jurisdictions, may evade the local laws of its host state or avoid being treated as any other shareholder.

However, where a state coordinates the outgoing investment activities of multiple SOEs, the effects can be more profound. The SOE coordination can test the integrity of markets and serve as an indirect method of projecting public power through ostensibly private and commercially motivated activity. China, by systemizing and coordinating both direct and indirect sovereign investment overseas, may be heading in this direction.²⁷³ Under this model, the state can maximize the effect of its private sector participation by fracturing its sovereign investment along conventional reserves-driven lines. The SWF and SOEs can invest in various sectors and then influence investment choices.²⁷⁴ These choices would not necessarily be driven by an individual entity's determination of its own profit maximizing choices, but by the aggregate welfare maximization of any SOE to the state. Thus, at least at a general level, determinations of sector investment, of targeting particular host states and the like, could be understood as a political matter.²⁷⁵ Within the framework of the overall policy objectives, individual enterprises would then operate within those policy parameters. Meeting profit maximizing, coordinated, political objectives would then be possible.

²⁷³ See KEN DAVIES, VALE COLUMBIA CTR. ON SUSTAINABLE INT'L INV., WHILE GLOBAL FDI FALLS, CHINA'S OUTWARD FDI DOUBLES, NO. 5 (2009), available at <http://vcc.columbia.edu/documents/DaviesPerspective-Final.pdf>; see also Ken Davies, *On China's Rapid Growth in Outward FDI*, CHINA DAILY, Aug. 3 2008, http://www.chinadaily.com.cn/bizchina/2009-08/03/content_8507784.htm.

China's worries are not unfounded. While there are those who welcome Chinese investment, for example in African countries happy to receive accompanying unconditional aid, there are also widespread suspicions of China's intentions. The predominance of SOEs in China's OFDI has raised fears that such investment may not be governed by normal commercial considerations and may even be an arm of the country's foreign and defense policy.

Id.

²⁷⁴ See *infra* Part V.B.

²⁷⁵ Shai Bernstein et al., *The Investment Strategies of Sovereign Wealth Funds* (Harvard Bus. Sch., Working Paper No. 09-112, 2009), available at <http://www.hbs.edu/research/pdf/09-112.pdf>. They suggest:

It may be that funds investing more heavily in their domestic markets, particularly those with the active involvement of political leaders, are more sensitive to the social needs of the nation. As a result, they might be willing to accept investments which have high social returns but low private ones. Since the social returns are not easily observable to us, it would appear that these funds are investing in industries with lower performance.

Id. at 4.

The state would then serve as the supervisory headquarters of a conglomerate with both significant internal regulatory power and external participatory power.²⁷⁶ These objectives could permeate the system so that, at its point of contact with host states or in foreign markets, the transactions appear substantially private.²⁷⁷ Yet, private enterprises test those limits as well. Large private enterprises also coordinate global operations and take political action to enhance their overall welfare,²⁷⁸ and thus also test the integrity of markets. A functional analysis does raise some of those concerns. Principal among them is that a large corporation may order its operations so that it effectively regulates itself.²⁷⁹

Any enterprise that can disperse its assets among a large enough number of regulatory units will transform the relationship between regulator and enterprise. For the traditional relationship that is both singular and hierarchical, globalization permits the enterprise to treat regulation as another factor in the production of wealth. The enterprise, now in a position to shop for regulatory regimes, or even bargain for domestication within the territory of a regulatory territory, can take advantage of the limitations of the territorial principle to minimize the effects of regulation on enterprise activity. The principle of regulatory hierarchy can then be turned on its head.²⁸⁰

²⁷⁶ See, e.g., Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1346–47 (2008). “In this form, the country is the unit whose value is to be maximized, with a corresponding increase in the role of the national government as a direct participant in and coordinator of the effort.” *Id.* at 1346. For a comparison with traditional mercantilism, at least in the judicial conception, see *Standard Brands v. Smidler*, 151 F.2d 34 (2d Cir. 1945) (Franks, J., concurring). For a popular press account, see, e.g., Robert J. Samuelson, *Mercantilism Is Making a Comeback*, INVESTOR’S BUS. DAILY, Dec. 26, 2007, at A11.

²⁷⁷ See Chen Jialu, *China SOEs Move to Fill African Investment Gap*, CHINA DAILY, June 16, 2009, http://www.chinadaily.com.cn/cndy/2009-06/16/content_8287028.htm. Consider, for example, the lending activities of a bank, controlled by a subsidiary of a state SWF, whose lending and acquisition activities might serve to further overall state objectives, but the transactions—loans, acquisitions of foreign banks, foreign joint ventures—might not appear to have a sovereign element. Even something as simple as determining to which economic sector loans might be targeted (and of what purposes) could reflect both state policy to foster a particular sector, and especially its overseas activities, and provide as conventional basis for wealth maximizing commercial activity. For example, China’s state-owned enterprises are allegedly the largest Chinese players in the African continent by far. *Id.*

²⁷⁸ See Donna E. Arzt & Anna G. Kaminska, *From Soviets to Saddam: Introduction to the Thirtieth Anniversary Symposium*, 30 SYRACUSE J. INT’L L. & COM. 181 (2003); see also PETER MUCHLINSKI, *MULTINATIONAL ENTERPRISES AND THE LAW* (2d ed. 2007).

²⁷⁹ See Larry Catá Backer, *The Autonomous Global Enterprise: On the Role of Organizational Law Beyond Asset Partitioning and Legal Personality*, 41 TULSA L.J. 561 (2006).

²⁸⁰ *Id.* “The ability to commodify regulation makes it at least theoretically possible to construct an economic entity which, through careful planning can take advantage of asset partitioning,

Because they are able to achieve a measure of self-regulation, the largest private enterprises can assert regulatory and political power. There may be little functional difference between a large multinational corporation targeting a small state and a large state operating significant SOEs that target the economic infrastructure of a third country.²⁸¹ Economic activity can have political, regulatory, and economic effects, whether undertaken by public or private concerns. Still, the political effect when states participate in foreign investment as a tool of their political relations with each other is substantially greater than the political effect resulting from interactions between private enterprises, or between private enterprises and states.²⁸²

A state-owned enterprise that is focused on aggressive investment in other entities abroad might pose a similar danger to that of a SWF that projects foreign interests outbound through financial markets.²⁸³ The point is not just that such entities are owned and perhaps managed in the ultimate interests of a state. Rather, it is that such enterprises, if managed well enough, might also be able to evade local control and project their domestic policies into foreign states, sometimes in ways inconsistent with the host state's public policy.²⁸⁴

Consequently, even within a functional orientation, SWFs and SOEs can be distinguished at least at the margins. Most SWFs are investment vehicles. In other words, their object is to invest in more or less liquid markets for

cross holdings, and global dispersion of assets to avoid effective regulation by any one political community." *Id.*

²⁸¹ See Larry Catá Backer, *Multinational Corporations as Objects and Sources of Transnational Regulation*, 14 ILSA J. INT'L & COMP. L. 499 (2008). An excellent example of this is the creation of large and effective systems of transnational governance within an integrated production, distribution and sales system of large multinational enterprises. *Id.* at 507–08. In this case, the multinational enterprise, through systems of contract that now assume a regulatory purpose, can harmonize behavior among its global supply chain as well as within any other segment of its operations. This harmonization occurs below and beyond state regulatory provisions in host countries. See also Larry Catá Backer, *Economic Globalization and the Rise of Efficient Systems of Global Private Law Making: Wal-Mart as Global Legislator*, 39 CONN. L. REV. 1739 (2007); see also Li-Wen Lin, *Legal Transplants Through Private Contracting: Codes of Vendor Conduct in Global Supply Chains As an Example*, 57 AM. J. COMP. L. 711 (2009) (commenting that Lin has recently argued that these private transnational law systems might well leak into the law of host and home states as well, and as such, ought to be an object of comparative law study).

²⁸² That, of course, is the foundational assumption of projects such as the OECD's principles and guidelines for SWFs and SOEs. See *infra* Part IV.B.

²⁸³ Cf. DANIEL H. ROSEN & THILO HANEMANN, PETERSON INST. FOR INT'L ECON., CHINA'S CHANGING OUTBOUND FOREIGN DIRECT INVESTMENT PROFILE: DRIVERS AND POLICY IMPLICATIONS (2009), available at <http://www.iie.com/publications/pb/pb09-14.pdf>.

²⁸⁴ See *Extraterritoriality and Corporate Social Responsibility: Governing Corporations, Governing Developing States*, http://lcbackerblog.blogspot.com/2008_03_01_archive.html (Mar. 27, 2008, 11:47 EST). These interventions can be motivated by the loftiest as well as the basest of motives. The ethics framework of the Norwegian Fund reminds us that economic aggression can occur for the best of all reasons, the attainment of welfare. But the valuation of such measures remains that of the projecting state and not that of the host state or its electorate.

securities, now including equities.²⁸⁵ In contrast, most SOEs are operating enterprises.²⁸⁶ To the extent that both invest in the securities of other enterprises abroad, SWFs and SOEs ought to have functionally identical objectives: to maximize the welfare of the entity or its owners. These objectives are also comparable to those of similarly constituted private actors. Yet, differences at the margin do not produce substantial differences either between SWFs and SOEs, or with similarly constituted private actors. Like private actors, SWFs and SOEs might seek to aggressively insert themselves in the economic life of other states where it would have the effect of enhancing their own financial condition, increasing their market share or reducing competitive pressures, among the usual "reasonable actor" objectives.²⁸⁷ However, such conduct can produce interventions that make host states nervous. This is true especially where the entity is state-owned, both in terms of disguising political intervention through SOE activity and negatively impacting the integrity of private economic markets.²⁸⁸ But generally, while SWFs are in the business of investment, SOEs are not. In that respect, at least, many SWFs can be distinguished from many SOEs.

²⁸⁵ See, e.g., Norway, *Report No. 20*, *supra* note 85; Greene & Yeager, *supra* note 32, at 247.

²⁸⁶ See OECD, OECD Working Group on Privatisation and Corporate Governance of State-Owned Assets, *Occasional Paper: State-Owned Enterprises in China: Reviewing the Evidence*, § 2.1 (Jan. 26, 2009), available at <http://www.oecd.org/dataoecd/14/30/42095493.pdf> [hereinafter OECD, *State-Owned Enterprises in China*] ("The term 'state-owned enterprises' refers to business entities established by central and local governments, and whose supervisory officials are from the government. Most importantly, this definition of 'state-owned enterprises' includes only wholly state-funded firms.").

²⁸⁷ With respect to China, for example, it has been noted that "[t]he 'going-global strategy' means in a practical sense that government supports and encourages globalisation of enterprises, but at a political level, it means that government economic policy takes into account international issues like regional free trade agreements and natural resource development projects abroad, such as funding oil exploration in Africa." *Id.*, § 3.1.

²⁸⁸ Suma Athreye & Sandeep Kapur, *Introduction: The Internationalization of Chinese and Indian Firms—Trends, Motivations and Strategy*, 18 *INDUS. & CORP. CHANGE* 209, 209–21 (2009), available at <http://icc.oxfordjournals.org/cgi/reprint/18/2/209>.

In the Chinese case, state-owned enterprises have been most active abroad, while in India private sector firms have led the drive to internationalization. . . . Consider the growing unease with the entry of large sovereign wealth funds, and the concerns that these are largely instruments of an overbearing Chinese state. Of course, the dominance of state-owned enterprises in Chinese internationalization may be structural: unlike Indian business houses, a poorly developed domestic capital market might imply that state sponsorship is critical for Chinese firms' overseas ventures. But at the same time it creates the perception that these firms are beneficiaries of "unfair state aid," an argument that resonates with old debates about strategic trade policy.

But the emerging regulatory framework for SWFs distinguishes between SOEs and SWFs on formal grounds.²⁸⁹ Because SOEs tend to be defined as distinct from SWFs, their investment activities might not fall within the limitations of the Santiago Principles²⁹⁰ and similar mechanisms, even when their investment activities are functionally the same. Where SWFs invest in or through SOEs that invest abroad, the problem of regulatory irrelevance becomes more acute.²⁹¹

Thus, the SOE presents a unique variant on the SWF. A SOE is not a fund, nor was it created for the purpose of investing in other entities. Nevertheless, it naturally might engage in those activities. A SOE so invests in other entities in the context of maximizing its own business operations rather than as an end in itself (like a SWF). Yet those business operations, as classically understood, are themselves undertaken to maximize the interests of the entity (and its shareholders). If unity exists between shareholder and corporate interests, for example, where the entity's shares are wholly state-owned, then it might be logical to assume that value maximization includes the political value of that enterprise's operations. On the other hand, even if that is the case, at least with respect to its global operations, such an entity (and its state owner) would be liable in host jurisdictions for breaches of duty, abuses of power, looting, and the like in its relationships with its foreign-owned subsidiaries. Consequently, the similarities in result mask significant differences between states as owners of SWFs and states as sole shareholders of operating entities that may also invest in foreign undertakings.

²⁸⁹ Thus, for example, the IWG defined SOEs as distinct from SWFs and thus subject to their own regulation. "Foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, operations of state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals, are not deemed to be Sovereign Wealth Funds." Press Release, Int'l Working Group of Sovereign Wealth Funds, No. 08/06, Santiago Principles (Oct. 11, 2008), *available at* <http://www.iwg-swf.org/pr/swfpr0806.htm>.

²⁹⁰ SANTIAGO PRINCIPLES, *supra* note 55. The Santiago Principles are specifically grounded in the nature of SWFs as engaged in the business of investment:

The principles and practices laid out in the GAPP, along with their explanatory notes, can be expected to guide existing and future SWFs in various aspects of their activities—most importantly investing professionally in accordance with their investment policy objectives—and to help inform any associated legal and institutional reform. As investment institutions, SWFs operate on a good faith basis, and invest on the basis of economic and financial risk and return-related considerations.

Id. at 5. For a discussion, see *supra* Part II.

²⁹¹ This, in essence, is the problem of regulation in the context of the emerging structure of Chinese state investments discussed *infra* Part V.

The SOEs also present their own set of unique regulatory problems. As suggested above, the regulatory approaches of the Santiago Principles²⁹² (and other efforts designed to control enterprises in the business of investing) have little relevance to enterprises that do not engage solely in investing. These enterprises constitute operating units in other industries, but—like their privately owned counterparts—also engage in investment activities or in the development of a global network of operations that are grounded in owning enterprises in a variety of host states.²⁹³ Indeed, the problem of control is different, and the ability to distinguish between the behavior of SOEs and others is much more difficult. The regulatory tools are also cruder. They consist of foreign direct investment regimes and baroque exemptions for SOEs from free movement provisions available to others. Both of these regulations probably do more harm than good.

Alternatively, an SOE version of the Santiago Principles²⁹⁴ of a “reasonable private company investment model” would be difficult to

²⁹² See Posting of Anna Gelpern (Guest Blogger) to Law and Development Blog, Sovereign Self-regulation, <http://lawprofessors.typepad.com/lawdevelopment/2008/09/guest-blogger-a.html> (July 21, 2009); see also DELOITTE, MINDING THE GAPP SOVEREIGN WEALTH, TRANSPARENCY, AND THE “SANTIAGO PRINCIPLES” 2–13 (2008), available at http://www.deloitte.com/dtt/cda/doc/content/dtt_fs_mindtheGAPP_111108.pdf.

²⁹³ Those principles, whether as articulated through the Santiago Principles, those developed by the U.S. Department of the Treasury, the European Union, or the OECD, focus on the investment activities of entities. See SANTIAGO PRINCIPLES, *supra* note 55. The U.S. Department of the Treasury, on behalf of the Committee on Foreign Investment in the United States (“CFIUS”), issued final regulations governing CFIUS on November 14, 2008. Treas. Reg. § 31 C.F.R. Part 800 (2008), available at <http://www.treas.gov/offices/international-affairs/cfius/docs/CFIUS-Final-Regulations-new.pdf>. The regulations implement Section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 § 721 (Sept. 28, 2009). For further guidance on Article 43 on freedom of establishment, see Europa.eu, Internal Market, http://ec.europa.eu/internal_market/services/principles_en.htm (last visited Jan. 20, 2010). For a complete report on special rights or “golden shares,” including rulings by the European Court of Justice, see COMM’N OF THE EUR. CMTYS., COMMISSION STAFF WORKING DOCUMENT: SPECIAL RIGHTS IN PRIVATISED COMPANIES IN THE ENLARGED UNION—A DECADE FULL OF DEVELOPMENTS (2005), available at http://ec.europa.eu/internal_market/capital/docs/privcompanies_en.pdf. For the OECD principles, see OECD, PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 18. Also, for OECD Guidance on Sovereign Wealth Funds, see OECD, INV. COMM. *supra* note 39 (focusing on investment activities). They impose something that is beginning to sound like a manifesto of formally constituted principles of private party investing—though its relationship to the objectives of private parties remains at best untested and at worst irrelevant. *Id.* But these guidelines do not focus on the behaviors of operating entities that are engaged in economic activities that seek to invest in other entities abroad. The motivations for such investments can be quite aggressive and destructive—to obliterate competition, to increase market share, to prevent a competitor from acquiring potentially useful assets, to vertically or horizontally integrate operations—but these are the same objectives that private parties indulge in when ordering their own economic activities. The separation of sovereign objectives from private equivalent objectives would involve the creation of another standard—something like a reasonable operating company investment policies standard. However, there is nothing like that available.

²⁹⁴ According to the Santiago Principles, SOEs are excluded from the definition of a SWF. SANTIAGO PRINCIPLES, *supra* note 55, at 10 n.6 (“These exclude, *inter alia*, foreign currency

articulate and harder to apply with any degree of consistency. Indeed, in the case of SOEs investing abroad, even more so than with SWFs, host states might be tempted to use the difference in ownership to their advantage. Perversely, host states may subject SOEs to regulatory hurdles as a method to manipulate the competitive environment internally. These same regulations would be irregular if the regulating state had sought to distinguish among privately owned firms.

As a consequence, states that act as market participants outside their territories—especially when operating through wholly owned or controlled SOEs—present a unique problem. They are not formally constituted as entities in the business of investment, yet they might make such investments in the course of their economic activities just like virtually every other privately owned enterprise. As suggested above, aggressively operated SOEs functionally can project state power abroad as effectively as a traditional SWF. The regulatory approaches to such enterprises are unlikely to be found in the control mechanics being developed for SWFs.

It would seem that a different framework might better suit the development of regulatory principles.²⁹⁵ On the one hand, such regulations ought to be strengthened so that minority shareholders of foreign subsidiaries can protect their interests against the actions of SOEs and their owners. This would include actions against the state-owners of the SOE and national laws. It would also ensure that SOEs, acting as shareholders of subsidiaries, act solely in the interests of the company they control—at least when they act as corporate directors, or when they exercise shareholder power in self-dealing transactions. On the other hand, the host state might take additional power for itself to intervene in the actions of enterprises over which it has regulatory control. Many corporate statutes confer power to the state to bring an action to dissolve a corporation that exceeds or abuses the authority law confers on it.²⁹⁶ Moreover, law usually grants states a right to administratively dissolve a corporation.²⁹⁷ For a state to have the power to intervene in such subsidiaries, it could broaden its use of corporate dissolution to fit the context of subsidiaries of foreign, state-owned corporations. Such action would be justified if it became clear that those who owned or controlled a domestically chartered enterprise were using it for

reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.”).

²⁹⁵ For an alternative theory based on a participatory-regulatory distinction applied equally to sovereign and private actors, see Backer, *Regulatory Chameleons*, *supra* note 75.

²⁹⁶ REVISED MODEL BUSINESS CORP. ACT, § 14.30 (2005).

²⁹⁷ *Id.* at § 14.20.

purposes other than those for which the enterprise was chartered, for example, "to engage in any lawful business."²⁹⁸

But a difficulty arises where a SWF owns a state enterprise, or better put, when a SWF is organized to include control of sovereign wealth enterprises that include operating companies. When operating companies are part of the controlled enterprises of a SWF, then the differences between the two forms of sovereign investment become more complicated and may merge. In that context, it may not be realistic to assume differences either in purpose or methods. On the other hand, rather than a state entity fixated on maximizing the value of sovereign reserves, a better regulatory model might be a multinational enterprise that controls and invests in a number of operating companies whose interests it buys and sells.

The discussion of the placement of SOEs within or beyond the definition of SWFs highlights the ways that the definitions of SWFs incorporate their own critiques. All suggest the special character of the object (the sovereign investment vehicle) and its deviation from the standard regulatory model (the private investing entity). The difficulties of definition suggest the limited range of utility and the dangers that stem from nonconformity with the standard investment model. The SWFs are a problem because they deviate from the behavior patterns that are associated with, and required of, the instrumentalities of states seeking to protect and invest their reserves as part of their regulatory and sovereign obligations. The SOEs present the dangers of such state activity in a more direct form. As a consequence, the definitions also imply the need for a specific approach to regulatory responses and the character of that response.

IV. THE EXPRESSION OF DISSONANCE IN REGULATORY RESPONSES

The dissonance between the formal and functionalist approaches to sovereign investing, in both definition and policy debates, mirrors the current and proposed regulatory approaches to regulating these entities. Regulatory dissonance is particularly acute in states where sovereign investing activities are directed; these states have tended to adopt a wary openness in constructing regulatory frameworks.

A. *National Approaches to Regulatory Reform*

This Part addresses the efforts of developed states to reform the way they regulate SWFs. The SWF activity sparked conceptual ambiguities and policy debates during the 2008 global financial crisis that started in 2007. The 2008 financial crisis magnified the institutional problems that SWFs have in systems of global investment. On the one hand, SWFs are a critical factor in

²⁹⁸ *Id.*

the recovery from the global economic downturns of 2008.²⁹⁹ On the other hand, SWFs might pose a threat to the integrity of global markets because SWFs do not play by the same rules as private investors or in traditionally constructed markets.³⁰⁰ In the face of these fears and desires, national governments have begun to pursue reforming their rules for inbound investments. Reforms seek to target SWFs without cutting off the flow of funds into national private markets. This is a tall order, one that has produced loud but essentially anemic responses. Much of the reforms have tinkered with current legislative approaches. The efforts in the United States, Germany, and France are offered as typical examples of the legislative responses of developed states.

1. The United States, Canada, and Australia

“Existing U.S. policies are designed to prevent foreign investors—including sovereign investors—from buying assets that would jeopardize U.S. national security. These policies do not address the full range of issues raised by the development of SWFs and growing external investment of state firms.”³⁰¹ The Committee on Foreign Investment in the United States (“CFIUS”)³⁰² has been reviewing foreign investments for U.S. national security purposes since President Ford established it in 1975.³⁰³ It was

²⁹⁹ Rose, *supra* note 24, at 83–93 (“SWFs are generally considered to be stable investors by the U.S. Department of the Treasury. Investment stability has been especially prized in the volatile period associated with the subprime crisis which saw numerous investments by SWFs in U.S. financial firms.”).

³⁰⁰ Jim Heskett, *What Is the Future of State Capitalism?*, HARV. BUS. SCH.—WORKING KNOWLEDGE, May 2, 2008, <http://hbswk.hbs.edu/item/5928.html>.

³⁰¹ BRAD W. SETSER, CFR, CTR. FOR GEOECONOMIC STUDIES, SOVEREIGN WEALTH AND SOVEREIGN POWER 40 (2008), available at <http://www.cfr.org/publication/17074>; see also Chris Lalonde, *Dubai or Not Dubai?: A Review of Foreign Investment and Acquisition Laws in the U.S. and Canada*, 41 VAND. J. INT’L L. 475 (2008); see also U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-09-608, SOVEREIGN WEALTH FUNDS: LAWS LIMITING FOREIGN INVESTMENT AFFECT CERTAIN U.S. ASSETS AND AGENCIES HAVE VARIOUS ENFORCEMENT PROCESSES (2009), available at <http://www.gao.gov/new.items/d09608.pdf> [hereinafter GAO COMM. REPORT].

³⁰² “The [CFIUS] is an interagency committee in the U.S. federal government which reviews inward foreign investment policy and specific foreign investment transactions which have national security implications. Chaired by the representative of the Secretary of the Treasury, CFIUS was established by executive order in 1975.” Thomas R. Howell, et al., *China’s New Anti-Monopoly Law: A Perspective from the United States*, 18 PAC. RIM L. & POL’Y J. 53, 91 n.193 (2009) (citing Exec. Order No. 11,858(b), 40 Fed. Reg. 20,263 (May 7, 1975)).

³⁰³ Many firms published at length about the CFIUS process (e.g., Skadden, WilmerHale) on their websites following the Dubai Ports controversy in light of the CFIUS’s more publicly scrutinized role involving a potential M&A. See John B. Reynold III et al., *CFIUS Reform Legislation Signed Into Law*, WILEY REIN LLP, Aug. 3, 2007, http://www.wileyrein.com/publication.cfm?publication_id=13209.

originally the executive branch's sole province and was not subject to congressional review.³⁰⁴

After Dubai Ports World³⁰⁵ purchased it, British P&O sought to acquire contracts to operate many U.S. ports. This caused a political scandal when it was suggested that such a change in management would put U.S. ports under the indirect control of foreign states potentially hostile to the interests of the United States. The Foreign Investment and National Security Act ("FINSA") was enacted in 2007³⁰⁶ in response to the efforts of Dubai Ports World. Congress' intent was clear enough,³⁰⁷ codifying existing administrative practices and creating additional CFIUS processes.³⁰⁸ Specifically, FINSA reconstitutes the multi-agency CFIUS, composed of the

³⁰⁴ George Stephanov Georgiev, *The Reformed CFIUS Regulatory Framework: Mediating Between Continued Openness to Foreign Investment and National Security*, 25 YALE J. ON REG. 125, 126–27 (2008). Georgiev wrote:

[T]he Department of the Treasury originally tasked CFIUS with monitoring the impact of inbound foreign investment and coordinating U.S. investment policy. The President's power to act in this domain was formalized by the International Investment Survey Act of 1976. In the 1980s, mounting concerns over the acquisition of U.S. firms by Japanese and British investors prompted Congress to introduce a system of formal review of these transactions through the Exon-Florio Amendment to the Defense Production Act of 1950. The Amendment authorized the President to investigate the effect of foreign acquisitions on U.S. national security and, acting based on "credible evidence," to suspend or prohibit acquisitions that might threaten national security. Prior to the Amendment, foreign acquisitions could be blocked only if the President declared a national emergency or regulators found a violation of federal antitrust, environmental, or securities laws.

Id.

³⁰⁵ See Sovereign Wealth Fund Inst., Dubai Ports World, <http://www.swfinstitute.org/fund/dubaiworld.php> (last visited Jan. 20, 2010). Dubai Ports World describes itself as "one of the largest marine terminal operators in the world with 49 marine terminals and 12 new developments across 31 countries [as of March 2009]." *Id.* "DP World's hallmark is [its] unique 'integrated port management' model, which brings together container terminals, other cargoes, free zones, infrastructure developments and consultancy services." *Id.* Also, "In 2008, DP World handled more than 46.8 million TEU across its portfolio from the Americas to Asia—an increase of 8% on 2007." *Id.* With a pipeline of expansion and development projects in key growth markets, including India, China and the Middle East, capacity is expected to rise to around 95 million TEU over the next ten years. *Id.*

³⁰⁶ Foreign Investment and National Security Act (FINSA) of 2007, Pub. L. No. 110-49, 121 Stat. 246 (2007) (codified at 50 U.S.C. app. § 2170).

³⁰⁷ Press Release, Rep. John D. Dingell, Chairman, Comm. on Energy and Commerce, House Passes Foreign Investment and National Security Act (July 11, 2007), available at http://energycommerce.house.gov/Press_110/110nr47.shtml ("This is good legislation that will contribute to the improvement of CFIUS. . . . Our nation must remain ever vigilant of its own security as we work to achieve a free and fair flow of capital and trade in the global economy.").

³⁰⁸ The more significant changes included: 1) requiring more stringent investigations for cases involving state-owned transactions that would normally be completed before the ordinary 45-day review window; 2) expanding the factors required to be considered when reviewing transactions; and 3) strict Congressional oversight. FINSA §§ 1–12.

Secretaries of the Treasury, Commerce, Defense, State, Energy, Labor, Homeland Security, and National Intelligence, the Attorney General, and heads of other executive agencies that the President deems appropriate.³⁰⁹ It requires the President, acting through CFIUS, to review all covered transactions to determine the potential effects that the transaction would have on national security.³¹⁰ Covered transactions include any merger, acquisition, or take-over proposed or pending after August 23, 1988, by or with any foreign person, which could result in foreign control of any person engaged in interstate commerce in the United States.³¹¹ The FINSA requires CFIUS to conduct an investigation of the transaction's effect. If the transaction is foreign government-controlled, threatens to impair national security, or results in the control of a critical piece of U.S. infrastructure by a foreign person.³¹² The investigation must be completed within forty-five days of initiation, and submitted to Congress.³¹³ The FINSA vests in CFIUS the power to negotiate, enter into, impose, and enforce any agreement or condition with any party to the covered transaction in order to mitigate any resulting threat to U.S. national security that arises as a result of the covered transaction.³¹⁴ Lastly, it requires the President to determine within fifteen days a course of action regarding a covered transaction.³¹⁵

Moreover, under the amendments to the Defense Production Act, the President can exercise authority under section 721 of the Exon-Florio provisions to block a foreign acquisition of a U.S. corporation.³¹⁶ The President may examine the authority if he finds credible evidence that the foreign entity exercising control might take action that threatens national security and the provisions of law, other than the International Emergency Economic Powers Act, do not provide adequate and appropriate authority to protect the national security.³¹⁷

³⁰⁹ *Id.* § 3.

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.*

³¹³ FINSA § 2.

³¹⁴ *Id.* § 5.

³¹⁵ *Id.* § 6.

³¹⁶ See Defense Production Act, Pub. L. No. 110-49, § 721(a)(3), 121 Stat. 246 (2007) (to be codified at 50 U.S.C. app. § 2170); Christopher M. Weimer, *Foreign Direct Investment and National Security Post FINSA 2007*, 87 TEX. L. REV. 663 (2009); Press Release, U.S. Dep't of the Treasury, Office of Inv. Sec., The Committee on Foreign Investment in the United States (CFIUS) (Feb. 20, 2009), available at <http://www.ustreas.gov/offices/international-affairs/cfius/>. The Exon-Florio provision has been in place for many years; it is important because it details the President's authority which, although it might not be new to the 2007 Act, is relevant. *Id.*

³¹⁷ Defense Production Act, Pub. L. No. 110-49, § 721(a)(3), 121 Stat. 246 (2007) (to be codified at 50 U.S.C. app. § 2170). Some have suggested that greater scrutiny may be necessary under the Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1-3 (as amended). See Palmina M.

Also under review is sovereign tax immunity and its extension to SWFs.³¹⁸ Beyond BHC provisions,³¹⁹ the IRS treats sovereign governments differently with respect to immunity.³²⁰ In section 892(a)(1) of the Internal Revenue Code, the income of foreign governments received from stocks, bonds, or other domestic securities are exempt from taxation.³²¹ However, there is an exception made in (a)(2) that the immunity does not apply to any income derived from commercial activity.³²²

In 2008, Senator Max Baucus, then chairman of the Committee on Finance, and Senator Charles Grassley, then the top-ranking Republican member, requested "the non-partisan Joint Committee on Taxation to describe and analyze the history, current rules, and policy underpinnings of the U.S. tax rules applicable to U.S. investment by foreign governments, including investments made by [SWFs]"³²³

The U.S. has long exempted passive investment income of foreign governments on sovereign immunity grounds. . . . Income from commercial activities is not exempt, however, because such an exemption would grant a competitive advantage over non-governmental market participants. . . . In light of the rapid increase in the size and number of SWFs,

Fava & Timothy Birnbaum, *The Financial Crisis May Trigger Increased FCPA Scrutiny*, MARTINDALE.COM, Nov. 18, 2009, available at http://www.martindale.com/banking-financial-services/article_DLA-Piper_565518.htm ("The basis for increased liability . . . is what the SEC and DOJ define as 'quid pro quo' arrangements. A transaction may be vulnerable to FCPA enforcement if a business accepts SWF funding with the sole intent of achieving new business opportunities in the SWF's home nation.").

³¹⁸ See Melone, *supra* note 30, at 143.

³¹⁹ *SWF Hearing*, *supra* note 90. The hearing concluded that:

The effect of the Board's long-standing interpretation is that a sovereign wealth fund that seeks to make an investment in a U.S. bank or bank holding company that exceeds the thresholds in the BHC Act would be required to obtain Board approval prior to making the investment and would become subject to the other provisions of the BHC Act, but its parent foreign government would not. . . . As a general matter, the same statutory and regulatory thresholds for review by the federal banking agencies apply to investments by sovereign wealth funds as apply to investments by other domestic and foreign investors in U.S. banks and bank holding companies.

Id.

³²⁰ See Melone, *supra* note 30.

³²¹ I.R.C. § 61(a)(1)(1986), available at <http://www.fourmilab.ch/ustax/www/t26-A-1-N-II-D-892.html>.

³²² *Id.* § 61 (a)(2). The sovereigns' taxed income will be treated as if they are a corporation of their state. *Id.*

³²³ Press Release, U.S. Senate Comm. on Fin., Baucus-Grassley Letter to the Joint Comm. on Taxation, (Mar. 13, 2008), available at <http://finance.senate.gov/press/Gpress/2008/prg031308.pdf>.

their U.S. investments, and their expected continued growth, it is appropriate to examine the tax regime applicable to their U.S. investments and its policy underpinnings.³²⁴

The object is to ensure that the SWFs competing directly with the private sector do so without an unfair tax-exemption advantage.³²⁵ Although the agreement is only between the U.S. Treasury Department, Abu Dhabi, GIC, and Singapore, it is no doubt a model that the Treasury Department would like to see all others following.³²⁶

Canada and Australia follow a similar regulatory pattern. A review of both suggests that sovereign investing—other than the traditional investment in government securities—is subject to review for its effects on the ability of the state to control the economic sector. The object is to avoid control by another political entity where the sovereign character of the investment cannot be separated from its commercial element. In Canada, control of inbound investment is regulated through the Investment Canada Act.³²⁷ “It is the policy of the Government of Canada to ensure that the governance and commercial orientation of SOEs are considered in determining whether reviewable acquisitions of control in Canada by the SOE are of net benefit to Canada.”³²⁸ The framework is based on the effect of these transactions on Canada.³²⁹

³²⁴ *Id.*

³²⁵ See Treasury Reaches Agreement, *supra* note 52 (“The agreement set out both principles for SWFs and for countries receiving SWF investment.”); see also Industry Canada, *Investment Canada Act*, INV. CAN., July 17, 2009, <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html>. Section 38 of the ICA provides that “[t]he Minister may issue and publish, in such manner as the Minister deems appropriate, guidelines and interpretation notes with respect to the application and administration of any provision of this Act or the regulations.” Investment Canada Act, R.S.C., § 38.

³²⁶ See Treasury Reaches Agreement, *supra* note 52.

³²⁷ See Investment Canada Act, R.S.C., ch. 20 (1985), available at http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00071.html.

³²⁸ Industry Canada, *Investment Canada Act Guidelines—Investment By State-Owned Enterprises—Net Benefit Assessment*, http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00054.html (last visited Jan. 20, 2010).

³²⁹ SHULI RODA ET AL., OSLER, SOVEREIGN WEALTH FUNDS TO THE RESCUE (2008), available at <http://www.osler.com/resources.aspx?id=16450>. Roda et al. stated:

In response to a number of proposed transactions (including three significant energy sector acquisitions—Northrock Resources Ltd., PrimeWest Energy Trust and the assets of Pioneer Canada Ltd.) by the Abu Dhabi National Energy Company PJSC (TAQA), a company that is majority owned by the Abu Dhabi government, Canada introduced new guidelines (the SOE Guidelines) under the *Investment Canada Act* to address proposed investments in Canada by SWFs (referred to in the Guidelines as “state-owned enterprises”).

Id.

Under the Investment Canada Act, certain investments by foreign entities (whether SWFs or not) resulting in the acquisition of control of a business in Canada are subject to review and ministerial approval if the value of those investments meets or exceeds certain financial thresholds. If a transaction is reviewable, the Federal Minister of Industry (the Minister) must determine whether completion of the transaction will result in a "net benefit to Canada."³³⁰

The review is open-ended, though the focus is on both control and the misuse of foreign acquired assets for noncommercial purposes.³³¹ Similarly, in Australia the focus is on the internal effects of inbound investment.³³² Australia is more focused on the sovereign character of the actor,³³³ but its

³³⁰ See *id.* "The SOE Guidelines prescribe a set of specific criteria that the Minister will apply when assessing whether a reviewable investment by a SWF satisfies the net benefit to Canada test." *Id.* These include "additional scrutiny of their governance structure and commercial orientation in determining whether their investments meet the 'net benefit to Canada' test, and undertakings may be sought as a condition of obtaining approval." *Id.*

³³¹ See Industry Canada, *Investment Canada Act*, *supra* note 328. In addition to the general factors set forth in ICA, Section 20:

[The] Minister will assess whether a Canadian business to be acquired by a non-Canadian that is an SOE will continue to have the ability to operate on a commercial basis regarding: where to export; where to process; the participation of Canadians in its operations in Canada and elsewhere; support of on-going innovation, research and development; and the appropriate level of capital expenditures to maintain the Canadian business in a globally competitive position.

Id.

³³² See Press Release, Treasurer of the Commonwealth of Aust., No. 009, Government Improves Transparency of Foreign Investment Screening Process (Feb. 17, 2009), *available at* <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=003&min=wm&Year=&DocType>. The Treasurer states:

To ensure they are consistent with Australia's national interest, the FIRB examines whether proposed foreign investments may have any adverse implications for Australia's national security or economic development and ensures they are consistent with any specific foreign investment legislation in areas such as transport and telecommunications. It also examines whether proposals have implications for other Government policies, competition and the operations of Australian businesses. If the Treasurer forms a view that a foreign investment would be inconsistent with Australia's national interest, it may be blocked or made subject to conditions to address any problems that have been identified.

Id.

³³³ *Id.* ("The principles set out the main factors that are considered in determining, on a case-by-case basis, whether particular investments by foreign governments and their agencies are consistent with Australia's national interest.").

review framework is applicable to all inbound investment.³³⁴ In both cases, the form of the investment may make less of a difference than the sovereign character of the owner or director of the enterprise and the nature of the relationship between the political and commercial sectors of the investing government.

The fact that these investors are owned or controlled by a foreign government raises additional factors that must also be examined. This reflects the fact that investors with links to foreign governments may not operate solely in accordance with normal commercial considerations and may instead pursue broader political or strategic objectives that could be contrary to Australia's national interest.³³⁵

For this purpose, the government considers six factors.³³⁶ The effect of the Australian Guidelines, in contrast to those of Canada or even those of the

³³⁴ *Id.* ("Proposed investments by foreign governments and their agencies (e.g. state-owned enterprises and [SWFs]) are assessed on the same basis as private sector proposals. National interest implications are determined on a case-by-case basis.").

³³⁵ *Id.*

³³⁶ Swan, *supra* note 256. These factors include the independence of the investor's operations from the relevant foreign government.

1. An investor's operations are independent from the relevant foreign government.
In considering issues relating to independence, the Government will focus on the extent to which the prospective foreign investor operates at arm's length from the relevant government.
It also considers whether the prospective investor's governance arrangements could facilitate actual or potential control by a foreign government (including through the investor's funding arrangements).
Where the investor has been partly privatised, the Government would consider the size and composition of any non-government interests, including any restrictions on governance rights.
2. An investor is subject to and adheres to the law and observes common standards of business behaviour.
To this end, the Government considers the extent to which the investor has clear commercial objectives and has been subject to adequate and transparent regulation and supervision in other jurisdictions.
The Government will examine the corporate governance practices of foreign government investors. In the case of a SWF, the Government would also consider the fund's investment policy and how it proposes to exercise voting power in relation to Australian companies.
Proposals by foreign government owned or controlled investors that operate on a transparent and commercial basis are less likely to raise additional national interest concerns than proposals from those that do not.
3. An investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned.

United States, is to permit the government some latitude in enforcing, though only in a cumbersome case-by-case basis, the formally public but functionally private model. This model forms the basis of efforts like the Santiago Principles, but extends its reach to all sovereign investing. In 2009, under the pressure of criticism, the Australian government modified its rules to reduce the sorts of investment subject to review.³³⁷

2. Europe

Europeans adopted a variation on the approaches thus far considered.³³⁸ Germany, for example, sought to follow the American lead by considering a

These issues are also examined by the Australian Competition and Consumer Commission in accordance with Australia's competition policy regime.

4. An investment may impact on Australian Government revenue or other policies.
For example, investments by foreign government entities must be taxed on the same basis as operations by other commercial entities. They must also be consistent with the Government's objectives in relation to matters such as the environment.
5. An investment may impact on Australia's national security.
The Government would consider the extent to which investments might affect Australia's ability to protect its strategic and security interests.
6. An investment may impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community.
The Government would consider any plans by an acquiring entity to restructure an Australian business following its acquisition. Key interests would include impacts on imports, exports, local processing of materials, research and development and industrial relations.
The Government would also consider the extent of Australian participation in ownership, control and management of an enterprise that would remain after a foreign investment, including the interests of employees, creditors and other stakeholders.

Id.

³³⁷ See Mark Bendeich et al., *Australia to Ease Investment Rules*, REUTERS U.K., Aug. 4, 2009, available at <http://uk.reuters.com/article/idUKTRE5726D620090803?sp=true>. On August 4, 2009, Australian Treasurer Wayne Swan announced:

[T]he rules would be changed effectively fast track investments by allowing more of them to go ahead without notification to the Foreign Investment Review Board. Even though most inbound investments are approved, investment experts argue that Australia's 34 year old foreign investment regime remains murky and can turn off investors.

Id. This was especially troublesome as Chinese investors "mainly state-owned forms, announced more than \$12 billion in investment in Australia in the first five months of 2009." *Id.*

³³⁸ A useful review of the approaches of influential EU Member State legal regimes was published by Gulf Research Center. See GULF RESEARCH CTR., A COMMON EUROPEAN APPROACH TO SOVEREIGN WEALTH FUNDS—CONTINUITY OF THE STATUS QUO? (2008), available at http://www.grc.ae/index.php?frm_action=view_newsletter_web&sec_code=grcanalysis&frm_module=co

form of the CFIUS framework. The form of the activity was a proposed amendment to the Foreign Trade Act of 1961.³³⁹ The German government proposed the amendment in November 2007,³⁴⁰ with a formal copy presented in June 2008.³⁴¹ German officials compare the new legislation to a minimalist version of the CFIUS,³⁴² although they were quick to point out their proposal is less restrictive than others of its kind.³⁴³

The object of screening on a case-by-case basis is to permit German authorities to block certain acquisitions of 25 percent or more of voting power of German companies by foreign (non-EU) investors. Blocking is limited to those acquisitions that may be classified as a threat to the public order or national security, as defined by regulations of the European Union and the rulings of the European Court of Justice, and if action is taken within only three months of the acquisition.³⁴⁴

Legislative activity in France has been more aggressive. In 2005, France created a new Foreign Direct Investment ("FDI") law granting review of any attempt to purchase a controlling interest in a sector they deem essential to public policy.³⁴⁵ France created a law allowing review of attempted purchases in certain sectors that could affect public policy.³⁴⁶ The decree provided that any investment that grants control of a firm, surpasses the 33 percent

ntents&show_web_list_link=1&int_content_id=48413 (presenting a useful review of the approaches of influential EU Member State legal regimes).

³³⁹ See NORTON ROSE, GERMANY: AMENDMENT OF FOREIGN TRADE AND PAYMENTS ACT (2009), available at <http://www.nortonrose.com/knowledge/publications/2009/pub20058.aspx?lang=en-gb>.

³⁴⁰ Nermina Biberovic, *SWFs: Common European Approach Need of the Hour*, ARAB NEWS, Apr. 25, 2008, available at <http://www.arabnews.com/?page=6§ion=0&article=109283&d=25&m=4&y=2008>.

³⁴¹ *Germany Finalises Draft Law on Sovereign Wealth Funds: Report*, AFP, June 2, 2008, <http://afp.google.com/article/ALeqM5hMo5wPxBXB3m4QhrnDKz4nxjUWRw>.

³⁴² Bertrand Benoit et al., *Germany Plans for Own CFIUS Deal Watchdog*, FIN. TIMES, Sept. 27, 2007, available at http://www.ft.com/cms/s/0/48128c56-6c82-11dc-a0cf-0000779fd2ac.html?ncllick_check=1.

³⁴³ *Sovereign Funds Welcome in Germany, FinMin Says*, REUTERS, May 9, 2008, <http://www.reuters.com/article/hedgefundsNews/idUSZWE96121220080509>.

³⁴⁴ Biberovic, *supra* note 340 ("It is noteworthy, that Germany—unlike several other European countries—does not name particular industries as sensitive to national security considerations, but reserves its right to decide on a case by case basis whether an enterprise is of 'strategic relevance.'").

³⁴⁵ Press Release, Europa, Free Movement of Capital: Commission Scrutinises French Law Establishing Authorisation Procedure for Foreign Investments in Certain Sectors (Apr. 4, 2006), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/438&format=HTML&aged=0&language=EN&guiLanguage=en> [hereinafter Free Movement].

³⁴⁶ American Chamber of Commerce in Fr., *The French Investment Climate*, <http://www.amchamfrance.org/theme1.php?idcontenu=107&idpage=15> (last visited Jan. 20, 2010) [hereinafter *The French Investment Climate*].

threshold, or involves any part of any branch of any firm that has established headquarters in France, is subject to government review.³⁴⁷

However, the European Union objected on the perfectly reasonable grounds that the French action went too far in its attempt to protect the national territory from the other free member states' inbound flow of investments.³⁴⁸ Instead, the European Union has shifted its regulatory focus to the voluntary and guidelines-based efforts of other supranational entities, among them the OECD and the IMF.³⁴⁹ As a consequence of France's actions, other EU Members tend to limit their control of inbound sovereign investment, and instead ground their restrictions on national security exceptions.³⁵⁰

Despite this consequence, the French administration continues to call for heightened regulatory protection against inbound investment directly or indirectly controlled by foreign sovereigns.³⁵¹ On the eve of the acknowledgement of the financial crisis, for example, President Sarkozy announced he would like state-owned banks to protect French companies from aggressive SWFs.³⁵² France, in line with the restrictions of the

³⁴⁷ *Id.*

³⁴⁸ See Free Movement, *supra* note 345. The press release stated:

Although objectives of public policy, public security and national defence may require measures that restrict the fundamental freedoms established by the EC Treaty, the Commission is concerned that the authorisation procedure detailed in the French decree lacks the required proportionality with regard to these objectives. . . . France is also asked to justify that the procedure would not go beyond what is necessary to the extent that foreign investment operations might not necessarily induce the risks that motivate the requirement for authorisation.

Id. For a discussion of the principles and regulations involved see Backer, *The Private Law of Public Law*, *supra* note 23, at 1801.

³⁴⁹ For a discussion of the shift in the approach of the EU, see *Common European Approach*, *supra* note 48, at 9.

³⁵⁰ Spain is a recent example. See Fernando De Las Cuevas, *Spain: Corporate Acquisitions and Mergers in Spain*, MONDAQ.COM, Feb. 19, 2008, <http://www.mondaq.com.au/article.asp?articleid=57460>. A recent decree, Royal Decree 664/1999, modifies existing rules by deregulating practically all FDI transactions, eliminating "prior verification," and aligning Spanish FDI law with the Treaty on the European Union. *Id.* As is consistent with other EU nations (for example, Germany and France, mentioned previously), Spain does have sectors that it protects from FDI. *Id.*

³⁵¹ Sarkozy has called for state-owned bank Caisse des Depots et Consignations ("CDC") to protect local industry. *Sarkozy Says Strategic Fund to Start in Coming Weeks*, REUTERS.UK, Oct. 30, 2008, <http://uk.reuters.com/article/idUKTRE49T7N120081030?sp=true><http://uk.reuters.com/article/idUKTRE49T7N120081030?sp=true>.

³⁵² *Sarkozy to Use CDC to Defend French Cos Against 'Aggressive' Speculators*, FORBES, Jan. 8, 2008, available at <http://www.forbes.com/afxnewslimited/feeds/afx/2008/01/08/afx4505120.html>.

regulatory structure of the EU, specifies a number of protected sectors of the economy.³⁵³

As a consequence, much effort has been expended on measures to control the investment strategies of SWFs, understood as another arm of national policy and a possible source of indirect protections of national power abroad, along with other forms of sovereign investment in the private sector. These efforts have been undertaken to avoid affecting the level of such inbound investment available to states that are desperately hungry for the funds.³⁵⁴ Ironically, at least one country, France, has suggested that it might use its own SWF as a sort of state asset pool geared at protecting local businesses from acquisition by foreign-owned SWFs.³⁵⁵

B. *Proposed Non-National Approaches to Regulatory Reform*

The reforms generated since 2005 share a common conceptual basis, similar to something like a reasonable investor policy. Essentially, the governance efforts followed this logical sequence: (1) states are different from private actors; (2) SWFs are creatures of the states that own and fund them; (3) when SWFs invest in private markets they are acting for states, and as a result they cannot be making decisions in the same way as a private owner

³⁵³ The French Investment Climate, *supra* note 346. In France, protected sectors included:

Gambling activities (e.g., casinos); private security services; research, development or production of chemical or biological antidotes; activities concerning equipment for intercepting communications or eavesdropping; services for evaluation of security of computer systems; dual-use (civil and military) technologies; cryptology; activities of firms that are repositories of defense secrets; research, production or trade in arms, munitions, explosives or other military equipment; or any other industry supplying the defense ministry any of the goods or services described above.

Id.; see De Las Cuevas, *supra* note 350 (explaining protected sectors, corporate acquisitions, and mergers, stating that the protected sectors in other states may be much more focused). In Spain, for example, protected sectors include gambling, radio, air transportation, banks, and credit institutions, and authorization is required from the Spanish Central Bank to acquire participation exceeding 15 percent. *Id.*

³⁵⁴ See Sovereign Wealth Funds and Hungry States: Adjusting the Borders of Public and Sovereign Activity Across Borders, <http://lebackerblog.blogspot.com/2008/06/sovereign-wealth-funds-and-hungry.html> (June 6, 2008, 15:42:00 EST).

³⁵⁵ *France's Sovereign Wealth Fund to Boost Economic Security*, THAINDIAN NEWS, Oct. 28, 2008, http://www.thaindian.com/newsportal/uncategorized/frances-sovereign-wealth-fund-to-boost-economic-security_100112266.html. As reported by the Asian press:

France's plan to create a sovereign wealth fund is a part of the country's efforts to guarantee its economic security in the current world financial crisis. The fund, announced by French President Nicolas Sarkozy last week, is designed to protect the strategically important French enterprises threatened by the global credit crunch and prevent those companies from foreign takeover, the latest manifestation of economic patriotism of the country.

Id.

might expect; (4) the result might be to challenge the integrity of the private market (through the introduction of sovereign regulators as market participants); (5) or to destabilize the international political system by permitting sovereign regulators to use private markets for public policy purposes, especially within the national territory of other states; (6) so that if sovereigns are permitted to act through SWFs in global private markets, they will be required to act like other participants; (7) but since the prime assumption is that states are not like private economic actors; (8) it will be necessary to construct a sort of artificial private personality; (9) a system for monitoring compliance therewith; and (10) that states and their SWFs will adopt if they expect to be treated like other private participants in global markets by those states within those territories in which SWFs seek to operate.

This framework suggests a basis of critique that these regulations tend to both over-include and under-include restraint, all the while remaining ignorant of the nature and scope of investment.³⁵⁶ Still, a more detailed review of the basis for a regulatory approach is useful for understanding the limitations and weaknesses of current approaches to SWFs. A few important international actors have sought to introduce regulatory mechanisms that might systematize approaches to the regulation of SWFs. These regulations are soft law principles intended to develop both a foundation for customs to form around benchmarked practices and international consensus in conceptualizing sovereign funds. This Part examines some of the recent and more important efforts in that direction to date.

1. The European Union

The European Union has not directly sought to develop its own regulatory framework for either inbound or outbound sovereign investing activity through SWFs or SOEs. However, current EU jurisprudence suggests that the European Union would be more suspicious of governments investing outside its home territories and less likely to accept a regulatory scheme in which states can be treated as wholly equivalent to private economic actors.³⁵⁷ The twin pillars of emerging European regulation of the

³⁵⁶ See State Subsidies and the Character of the Market Transactions of Sovereigns: The Case of EADS, <http://lbackerblog.blogspot.com/2008/05/state-subsidies-and-character-of-market.html> (May 29, 2008, 16:03 EST); Brazil Builds a Sovereign Wealth Fund and Norway Flexes Its Muscles: Private Participation in the Market or Regulation by Other Means, <http://lbackerblog.blogspot.com/2008/05/brazil-builds-sovereign-wealth-fund-and.html> (May 24, 2008, 19:04 EST); Extraterritoriality and Corporate Social Responsibility: Governing Corporations, Governing Developing States, <http://lbackerblog.blogspot.com/2008/03/extraterritoriality-and-corporate.html> (Mar. 27, 2008, 23:47 EST).

³⁵⁷ See *EC to Rule on Sovereign Wealth Funds*, *supra* note 224. The EU Economic Commissioner said:

participatory (rather than the regulatory) activities of state sovereigns in economic markets are derived from the construction of an internal governance framework for EU Member States. The first pillar consists of the jurisprudence of free movement of capital provisions of the European Community Treaty.³⁵⁸ The second pillar comprises the regulation of state subsidies to businesses under the competition provisions of the European Community Treaty ("EC Treaty").³⁵⁹

With respect to the first, jurisprudence has focused on the privatization of state enterprises where the state seeks to retain an interest or otherwise intervene to protect the national character of the enterprise. In a recent series of cases, the so-called Golden Share Cases,³⁶⁰ the European Court of Justice has rejected assertions of state power, characterizing them as regulatory, and, consequently, in breach of a Member State's obligations under Art. 56 of the EC Treaty. With respect to the second jurisprudential pillar, both the Court and the Commission have sought to narrow the scope of permissible state intervention in the form of investment by treating many forms of formally private investment activity as public and, consequently, in breach of the competition provisions of the EC Treaty. The jurisprudence has focused on the special character of Member States' interventions in their own economies. Its object is to reduce all possible transaction costs to the free movement of capital that might be based on the "nationality" of that capital. Investors may be deterred by rules that discriminate on the basis of nationality. Likewise, investment deterrence may be produced by other rules, for example, rules privileging state investment. The form of that privilege is immaterial. All state intervention that is accompanied by regulation, the threat of regulation, or indirectly supported by special regulation, constitutes an impediment to free movement. Derogations in the public interest are

Brussels would soon submit proposals to EU governments and Euro-MPs, a use of wording that hints at a legally-binding directive. Germany has led the campaign to clamp down on state-funds wielding \$3 trillion, afraid that "giant locusts" may buy stakes in strategic industries to gain technology secrets. German Chancellor Angela Merkel stopped Russia's Mischkonzerns Sistema from taking a bite of Deutsche Telekom last year, and put her foot down when Russia's VTB bank began nibbling at EADS, the Airbus and defence group. Berlin is now drafting a law enabling it to vet non-EU takeovers, and to create a superfund to defend German crown jewels. Both Austria and Hungary have erected barriers.

Id.

³⁵⁸ Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325) 56 [hereinafter EC Treaty].

³⁵⁹ *Id.* art. 87.

³⁶⁰ See The End of Golden Shares in the EU: The EU Commission Takes a Step in Its Abolition, It Ought to Harmonize the Rules of Sovereign Investments Instead, <http://lcbackerblog.blogspot.com/2008/03/end-of-golden-shares-in-eu-eu.html> (Mar. 9, 2008, 15:26 EST).

narrowly construed.³⁶¹ In a general sense, then, a sovereign regulates—even when it appears to be participating in the market—if it participates in the market that is the subject of its regulation. It is the regulatory character of the action that is important, along with the power to implement it within its territory. In that context, private law offers no protection.

With respect to the application of the rules of competition law to state investment activity in domestic enterprises, the European Court of Justice has long held that the purchase by a Member State of a company's equity interests might be characterized as "state aid"³⁶² under the competition provisions of the EC Treaty.³⁶³ The framework is parity between state and private investors.³⁶⁴ From the principle of equal treatment, it fell to the Commission to determine whether the state's investment programs corresponded to normal market conditions.³⁶⁵

Still, both the European Court of Justice, in the Golden Share Cases, and the Commission, in its elaboration of state aid through shareholding, were concerned with the effects of privatization and the creation of a European private market in place of the old controlled economies of the Member States. The Commission made its position clear in the 1980s.³⁶⁶ At first blush,

³⁶¹ See, e.g., Case C-503/99, *Comm'n v. Belgium*, 2002 E.C.R. I-4809, paras. 46–47. The court has also held that the requirement of public security, as a derogation from the fundamental principle of free movement of capital, must be interpreted strictly. *Id.*

³⁶² EC Treaty, *supra* note 358, art. 87(1).

³⁶³ See Case 323/82, *SA Intermills v. Comm'n*, 1984 E.C.R. 3809. In Case T-198/01, *Technische Glaswerke Ilmenau GmbH v. Comm'n*, 2004 E.C.R. II-2717, paras. 98–99, the Court explained that, in order to determine whether the reduction of some of the applicant's debts to the BvS constitutes state aid, it was appropriate, in that case, to apply the test of a private creditor in a market economy, which was referred to in the contested decision and which, moreover, was not challenged by the applicant. *Id.* By granting the price reduction, the BvS did not act as a public investor in a manner comparable to that of a private investor pursuing a structural policy—whether general or sectoral—and guided by the longer-term prospects of profitability of the capital invested. *Id.* Instead, that public body had to be compared to a private creditor seeking to obtain payment of sums owed to it by a debtor in financial difficulties. *Id.*

³⁶⁴ See Case C-303/88, *Italy v. Comm'n*, 1991 E.C.R. I-1433, para. 19. The Commission showed its awareness of the implications of the principle of equal treatment as between public and private undertakings in its communication to the Member States of Sept. 17, 1984 on public authorities' holdings in company capital. *Id.* In that statement, it correctly observes that its action may neither penalize nor favor public authorities that provide companies with equity capital. *Id.*

³⁶⁵ *Id.* para. 20 ("[Such investments] cannot be regarded as State aid. In the present case it must therefore be determined whether, in similar circumstances, a private industrial group might also have made up the operating losses of the four subsidiaries between 1983 and 1987. However, the 'dividing line between general measures of economic policy and state aids may . . . be a fine one.'"); see also PAUL CRAIG & GRÁINNE DE BÚRCA, *EU LAW: TEXT, CASES AND MATERIALS* 1088 (Oxford Univ. Press, 4th ed. 2008) ("[The] dividing line between general measures of economic policy and state aids may . . . be a fine one.").

³⁶⁶ See *Position of the Commission on the 'Application of Articles 92 and 93 of the EEC Treaties to Public Authorities'*, 1994 O.J. (C 350/5), available at http://www.europadecentraal.nl/documents/dossiers/Staatssteun/wet_regelgeving/Application_of_Articles_92_and_93_of_the_EEC_Treaty_to

application of the principles extracted from the state aids and golden share cases to the SWF regulatory context might suggest a more restrictive approach to regulation of inbound SWF and SOE activities within the European Union. If the essential “postulate” under free movement of capital and “state-aids” rules is that states in general (and Member States in particular) are different, and always sovereign, then there are regulatory consequences for SOE and SWF activity. Specifically, it might suggest that the creation of a standard of behavior that permits an exception, i.e., treatment as a private party, must be narrowly drawn. It may not be possible to have an open policy in light of the construction of the internal market limitation in EU jurisprudence.³⁶⁷ Yet, it is just as likely that one could extract some sort of idealized private investor from that jurisprudence.³⁶⁸ The key is to privilege that part of the jurisprudential development that posited the possibility of equivalence where the state actor could demonstrate that its motives and behaviors approximated those of private actors in ways that can be described and measured. Certainly, the cases hold that possibility open. And it may be reasonable to assume that while there is an emphasis on the sovereign power of states seeking to intervene in the economy *within their borders*, the same emphasis would be less compelling when sovereigns sought to intervene within the regulatory territory of another state. State intervention accomplished outside its national territory through a separate legal person—a form also available to private investors like SWFs—represents one aspect of this change.³⁶⁹ The willingness of states to invest in SOEs like other investors is another.³⁷⁰

_public_holdings.pdf. The Commission noted, for example, four situations “in which public authorities may have occasion to acquire a holding in the capital of companies.” These are:

(a) the setting up of a company (b) partial or total transfer of ownership from the private to the public sector, (c) in an existing public enterprise, injection of fresh capital or conversion of endowment funds into capital (d) in an existing private sector company, participation in an increase in share capital.

Id. para. 2.

³⁶⁷ See *Common European Approach*, *supra* note 48.

³⁶⁸ Italy, 1991 E.C.R. para. 22.

[W]hen injections of capital by a public investor disregard any prospect of profitability, even in the long term, such provision of capital must be regarded as aid within the meaning of Article [87] of the Treaty, and its compatibility with the common market must be assessed on the basis solely of the criteria laid down in that provision.

Id.

³⁶⁹ See Brazil Builds a Sovereign Wealth Fund and Norway Flexes Its Muscles: Private Participation in the Market or Regulation by Other Means, <http://lcbackerblog.blogspot.com/2008/05/brazil-builds-sovereign-wealth-fund-and.html> (May 24, 2008, 19:04:00 EST).

³⁷⁰ See *Missing the Point of the Ports Problem—Getting Foreign Governments Out of U.S. Security Related Business*, http://lcbackerblog.blogspot.com/2006_03_01_archive.html (Mar. 26, 2006, 21:25 EST).

It appears that the European Union likely will take the broader view. "EU sources say Brussels is examining options stretching from an IMF-style code to a full directive giving Brussels the power to dictate policy."³⁷¹ This is a particularly sensitive topic for Britain. "London is a clearing house for the mammoth funds rapidly changing the investment universe."³⁷² The financial crisis intensified the need for a less-imposing system of regulation of inbound investment by sovereign entities.³⁷³ These were to mirror the principles prepared by the IMF for the Santiago Principles.³⁷⁴ The Commission has explained its outline of this common policy. It emphasizes a commitment to an open investment environment consistent with EU common market jurisprudence, support for a multilateral regulatory framework, reliance on existing instruments, respect for EC Treaty obligations, and, perhaps most importantly, adherence to the principles of transparency and proportionality as those concepts are understood in the EU treaty.³⁷⁵

Indeed, the European Union, at its base, continues to view sovereign investing as essentially sovereign, acceptable only when the sovereign is eliminated from the equation. This requires preventing the sovereign from controlling the policy of the investment of its funds. "Clarity about the degree of possible political interference in the operation of [a] SWF is a prerequisite for addressing concerns about the existence of political and other noncommercial considerations in the operation of a fund."³⁷⁶ The European Union makes no bones of the equation of SWFs with old socialist state-run enterprises,³⁷⁷ but the limitations are clear. The reward will be available only where state investors can establish (perhaps according to a formula or a set of standards of actions) that they are not investing for the purpose of maximizing their own aggregated best interests. This is a luxury not denied other shareholders. The European Union thus appears suspicious but perhaps ready to deal. It was no surprise, then, that the European Union welcomed a joint commitment by OECD Ministers at their annual meeting in

³⁷¹ *EC to Rule on Sovereign Wealth Funds*, *supra* note 224.

³⁷² *Id.*

³⁷³ William Schomberg & David Lawsky, *EU To Consider Sovereign Wealth Fund Voluntary Code*, REUTERS, Feb. 23, 2008, <http://www.reuters.com/article/ousiv/idUSL2373561420080224> ("The European Commission will consider a code of conduct asking sovereign wealth funds run by countries to stress commercial goals rather than strategic considerations when making investments.").

³⁷⁴ *Id.* ("Mr. McCreery added that the EU had no plans to limit investment by such funds, only that all business 'should follow some common principles on transparency and governance.'").

³⁷⁵ *Common European Approach*, *supra* note 48, at 9; see TAKIS TRIDIMAS, *THE GENERAL PRINCIPLES OF E.U. LAW* (Oxford Univ. Press, 2d ed. 2007) (on proportionality as a general concept of EU law).

³⁷⁶ See *Common European Approach*, *supra* note 48, at 10.

³⁷⁷ *Id.*

Paris on June 5, 2008 to an open investment environment for SWFs.³⁷⁸ The OECD Ministers adopted a declaration that committed them to a transparent and predicable investment environment that does not discriminate against SWF investors.³⁷⁹

2. American Bilateralism

The United States has been at the forefront of creating a bilateral approach to the regulation of SWFs. In a manner that mimics the way in which multinational corporations construct regulatory systems to bind their suppliers,³⁸⁰ the United States has sought to arrange the terms of mutual investment according to bilateral treaty arrangements.³⁸¹ "In nine cases, the United States has entered into a BIT or a free trade agreement with countries with SWFs. . . . [T]he countries that have signed investment treaties or entered into free trade agreements with the United States, are members of the OECD and WTO."³⁸² In some cases, the Treasury Department sought to impose certain otherwise soft law obligations on SWF countries through bilateral trade agreements.³⁸³ The Department's policy for SWFs states:

SWF investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly, the geopolitical goals of the controlling government Greater information disclosure by SWFs . . . strong governance structures, internal controls, and operational and risk management systems . . . SWFs and the private sector

³⁷⁸ See *Outreach, Reform and the Economics of Climate Change*, OECD OBSERVER, June 4–5, 2008, available at http://www.oecdobserver.org/news/fullstory.php/aid/2757/Outreach,_reform_and_the_economics_of_climate_change.html.

³⁷⁹ *Id.*; see also *Chair's Summary of the OECD Council at Ministerial Level, Paris*, OECD OBSERVER, June 4–5, 2008, available at http://www.oecd.org/document/56/0,3343,en_2649_201185_40778872_1_1_1_1,00.html.

³⁸⁰ Larry Catá Backer, *Economic Globalization and the Rise of Efficient Systems of Global Private Law Making: Wal-Mart as Global Legislator*, 39 CONN. L. REV. 1739, 1754–55 (2007).

³⁸¹ GAO COMM. REPORT, *supra* note 301.

³⁸² *Id.* at 9.

³⁸³ See *Treasury Reaches Agreement*, *supra* note 52. For example, the Treasury Department explains:

The United States, Abu Dhabi, and Singapore, being a group of nations with SWFs and a country receiving investments from SWFs, have a common interest in an open and stable international financial system. We support the processes underway in the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) to develop voluntary best practices for SWFs and inward investment regimes for government-controlled investment in recipient countries, respectively.

should compete fairly. . . . SWFs should respect host-country rules. . . .³⁸⁴

In return, the United States agreed to adhere to certain principles, including “not [to] erect protectionist barriers to portfolio or foreign direct investment . . . [to] ensure predictable investment frameworks . . . not discriminate among investors . . . [and to] respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment.”³⁸⁵

3. Santiago Principles³⁸⁶

As the prior discussion of national regulatory approaches makes clear, host state regulation faces two great difficulties. The first is structural—the more intensely host states regulate inbound sovereign investment, the more likely it will impede the flow of capital. Beyond its protectionist consequences,³⁸⁷ such an approach, if more widely adopted, might affect the integrity of global markets.³⁸⁸ If regulation of outbound foreign investment in host states proved difficult because of its effect on the framework for economic globalization, then the solution might lie in the regulation of those

³⁸⁴ *Id.*

³⁸⁵ *Id.*

³⁸⁶ See Backer, *Regulatory Chameleons*, *supra* note 75 (providing a more detailed analysis of the Santiago Principles).

³⁸⁷ See Robert M. Kimmett, *Public Footprints in Private Markets: Sovereign Wealth Funds and the World Economy*, 87 FOREIGN AFF. 119, 126–28 (2008); see also *The Invasion of the Sovereign Wealth Funds*, ECONOMIST, Jan. 19, 2008 (providing the viewpoint of the popular press).

³⁸⁸ See Letter from Warren Buffet, Chairman, Berkshire Hathaway, Inc., to Shareholders, Annual Report 2007, at 17 (Feb. 2008), available at <http://www.berkshirehathaway.com/letters/2007ltr.pdf>. For a discussion in the popular press:

There's been much talk recently of sovereign wealth funds and how they are buying large pieces of American businesses. This is *our* doing, not some nefarious plot by foreign governments. Our trade equation guarantees massive foreign investment in the U.S. When we force-feed \$2 billion daily to the rest of the world, they must invest in *something* here. Why should we complain when they choose stocks over bonds?

Id.; see also Stephen Schwartzman, *Reject Sovereign Wealth Funds at Your Peril*, FIN. TIMES, June 19, 2008, available at <http://www.ft.com/cms/s/0/405b8888-3dff-11dd-b16d-0000779fd2ac.html>.

I have known CIC since it bought a 9.4 per cent non-voting interest in Blackstone when we went public last year. The fact that its president publicly suggests that CIC may invest only where it feels welcome—a view I know many other SWFs share—has serious implications for the economic well-being of the US and other western countries where political opposition to SWF investments has mounted. From the point of view of a rational economist, this is frightening. It is difficult to think of how much worse off we would be in the current financial crisis without SWFs.

Id.

vehicles by the home states.³⁸⁹ This approach mimics those used to regulate the activities of multinational corporations.³⁹⁰ Regulatory activity in that direction became more pronounced on the eve of the financial crisis. Thus, by "October [2007], the United States joined with Europe and Japan to call for a set of best practices to which funds would subscribe voluntarily. The practices would include pledges of nonpolitical governance structures and more disclosure of portfolio activities."³⁹¹ The solution, as conventionally understood, neutralized the sovereign element of sovereign investment and reduced the universe of acceptable operations to commercial or financial objectives. For that purpose, a self-regulating system of soft law, similar to those being developed for the large, commercial, transnational enterprises, appeared most suitable.³⁹²

In effect, the intent was to create a set of customary norms by which SWFs would avoid at least the appearance of political considerations in their investment activities. The intent was also to provide a legal basis, even in soft law, for conformity to these standards that would, over time, become increasingly difficult to avoid without great cost. Once established, these standards can also provide a framework for future state legislation, for example, by distinguishing between nonconforming and conforming SWFs.

In May 2008, the International Working Group of Sovereign Wealth Funds ("IWG") was created in response to a G-8 initiative.³⁹³ The IMF provides support in the form of a secretariat. The IWG was tasked with identifying and drafting a set of Generally Accepted Principles and Practices ("GAPP") that would properly reflect the investment practices and objectives

³⁸⁹ See EDWIN M. TRUMAN, PETERSON INST. FOR INT'L ECON., POLICY BRIEF NO. 08-3, A BLUEPRINT FOR SOVEREIGN WEALTH FUNDS BEST PRACTICES (2008), available at <http://www.iie.com/publications/pb/pb08-3.pdf>.

³⁹⁰ See Backer, *Multinational Corporations*, *supra* note 87, at 287.

³⁹¹ Steven R. Weisman, *Overseas Funds Resist Calls for a Code of Conduct*, N.Y. TIMES, Feb. 9, 2008, available at <http://www.nytimes.com/2008/02/09/business/09sovereign.html>.

³⁹² *Id.* Weisman recounts:

"These funds do not think of themselves as political, and so far they haven't been," said an I.M.F. official involved in the drafting of a code who would not speak on the record about internal discussions. "What we're hearing from them is, 'What are you so upset about?' But the concerns are there, and they need to be taken care of in a code of best practices. . . ."

Id.

³⁹³ See DELOITTE, MINDING THE GAPP SOVEREIGN WEALTH, TRANSPARENCY, AND THE "SANTIAGO PRINCIPLES" 5-6 (2008), available at <http://www.iasplus.com/dttdpubs/0811sovereignwealth.pdf> ("In October 2007, at their yearly meeting, the G-8 asked the IMF to develop a set of best practices for SWFs that might be uniformly adopted across countries. . . . Responding to the G-8's direction, the International Working Group of Sovereign Wealth Fund was formed in May 2008, with the IMF providing support in the form of a secretariat."); see generally SANTIAGO PRINCIPLES, *supra* note 55.

of SWFs.³⁹⁴ The negotiations leading to the adoption of the Santiago Principles GAPP framework was not easy, and the GAPP itself masked significant divergences of views among SWF home states. There was, for example, substantial jockeying over the construction of these benchmarked patterns of acceptable behavior.³⁹⁵

Despite these differences, the GAPP, or Santiago Principles, provided a model framework for SWFs and their governing bodies to ensure that SWFs remain a stabilizing force in financial markets, regardless of where these markets are located.³⁹⁶ In its own words, the IWG describes the purpose of the GAPP as "identify[ing] a framework of generally accepted principles and practices that properly reflect appropriate governance, accountability, and arrangements as well as the conduct of investment practices by SWFs on a prudent and sound basis."³⁹⁷ In addition to ensuring that these principles are achieved, the GAPP also hopes that SWFs will "continue to bring economic and financial benefits to home countries, and the international financial system."³⁹⁸ By enacting the GAPP, the IWG aimed "to contribute to the stability of the global financial system, reduce the protectionist pressures, and help maintain an open and stable investment climate."³⁹⁹

"The GAPP covers practices and principles in three key areas. These include (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; and (iii) investment and risk management framework."⁴⁰⁰ The incorporation of the GAPP was left to each respective nation in accordance with its national policies. As such, the GAPP "is subject to provisions of intergovernmental agreements, and legal and regulatory requirements. Thus, the implementation of each principle of the GAPP is subject to applicable home country laws."⁴⁰¹ Adherence to GAPP is meant to produce relatively well

³⁹⁴ *Id.*

³⁹⁵ Weisman, *A Fear of Foreign Investment*, *supra* note 224 ("Lou Jiwei, head of China's \$200 billion fund, said at a talk at the World Bank that the I.M.F.'s effort had run into disagreement over the meaning of transparency and political motivation.").

³⁹⁶ SANTIAGO PRINCIPLES, *supra* note 55, at 4. The GAPP are grounded in four "guiding objectives for SWFs." *Id.* These include the maintenance of financial stability and free capital flows, compliance with applicable laws of host countries, and an idealized private investor strategy for investments, focused on investment "on the basis of economic and financial risk and return-related consideration." *Id.* Lastly, adhering SWFs ought to have in place systems of transparency and a "sound governance structure that provides for adequate operational controls, risk management, and accountability." *Id.*

³⁹⁷ *Id.*

³⁹⁸ SANTIAGO PRINCIPLES, *supra* note 55, at 4.

³⁹⁹ *Id.*

⁴⁰⁰ *Id.* at 5.

⁴⁰¹ *Id.*

understood and transparent entities or operations that mimic some sort of idealized private investor model.⁴⁰² The effect is meant to assure host states of the absence of threatening political agendas affected through sovereign investment activity.⁴⁰³ Thus convinced, the hope is to avoid host state lawmaking that would inhibit sovereign investing.⁴⁰⁴

4. OECD Soft Standard Setting

Like the developers of the Santiago Principles, the OECD has declared its adherence to a policy of transparency as well.⁴⁰⁵ Within that context, it has sought to develop its own version of a set of benchmark rules of behavior for SWFs.⁴⁰⁶ The OECD rules were developed in the context of drafting of the Santiago Principles and were meant to be read with them, as a host country analogous to the home country measures that are the focus of the Santiago Principles.⁴⁰⁷ "The resulting framework will foster mutually beneficial situations where SWFs enjoy fair treatment in recipient country markets and recipient countries can confidently resist pressures for protectionist responses."⁴⁰⁸ The principles are grounded in the body of investment traditions developed for the operation of enterprises across borders and the principles of state regulation based on equal treatment, transparency, and trade liberalization.⁴⁰⁹ Within that context, national security was recognized

⁴⁰² Backer, *Regulatory Chameleons*, *supra* note 75.

The regulatory "deal" becomes clear now. Sovereign wealth funds are formally sovereign. They may be detached from the state and, to the extent that they operate as functionally private, they may hope to be treated like other private investment vehicles and participate in global financial markets, especially those beyond the borders of their sovereign owners.

Id.

⁴⁰³ *Id.*

⁴⁰⁴ *Id.*

⁴⁰⁵ *OECD Countries Commit to Open Climate for Sovereign Wealth Funds*, EUROPA, June 6, 2008, http://trade.ec.europa.eu/doclib/docs/2008/june/tradoc_139096.pdf.

⁴⁰⁶ See ANGEL GURRÍA, OECD, SOVEREIGN WEALTH FUNDS AND POLICIES 5 (2008), available at <http://www.oecd.org/dataoecd/34/9/40408735.pdf> ("Investment policy guidance from the freedom of investment project.") [hereinafter SOVEREIGN WEALTH FUNDS]; see also *id.* at 2 (The project was undertaken at the behest of the G7 Finance Ministers "to develop guidance for recipient countries' policies toward investments from SWFs.").

⁴⁰⁷ *Id.* at 6 ("The OECD also supports the work underway at the IMF on best practices for sovereign wealth funds, calls attention to OECD's voluntary standards on corporate governance and good business conduct, and notes their relevance to work under way at the IMF.").

⁴⁰⁸ *Id.*

⁴⁰⁹ *Id.* at 3. The OECD's existing investment instruments already contain fundamental principles for recipient country policies needed for the required guidance. SOVEREIGN WEALTH FUNDS, *supra* note 406, at 3. Through their adherence to the OECD investment instruments, OECD and other adhering governments have committed to the principles of transparency, non-discrimination and liberalization. *Id.*

as a legitimate limitation on the OECD open trade principles,⁴¹⁰ but only if the national security principles are narrowly drawn.⁴¹¹ However, the OECD suggested that sovereign investment might serve as a legitimate basis for protection when a state uses it for foreign policy rather than commercial purposes, to obtain sensitive technology, or to aid "the intelligence capabilities of a foreign country that is hostile to the host country."⁴¹² The OECD suggested a principles-based framework for implementing national security limitations on open investment based on its principles of nondiscrimination, transparency/predictability, regulatory proportionality, and accountability.⁴¹³

In addition, the OECD has advanced a set of guidelines for state-owned enterprises ("Guidelines") that, in many respects, mimics the approach of regulatory efforts aimed at SWFs.⁴¹⁴ "The Guidelines are primarily oriented to state-owned enterprises using a distinct legal form (i.e., separate from the public administration) and having a commercial activity (i.e., with the bulk of their income coming from sales and fees), whether or not they pursue a public policy objective as well."⁴¹⁵ These Guidelines are grounded in principles of

⁴¹⁰ ANGEL GURRÍA, OECD, SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES 2 (2008), available at <http://www.oecd.org/dataoecd/0/23/41456730.pdf> [hereinafter SWF AND REC. COUNTRY].

⁴¹¹ *Id.* at 3. However, OECD members have agreed that the national security clause of the OECD investment instruments should be applied with restraint and should not be a general escape clause from their commitments to open investment policies. *Id.*

⁴¹² *Id.* at 4.

⁴¹³ *Id.* at 5, Box 2. (providing investment policy guidance from the freedom of investment project). Transparency, in turn, would be grounded in principles of: (1) codification ("Primary and subordinate laws should be codified and made available to the public in a convenient form."); (2) prior notification; (3) consultation ("Governments should seek the views of interested parties when they are considering changing investment policies."); and (4) procedural fairness ("Strict time limits should be applied to review procedures for foreign investments. *Id.* Commercially-sensitive information provided by the investor should be protected."), and disclosure. SWF AND REC. COUNTRY, *supra* note 410. Regulatory proportionality, in turn, is grounded in a set of subsidiary principles, including: (1) the right of a host state to determine its security concerns ("This determination should be made using risk assessment techniques that are rigorous and that reflect the country's circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear."); (2) narrow focus ("Investment restrictions should be narrowly focused on concerns related to national security."); (3) appropriate expertise ("Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions."); (4) tailored responses ("If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals."); and (5) last resort ("Restrictive investment measures should be used, if at all, as a last resort when other policies."). *Id.*

⁴¹⁴ See OECD, STATE-OWNED INDUSTRIES, *supra* note 18.

⁴¹⁵ *Id.* at 10.

transparency and the separation of function.⁴¹⁶ The objective, as with SWFs, is to neutralize the sovereign in the operation and control of these enterprises.⁴¹⁷ Within this framework, the OECD expects the state to act like an idealized private sector owner.⁴¹⁸ "It is often the multiple and contradictory objectives of state ownership that lead to either a very passive conduct of ownership functions, or conversely results in the state's excessive intervention in matters or decisions which should be left to the company and its governance organs."⁴¹⁹

Thus neutered, one could deem SOEs safe enough to compete on an equal basis with private actors.⁴²⁰ The Guidelines aim to create "a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions."⁴²¹ For that purpose, the Guidelines specifically require that SOEs "face competitive conditions regarding access to finance" and avoid indirect subsidies through cross-ownership of state enterprises.⁴²² "[SOEs'] relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds."⁴²³ Equivalence produces compatibility between state-owned and private enterprises. The OECD designed its Guidelines to produce SOEs that operate like private entities. It then follows that the OECD Principles of Corporate Governance can apply to SOEs and private enterprises on an equivalent basis.⁴²⁴ Effectively, the SOE

⁴¹⁶ *Id.* at 13 ("The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.").

⁴¹⁷ *Id.* at 17 (Thus, for example, the Guidelines suggest that the "boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management.").

⁴¹⁸ *Id.* at 13 (including separation of ownership and control, protecting the independence of the board of directors, not mixing regulatory and participatory powers in administering SOEs).

⁴¹⁹ OECD, STATE-OWNED INDUSTRIES, *supra* note 18, at 23.

⁴²⁰ *Id.* at 12 ("There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.").

⁴²¹ *Id.* at 18. The state often plays a dual role of market regulator and owner of SOEs with commercial operations, particularly in the newly deregulated and often partially privatized network industries. *Id.* Whenever this is the case, the state is at the same time a major market player and an arbitrator. *Id.* Full administrative separation of responsibilities for ownership and market regulation is therefore a fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition.

⁴²² OECD, STATE-OWNED INDUSTRIES, *supra* note 18, at 12.

⁴²³ *Id.*

⁴²⁴ *Id.*

Guidelines are a condition precedent to preparing SOEs to conform to emerging principles meant to govern all economic organizations.⁴²⁵

Realizing that SOEs face some distinct governance challenges, the OECD Guidelines treat transparency as a key factor in governing SOEs. First, the Guidelines require that "[t]he coordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs."⁴²⁶ Second, the Guidelines impose requirements of efficient internal and external audit procedures on SOEs.⁴²⁷ Similarly, the Guidelines impose the same high quality accounting and auditing standards as they impose on listed companies on SOEs.⁴²⁸ Lastly, the Guidelines are based on disclosure of deviations from a private-actor model of SOE operation rather than on mandatory provisions.⁴²⁹ The idea, it seems, is to permit SOEs to be structured according to government preferences, while altering others within the global economic sector so that they know what to expect. Transparency extends to host governments as well.⁴³⁰ Still, commentators have criticized the OECD's approach as both unrealistic and unenforceable.⁴³¹

⁴²⁵ *Id.* at 9–10. The guidelines explain that:

These Guidelines should be viewed as a complement to the OECD Principles of Corporate Governance on which they are based and with which they are fully compatible. The Guidelines are explicitly oriented to issues that are specific to corporate governance of State-Owned Enterprises and consequently take the perspective of the state as an owner, focusing on policies that would ensure good corporate governance.

Id.

⁴²⁶ OECD, STATE-OWNED INDUSTRIES, *supra* note 18, at 16.

⁴²⁷ *Id.*

⁴²⁸ *Id.*

⁴²⁹ *Id.*

⁴³⁰ *Id.* Likewise it hosts governments to the character of an SOE. OECD, STATE-OWNED INDUSTRIES, *supra* note 18, at 16.

⁴³¹ See, e.g., Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440, 478 (2009). One commentator put it well:

[T]he problem with the best practices model is that a gap may arise between the stated practices of a fund and its actual practices, and it may be difficult to anticipate such departures from best practices before they occur. It is not difficult to imagine, for example, that managers of China's or Russia's state-owned funds could find themselves subject to unofficial political pressure.

Id. (internal citation omitted); Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1362 (2008). Gilson and Milhaupt state:

Could anyone genuinely believe that the investment managers of China Investment Corporation or Singapore's Temasek would hang up the phone if a senior government (or in China's case, Party) official called to offer advice

V. COORDINATION, DEVELOPMENT, OPPOSITION, AND THE CHALLENGES OF
SOVEREIGN INVESTING IN THE CONTEXT OF GLOBAL ECONOMIC CRISIS: THE
CASE OF CHINA

In the context of sovereign investing, whether by SWFs or SOEs, commentators have also proposed ways to force sovereigns to benchmark their conduct their motivations for investing, and for shareholder activism.⁴³² To that extent, those proposals seek to severely limit what is essentially ungovernable. The problem with these proposals is that they are mutually exclusive. Mirroring the American approach, the proposals tend to encourage investment but seek to treat sovereign investors differently from others. Prior consultations with affected states—whatever that means in a private market for shares of publicly traded companies, severe control of investment strategies, trade volume, and the like—all suggest that the sovereign is not a private investor. Nevertheless, such a sovereign would be treated as *private* with respect to invested funds and *public* with respect to the investment decision.

This conflicted view of SWFs tends to distort markets and impede the very investment that aggregate wealth transfers, at the heart of the current global financial imbalance, has made necessary. Still, sovereigns remain unitary entities. As long as national legal systems require all shareholders to avoid activity that breaches certain duties, for example, looting or defrauding the company, permit shareholders and others to sue the sovereign investor like any other private party, and permit the host state itself to intervene in the national interest according to law, then SWF/SOE investment does not present a danger of a distinct character. If not, then it seems that more than the SWFs' character is at issue, and a discussion about reforming shareholder rights and obligations vis-à-vis the corporation for all security holders, but principally equity holders, is necessary.

This view may miss the mark. While the global community moves toward a piecemeal encounter with the instruments of sovereign investing, sovereigns have begun coordinating and using their sovereign investment vehicles in innovative ways that may render much of the thrust of current regulatory approaches less relevant. As this Part argues, even as the developed world was engaged in its own self-directed conversation about the nature of sovereign investing, its taxonomy, and the character of its own regulatory frameworks (appropriate for each piece of what appeared to be the universe of separable components of sovereign investing), one of the principal global sovereign investors, the People's Republic of China, created a distinct

on the fund's handling of a particular investment to advance the country's, rather than the portfolio company's interests?

⁴³² See generally EDWIN B. TRUMAN, PETERSON INST. FOR INT'L ECON., SOVEREIGN WEALTH FUNDS: THE NEED FOR GREATER TRANSPARENCY AND ACCOUNTABILITY (2007), available at <http://www.iie.com/publications/pb/pb07-6.pdf>.

sovereign investing model that has the potential to make the regulatory framework substantially irrelevant.

"China is also becoming increasingly important as a source of outbound FDI. The 'goigo globali' ("Go Global") campaign launched in the late 1990s encourages both state-owned enterprises and smaller private and collective enterprises to invest abroad."⁴³³ This Part first focuses on the "Go Global" campaign as the template through which a new basis for strategic coordination of sovereign investment—grounded in an aggregation of commercial and political welfare maximization objectives—was forged. It then examines the organization and operation of Chinese sovereign investing in light of the "Go Global" strategy. Next, this Part examines the operation of the model of sovereign investing that the Chinese organizational framework coordinates among investment vehicles and financial objectives that advance state interests. Finally, this Part contextualizes this approach in the emerging global regulatory matrix and suggests reasons why the emerging "idealized private investor standard" of SWF regulation may serve little purpose in the regulation of Chinese SWF/SOE activity.

A. "Go Global" Strategy and the Consolidation of Sovereign Investment

On July 20, 2009, China's Premier Wen Jiabao addressed ambassadors in a conference and discussed China's current policy and strategy.⁴³⁴ He pointed out that the relation between China and the world was currently undergoing a historical transformation that affected diplomacy.⁴³⁵ Crucially, Wen emphasized that China should accelerate the "Go Global" strategy, consolidate the utilization of China's foreign reserves with Chinese enterprises' implementation of the "Go Global" strategy, and to consolidate outbound investment with the exportation of products.⁴³⁶ Wen said that he wanted to "speed up the implementation of the 'going out' strategy, the use of foreign exchange reserves and business' go to 'combine up to foreign investment and merchandise exports.'"⁴³⁷ China's foreign reserves are exactly the source of capital that was used to build the Chinese SWF. Wen's speech explicitly connected China's "Go Global" Strategy to its SWF, as well as other sovereign investment vehicles.

⁴³³ PHILIP C. SAUNDERS, INST. FOR NAT'L STRATEGIC STUDIES, OCCASIONAL PAPER NO. 4, CHINA'S GLOBAL ACTIVISM: STRATEGY, DRIVERS, AND TOOLS 12 (2006), available at http://www.ndu.edu/inss/Occasional_Papers/OCP4.pdf [hereinafter CHINA'S GLOBAL ACTIVISM].

⁴³⁴ 温家宝：继续刺激经济稳定汇率 [Wen Jiabao: Continues to Stimulate the Economic Stability of the Exchange Rate], CAIJING, July 21, 2009, <http://www.caijing.com.cn/2009-07-21/110200767.html>.

⁴³⁵ *Id.*

⁴³⁶ *Id.*; see also OECD, *State-Owned Enterprises in China*, *supra* note 286, § 3.1.

⁴³⁷ Wen Jiabao, *supra* note 434.

Wen's speech suggested the self-consciousness of a new approach to sovereign investing, in which all formally distinct components of sovereign participatory vehicles—from SWFs to state-owned enterprises, to traditional reserves—are deployed in a coordinated manner to maximize the benefits to the domestic and foreign affairs policies of the state.⁴³⁸ The Chinese development of coordinated sovereign investing suggests both the dynamic nature of developments in sovereign investment and the disjunctions between regulatory approaches coming out of host states and the reality on the ground in home states. The notion of neutralizing the sovereign element in sovereign investing in return for the free movement of capital by sovereigns participating in the market is, at least in China's case, giving way to a different model. The new model is grounded in the projection of state power through direct economic activity which blends commercial and sovereign objectives.⁴³⁹

Three days after Wen's speech, the Chinese government indicated that China would actively utilize its foreign reserves to advance the "Go Global" strategy.⁴⁴⁰ Economists point out that the new policy is meant to diversify China's foreign reserves. For example, the Chief Economist at HSBC, Qu Hongbin, commented in an interview with the British news organization Financial Times that this was the first time the government declared where it stood with regard to Chinese companies' overseas acquisitions.⁴⁴¹ Qu also

⁴³⁸ 汇丰银行 (HSBC) 首席经济学家屈宏斌在接受英国《金融时报》(FT)采访时表示：“这是我们首次听到官方对这一政策的明确表态，即直接支持企业购买海外资产。这一战略的目的是使外汇储备投资多元化 [“HSBC Bank (HSBC) chief economist said: ‘This is the first time we heard policy official make it clear that the direct support enterprises would purchase foreign assets. The purpose of this strategy is to diversify foreign exchange reserve investments.’”] *Id.*

⁴³⁹ 中国政府将加快实施“走出去”战略 [*The Chinese Government Will Speed Up the Implementation of the “Going Out” Strategy*], INT'L BUS. TIMES, July 23, 2009, <http://china.ibtimes.com/articles/20090723/zhongguo-zouchuqu.htm> [hereinafter *Speed Up Implementation*] (中国政府表示，积极利用超过2万亿美元的外汇储备推进“走出去”战略经济学家称这是为了促使外汇储备多元化。[“The Chinese government said that the active use of more than 2 trillion U.S. dollars of foreign exchange reserves to promote the ‘going out’ strategy. Economists say this is the purpose of promoting diversification of foreign exchange reserves.”]. See also *Foreign Reserves Bolster Chinese Enterprises, Going Global Becomes a Trend*, PR NEWswire, July 22, 2009, available at http://www.breitbart.com/article.php?id=prnw.20090722.CNW034&show_article=1. The article reported:

The government may use these reserves to buy U.S. Treasuries and invest in various ways, but it is more preferable to distribute some of the reserves to its enterprises to encourage overseas investment and merger & acquisition, which is a more efficient, more widely-beneficial inflation-proof method. Also, the funding will enhance many Chinese enterprises, increase their size and strength while creating more jobs. Therefore, the government is spending money in a much more cost-effective way.

Id.

⁴⁴⁰ *Speed Up Implementation*, *supra* note 439.

⁴⁴¹ *Id.*

believed that this policy was meant to diversify China's foreign reserves.⁴⁴² At the same time, the president of China Development Bank emphasized that the bank's target is not "Wall Street," but the international natural resources and energy sectors.⁴⁴³

While the effort to consciously combine the "Go Global" strategy with China's foreign reserves entails one of the Chinese government's newest policies, the "Go Global" strategy itself is not new. The "Go Global" strategy, which is also referred to as the "Go Out" policy, was an effort initiated in 1999 by the Chinese government to promote Chinese investments abroad.⁴⁴⁴ "The igo globali ["Go Global"] Strategy was highlighted in work reports at the 2003 National People's Congress and promoted at Chinese business conferences in 2004."⁴⁴⁵ The "Go Global" strategy is itself a component of a two prong economic strategy, which combines the "Bring In" and "Go Out" policies.⁴⁴⁶ The Chinese government, together with the China Council for the Promotion of International Trade, introduced several schemes to assist

⁴⁴² *Id.*

⁴⁴³ *Id.*

⁴⁴⁴ See ACCENTURE, CHINA SPREADS ITS WINGS, CHINESE COMPANIES GO GLOBAL 2 (2005), available at <http://www.accenture.com/NR/rdonlyres/6A4C9C07-8C84-4287-9417-203DF3E6A3D1/0/Chinaspreadsitswings.pdf>.

⁴⁴⁵ CHINA'S GLOBAL ACTIVISM, *supra* note 433, at 3; see also ACCENTURE, *supra* note 444, at 5. Accenture states:

The "go-out" policy reinforces the government's efforts to support the rapid development of technological skills and know-how, as well as building new markets and global brands that will underpin further economic growth at home. The quest has begun to create Chinese companies on a par with global giants such as Coca-Cola, Microsoft and Wal-Mart.

Id.

⁴⁴⁶ See Hu Jintao, *Hold High the Great Banner of Socialism With Chinese Characteristics and Strive for New Victories in Building a Moderately Prosperous Society in All*, Report to the Seventeenth National Congress of the Community Party of China, Oct. 15, 2007, para. 8, available at <http://www.china.org.cn/english/congress/229611.htm>. Hu Jintao emphasized both the connection between the two, and the coordination of the "Go Out" or "Go Global" strategy with all aspects of state and private investment by stating:

Adhering to the basic state policy of opening up, we will better integrate our "Bring In" and "Go Global" strategies, expand the areas of opening up, optimize its structure, raise its quality, and turn our open economy into one in which domestic development and opening to the outside world interact and Chinese businesses and their foreign counterparts engage in win-win cooperation, and one that features security and efficiency, in order to gain new advantages for China in international economic cooperation and competition amid economic globalization.

Id.

domestic companies in developing global strategies exploiting opportunities in expanding local and international markets.⁴⁴⁷

Beginning in 1979, the Chinese government opened its economy to foreign investment and international competition, thus reducing the state's role in the economy and allowing foreign, private, and collectively owned firms to account for an increasing share of production.⁴⁴⁸ "Beijing's economic reforms (and broader foreign policy) reflect . . . a relatively coherent grand strategy for building China into a wealthy and powerful state. . . ."⁴⁴⁹ Over the last 30 years, "economic reforms have transformed China's economy from a backward and isolated economy run by inefficient central planning mechanisms into a large and rapidly growing economy driven primarily by market forces and increasingly integrated into a globalized world."⁴⁵⁰

China has welcomed trade and investment from overseas economies, yet simultaneously has become dependent on exports to overseas markets.⁴⁵¹ After entering the WTO in November 2001, the Chinese government refocused its economic policy on the tasks of securing access to energy and other resources, building competitive international companies, and opening developing countries' markets with Chinese products and investment. This policy has led to a substantial increase in the amount of Chinese resources devoted to Africa, Latin America, and the Middle East.⁴⁵² Concurrently, anticipating what it understood as world-class competitors for business in the Chinese market, the Chinese government sought to provide domestic firms and their managements with international experience. The objective was to ensure that domestic firms, including SOEs, could stay competitive both in the home markets of foreign nations and in mainland China's own domestic market.⁴⁵³ Chinese leaders emphasized the integrative nature of economic activity, especially in its "Going Out" or "Go Global" aspects.⁴⁵⁴ As such, the

⁴⁴⁷ The Central People's Government of the People's Republic of China, 更好地实施“走出去”战略 [To Better Implement the "Going Out" Strategy], http://www.gov.cn/node_11140/2006-03/15/content_227686.htm (last visited Jan. 20, 2010).

⁴⁴⁸ CHINA'S GLOBAL ACTIVISM, *supra* note 433, at 3.

⁴⁴⁹ *Id.*

⁴⁵⁰ *Id.*

⁴⁵¹ *Id.* at 4.

⁴⁵² *Id.* at 6.

⁴⁵³ Jiang Zemin, 全方位高起点实施“走出去”战略 [All-round Implementation of a High Starting Point "Going Out" Strategy], MACROCHINA.COM, Apr. 28, 2001, <http://www.macrochina.com.cn/zhz/000051/001/20010428003320.shtml>.

⁴⁵⁴ *Id.* 因此, “走出去”首先是全方位的, 其基础是货物商品的大规模出口, 同时包括国际服务贸易和对外投资。 . . . 第三, “走出去”是长期性的, 是一个长远战略, 不能有短期行为。国家、行业、地方和有条件的企业要对“走出去”进行战略规划, 分步骤地实施, 以求对经济发展产生稳定的拉动效应。

[Therefore, the "Going Out" is the first comprehensive, on the basis of large-scale exports of goods and merchandise, at the same time, including

notion of separation of function and character, which is inherent in the regulatory framework developed for SOEs, SWFs, and the like, was missing from virtually the inception of the Chinese strategic thinking about sovereign investment.

Thus far, the Chinese government has five goals in launching the strategy: (1) to increase Chinese Foreign Direct Investment ("FDI"); (2) to pursue product diversification; (3) to improve the level and quality of the projects; (4) to expand financial channels with respect to the national market; and (5) to promote brand recognition of Chinese companies in EU and U.S. markets.⁴⁵⁵ To further these goals, all sectors of the Chinese economy required guidelines. Little distinction existed between the direction of sovereign investment vehicles and private entities. There would be conformity to the forms of economic organization through which global economic activity functioned. However, embracing this form of global economic activity did not require adoption of all of the policy postulates on which they were based in the West. The "Go Global" strategy effectively implements a well conceived Chinese model of engagement, which:

[P]rovides a blueprint for how nations that choose a more collectivist approach to state organization can engage the emerging economic community on its own terms—using the language of private economic collectives as the primary vehicle for the development of the means of production of the state and reserving to states a secondary role as regulator and shareholder.⁴⁵⁶

international trade in services and foreign investment. . . . Third, the "Going Out" is a long-term in nature, is a long-term strategy, can not have short-term behavior. State, industry, local and qualified enterprises will "go out" to engage in strategic planning, step-by-step implementation, in order to have a stable economic development of the pulling effect.]

Id.

⁴⁵⁵ *Id.* at 2; see also ROSEN & HANEMANN, *supra* note 283, at 2.

For 30 years China has sustained high growth by producing goods for export to the world without a significant presence in the world beyond its borders. Expanding economies of scale in domestic manufacturing is no longer sufficient to fuel growth, and China's firms are increasingly being forced to fight for vast profit margins they have traditionally conceded to foreign partners able to operate abroad.

Id.

⁴⁵⁶ Larry Catá Backer, *Cuban Corporate Governance at the Crossroads: Cuban Marxism, Private Economic Collectives, and Free Market Globalism*, 14 TRANSNAT'L L. & CONTEMP. PROBS. 337, 389 (2004). In the Article, I argued:

While China has acquired many of the outward forms required for participation in the global free market economy, those forms merely paper over the contradictions inherent in their adoption. The most important of those contradictions lies at the heart of the Marxist-Leninist system:

Since the launching of the “Go Global” Strategy, Chinese companies’ interest in overseas investing has increased substantially, especially among state-owned enterprises. Statistics indicate that Chinese direct foreign investments rose from \$3 billion in 1991 to \$35 billion in 2003.⁴⁵⁷ In the context of the 2008 financial crisis, Chinese companies significantly accelerated their outbound investment. In order to guide and assist these companies’ investment activities, the Chinese government has been actively providing regulatory, enterprise, and diplomatic support.⁴⁵⁸ The Chinese Ministry of Commerce implemented this strategy by issuing, among others, the Procedures for the Administration of Overseas Investment, which delicately defines the relationship between the government and companies seeking outbound investments.⁴⁵⁹

The Chinese government has also been developing internal strategies to encourage and support outbound Chinese investments. This strategy will lower the investment threshold in the entertainment and cultural industry and allow more private and foreign interests to invest in state-owned media groups.⁴⁶⁰ The statement says that multimedia broadcasting, digital media, web, and mobile television service should be “actively promoted.”⁴⁶¹ In addition, other elements of the state apparatus have begun to educate

squaring the *Grundnorm* that all communal organization must be subordinated to the needs and rules of the Communist Party as it leads the community to the attainment of a pure Marxist state, with the realities of autonomous and independent economic collectives which are subject only to regulatory restraint by the state. For the moment, pragmatism seems to be the order of the day.

Id.

⁴⁵⁷ *UN Report: China Becoming Major Investor Abroad*, PEOPLE’S DAILY, Jan. 7, 2004, available at http://english.peopledaily.com.cn/200401/07/eng20040107_132003.shtml.

⁴⁵⁸ ROSEN & HANEMANN, *supra* note 283, at 11. Rosen and Hanemann stated:

Along with lower barriers, Beijing has introduced policies to actively support firms in going abroad. These include facilitation services, such as risk assessment and insurance; commercial incentives, such as subsidies and tax breaks; expanded avenues for financing overseas operations (see below); and OFDI delegation participation to help bridge credibility and brand disadvantages. These supportive measures have also been localized, so most provinces now have their own budget and agencies to support firms going abroad.

Id. at 14.

⁴⁵⁹ Ruminations . XV: Exposure Draft Chinese Overseas Investments Rules, <http://lbackerblog.blogspot.com/2009/02/ruminations-xv-exposure-draft-chinese.html> (Feb. 15, 2009, 10:44 EST).

⁴⁶⁰ Zhang Boling, *China to Encourage Foreign, Private Investment in Cultural Industry*, CAIJING, July 23, 2009, <http://english.caijing.com.cn/2009-07-23/110213268.html>.

⁴⁶¹ *Id.*

Chinese children on the value of outbound investment and entrepreneurship.⁴⁶²

Stabilization has been a key part of China's diplomatic policy. In addition to stabilizing the economy, the Chinese government has also been increasing its efforts to strengthen and promote relations with countries where Chinese companies may invest. "In 2001–2002, China established strategic partnerships with major European countries and began to repair ties with India. The government also deepened economic and political ties within East Asia via its relationship with ASEAN and the ASEAN+3 . . . grouping."⁴⁶³ This blending of public interest and private wealth maximization marks the foundations of Chinese sovereign investing as different from those of private enterprises. It also differentiates the Chinese model from the Santiago Principles-based SWF model of pursuing solely commercial objectives. As Duetsche Bank stated:

The key motives behind the Chinese government's advocacy of its 'Going Global' strategy differ, not surprisingly, in their essential form from those of private enterprises. . . . In effect, the government's push for the development of national industry champions and the procurement of overseas natural resources underpins a broader politically driven agenda of economic nationalism focused on issues of energy security, geopolitical positioning and national competitiveness.⁴⁶⁴

It is only within this conceptual context that the organization of Chinese sovereign investing can be understood. Its critical foundation is to bend economic activity to the maximization of the interests of the state. Within that context, commercial and financial welfare maximization models may be

⁴⁶² China Nat'l Technical Imp. and Exp. Corp., Sun Jian the Youth Contribution to "Go Global" Strategy Award, <http://www.cntic.com.cn/en/newsCenter/news/cnticnewsen00124.htm> (last visited Jan. 20, 2010).

The first Central Enterprise Youth (Outstanding) Contribution to "Go Global" Strategy Award sponsored by Central League Work Committee and Central Youth Union has been successfully concluded in Beijing. Being nominated by central enterprises and strictly appraised by the jury, Mr. Sun Shuping, the general manager assistant of Jincheng (Group) Corporation Ltd. of China Aviation Industry Corporation I (AVIC I), and other nine comrades were honored Central Enterprise Youth Outstanding Contribution to "Go Global" Strategy Award. Thirty-five comrades including Mr. Wang Xiaodong, the vice president and general manager of CASIL Telecommunications Holdings Limited were awarded Central Enterprise Youth Contribution to "Go Global" Strategy Award.

Id.

⁴⁶³ CHINA'S GLOBAL ACTIVISM, *supra* note 433, at 15.

⁴⁶⁴ ANDREAS LANDING, DEUTSCHE BANK RESEARCH, GLOBAL CHAMPIONS IN WAITING: PERSPECTIVES ON CHINA'S OVERSEAS DIRECT INVESTMENT 5 (2006), available at http://www.dbresearch.com/PROD/CIB_INTERNET_EN-PROD/PROD000000000201318.pdf.

appropriate. Since Deng Xio Ping, it is hard to suggest that macro or micro-economic strategies that do not improve the material welfare of the people of China serve the interests of the state. Yet the form of that activity, the long and short-term ways in which investing strategies are formulated, the places where economic power is projected, and the factors that weigh on determination of relations with foreign assets are meant to be understood as manifestations of state policy. Moreover, the form of that investment—whether as SWF, SOE, bank, or industrial concern—is essentially instrumental. All are meant to prosper, and to prosper in conventional terms. However, that is a baseline goal in the attainment of the greater goal of benefitting the state and advancing state interests internally and abroad. This Article has suggested how the Norwegian SWF has sought similar goals through a very narrow and directed program of investing. This Article also suggests that these objectives, in more limited form, serve private as well as public investment. The Chinese have created a far more elaborate and sophisticated instrument, and a model that appears to blend financial and political welfare maximization within a private-public system of economic organization. It is only in this context that Chinese sovereign investing, and the inaptness of emerging global regulatory frameworks in light of this new form of holistic and integrated public-private investment, can be understood.

B. *The Organization and Operation of Chinese Sovereign Investing*

China founded its SWF in 2007 by incorporating China Investment Corporation in order to manage some of “China’s massive foreign exchange reserves.”⁴⁶⁵ The CIC, “duly incorporated under the Company Law of the People’s Republic of China . . . is a wholly state-owned company engaging in foreign exchange investment management businesses.”⁴⁶⁶ “CIC was established on September 29, 2007 with the issuance of special bonds worth RMB 1.55 trillion by the Ministry of Finance. These were, in turn, used to acquire approximately \$200 billion of China’s foreign exchange reserves and formed the foundation of its registered capital.”⁴⁶⁷ The issuance of 1.55 RMB trillion special bonds was voted by the Standing Committee of the National People’s Congress in June 2007.⁴⁶⁸ At the same time, Central Huijin Investment Company, the former state investment vehicle, was merged into the CIC as a wholly-owned subsidiary.⁴⁶⁹

⁴⁶⁵ Yan Pei, *Fierce Competition in Bidding to Manage CIC Assets*, CHINA.ORG, July 1, 2008, http://www.china.org.cn/business/news/2008-07/01/content_15916897.htm.

⁴⁶⁶ CIC Abstract, *supra* note 64.

⁴⁶⁷ China Inv. Corp., http://www.china-inv.cn/cicen/about_cic/aboutcic_overview.html (last visited Dec. 20, 2010).

⁴⁶⁸ *Id.*

⁴⁶⁹ Pei, *supra* note 465.

The CIC conducts its internal management and builds its legal structure under the Company Law of the People's Republic of China.⁴⁷⁰ The CIC's governing boards are comprised of the Board of Directors and Board of Supervisors.

The CIC Board of Directors is mandated and authorized to oversee the company's operation and overall performance. Based on objectives and broad policy set by the State Council,⁴⁷¹ the Board sets investment strategy and operational guidelines. Its mandate also includes: (i) deciding how to implement such strategies; (ii) identifying major issues that need to be reported to the State Council; (iii) appointing, and if required, authorizing the removal of management; and (iv) delegating responsibilities and establishing committees as necessary. The Board also has the authority to carry out other functions according to the Law of the People's Republic of China, the company's Articles of Association, and other constitutive documents. The Board of Directors has eleven seats and is composed of executive, non-executive, independent, and employee directors.⁴⁷²

According to the CIC's website, the Board of Supervisors oversees the company's accounting and financial activities.⁴⁷³ The Board of Supervisors also monitors the Board of Directors and senior executives.⁴⁷⁴ "In situations where members of the Board of Directors or senior management have broken laws, regulations, ethical rules, or committed other breaches in conduct, the Board of Supervisors is empowered to call for disciplinary action or the removal of those directors or executives."⁴⁷⁵ Members of the Board of Supervisors include the chairman, Jin Liquin, three supervisors, Linhu An, Wang Huanqing, and Fan Fuchun, and an employee supervisor, Cui Guangquing.⁴⁷⁶ Mr. Jin also serves as a Chinese representative to the International Forum of Sovereign Wealth Funds.⁴⁷⁷

⁴⁷⁰ CIC Abstract, *supra* note 64 ("China Investment Corporation (the "Company"), duly incorporated under the Company Law of the People's Republic of China (the "Company Law"), is a wholly state-owned company engaging in foreign exchange investment management businesses.").

⁴⁷¹ See generally JIANG JINSONG, THE NATIONAL PEOPLE'S CONGRESS OF CHINA (2003) (discussing the State Council).

⁴⁷² China Inv. Corp., Board of Directors, http://www.china-inv.cn/cicen/governance/governing_bod.html (last visited Dec. 20, 2010).

⁴⁷³ China Inv. Corp., Board of Supervisors, http://www.china-inv.cn/cicen/governance/governing_bos.html (last visited Dec. 20, 2010).

⁴⁷⁴ *Id.*

⁴⁷⁵ *Id.*

⁴⁷⁶ *Id.*

⁴⁷⁷ Int'l Forum of Sovereign Wealth Funds [IFSWF], Jin Linquin Biography, <http://www.ifs.org/bios/bios-liquin.htm> (last visited Jan. 20, 2010) ("The IFSWF was established by the IWG. . . IFSWF is a voluntary group of Sovereign Wealth Funds (SWFs), which will meet, exchange

The daily operations of the CIC are delegated by the Board of Directors to an Executive Committee.⁴⁷⁸ Half the members of the Executive Committee are drawn from the Board of Directors (Lou Jiwei, Chairman and CEO; Gao Xiqing, and Zhang Hongli) and the Jin Lique Board of Supervisors.⁴⁷⁹ The other half of the Committee's membership appears to include people with operational responsibility, and include Yang Qingwei, Xie Ping, Wang Jianxi, and Liang Xiang.⁴⁸⁰ The Executive Committee, operationally independent, makes individual investment and operational decisions.⁴⁸¹ The Executive Committee is accountable to the Board of Directors and to the State Council.⁴⁸² The Chinese media heavily promoted the Executive Committee, describing it as an "all-star team."⁴⁸³

Three functional committees report to the Executive Committee: the International Advisory Council, the Investment Committee, and the Risk Management Committee. The CIC established the International Advisory Council ("the Council") as its legitimate public face. The Council members are primarily scholars from academic institutions all over the world.⁴⁸⁴ The Council provides the CIC's management with insight, advice, and expertise on issues such as: corporate development strategy; overseas investment policies and opportunities; best business practices; global economic and financial developments; and other key issues impacting the CIC's investments.⁴⁸⁵ The Council held its first meeting on July 5, 2009, and expects to convene at least once a year, though it may meet more often.⁴⁸⁶ An

views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities."); IFSWF, Home, <http://www.ifswf.org/index.htm> (last visited Jan. 20, 2010) (Daily operations of CIC are delegated by the Board of Directors to the Executive Committee).

⁴⁷⁸ China Inv. Corp., http://www.china-inv.cn/cicen/governance/management_executive.html (last visited Jan. 20, 2010).

⁴⁷⁹ *Id.*

⁴⁸⁰ *Id.* CIC members include, respectively, the Executive Vice President and CIO (Yang), an Executive Vice President (Xie), the Executive Vice President and CRO (Wang), and the counselor in charge of institutional integrity issues (Liang). *Id.*

⁴⁸¹ *Id.*

⁴⁸² China Inv. Corp., Executive Committee, http://www.china-inv.cn/cicen/governance/management_executive.html (last visited Dec. 20, 2010).

⁴⁸³ 中国投资有限公司亮相 列出管理层明星阵容 [*Star Line Up of CIC Unveiled*], SINA, Aug. 9, 2007, <http://finance.sina.com.cn/g/20070912/01513968797.shtml>.

⁴⁸⁴ China Inv. Corp., International Advisory Committee, http://www.china-inv.cn/cicen/governance/management_international.html (last visited Dec. 20, 2010) [hereinafter International Advisory Committee] (commenting that the Chairman of the Council is the former Vice Premier of the State Council of People's Republic of China, Zeng Peiyan).

⁴⁸⁵ *Id.*

⁴⁸⁶ News Release, China Inv. Corp., First Annual Meeting of the International Advisory Council (July 5, 2009), http://www.china-inv.cn/cicen/resources/resources_news09.html.

entity called the Public Relations and International Cooperation Department functions as the secretariat of the Council.⁴⁸⁷

The Investment Committee actually manages and implements the CIC's investment strategy, defines "permissible asset classes, approves the allocation of strategic assets, and changes in the balance of the company's investment portfolios."⁴⁸⁸ The Chief Executive Officer, Mr. Lou Jiwei, chairs the Committee and the President of the CIC, Mr. Gao Xiqing, is the deputy head of the Committee.⁴⁸⁹ The Risk Management Committee is responsible for "risk management systems and policies, defining exposure thresholds, reviewing and finalizing reports concerning risk management, and establishing risk control evaluation criteria."⁴⁹⁰ Overall risk management parameters are set by the Board of Directors and the Executive Committee.⁴⁹¹

Beyond these key management committees, the CIC has established a number of functional departments.⁴⁹² The relationships among them have been illustrated in the CIC's organizational structure chart, reproduced below:

⁴⁸⁷ International Advisory Committee, *supra* note 484.

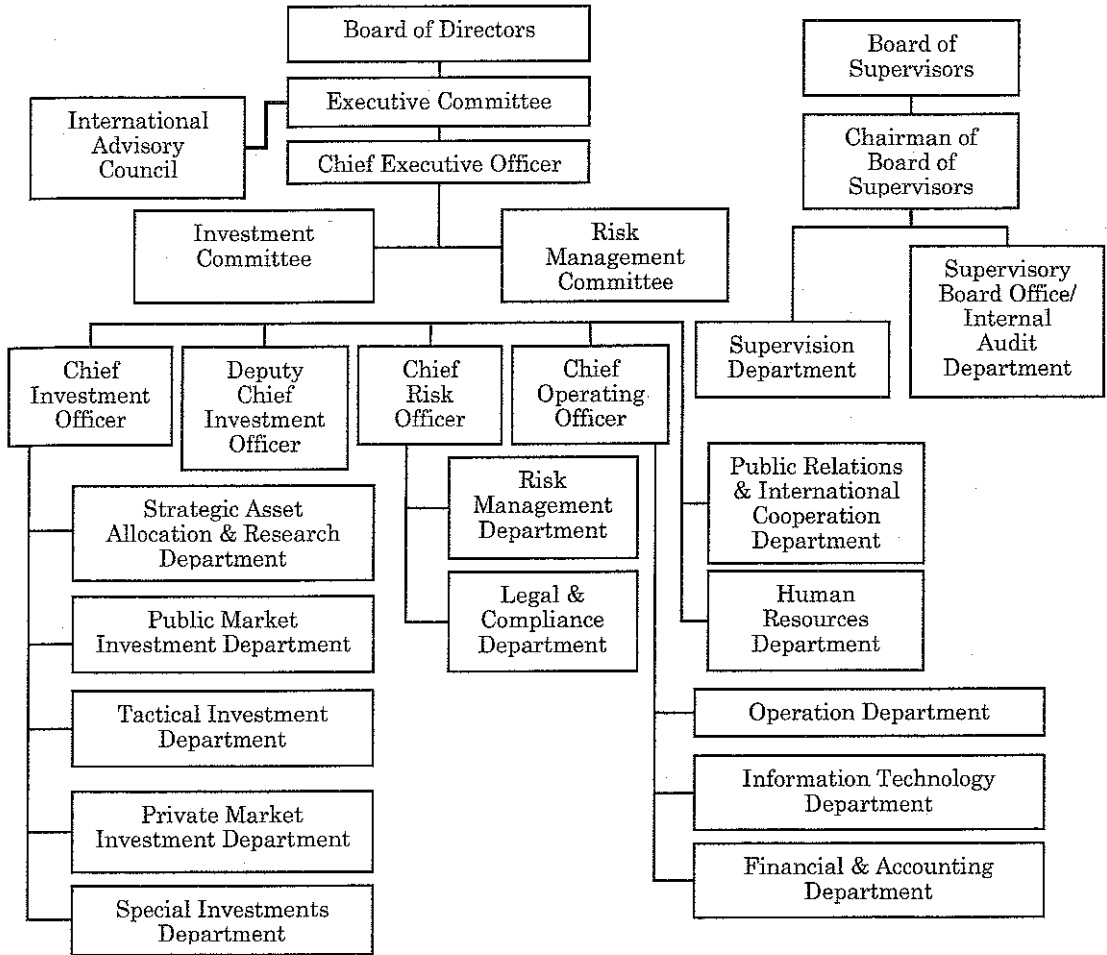
⁴⁸⁸ China Inv. Corp., Investment Committee, http://www.china-inv.cn/cicen/governance/management_investment.html (last visited Oct. 23, 2009).

⁴⁸⁹ *Id.*

⁴⁹⁰ China Inv. Corp., Risk Management Committee, http://www.china-inv.cn/cicen/governance/management_risk.html (last visited Oct. 23, 2009).

⁴⁹¹ *Id.*

⁴⁹² China Inv. Corp., Functional Departments, http://www.china-inv.cn/cicen/governance/functional_depts.html (last visited Oct. 23, 2009).



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The operational structure of the company produces a substantial incentive to cooperate and consult, both within the organization and between the CIC and the state apparatus.⁴⁹⁴ First, the Board of Directors sets the CIC's investment strategy and operational guidelines. Second, the Executive Committee makes individual investment decisions to implement the investment strategy and operational guidelines set by the Board of Directors. The Executive Committee is fully accountable to the Board of Directors and

⁴⁹³ China Inv. Corp., Organizational Structure, <http://www.china-inv.cn/cicen/governance/organizational.html> (last visited Jan. 20, 2010) [hereinafter Organizational Structure].

⁴⁹⁴ See, e.g., Simon Chesterman, *The Turn to Ethics: Disinvestment from Multinational Corporations for Human Rights Violations—The Case of Norway's Sovereign Wealth Fund*, 23 AM. U. INT'L L. REV. 577 (2008) (discussing an approach in Norway).

to the State Council.⁴⁹⁵ Both the Executive Committee and the Board of Directors may consult the International Advisory Council. Third, the Investment Committee manages and implements investment strategies, policies, and goals determined by the Board of Directors and the Executive Committee.⁴⁹⁶ The Executive Committee oversees the work of the Investment Committee, including approval of individual investments and related applications, reviews investment programs and reports, and approves amendments to investment plans. At the same time, the Risk Management Committee is responsible for setting risk management systems, defining exposure thresholds, reviewing and finalizing reports concerning risk management, and establishing risk control evaluation criteria. The review process is governed by the risk requirements set out by the Board of Directors and the Executive Committee. The Investment Committee and Risk Management Committee each oversee several functionally distinct departments, including those responsible for investments in specific markets, law compliance, finance and accounting, human resources, and the like.⁴⁹⁷

1. Role of the State Council and the Party Related to the CIC and Its Subsidiaries

The CIC, as positioned at the premium cabinet-level within the Chinese government, is accountable directly to the State Council through the State-Owned Assets Supervision and Administration Commission of the State Council ("SASAC").⁴⁹⁸ The purpose of this policy is to separate economic and political functions within the state apparatus.⁴⁹⁹ But this separation is effected only functionally. The SOEs, like the political elements of state administration, remain subject to the overall direction of the Chinese Communist Party ("CCP") and state policy. In 2003, the Chairman of SASAC,

⁴⁹⁵ See State-Owned Assets Supervision & Admin. Comm'n of the State Council [SASAC], The People's Republic of China, Main Functions and Responsibilities of SASAC, <http://www.sasac.gov.cn/n2963340/n2963393/2965120.html> (last visited Jan. 20, 2010).

⁴⁹⁶ In many areas, the State Council devolves direct oversight power to the SASAC. *Id.* ¶¶ 1-3. The SASAC performs this responsibility as the investor guides and pushes forward the reform and restructuring of state-owned enterprises, supervises the preservation and increment of the value of state-owned assets of the supervised enterprises, enhances the management of state-owned assets, advances the establishment of modern enterprise system in SOEs, improves corporate governance, and propels the strategic adjustment of the structure and layout of the state economy. *Id.*; see also State-Owned Assets Supervision & Admin. Comm'n of the State Council (SASAC), The People's Republic of China, Name List of Central SOEs, <http://www.sasac.gov.cn/n2963340/n2971121/n4956567/4956583.html> (last visited Jan. 20, 2010) (noting the inclusion of the CIC as a central SOE administered through SASAC).

⁴⁹⁷ Organizational Structure, *supra* note 493.

⁴⁹⁸ See Jason Buhi, *Negocio de China: Building Upon the Santiago Principles to Form an International Regime for Sovereign Wealth Fund Regulation*, 39 H.K. L.J. (forthcoming 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1412828.

⁴⁹⁹ SASAC, *supra* note 496.

Li Rongrong, re-emphasized the relationship between SOE oversight and the governing principles that generally apply to the state.⁵⁰⁰ Other SOEs follow the same path by directing business analysis to conform to the current CCP party line of scientific development.⁵⁰¹

The State Council, through SASAC, exercises the authority of appointment and dismissal of the governing board members of the CIC. However, the CIC's organization formally separates state and fund operators. The CIC's Article of Association clarifies that it "shall separate its commercial activities from governmental functions, make its business decisions independently, and operate based on commercial grounds. The Company bears civil liabilities to the extent of the total assets held by it as a legal person."⁵⁰² However, the relationship is not purely an arms-length transaction. Like the Norwegian Fund, separation does not mean insensitivity to state policies and objectives. "While it operates with independence and its investment decisions are based on the pure economics of each deal, the CIC remains accountable to the State Council of the People's Republic of China and, ultimately, to the citizens of the People's Republic of China."⁵⁰³

Integration with the state apparatus is not limited to oversight by the State Council. In line with the Chinese constitutional system that accords the CCP a preeminent place as "party in power,"⁵⁰⁴ the CCP is represented

⁵⁰⁰ *Id.* ("Guided by the important thought of Three Represents, our website will direct the reform of SOEs and promote the development of the state economy by providing policies, laws and regulations related to the supervision and management on state-owned assets and to the reform and development of SOEs."); see Larry Catá Backer, *The Rule of Law, The Chinese Communist Party, and Ideological Campaigns: Sange Daibiao (the Three Represents), Socialist Rule of Law, and Modern Chinese Constitutionalism*, 16 TRANSNAT'L L. & CONTEMP. PROBS. 29 (2006).

⁵⁰¹ Indus. & Commercial Bank of China, About Us, Introduction of Industrial and Commercial Bank of China Limited in 2008, <http://www.icbc.com.cn/ICBC/About%20Us/Brief%20Introduction/> (last visited Jan. 20, 2010). Thus, for example, the Industrial and Commercial Bank of China, indirectly owned by the CIC, was careful to note that it "stuck to the concept of scientific development for obtaining new driving force for growth, striving to ameliorate its operational structure, and strengthening the internal management and promoting innovative development, and hence it maintained a sound development under the rigorous and complicated circumstance and realized a relatively high profit growth." *Id.* For a discussion of scientific development in Chinese political theory, see, e.g., 科学发展观 [Scientific Development] and Deepening CCP Governance at the Local Level—The Challenge, (Dec. 06, 2008, 11:38 EST), <http://lcbacker.blog.blogspot.com/2008/12/scientific-development-and-deepening.html>.

⁵⁰² CIC Abstract, *supra* note 64.

⁵⁰³ CIC Overview, *supra* note 62.

⁵⁰⁴ On the role of the Chinese Communist Party within Chinese constitutionalism, see Larry Catá Backer, *The Party as Polity, The Communist Party and the Chinese Constitutional State: A Theory of Party-State Constitutionalism*, 16 J. CHINESE & COMP. L. (forthcoming 2010); Robert Heuser, *The Legal Status of the Chinese Communist Party*, in *RULING COMMUNIST PARTIES AND THEIR STATUS UNDER LAW* 421–34 (D.A. Loeber; Dordrecht, Netherlands: Martinus Nijhoff, 1986) (1987).

within the organizational structure of the CIC.⁵⁰⁵ Indeed, as a Chinese corporation, the CIC must permit the establishment of an organization of the CCP in a company to carry out Party activities in the Company.⁵⁰⁶ The CIC's Party committee has six seats. Among them are the Chairman of the Board of Directors and Chief Executive Officer, Mr. Lou Jiwei, who serves as the secretary of the Party committee; the Vice Chairman of the Board of Directors, President and Chief Investment Officer, Mr. Gao Xiqing, who is one of the two deputy secretaries; and Mr. Zhang Hongli, who is one of the Executive Directors and the Executive Vice President and Chief Operating Officer.⁵⁰⁷ As cadres, they owe an overarching duty to implement the party line in accordance with the important political principle of democratic centralism.⁵⁰⁸

In a recent important commentary published prominently in the People's Daily, the CCP made clear the nature of the relationship between SWFs, SOEs, and the Party.⁵⁰⁹ The Commentary suggests that to:

[F]irmly establish the Party's core political status in corporate governance in SOEs is a valuable experience, drawing on the practice of reform and development over the past 30 years, and also an important principle which should be firmly grasped to strengthen and improve Party building work in SOEs, which reflects the distinctive characteristics and

⁵⁰⁵ ROSEN & HANEMANN, *supra* note 283, at 6. This arrangement is not unique to CIC. China's unique Party-related corporate governance may affect perceptions of its OFDI motives. *Id.* In Chinese state-owned enterprises, shareholders may not have the same power as their counterparts in American corporations, "but nonowners like the secretary of the Communist Party Committee within each firm often have that power and more, while the senior management of state-owned enterprises is appointed directly by the Party." *Id.*

⁵⁰⁶ See Wang Jiangyu, *Company Law in China* 33 (Nat'l Univ. of Singapore, Working Paper, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1222061.

⁵⁰⁷ 中投公司人事名单 [*List of Investment Company Personnel*], CAIJING, Aug. 9, 2009, <http://www.caijing.com.cn/2007-09-29/100031997.html>.

⁵⁰⁸ XIAN FA art. 3 (1982) (P.R.C.), available at <http://english.peopledaily.com.cn/constitution/constitution.html> (Democratic centralism refers to a key element of Marxist Leninist constitutionalism that requires Party members to adhere to Party policies until they are changed. Article 3 of the Chinese Constitution incorporates this principle as a central element of Chinese constitutionalism. It provides, in part, "The state organs of the People's Republic of China apply the principle of democratic centralism."). *Id.*

⁵⁰⁹ 坚持国企党组织的政治核心地位不动摇 [*Unswervingly Upholding the Party's Core Political Status in State-Owned Enterprises*], PEOPLE'S DAILY, Aug. 27, 2009, available at <http://www.finance.people.com.cn/GB/9935600.html> [hereinafter *Party's Core*] (This article was made available only in the Chinese version of the People's Daily and does not appear for its English speaking audience. For both the original and an English translation, see, The Chinese Communist Party and the Governance Structures of SWFs and SOEs: Unswervingly Upholding the Party's Core Political Status in SOEs, <http://lbackerblog.blogspot.com/2009/09/chinese-communist-party-and-governance.html> (Sept. 1, 2009, 20:07 EST).

fundamental requirements of the modern state-owned enterprise system with Chinese characteristics.⁵¹⁰

This work includes actively participating in corporate governance, personnel decisions, and ensuring the implementation of principles and policies from the Party and state.⁵¹¹ Clearly, this Commentary is not law. Nor does it affect any formal changes in governance. It may not be directly enforced. But it does serve to indicate important currents of understanding whose effects will be felt.⁵¹² First, the Western notion of corporate autonomy does not align to Chinese SWFs and SOEs in these relationships to the CCP, even if the notion is engrained into the formal relationships between the state apparatus and the enterprise. But that relationship between the CCP and the enterprise ought not to be thought of as analogous to a private institution. The CCP retains authority to provide overall guidance.⁵¹³ Second, corporate governance, like the state apparatus in China, is subject to the overall leadership of the Communist Party. Corporations are autonomous but subject to the overall direction of the CCP. "The unified decision-making power of the board of directors on major issues should be supported, while the views of the Party committee should also be respected and reflected. Thus, the participation of the Party in deciding vital issues integrates with the decision-making of the board under law."⁵¹⁴ Third, like the state, SWFs and SOEs are extensions of the power of Chinese society, all directed to the attainment of the same set of objectives, each in its own way. In this sense, the separation between public and private, between regulatory and participatory activity, and between political and economic activity is understood from a fundamentally distinct framework.

Consequently, there is a close and necessary connection between the state, the party, and the fund that exists beyond the formal limitations of fund objectives. The connection may supersede technically narrow readings of such limitations in the interests of the state and party. It would be difficult to

⁵¹⁰ *Party's Core*, *supra* note 509 ("牢固确立国有企业党组织在公司治理结构中的政治核心地位, 是国有企业经过30年改革发展实践得出的一条宝贵经验, 也是在现代企业制度条件下, 加强和改进国有企业党建工作必须牢牢把握的一条重要原则, 它反映了中国特色现代国有企业制度的鲜明特征和本质要求。" ["Firmly securing party affiliates' political position in the center of a company's governance structure" is a valuable lesson taken from thirty years of reforming, developing, and implementing changes in state-owned enterprises. Under the modern business enterprise system, it is also a paramount guiding principle for those who endeavor to improve and strengthen party coalition in state-owned enterprises. This principle reflects the unique conditions and inherent demands of China's modern state-owned enterprises."]).

⁵¹¹ *Id.*

⁵¹² For a more detailed version of what follows, see *Party's Core*, *supra* note 509.

⁵¹³ Heuser, *supra* note 504.

⁵¹⁴ 坚持国企党组织的政治核心地位不动摇 本报评论员 [State-Owned Enterprises Adhere to the Core of the Political Party], PEOPLE'S DAILY, Aug. 27, 2008, available at http://paper.people.com.cn/rmrb/html/2009-08/27/content_328498.htm.

understand the investment strategy of the CIC in isolation, or otherwise apart from the activities of other state organs, whether political or economic. In this sense, the connection and coordination suggests a different conceptual basis for the organization of sovereign investing, one that is grounded in specialization and coordination. While the pieces may appear distinct, they do not operate independently of each other in a broader sense. Thus, the political and organizational structure suggests the operational culture of the fund and its controlled entities. The essay next examines the CIC's web of organizational activity.

2. The CIC's Investment Strategy

The CIC's investment strategy has been slowly evolving as it has moved from a traditional, stand-alone SWF structure to the center of a web of investment, including direct and indirect investment through SWFs, SOEs, and financial and operating enterprises from within and outside China. This evolution was both highlighted and accelerated by the 2008 financial crisis. The CIC suggests its overarching investment principle in its Articles of Association: "[CIC's] business objectives are to carry out an active and steady operation, endeavor to maximize the shareholder's interests within an acceptable scope of risks, and continuously improve the corporate governance in the state-owned major financial institutions it controls."⁵¹⁵ The CIC's Articles of Association also broadly define its scope of business:

The scope of business of [the CIC] includes: domestic investments in debt securities denominated in foreign currencies and other financial products denominated in foreign currencies; overseas investments in debt securities, stocks, funds and derivative instruments and other financial products; domestic and overseas equity investments; overseas investments through external fund managers; provision of loans through entrusted financial institutions; management of entrusted foreign exchange assets; establishment of equity investment funds and fund management companies as a promoter; and other businesses approved by the relevant governmental authorities.⁵¹⁶

The Articles of Association further explicitly limit the CIC's direct investment in domestic enterprises,⁵¹⁷ but permit indirect oversight of such

⁵¹⁵ CIC Abstract, *supra* note 64.

⁵¹⁶ *Id.*

⁵¹⁷ *Id.* ("As a matter of principle, [the CIC] shall not actively seek investment in domestic non-financial enterprises, with the exceptions of purchasing overseas listed stocks, passive shareholdings and other circumstances as approved by the relevant governmental authorities.").

investment through subsidiaries.⁵¹⁸ Lastly, the Articles of Association suggest a comprehensive system in making investment decisions.⁵¹⁹ The CIC articulated its specific investment policies in 2008.⁵²⁰ They now reflect conventional understanding of the investment strategies globally appropriate for these enterprises:

- The CIC selects investments based on economic and financial objectives, and an assessment of the commercial return.⁵²¹
- The CIC allocates capital and assets within the given risk tolerance of the owner to maximize shareholder value.⁵²²
- The CIC usually does not seek an active role in the companies in which it invests or attempts to influence those companies' operations.⁵²³
- The CIC seeks long-term, stable, sustainable, and risk-adjusted returns.⁵²⁴

The CIC's investment principles also suggest an ethical and, indirectly, political nature.⁵²⁵ In its 2008 Annual Report, the CIC described its investment strategy as grounded in five principles: long-term, sustainable risk adjusted returns for its shareholder; avoidance of control enterprises or sectors in which it invests; investment on a commercial basis; compliance with local law and sensitivity to corporate social responsibility; and research driven investment.⁵²⁶

The CIC allocates its assets among equity, fixed income, and alternative assets.⁵²⁷ Equity investments include outsourced equity investments,

⁵¹⁸ *Id.* ("[The CIC] makes equity investments in domestic financial institutions primarily through its subsidiary, Central Huijin Investment Ltd.").

⁵¹⁹ *Id.* ("According to its own business characteristics, [the CIC] shall establish and improve investment decision-making mechanisms, internal control systems and risk monitoring and control mechanisms to guard against operation risks and to ensure [the CIC]'s steady operation and compliance with applicable laws and regulations.").

⁵²⁰ China Inv. Corp., Investment Policy, http://www.china-inv.cn/cicen/investment/investment_investment.html (last visited Jan. 20, 2010) [hereinafter Investment Policy].

⁵²¹ *Id.*

⁵²² *Id.*

⁵²³ *Id.*

⁵²⁴ *Id.*

⁵²⁵ Investment Policy, *supra* note 520.

⁵²⁶ CHINA INV. CORP., ANNUAL REPORT 2008 28 (2009), available at http://www.swfinstitute.org/research/CIC_2008_annualreport_en.pdf.

⁵²⁷ China Inv. Corp., Asset Classes, available at http://www.china-inv.cn/cicen/investment/investment_asset.html (last visited Jan. 20, 2010).

concentrated equity holdings, initial public offerings, and open market investments.⁵²⁸ Fixed income investments include outsourced fixed income investments, limited outsourced fixed income investments, and cash management.⁵²⁹ Alternative asset investments include private equity investments, direct investments, and real estate investments.⁵³⁰

The CIC's risk management is also framed in conventional terms.⁵³¹ "Its internal risk management system is based on international best practices, such as the risk management principles established by the Committee of Sponsoring Organizations ("COSO"), developed to give clear directions and guidance for enterprise risk management."⁵³² Like other SWFs, its internal risk management apparatus is structured in conventional terms.⁵³³ The Risk Management Committee is responsible for setting company-wide strategy, risk management systems and policies, defining exposure thresholds, and reviewing and finalizing reports concerning risk management.⁵³⁴ In addition to making investment by itself, "CIC retains external fund managers to assist with the management of certain aspects of its international investment portfolio."⁵³⁵

Lou Jiwei, chairman and CEO of the CIC, recently published an article entitled *Sovereign Wealth and the Financial Crisis*, in which he summarized the CIC's investment principles as follows:

CIC's mission is to diligently seek long-term investments that maximize returns while maintaining a rigorous approach to managing risks for the benefit of shareholders. Thus, through its management style, CIC sticks with a commercial orientation that maximizes financial returns. In terms of risk

⁵²⁸ *Id.*

⁵²⁹ *Id.*

⁵³⁰ *Id.*; see also ANNUAL REPORT 2008, *supra* note 526, at 29–33.

⁵³¹ ANNUAL REPORT 2008, *supra* note 526, at 38–39.

⁵³² China Inv. Corp., Risk Management, http://www.china-inv.cn/cicen/investment/investment_risk.html (last visited Jan. 20, 2010) ("CIC has an established risk management framework and risk thresholds that governs its investment activities to ensure shareholder's return is maximized within a clear risk tolerance. CIC assumes and manages those risks where it can extract value, such as credit and market risk, while reducing and preventing its exposure to operational risk.").

⁵³³ *Id.* ("CIC manages risks via an internal set of positions, departments, and committees that are tasked to directly manage or monitor risk issues. These include, but are not limited to Executive Committee, Risk Management Committee, Chief Risk Officer, Risk Management Department, Legal and Compliance Department, other relevant departments and desk positions").

⁵³⁴ *Id.*

⁵³⁵ China Inv. Corp., External Fund Management, http://www.china-inv.cn/cicen/investment/investment_external.html (last visited Jan. 20, 2010).

tolerance, CIC can afford rather high, short-term risk fluctuations to maximize long-term returns. In strategic assets allocation, CIC is more aggressive than traditional central banks in managing forex reserves by investing both traditional equity and fixed-income investments that have rather low liquidity but are forecast for rather high investment returns.

Affected by limited talent and capital, CIC developed an investment strategy based on "an investment approach that is a mixture of international financial products, with most assets invested in public market products and the rest invested in alternative assets." Meanwhile, direct investment should not be abandoned. Investments are mainly made through external fund managers with a gradual increasing weight of proprietary investments.⁵³⁶

Lou Jiwei further stressed that the financial crisis had not affected the CIC's investment principles:

During this crisis, SWFs have suffered some losses and are going through a very difficult time. They are trying to rebalance and reshuffle their portfolios. Some funds adjusted investment strategies or amended investment solutions by shifting to domestic investments. . . . As the sole SWF in China, CIC continues to comply with our previously set goals of cautious overseas investments and commercial operations. One important factor is that, despite China's high level of foreign exchange reserves, CIC has not shifted its investment goals or strategy.⁵³⁷

Yet, appearances can be deceiving. As the number of Chinese companies has expanded globally during the financial crisis, especially state-owned companies in the natural resources sector, the CIC appears to have adjusted its function in order to assist these companies. Some Beijing based bankers and officials described the CIC's preferred role as a financier and facilitator for state-owned companies making offshore acquisitions.⁵³⁸ "In spite of its earlier protestations, the CIC now seems to have accepted a role as piggy bank for global expansion of China Inc."⁵³⁹

⁵³⁶ *Id.*

⁵³⁷ *Id.*

⁵³⁸ Jamil Anderlini, *CIC Accepts Role as Piggy Bank for China Inc.*, FIN. TIMES, Mar. 4, 2009, available at http://www.ft.com/cms/s/0/47cc33ea-08e5-11de-b8b0-0000779fd2ac.html?ncllick_chck=1.

⁵³⁹ *Id.*

The CIC, together with its two subsidiaries, has manifested a change in investment strategies in at least three aspects. First, the CIC's investment in large international companies has expanded from preferred stocks to common stocks and hedge funds.⁵⁴⁰ Second, the CIC has switched its emphasis from the financial sector to the natural resources sector.⁵⁴¹ Third, the reallocation of functions between the CIC's two subsidiaries, Central Huijin and Jianyin, will certainly affect the strategy of China allocating and managing its sovereign wealth.⁵⁴² The CIC has manifested a tendency of expanding its portfolio from purely preferred stocks to common stocks, as evidenced by its investment of \$1.2 billion in common stock in Morgan Stanley ("MS").⁵⁴³ On December 19, 2007, the CIC purchased \$5.6 billion mandatory convertible securities into MS common stock, representing approximately 9.86 percent equity ownership in MS. After Mitsubishi UFJ Financial Group's investment in MS in October 2008, the CIC's equity ownership was diluted to approximately 7.68 percent, but is now likely to increase with fresh cash infusions.⁵⁴⁴ This new purchase will bring the CIC's equity ownership in MS back to approximately 9.86 percent, effectively reducing its overall cost basis and increasing the potential returns.⁵⁴⁵ Similarly, the CIC intended to increase its stake in the U.S. private equity firm Blackstone to 12.5 percent from the original 9.9 percent via buying shares on the open market after the two sides agreed to raise the ownership limit to that level.⁵⁴⁶ It was reported that the additional stocks would be common stocks, as opposed to the 9.9

⁵⁴⁰ Paritoch Bansai & Megan Davies, *CIC to Invest \$500 Mln in Blackstone Fund*, REUTERS, June 19, 2009, <http://www.reuters.com/article/mergersNews/idUSN1942810220090619>.

⁵⁴¹ Rick Carew & Tom Wright, *CIC Bets Big on Resources*, WALL ST. J., Sept. 24, 2009, available at <http://online.wsj.com/article/SB125373234125034921.html> ("China's sovereign-wealth fund is fast becoming a major backer of natural-resources companies world-wide, as the \$300 billion fund seeks to buy into a global rebound.").

⁵⁴² See *infra* Part V.C.

⁵⁴³ Press Release, China Inv. Corp., *CIC Purchases \$1.2 Billion Morgan Stanley Common Stock* (June 2, 2009), http://www.china-inv.cn/cicen/resources/resources_news01.html [hereinafter *CIC Purchases \$1.2 Billion*].

⁵⁴⁴ As reported by the Shanghai Daily:

[CIC] will spend U.S. \$1.2 billion in buying common shares offered by Morgan Stanley because it is optimistic about the company's future growth and progress. . . . CIC's equity ownership was diluted to 7.68 percent in October 2008 when the Mitsubishi UFJ Financial Group Inc invested in Morgan Stanley.

Optimistic CIC to Buy More Morgan Stanley, SHANGHAI DAILY, June 3, 2009, available at http://www.shanghaidaily.com/sp/article/2009/200906/20090603/article_402957.htm.

⁵⁴⁵ *CIC Purchases \$1.2 Billion*, *supra* note 543.

⁵⁴⁶ *China's CIC Chief Defends Investments, Blackstone*, REUTERS, Oct. 26, 2008, <http://www.reuters.com/article/privateEquity/idUSPEK8426920081026>.

percent preferred stocks that the CIC bought initially in 2007.⁵⁴⁷ If that is the case, the additional stocks would give the CIC voting rights in Blackstone.

Theoretically, preferred stocks should have been more preferable to a risk adverse investor, especially in the present economy where even large companies that have been operating over centuries may go out of business. This is because the preferred shareholders will receive dividends before the common shareholders receive any dividends, and will also receive a share of the assets in the event of bankruptcy before the common shareholders get any bankruptcy proceeds. The downside of preferred stock is that preferred shareholders do not get a vote in running the company. Changing the portfolio from a preferred stock to a common stock portfolio could show that the CIC has departed from its investment policy of “not [seeking] an active role in the companies in which it invests nor [attempting] to influence those companies’ operations.”⁵⁴⁸ Indeed, by April 2009, the CIC Chairman was suggesting a shift away from equities, at least to some extent.⁵⁴⁹

The CIC’s program of direct investment for the purpose of obtaining controlling interests in domestic and foreign enterprises has been a significant part of its investment strategy. First, the CIC has acquired control of important state sector industries. Prominent among these has been the China Reinsurance (Group) Corporation, China’s only state-owned reinsurance company.⁵⁵⁰ The CIC acquired management of the SWF, China

⁵⁴⁷ Michael J. de la Merced, *China Allowed to Raise Stake in Blackstone*, N.Y. TIMES, Oct. 16, 2008, available at <http://dealbook.blogs.nytimes.com/2008/10/16/blackstone-lets-china-raise-its-stake-in-the-firm>.

⁵⁴⁸ Investment Policy, *supra* note 520.

⁵⁴⁹ Lou Jiwei, *Sovereign Wealth Funds Can Help Stabilize Global Financial System*, CHINA DAILY, Apr. 1, 2009, http://www.chinadaily.com.cn/bizchina/2009-04/01/content_7639539_2.htm. As Mr. Jiwei stated at the Second Annual Roundtable of Sovereign Asset and Reserve Managers:

In the past year, the global financial crisis also had impact on the business of a new company such as CIC, especially its investment on overseas financial products. Yet CIC’s investment size is relatively limited at this stage. Under the circumstances, we have been trying our best to analyze and understand the trends of global financial markets and macro economy. While allocating long-term strategic assets properly, we have adjusted the annual asset allocation strategy in a timely manner by voluntarily slowing down the pace of investment in stocks and setting a cash-based prudential investment strategy.

Id.

⁵⁵⁰ The history of this acquisition is telling:

Central Huijin Investment Co, an investment arm of CIC, injected \$4 billion into China Reinsurance in April 2007, helping the country’s largest reinsurer to restructure into a corporation. Central Huijin owns 85.5 percent of China Reinsurance, as a result of the recapitalization, and the Ministry of Finance owns the remaining 14.5 percent.

Investment Company, from China Insurance Regulatory.⁵⁵¹ According to a statement on the CIC's website, China Reinsurance has six units covering reinsurance, property insurance, life insurance, asset management, insurance brokerage, and insurance media.⁵⁵² This may reflect the need to insure the profitability of these enterprises while adhering to state investment targeting, especially after the CIC suffered large losses in the course of the 2008 financial crisis.⁵⁵³

Second, since 2008, the CIC and other SOEs have been aggressively investing in the natural resources sector.⁵⁵⁴ The CIC's activities, of course, reflect participation both in the "Go Global" Strategy and implementation of the State Council's preference for investment in the global resources sector.⁵⁵⁵ But it also reflects the investment strategy that such state-directed investment ought to be commercially advantageous.⁵⁵⁶ Much of the focus was on acquiring control of natural resources.⁵⁵⁷ Thus, it was reported that "[t]he shift of CIC's investment focus from U.S. banks and funds to global resources comes on the heels of two high-profile Australian deals recently made by Chinese companies."⁵⁵⁸ The CIC's most recent deal in the natural resources

CIC Takes Over Supervision of China Re's Management Team, CHINA DAILY, June 18, 2009, http://www.chinadaily.com.cn/bizchina/2009-06/18/content_8299245.htm. Thereafter, the CIC took over the supervision of China Reinsurance (Group) Corp's management team from the insurance regulator.

⁵⁵¹ *CIC Takes over China Reinsurance Management*, CAIJING, June 18, 2009, <http://english.caijing.com.cn/2009-06-18/110186187.html>.

⁵⁵² *Id.*

⁵⁵³ Zhao Jianfei, *Overseas Acquisitions: A Chorus Without a Conductor*, CAIJING, Feb. 25, 2009, <http://english.caijing.com.cn/2009-02-25/110074133.html>.

⁵⁵⁴ Anderlini, *supra* note 538.

⁵⁵⁵ Jianfei, *supra* note 553.

⁵⁵⁶ *March 2 to 6*, CAIJING, Mar. 6, 2008, <http://english.caijing.com.cn/2009-03-06/110114079.html>. Thus, for example, CIC officials asserted that it saw foreign mining assets as potential investment targets as global commodity prices continue to fall. According to CIC Deputy General Manager Wang Jianxi, CIC has placed the foreign mining sector within its universe of possible investments. *Id.* Wang said weak market conditions will mean that mining investments retain downside risk, but added as a long-term investor CIC will only absorb unrealized losses. *Id.*

⁵⁵⁷ George Chen, *Chinese Sovereign Fund Turning to Natural Resources*, N.Y. TIMES, Feb. 19, 2009, available at <http://www.nytimes.com/2009/02/19/business/worldbusiness/19iht-deal20.1.20303203.html>.

⁵⁵⁸ *Id.*; see also *Australia Will Not Deter China Investors*, FIN. TIMES, July 6, 2008, available at http://www.ft.com/cms/s/0/723dfc8c-4b92-11dd-a490-000077b07658.html?nclink_check=1. (Wayne Swan, Australia's treasurer, told a business audience that he had approved a Chinese investment proposal on average once every nine days since Mr. Rudd's Labor Party was elected last November.); 中投洽购澳资源类企业 [*Investment in Australian Resource Companies Under Negotiation*], CAIJING, Feb. 2, 2009, <http://www.caijing.com.cn/2009-02-18/110071112.html> (stating that CIC planned to invest in Australia's metal assets, including Fortescue Metals Group, and it is likely to collaborate with China's state-owned enterprises in acquiring overseas resources companies).

sector was with Teck Resources Limited, a transaction that was meant to provide the CIC with an indirect stake in the target company.⁵⁵⁹ The speed and intensity of transactions coming from various sectors of the sovereign investing establishment sometimes present coordination problems as one sovereign acquisition may jeopardize another. That, effectively, was the fear when the Hunan Valin Steel Company acquired Foreclosure Metals Group ("FMG") and consequently affected CHINALCO's⁵⁶⁰ acquisition of a stake in the Australian enterprise, Rio Tinto.⁵⁶¹ As a result, CHINALCO lost the deal with Rio Tinto in June 2009.⁵⁶²

The Rio Tinto investment itself highlights another point of convergence between state and sovereign investing. China has tended to apply its political and criminal laws to the commercial activities of its SWFs and SOEs. It effectively conflates, at the state level, both in-bound and out-bound political

⁵⁵⁹ News Release, China Inv. Corp., China Investment Corporation Announces Investment in Teck Resources Limited (July 3, 2009), available at http://www.china-inv.cn/cicen/resources/resources_news08.html. The CIC announced that:

[I]t has agreed to purchase on a private placement basis, through its wholly-owned subsidiary (SPV) Fullbloom Investment Corporation, 101,304,474 Class B subordinate voting shares ("Class B Shares") of Teck Resources Limited ("Teck") for C\$ 17.21 per share (the "Subscription Price"). The aggregate purchase price was expected to be US\$ 1.5 billion (or approximately C\$ 1.74bn) in cash. CIC did not currently hold any of Teck's shares before. After completion of the purchase, CIC would indirectly hold Class B Shares representing approximately 17.5% of Teck's issued and outstanding Class B Shares, approximately 17.2% of Teck's issued and outstanding shares and approximately 6.7% of the aggregate voting rights attaching to Teck's Class A common shares and Class B Shares.

Id.

⁵⁶⁰ CHINALCO, Overview, http://www.chalco.com.cn/zl/web/chinalco_en_show.jsp?ColumnID=122 (last visited Jan. 20, 2010). The article stated:

Aluminum Corporation of China (CHINALCO), an investment management and holding company authorized by the state, is a backbone state-owned enterprise. As of the end of June 2008, its assets totaled RMB 377.7 billion, with its value growth rate on fixed assets and return on equity leading among the state-owned enterprises with assets over RMB 10 billion. It is the world's second largest alumina producer and the third largest primary aluminum producer.

Id.

⁵⁶¹ Jianfei, *supra* note 553. Hunan Valin Steel Company Ltd. completed a deal with Fortescue Metals Group Ltd. ("FMG") for 16.48 percent of the miner's equity in exchange for a capital injection of some AU\$ 858 million, which made Valin the second largest shareholder of FMG. (Meanwhile, CIC has also shown interest in FMG's shares and rumors are the possible deal would be worth AU\$ 3 billion.) When rumors of the Valin-FMG deal circulated, an insider familiar with overseas acquisitions questioned why the Chinese government did not urge the company to postpone the deal, as Valin's investment would likely make it harder. *Id.*

⁵⁶² *Rio Tinto to Withdraw from U.S. \$19.5 Bln CHINALCO Deal*, CAIJING, June 3, 2009, <http://english.caijing.com.cn/2009-06-04/110178237.html>.

and economic activity. The recent arrests of the Rio Tinto executives for breach of the Chinese State Secrets law is a case in point.⁵⁶³ Sovereign investment, whatever its form, remains an integrated component of the projection of state power. As a projection of state power sovereign investments are first and foremost a sovereign activity and a commercial or financial venture thereafter.

Third, the CIC reallocated the functions and operations of its principal investment subsidiaries, Central Huijin and Jianyin, to permit certain flexibility in indirect investment.⁵⁶⁴ Central Huijin became a policy-related financial investment institution, controlling majority stakes in the largest state-owned enterprises. It will serve effectively as a state investment agency.⁵⁶⁵ Jianyin will serve as an industrial investment platform for the CIC, in order to assist Chinese companies to expand overseas.⁵⁶⁶ It might be reasonable to assume that the CIC, or the State Council, intends to build a sophisticated state investment mechanism to manage China's sovereign wealth, and to promote and stabilize China's economy.

C. *Sovereign Investment as Cooperative Public-Private Networks: The CIC and Its Subsidiaries*

Taken in isolation, the CIC appears like a fairly standard and somewhat transparent SWF. Like the Norwegian Fund, the CIC seems to be taking a greater interest in both equity positions and increased shareholder activism. However, the CIC's operations cannot be understood in isolation. As the center of a large network of interrelated sovereign wealth, finance, and operating entities, the CIC is a pivotal point of an integrated approach to sovereign investing. This Part examines that web more closely. It first considers the CIC's principal subsidiaries, and then looks at their aggregate investment operations through controlled SOEs in the financial and operations sectors.

1. The CIC's Subsidiaries: Central Huijin and Jianyin

To understand the investment strategies of the CIC, it is important to understand the roles of Central Huijin and Jianyin. For that purpose, this Part will explore the legal structures and investment activities of both

⁵⁶³ See State-Owned Enterprises and the Integrity of Private Markets and Commercial Activity: On the Arrest of the Rio Tinto Executive, <http://lcbackerblog.blogspot.com/2009/07/state-owned-enterprises-and-integrity.html> (Sept. 20, 2009, 9:33 EST).

⁵⁶⁴ Zhang Bing, *China Investment Agencies Get New Roles*, CAIJING, Feb. 2, 2009, <http://english.caijing.com.cn/2009-02-12/110055513.html>.

⁵⁶⁵ *Id.*

⁵⁶⁶ 建银投资告别金融控股 资产重分配 [*Jianyin Investment Bids Farewell to Financial Holdings Through Asset Reallocation*], CAIJING, Oct. 10, 2008, <http://www.caijing.com.cn/2008-10-23/110022493.html> [hereinafter *Jianyin Investment*].

Central Huijin and Jianyin. This will serve as a foundation for the discussion of the institutions that are financially related to Central Huijin or Jianyin, such as Chinese SWFs and other SOEs, in the following subsection.

The CIC wholly owns a subsidiary, Central Huijin,⁵⁶⁷ which manages the sovereign assets invested in state-owned financial enterprises including five large commercial banks, two securities companies, one financial holding company, one investment company, and one reinsurance company.⁵⁶⁸ Further, Central Huijin wholly owns another subsidiary, Jianyin.⁵⁶⁹ The two subsidiaries conduct different functions as assigned by the state council.⁵⁷⁰

Established in December 2003, Central Huijin's main function was to recapitalize and stabilize China's major state-owned commercial banks. In September 2007, the Ministry of Finance issued special treasury bonds and acquired all the shares of Central Huijin from the People's Bank of China.⁵⁷¹ The acquired shares were injected into the CIC as part of its initial capital contribution for around \$67 billion.⁵⁷² However, shareholder rights are exercised directly by the State Council.⁵⁷³ The State Council authorized Central Huijin to exercise rights and obligations as an investor in major state-owned financial enterprises on behalf of the Chinese government.⁵⁷⁴ Its role is to act as an investor, exercising shareholder and other rights on behalf of the state.⁵⁷⁵

Historically, China's underdeveloped financial sector, partially reformed banking industry, and vulnerable state-owned enterprises have had many problems. The banking industry is still in the middle of reforms and its problems affect the economy as a whole. It suffers from deep-rooted problems such as a low degree of commercialization, distorted incentives, a high ratio of bad loans, government ownership, and inefficient management. The

⁵⁶⁷ "The Company's Chinese name shall be '中央汇金投资有限责任公司,' and its English name shall be 'Central Huijin Investment Ltd.' The scope of business of the Company is as follows: to accept the authorization of the State to make equity investments in state-owned major financial enterprises." Cent. Huijin Inv. Ltd., Articles of Association (Abstract), <http://www.china-inv.cn/cicen/governance/articles.html> (last visited Jan. 20, 2010) [hereinafter Central Huijin Articles].

⁵⁶⁸ See *A Simmering CIC-Huijin Separation*, CHINA STAKES, July 8, 2008, <http://www.chinastakes.com/2008/7/a-simmering-cic-huijin-separation.html>.

⁵⁶⁹ Li Qing, *New Roadmap for Central Huijin's Brokers*, CAIJING, Jan. 9, 2009, <http://english.caijing.com.cn/2009-01-06/110045271.html> (Nov. 5, 2009).

⁵⁷⁰ *Id.*

⁵⁷¹ Cent. Huijin Inv. Ltd., About Us, http://www.huijin-inv.cn/hjen/aboutus/aboutus_2008.html (last visited Jan. 20, 2010) [hereinafter About Central Huijin].

⁵⁷² *Id.*

⁵⁷³ *Id.*

⁵⁷⁴ Sovereign Wealth Fund Inst. [SWFI], Central Huijin Investment Limited, <http://www.swfinstitute.org/fund/cic.php>. (last visited Jan. 10, 2009) [hereinafter SWFI].

⁵⁷⁵ About Central Huijin, *supra* note 571.

estimated size of bad loans, or non-performing loans, ranges from about 25 to 45 percent of the total loans outstanding for Chinese banks.⁵⁷⁶ The State Council endeavored to reform and restructure China's major commercial bank, and consequently created Central Huijin in 2003.⁵⁷⁷ Central Huijin is a purely internal financial investment company.⁵⁷⁸

An important wholly owned subsidiary of Central Huijin is China Jianyin Investment. It was founded in 2004, with a registered capital of RMB 20.69225 billion,⁵⁷⁹ through the restructuring of China Construction Bank, one of the four largest state-owned commercial banks in China.⁵⁸⁰ "China Jianyin Investment took over all of the state-run lender's non-banking business, including a 40 percent stake in China International Capital Corp.,

⁵⁷⁶ See Yi Gang, *China's Accession to the WTO and the Opening and Reform of Financial Services*, in CHINA: ACCESSION TO THE WTO AND ECONOMIC REFORM 209 (Wang Mengkui ed. 2002).

⁵⁷⁷ SWFI, *supra* note 574.

⁵⁷⁸ About Central Huijin, *supra* note 571. The Central Huijin website states:

Central Huijin, in accordance with authorization by the State Council, makes equity investments in major state-owned financial enterprises, and shall, to the extent of its capital contribution, exercise the rights and perform the obligations as an investor on behalf of the State in accordance with applicable laws, to achieve the goal of preserving and enhancing the value of state-owned financial assets. Central Huijin does not conduct any other business or commercial activity. It does not intervene in the day-to-day business operations of the firms in which it invests.

Id.

⁵⁷⁹ China Int'l Capital Corp. Ltd., CICC Shareholders, <http://www.cicc.com.cn/CICC/english/about/page2.htm> (last visited Jan. 20, 2010) [hereinafter CICC Shareholders].

⁵⁸⁰ China Constr. Bank, China Jianyin Investment Limited: Notice on the Issuance of Financial License, <http://www.ccb.com/en/ccbtoday/1134459149100.html> (last visited Jan. 20, 2010). According to its shareholder history, "China Banking Regulatory Commission approved the spin-off of China Construction Bank into China Construction Bank Corporation and China Jianyin Investment Limited, and the five sponsors including Central Huijin Investment Company set up China Construction Bank Corporation." China Constr. Bank, Shareholders History, http://www.ccb.com/portal/en/home/info_detail.jsp?info_id=1134457253100&info_type=CMS.STD&miniset_column (last visited Jan. 20, 2010); *China Construction Bank Corporation Holds Grand Opening Celebration of New York Branch*, REUTERS, June 5, 2009, <http://www.reuters.com/article/pressRelease/idUS211699+05-Jun-2009+PRN20090605>. Reuters reported:

CCB is one of the largest commercial banks in China, ranked second in terms of market capitalization among all listed banks in the world, and is among global industry leaders in terms of profitability. CCB owns the largest number of ATMs in the world. CCB ranks first among banks in China in terms of medium and long term capital construction loans and personal residential mortgage loans. As of the end of the first quarter of 2009, CCB's total assets were approximately USD \$1.3 trillion (RMB 8674.633 billion), with an NPL ratio of 1.9% and a provision coverage ratio of 141.8%, and the net profit for the first quarter of 2009 was USD \$3.84 billion (RMB 26.276 billion).

Id.

which is 34 percent owned by Morgan Stanley.”⁵⁸¹ In the year before its reorganization, China Construction Bank had been the recipient of substantial financial infusions from Central Huijin.⁵⁸² Its initial objective after restructuring was to manage bad assets in ailing Chinese state banks and securities firms.⁵⁸³ Its activities eventually expanded to include operation of six securities firms including Huaxia Securities, Nanfang Securities, Xinan Securities, and Beijing Securities—all of which were recapitalized and restructured.⁵⁸⁴ Jianyin turned Zhejiang International Trust Investment Company into a subsidiary and has planned to establish fund managers.⁵⁸⁵

In October 2008, the State Council reallocated functional authority between Central Huijin and Jianyin.⁵⁸⁶ Central Huijin became a policy-related financial investment institution, controlling a majority of stakes in the largest state-owned enterprises that were primarily banks.⁵⁸⁷ Jianyin abandoned its objective to become a financial holding company and instead was redirected to serve as an industrial investment platform for the CIC.⁵⁸⁸ As such, Jianyin would serve as a vehicle for indirect overseas investment activities of the CIC through programs of assistance to Chinese SOE and private companies for overseas expansion.⁵⁸⁹ This reform was also motivated by a legal restriction provided in the Securities Companies Supervision and Management Regulations⁵⁹⁰ that bar any two closely affiliated firms from engaging in similar businesses without special permission.⁵⁹¹ This restriction, however, will not take full effect for five years.⁵⁹² As a consequence, Central

⁵⁸¹ *Central Huijin to Consolidate CCB Stake*, SHENZHEN DAILY, May 28, 2009, available at http://szdaily.sznews.com/html/2009-05/28/content_640661.htm [hereinafter *Central Huijin*].

⁵⁸² *China Construction Bank*, *supra* note 580.

⁵⁸³ *Jianyin Investment*, *supra* note 566.

⁵⁸⁴ *Id.*

⁵⁸⁵ *Reshuffling Begins for State Finance Arms*, CAIJING, (Nov. 4, 2008), <http://english.caijing.com.cn/2008-11-04/110025902.html> [hereinafter *Reshuffling Begins*].

⁵⁸⁶ *Jianyin Investment*, *supra* note 566.

⁵⁸⁷ *Reshuffling Begins*, *supra* note 585.

⁵⁸⁸ *Bing*, *supra* note 564.

⁵⁸⁹ *Jianyin Investment*, *supra* note 566.

⁵⁹⁰ 个以上的证券公司受同一单位、个人控制或者相互之间存在控制关系的，不得经营相同的证券业务，但国务院证券监督管理机构另有规定的除外《证券公司监督管理条例》，第二十六条，第三款 [“Any two or more, closely affiliated securities companies—controlled by the same group or individual, or where there is mutual governance between the entities—are prohibited from engaging in similar securities businesses. This rule is subject to exceptions provided by other regulations promulgated by the State Council’s securities supervisory agency.”] Securities Companies Supervision and Management Regulations, art. 26, sec. 3, available at http://www.china.com.cn/law/txt/2008-04/24/content_15007817_2.htm.

⁵⁹¹ *Id.*

⁵⁹² *Id.*; *Reshuffling Begins*, *supra* note 585.

Huijin is increasing its direct stake in China Construction Bank, with the eventual aim of acquiring full control from its wholly owned subsidiary.⁵⁹³ Jianyin transferred its holding of 20.7 billion H-shares of CCB to Huijin in May 2009.⁵⁹⁴

The reorganization is said to further the aims of the Chinese State Council "to encourage state agencies to spin off nine securities firms currently under their wings. These nine firms would be related through shareholders and common parents."⁵⁹⁵ Under the new allocation of functions, the State Council expects Central Huijin to accelerate the restructuring of major financial enterprises.⁵⁹⁶ As a result, Central Huijin continues its role as a state investment agency,⁵⁹⁷ while Jianyin possibly will become a platform or even a piggy bank for Chinese companies acquiring overseas assets.⁵⁹⁸

Central Huijin is established as an SOE under Chinese corporate law.⁵⁹⁹ Central Huijin's chairman, Mr. Lou Jiwei, also oversees the Chairman and CEO of the CIC.⁶⁰⁰ The Articles of Association also establish a Board of

⁵⁹³ *Central Huijin*, *supra* note 581. As the Shenzhen Daily reported:

Central Huijin Investment Co., an investment arm of China's sovereign-wealth fund, said Wednesday it will take over a unit's 9 percent stake in China Construction Bank Corp. to consolidate its holdings in the large commercial lender. The stake transfer from wholly owned China Jianyin Investment Co. will raise Central Huijin's direct ownership of China Construction Bank to 57 percent from 48 percent . . . Central Huijin said it planned to continue increasing its stake in China Construction Bank over the next 12 months. It didn't elaborate.

Id.

⁵⁹⁴ *Jianyin Investment Hands Over Holdings in CCB to Huijin*, TRADING MARKETS, May 26, 2009, <http://www.tradingmarkets.com/.site/news/Stock%20News/2345560/>. Trading Markets reported:

[CCB revealed in an announcement] that Huijin has purchased 57.805 million A-shares of CCB since December 2008, and in the meantime plans to further add shares of CCB through purchase on the secondary market in the coming 12 months. Statistics showed that Huijin spent 228 million yuan in adding shares of CCB in the past six months.

Id.

⁵⁹⁵ Li Quing, *New Marching Orders for Securities Firms*, CAIJING, Oct. 23, 2008, <http://english.caijing.com.cn/2008-10-23/110022591.html>.

⁵⁹⁶ *Reshuffling Begins*, *supra* note 585.

⁵⁹⁷ Bing, *supra* note 564.

⁵⁹⁸ *Id.*

⁵⁹⁹ Central Huijin Articles, *supra* note 567. Its Board of Directors consists of not less than five directors. *Id.* The Board shall have one Chairman, who shall be the Company's legal representative. *Id.*

⁶⁰⁰ Cent. Huijin Inv. Ltd., Board of Directors (2008), http://www.huijin-inv.cn/hjen/governance/governance_bod.html (last visited Jan. 20, 2010).

Supervisors that shall consist of no less than three supervisors that are appointed by the State Council.⁶⁰¹ Central Huijin's Articles of Association came into effect upon approval by the State Council.⁶⁰² Any amendments to the Articles of Association are proposed by the Board of Directors and come into effect upon approval by the State Council.⁶⁰³ The State Council authorizes the Company's Board of Directors to interpret the Articles of Association.⁶⁰⁴

Since the 2008 reorganization, Jianyin began to fulfill its new role as an industrial investment platform and may become a shareholder of the German Daimler company. Daimler CEO Dieter Zetsche indicated the possibility of the Chinese investors becoming shareholders.⁶⁰⁵ Currently no decision has been made and talks may be ongoing. Reports indicated that the Chinese investor may be Jianyin.⁶⁰⁶ Jianyin makes few public announcements. Jianyin also rarely makes an effort to demonstrate transparency, unlike the CIC and Central Huijin. Yet, based on its official role described by the government, it will soon play an important role in assisting Chinese companies in acquiring assets overseas.

2. The CIC's Relation to Other SOEs

The complexity of sovereign investing of the Chinese model is nicely captured in the relationship between the CIC and its subsidiaries. The CIC indirectly controls a number of Chinese SOEs through its wholly owned subsidiary Central Huijin, despite the fact that the CIC's Articles of Association explicitly restrict the CIC's investment activity in domestic markets.⁶⁰⁷ These state-owned enterprises have been expanding into overseas markets, including both the resources sector and financial sector, especially since the beginning of the 2008 financial crisis. Based on Central Huijin's stock portfolio, along with its recent activity, it is necessary to explore the Chinese SWF's relation to other SOEs. This analysis will show what the key concerns of countries should be when determining the investment strategy of the state.

⁶⁰¹ Central Huijin Articles, *supra* note 567 (noting the term of office of a director is three years, and a director may be re-appointed).

⁶⁰² *Id.*

⁶⁰³ *Id.*

⁶⁰⁴ *Id.*

⁶⁰⁵ *Id.*

⁶⁰⁶ 传中投公司可能入股奔驰母公司 [*Investment Company May Purchase a Stake in the Parent Company of Mercedes-Benz*], HEXUN, Apr. 4, 2009, <http://news.hexun.com/2009-04-22/116933265.html>.

⁶⁰⁷ CIC Abstract, *supra* note 64.

Currently, Central Huijin holds shares in a significant part of the Chinese banking sector.⁶⁰⁸ Indeed, its purchase was meant to provide the CIC with indirect control of the outbound investment activities of the Chinese banking sector.⁶⁰⁹ Based on the list of companies that Central Huijin has disclosed on its official website and related sources,⁶¹⁰ it is possible to get a sense of the nature and extent of indirect sovereign holdings in the banking sector. These relationships are important to understanding both the ways in which sovereign investing is being consolidated within the Chinese SWF structure, and the relationship between the Chinese SWF structure, SOEs, and outbound investment. Lastly, the Chinese model is useful for understanding the ways in which sovereign welfare maximization is accomplished through an integrated program of political and regulatory, as well as private and participatory, projections of power abroad. This Part starts with a description of the most significant financial sector holdings, and then turns to the strategies for integrating the operations of this sector with SOE investment and the SWF activities of the CIC. It is meant to highlight the organizational complexity of sovereign investing in the context of a "Go Out" or "Go Global" strategy. The complexity stems from the integration of commonly controlled SWF and SOE enterprises, when they coordinate their efforts at a macro level to both attain larger state objectives and directly project state economic power abroad.

⁶⁰⁸ Cent. Huijin Inv. Ltd., Investments (2008), http://www.huijin-inv.cn/hjen/investments/investments_2008.html?var1=Investments [hereinafter CHI Investments]. The investments include China Development Bank, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, China Everbright Bank, China Reinsurance (Group) Corporation, China Jianyin Investment Corporation, China Galaxy Financial Holding Corporation, Shenyin & Wanguo Securities Corporation, and Guotai Junan Securities Corporation. *Id.*

⁶⁰⁹ William Mellor & Le-Min Lim, *Lou Suffers Blackstone's Fat Rabbits in China Fund (Update 1)*, BLOOMBERG, Feb. 27, 2008, <http://www.bloomberg.com/apps/news?pid=20601109&sid=at7tCLylbz2U&refer=home>. As the article illustrates, the common understanding was that CIC was engaging in indirect investment through its controlled banks:

One of CIC's first actions in June was to buy Central Huijin Investment Co., the government investment arm that holds controlling stakes in China's three biggest banks, for \$67 billion. CIC also paid \$20 billion to recapitalize China Development Bank, a fourth Chinese lender. . . . In turn, the Chinese banks have been acquiring stakes in some of the world's biggest financial institutions. In July, China Development invested \$3.04 billion for 3.1 percent of Barclays Plc, the U.K.'s third-largest bank. And in October, Industrial & Commercial Bank of China, the world's biggest by market value, agreed to pay 36.7 billion rand (\$5.5 billion) for 20 percent of Johannesburg-based Standard Bank Group Ltd., Africa's biggest lender. CIC and the Ministry of Finance together control 70 percent of ICBC. "There's a very significant pool of foreign exchange in the hands of various state bodies in China, most of which are owned by CIC," Setser, 37, says.

Id.

⁶¹⁰ CHI Investments, *supra* note 608.

Beyond its stake in the China Construction Bank ("CCB"),⁶¹¹ Central Huijin acquired stakes in, and has undertaken outbound investment through, a number of other banks. Prominent among them is the China Development Bank ("CDB").⁶¹² The CDB is a state-owned bank currently in the process of transforming into an international commercial bank.⁶¹³ Its mission consciously blends commercial and sovereign macroeconomic objectives.⁶¹⁴ The CDB holds stakes in overseas financial entities, such as Barclays PLC, the third largest bank in Britain.⁶¹⁵ It also assists Chinese companies in acquiring overseas equities.⁶¹⁶ For instance, it provided financing for CHINALCO to participate in the allotment of shares in Rio Tinto.⁶¹⁷ The CDB also has been cooperating with the Shanghai Zhenhua Heavy Industry Corporation and will provide Zhenhua with up to \$10 billion in financing over the next five years.⁶¹⁸ The Shanghai Zhenhua Heavy Industry Corporation

⁶¹¹ John Liu, *China Construction Bank Rises After Huijin Boosts Stake*, BLOOMBERG, May 26, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a6RvYbNJVbow#>.

⁶¹² See China Dev. Bank, <http://www.cdb.com.cn/English/Index.asp> (last visited Jan. 20, 2010).

⁶¹³ Jiang Chaoliang, China Dev. Bank, Governor's Message, available at <http://www.cdb.com.cn/English/Column.asp?ColumnID=93>. ("CDB continued to support the State's 'Go Global' Strategy by increasing the depth and coverage of its international business and cooperation in key markets, and improving the platforms for expanding its international syndication business and strategic projects.").

⁶¹⁴ China Dev. Bank, CDB Mission, <http://www.cdb.com.cn/English/Index.asp> (last visited Jan. 20, 2010). Thus, China Development Bank's mission "is dedicated to the mission of strengthening the competitiveness of China and improving the living standards of its people in support of the State's medium to long term development strategies and policies." *Id.*

⁶¹⁵ 巴克莱CEO：有责任保证国开行投资长期盈利 [*Barclays CEO: Ensures that Investment Will Be for Long-Term Profitability*], CAIJING, July 1, 2009, <http://www.caijing.com.cn/2009-07-01/110191875.html> [hereinafter *Barclays*].

⁶¹⁶ China Dev. Bank, Strategic Focus, <http://www.cdb.com.cn/English/Column.asp?ColumnId=86> (last visited Jan. 20, 2010).

As the largest developing country in the world, China has the will and responsibility to share the story of its success with other developing countries. The Bank has continued to maintain its support for a large number of major Chinese enterprises in their strategies of expanding their business overseas, inviting foreign investment, and enhancing international cooperation. By the end of 2007, there were 180 international projects supported by the Bank with a total loan balance of USD 18.189 billion.

Id.

⁶¹⁷ 中铝落实融资 将参与力拓配股 [*Aluminum Corporation of China (CHINALCO) Has Secured Financing for the Purchase of Allotted Shares of Rio Tinto*], CAIJING, June 6, 2009, <http://www.caijing.com.cn/2009-06-30/110191042.html>.

⁶¹⁸ *Id.*

primarily manufactures automatic loading systems of container terminals, oil, or exploration platforms and other marine engineering equipment.⁶¹⁹

Central Huijin also controls the Industrial and Commercial Bank of China ("ICBC"), a commercial bank.⁶²⁰ The ICBC claims that it is the world's largest bank by market value, and has served as an instrument for the purchase of overseas bank assets.⁶²¹ It announced in June 2009 that it would purchase 70 percent of the Bank of East Asia's Canadian unit as it takes steps to expand overseas.⁶²² The ICBC previously paid about \$5.6 billion for a 20 percent stake of South Africa's Standard Bank, the largest bank in Africa.⁶²³ Additional purchases were announced in 2009.⁶²⁴ In addition, Central Huijin owns the controlling stake in the Bank of China⁶²⁵ and a 50 percent stake in the Agricultural Bank of China.⁶²⁶ Central Huijin continues to increase its stake in these banks.⁶²⁷ Together, these banks represent the

⁶¹⁹ Shanghai Zhenhua Heavy Industry (Group) Co., Ltd., 600320 Shanghai Stock Exchange, <http://investing.businessweek.com/research/stocks/snapshot/snapshot.asp?ric=600320.SS> (last visited Jan. 20, 2010).

⁶²⁰ See ICBC, Share Information, <http://www.icbc-ltd.com/icbcltd/investorrelations/shareinformation/shareholdingstructure/> (last visited Jan. 20, 2010); see also *Central Huijin Gets 9% CCB H Shares from China Jianyin*, CHINA KNOWLEDGE.COM, May 27, 2009, <http://news.alibaba.com/article/detail/business-in-china/100108818-1-central-huijin-gets-9%2525-cb.html>.

⁶²¹ See ICBC, About Us, Introduction of Industrial and Commercial Bank of China Limited in 2008, <http://www.icbc.com.cn/ICBC/AboutUs/BriefIntroduction/> (last visited Jan. 20, 2010) [hereinafter ICBC, About Us].

⁶²² *80.00 M for the Bank of East Asia (Canada)*, BUS. WEEK, June 4, 2009, available at <http://investing.businessweek.com/research/stocks/transactions/transactions.asp?ric=IDCBF.PK>.

⁶²³ *ICBC to Buy 70% of Bank of East Asia's Canadian Unit*, FIN. TIMES, June 4, 2009, available at <http://www.ft.com/cms/s/0/3f026ea0-5129-11de-84c3-00144feabdc0.html>.

⁶²⁴ See ICBC, About Us, *supra* note 621.

⁶²⁵ See *Central Huijin May Maintain Stake in BOC When Lock-Up Ends*, CHINA KNOWLEDGE.COM, July 1, 2009, <http://news.alibaba.com/article/detail/business-in-china/100128494-1-central-huijin-maymaintain-stake.html>.

⁶²⁶ See *Agricultural Bank of China to Get \$19 Bln Capital Injection*, CHINA VIEW, Oct. 22, 2008, available at http://news.xinhuanet.com/english/2008-10/22/content_10234609.htm; see also *China Approves Shareholding Reform of Agricultural Bank, New Infrastructure Plans*, CHINA VIEW, Oct. 21, 2008, http://news.xinhuanet.com/english/2008-10/21/content_10229530.htm.

⁶²⁷ *China Central Huijin Raises Stakes in 3 Largest Listed Banks*, WALL ST. J., Oct. 11, 2009, available at <http://online.wsj.com/article/BT-CO-20091011-702184.html>.

Central Huijin Investment Ltd., the domestic investment arm of China's sovereign wealth fund, increased its stakes in the country's three largest listed banks, the lenders said Monday. According to statements issued by the three lenders, Huijin purchased 30.07 million yuan-denominated A shares of Industrial & Commercial Bank of China Ltd. (1398.HK), 16.14 million A shares of China Construction Bank Corp. (0939.HK), and 5.13 million A shares of Bank of China Ltd. (3988.HK) through the Shanghai Stock Exchange recently. After the investment, Huijin held a 35.42% stake of ICBC, 57.09% stake of China Construction Bank and 67.5279% stake of Bank of China.

largest banking enterprises in China.⁶²⁸ The Chinese SWF, then, indirectly controls not only its own funds, but also those of a large segment of the Chinese banking sector and its investment activities.

In addition, Central Huijin serves as an investment coordinator through its interests in the China Everbright Group ("CEG"),⁶²⁹ which was established on November 30, 2007 as part of the restructuring of a large conglomerate of financial and industrial sector businesses "into the first full-fledged financial holding corporation in China."⁶³⁰ In furtherance of that purpose, CEG controls a variety of businesses, including the China Everbright Bank ("CEB"),⁶³¹ Everbright Securities,⁶³² China Everbright,⁶³³ Sun Life Everbright Insurance,⁶³⁴ Everbright Financial Holding Asset

Id.

⁶²⁸ "The big four"—the Industrial and Commercial Bank of China, the Bank of China, the China Construction Bank, and the Agricultural Bank of China—now hold more than 65% of domestic market shares." *"Big Four" Banks Grow Stronger*, CHINA DAILY, Dec. 19, 2003, http://www.chinadaily.com.cn/en/doc/2003-12/19/content_291684.htm.

⁶²⁹ 中国光大集团, China Everbright Group, History, <http://www.ebchina.com/en/about/history.html> (last visited Jan. 20, 2010). The company was started in Hong Kong in 1983, and as a "ministry level company under the administration of the State Council." *Id.* From July 1999, in responding to the request of the Chinese government, the group put financial business as its priority and further reduced its investment in industrial areas." *Id.*

⁶³⁰ *Id.*

⁶³¹ 业务概述, China Everbright Group, Business Overview, <http://www.ebchina.com/business/index.html> (last visited Jan. 20, 2010). The latter is a huge state-owned group engaging in the business of bank, securities, insurance, and investment management. *Id.* In addition to the business in the financial sector, the China Everbright Group family companies are also exploring the industry sector, such as hotel and property management. *Id.*

⁶³² China Everbright Group, Introduction of Main Enterprises of the Group, http://www.ebchina.com/en/business/busniss_yh.html (last visited Jan. 20, 2010) [hereinafter China Everbright Group]. According to the China Everbright Group:

Everbright Securities Co., Ltd. is one of the first three piloting innovative securities companies approved by China Securities Regulatory Commission. In 2008, its total assets reached RMB33.2 billion, with the annual operating revenue of RMB3.69 billion and the net profit of RMB1.45 billion. . . . The company has been active in involving itself in the capital market at home and abroad, and all kinds of its business developed rapidly.

Id.

⁶³³ *Id.* ("China Everbright Limited (Everbright Limited, stock code: 165), with China Everbright Group as its parent company, was established in 1997 as a diversified financial conglomerate focusing on direct investment, assets management and assets investment, whilst developing fee-based businesses including investment banking (corporate financing) and brokerage services (wealth management).").

⁶³⁴ *Id.* ("Sun Life Everbright Life Insurance Company (Sun Life) was established on April 22nd 2002. It is jointly organized by Sun Life Financial Group and China Everbright Group and headquartered in Tianjin. It is one of the first life insurance joint ventures in Northern China."); China Everbright Industrial (Group) Co. Ltd., Business Field, Introduction of Main Enterprises of the Group, http://www.ebchina.com/en/business/busniss_yh.html (last visited Jan. 20, 2010).

Management,⁶³⁵ Everbright Pramerica Fund Management,⁶³⁶ and Everbright Futures.⁶³⁷ The CEB has also engaged in large transactions with other SOEs in the financial services sector. On May 13, 2009, CEB and the China National Investment & Guaranty Corporation ("I&G"), another Central Huijin-controlled enterprise, concluded the Overall Cooperative Agreement at Everbright Plaza.⁶³⁸ The CEB granted a three billion RMB credit limit to the I&G.⁶³⁹ The two entities cooperate in steel trade financing, government procurement financing, and loan guarantees to other SMEs.⁶⁴⁰ Interestingly, the CEB included a number of businesses and other subsidiaries that can serve as fund managers at levels once or twice removed from the fund activities of the CIC. The CEB conglomerate suggests both the complex and multilayered approach to pioneering investing.

Central Huijin's other important holdings include indirect holdings in securities companies, insurance companies,⁶⁴¹ and guarantee institutions,

⁶³⁵ *Id.* ("The major business activities of Everbright Financial Holding Asset Management Company include investments in industrial funds and privately raised funds, investments in enterprises' stocks, and advisory services for mergers and acquisitions, bond financing, IPO, governmental financing platform, etc.").

⁶³⁶ *Id.*

Everbright Pramerica, headquartered in Shanghai, was established in April 2004. As a joint venture between Everbright Securities Co., Ltd., a subsidiary of China Everbright Group and the investment management business of United States-based Prudential Financial, Inc (PFI), Everbright Pramerica has a registered capital of RMB160 million with 67 percent of the shares owned by Everbright Securities Co., Ltd. and 33 percent by PFI, the American partner. Everbright Pramerica strives to help investors manage their wealth.

Id.

⁶³⁷ China Everbright Group, *supra* note 632.

Leveraging the nation-wide network of Everbright Securities, Everbright Futures is pursuing an all-dimensional development in financial futures, commodity futures as well as other innovative businesses. Everbright Futures is aiming to expand its network to cover every region, and to become the best choice for investors, regardless of when and where, providing the services they need.

Id.

⁶³⁸ China Nat'l Inv. & Guar. Co., Ltd., I&G Signed Overall Cooperation Agreement with China Everbright Bank, May, 19, 2009, http://www.guaranty.com.cn/en/new/view_user.asp?id=10977 (last visited Jan. 10, 2010) (granting RMB 3 billion credit line to I&G).

⁶³⁹ *Id.*

⁶⁴⁰ *Id.*

⁶⁴¹ Bi Xiaoning, *Central Huijin to Buy 38% Stake in New China Life*, CHINA DAILY, Mar. 30, 2009, http://www.chinadaily.com.cn/bizchina/2009-03/30/content_7629792.htm (announcing the purchase of a substantial stake in New China Life Insurance Company from the insurance protection fund by Central Huijin).

principally the I&G.⁶⁴² Each of these enterprises in turn controls inbound and outbound investment.⁶⁴³ Central Huijin also controls operating companies in the natural resources sector, including the China National Petroleum Corporation ("CNPC") and its subsidiaries.⁶⁴⁴ These companies have engaged in indirect acquisition activities abroad.⁶⁴⁵ PetroChina has signed agreements with the ICBC and the Agricultural Bank of China, under which the two state-owned commercial banks will cooperate with PetroChina in a wide range of areas, including the financing of PetroChina's global expansion.⁶⁴⁶ The cross-investments became tighter in June 2009, when PetroChina acquired the Commercial Bank of the City of Karamay and announced that it planned to promote that Bank and others to an international financial entity.⁶⁴⁷ Lastly, Central Huijin controls Sinopec, the China Petroleum and

⁶⁴² China Nat'l Inv. & Guar. Co. Ltd., The Introduction of China National Investment and Guaranty Co., Ltd, <http://www.guaranty.com.cn/en/about/index.htm> (last visited Jan. 20, 2010) [hereinafter I&G]. I&G, a member of State Development & Investment Corporation, is a state-owned guarantee institution specializing in credit guarantees and was established by the Ministry of Finance and the former State Economic and Trade Commission in 1993 with approval of the State Council. *Id.*

⁶⁴³ *Id.* ("As part of its business, since 1997, I&G began to provide commission services for foreign companies, providing credit information on the operation and financial status of certain Chinese enterprises. I&G has totally undertaken more than 40 credit information projects entrusted by Italian SIC Company, American F&D and Holland NCM.").

⁶⁴⁴ *PetroChina, Verenex Deal Delayed*, CAIJING.COM, June 26, 2009, <http://english.caijing.com.cn/2009-06-26/110190056.html> (noting that PetroChina is a subsidiary of CNPC whose wholly owned unit PetroChina International (Singapore) Pte. will buy a 45.5 percent stake in Singapore Petroleum Co. for around S\$1.5 billion (U.S. \$1 billion); but see Zee Yueyan Zhang et al., *Optimal Scale and Asset Allocation of SWF: China's Case* (Chinese Academy of Sciences-Graduate University Working Paper Series, 2008), available at <http://ssrn.com/abstract=1319887> (noting the failures of investments in the finance and energy fields).

⁶⁴⁵ *PetroChina to Pay U.S. \$1 Bln for 45% of Singapore Petroleum*, CAIJING, May 25, 2009, <http://english.caijing.com.cn/2009-05-25/110170981.html> ("PetroChina International will buy the stake from Keppel Oil & Gas Services Pte., pending approval from regulators, including the Chinese government.") [hereinafter *PetroChina*].

⁶⁴⁶ 中石油与工行再签战略合作协议 [ICBC Signs Strategic Cooperation Agreement for Oil], CAIJING, Apr. 30, 2009, <http://www.caijing.com.cn/2009-04-30/110157412.html> [hereinafter *Oil Agreement*].

⁶⁴⁷ 中石油集团大举进军金融业 [CNPC Makes Significant Inroads into the Financial Sector], CAIJING, June 6, 2009, <http://www.caijing.com.cn/2009-06-30/110191356.html> [hereinafter *Significant Inroads*].

Chemical Corporation.⁶⁴⁸ Sinopec too has been acquiring significant interests in related foreign entities.⁶⁴⁹

As described above, the organizational structure of an integrated approach to sovereign investing is complex. In this case, outbound and inbound investment flows through operating entities under the overall direction of an instrumentality of the Chinese SWF, which itself implements strategic policies of the State Council in a commercially or financially prudent manner. But this basic structure is mimicked in larger form by the relationship between Central Huijin and the financial enterprises it controls, including the Jianyin conglomerate. Again, the relationship between the CIC and Central Huijin also mimics this structure.

D. Conformity to Current Regulatory Models and Policy Ramifications

The CIC's web of activity demonstrates a model of coordination and intervention in foreign and domestic markets in the interests of state policy that is nonetheless grounded in commercial and financial welfare maximization. These activities spiral outward from the CIC through its subsidiaries, and then indirectly through the SOEs that both control. The effect is to coordinate, and to a certain extent, integrate, the commercial activities of SOEs, the investment activities of SWFs, and the political interests of the state in a way that advances state interests in a profit maximizing way. Each of these entities thus conforms to the expectations of both private enterprises and of SOEs and SWFs. However, the cumulative effect manages to avoid the policy limits of the piecemeal regulation through which these entities are regulated.

Thus, this exploration of the operations of the Chinese SWF evidences how innovation in its investment strategies, and its consequential synergies with SOEs, has produced an aggregate operation that is substantially unrelated to the assumptions underlying SWF regulation. Rather than operate discrete entities with individual programs of investment, the Chinese have begun combining operations in distinct ways. The effect is to leverage the CIC's SWF operations through SOE investment activities. Two principal aggregations are particularly important. The first is the investment in the Chinese banking sector that, in turn, invests abroad. The second is the investment in other SOEs, which, in turn, invest in companies abroad.

⁶⁴⁸ See ERIC G. ALTBACH & MICHAEL H. COGNATO, NAT'L BUREAU OF ASIAN RESEARCH, UNDERSTANDING CHINA'S NEW SOVEREIGN WEALTH FUND 25 (2008), available at <http://www.nbr.org/publications/analysis/pdf/vol19no1.pdf> ("Through a joint-venture with Morgan Stanley, Huijin also owns the China International Capital Corporation, the mainland's largest investment bank. CICC has taken public every SOE to have been involved in recent high-profile outward investment: CHINALCO, Shenhua, CNOOC, PetroChina, and Sinopec, among others.").

⁶⁴⁹ *Sinopec to Buy Swiss Oil Explorer Addax*, CAIJING, June 25, 2009, <http://english.caijing.com.cn/2009-06-25/110189293.html>.

Large state-owned commercial banks further support other state-owned enterprises in expanding globally. For instance, as discussed above, PetroChina has signed agreements with the ICBC and the Agricultural Bank of China to boost PetroChina's global expansion.⁶⁵⁰ With the support from state-owned commercial banks, PetroChina, like other state-owned enterprises engaged in the resources sector, is apparently accelerating its pace to expand globally. PetroChina's wholly-owned unit, PetroChina International (Singapore), will buy a 45.5 percent stake in Singapore Petroleum for around \$1.5 billion. PetroChina International will buy the stake from Keppel Oil & Gas Services, pending approval from regulators including the Chinese government.⁶⁵¹ In another deal, PetroChina agreed to buy Verenex, a Canadian oil firm engaged in drilling in Libya, for \$432 million. PetroChina has obtained substantial financial support from commercial banks and is actively exploring the financial sector by itself. In June 2009, PetroChina acquired the Commercial Bank of the City of Karamay and announced that it planned to promote the Bank, together with other financial institutions, to an international financial entity.⁶⁵²

The CIC has also moved beyond the core activities of SWFs. It has become a manager of financial services businesses and related enterprises and, through them, an active manager of indirect investment both within and outside China. The CIC itself, for example, has taken over the management of China Reinsurance Group, the nation's biggest reinsurer from Central Huijin.⁶⁵³ As such, the CIC has ceased to be a stand-alone SWF in the Western model, and is itself evolving into an integrated financial sector enterprise. However, only one of the CIC's functions falls within the traditionally distinct activities of SWFs. This is not a traditional SWF looking for alternative investments of excess funds. It is an integrated business, but one with an active political management.

Spiraling out from the CIC's direct activities are those of Central Huijin, which handles the investment and financial activities of the largest banks in

⁶⁵⁰ *Oil Agreement*, *supra* note 646.

⁶⁵¹ *PetroChina*, *supra* note 645.

⁶⁵² *Significant Inroads*, *supra* note 647.

⁶⁵³ *CIC Takes Over China Reinsurance Management*, CAIJING, June 18, 2009, <http://english.caijing.com.cn/2009-06-18/110186187.html>. These investments include China Reinsurance (Group) Corporation, the only state-owned reinsurance company, as Caijing reported:

Sovereign wealth fund China Investment Co. said it has taken over the management of China Reinsurance Group Co., the nation's biggest reinsurer. Previously, the China Insurance Regulatory Commission was managing the reinsurance company. China Reinsurance has six units covering reinsurance, property insurance, life insurance, asset management, insurance brokerage, and insurance media, according to a statement on CIC's website.

the Chinese financial sector.⁶⁵⁴ For instance, Central Huijin holds shares in CDB, which is a state-owned policy bank currently in the process of transforming into an international commercial bank. As a policy bank, distinguishable from most commercial banks, the CDB's primary function is "supporting the state's infrastructure development initiatives, basic industries and pillar industries."⁶⁵⁵ The CDB also engages in "steadily promoting international cooperation and supporting the implementation of the state's 'go global' strategy."⁶⁵⁶ In furtherance of its policy-related functions, the CDB not only holds stakes in overseas financial entities, such as Barclays PLC, the third largest bank in Britain,⁶⁵⁷ it has also been assisting Chinese companies in acquiring overseas equities. For instance, it provides financing for CHINALCO to participate in allotting shares in Rio Tinto.⁶⁵⁸ Additionally, the CDB has been cooperating with Shanghai Zhenhua Heavy Industry Corporation and will provide Zhenhua up to \$10 billion in financing in the next five years.⁶⁵⁹

Central Huijin's other controlled banks, including ICBC, the CCB, the Agricultural Bank of China, and the Bank of China, have accelerated their overseas expansion. The ICBC, the world's largest bank by market value, announced in June 2009 that it would purchase 70 percent of the Bank of East Asia's Canadian unit, in an effort to expand overseas.⁶⁶⁰ Similarly, CCB's stake rose in Hong Kong trading after Central Huijin, the bank's largest government shareholder, raised its stake and promised to buy more shares.⁶⁶¹ In addition to supporting the four large state-owned commercial

⁶⁵⁴ CHI Investments, *supra* note 608 (China Development Bank, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, China Everbright Bank, China Reinsurance (Group) Corporation, China Jianyin Investment Corporation, China Galaxy Financial Holding Corporation, Shenyin & Wanguo Securities Corporation, and Guotai Junan Securities Corporation). *Id.*

⁶⁵⁵ China Dev. Bank, Strategic Focus, <http://www.cdb.com.cn/english/Column.asp?ColumnId=109> (last visited Jan. 20, 2010).

⁶⁵⁶ *Id.*

⁶⁵⁷ Barclays, *supra* note 615.

⁶⁵⁸ Liu, *supra* note 611.

⁶⁵⁹ 振华重工获国开行五年100亿美元融资额度 [China Will Finance Zhenhua Heavy Industries for Five Years by Providing U.S. \$10 Billion Financing Limit], CAIJING, June 6, 2009, <http://www.caijing.com.cn/2009-06-24/110188643.html> (stating that Zhenhua Heavy Industry primarily manufactures automatic loading system of container terminal, oil or exploration platforms, and other marine engineering equipment).

⁶⁶⁰ ICBC, About Us, *supra* note 621. ("The deal is one of just a handful of major overseas purchases so far for ICBC. ICBC previously paid about \$5.6 billion for a 20 percent stake of South Africa's Standard Bank, the largest bank in Africa.")

⁶⁶¹ China Construction Bank Rises After Huijin Boosts Stake, BLOOMBERG, May 27, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a6RvYbNJVbow#> ("Central Huijin received 20.69 billion of Construction Bank's Hong Kong-listed shares from its wholly owned unit

banks, Central Huijin may further support other state-owned financial entities' global expansion strategies in related sectors. The China Everbright Bank, a component of the China Everbright Group that is also controlled by Central Huijin, made an Overall Cooperative Agreement with the I&G. According to the agreement, the China Everbright Bank granted to the I&G a credit limit of \$3 billion.⁶⁶² The two entities have been cooperating in the business sector of steel trade financing, government procurement financing, and other SME loan guarantees.⁶⁶³

The Chinese SWF investment complex has also been increasingly engaging in coordinated activities with other state and private sector enterprises abroad. In 1995, Jianyin, Morgan Stanley, the I&G, the Government of Singapore Investment Corporation, and the Mingly Corporation founded the China International Capital Corporation Ltd. ("CICC"), the first joint venture investment bank in China, with a registered capital of \$125 million.⁶⁶⁴ Jianyin is currently the largest shareholder of the CICC, with a holding of 43.35 percent of the company's total shares.⁶⁶⁵ However, Jianyin will transfer its holding in the CICC to Central Huijin as a result of the reallocation of functional authorities between Jianyin and Central Huijin. In other words, Central Huijin may become the CICC's largest shareholder. The I&G, another state-owned enterprise, holds 7.65 percent of the CICC's total shares.⁶⁶⁶ The combination of these two holdings gives the state of China the controlling interest. Hence, the CICC is actually a state-held company, engaged in the business of investment banking, capital markets, sales and trading, research, fixed income, asset management, and private equity.⁶⁶⁷ The connection with the CICC is important for other reasons. The CICC serves as an investment bank and its clients are primarily SOEs.⁶⁶⁸ The CICC also served as a "Joint Lead Underwriter of State Grid's 2 enterprise bond offerings totaling RMB 39.5 billion in size."⁶⁶⁹

China Jianyin Investment for free. Consequently, Central Huijin raised its stakes in China Construction Bank from 48 percent to 57 percent.").

⁶⁶² I&G, *supra* note 642.

⁶⁶³ *Id.*

⁶⁶⁴ China Int'l Capital Corp. Ltd., Profile of CICC, <http://www.cicc.com.cn/CICC/english/about/index.htm> (last visited Jan. 20, 2010).

⁶⁶⁵ CICC Shareholders, *supra* note 579.

⁶⁶⁶ *Id.*

⁶⁶⁷ See China Int'l Capital Corp. Ltd., <http://www.cicc.com.cn/CICC/english/index.htm> (last visited Jan. 20, 2010).

⁶⁶⁸ *Id.* For that instance, in 2008, CICC was a joint sponsor and joint lead underwriter of China Coal Energy's RMB 25.7 billion A-share IPO. *Id.* The deal was the largest A-share IPO in 2008 and the 8th largest A-share IPO in history. *Id.* CICC was the sole bookrunner and lead underwriter of China Communication Services' \$240 million H share placement. *Id.*

⁶⁶⁹ China Int'l Capital Corp. Ltd., Major Transaction, Fixed Income and Structured Products in 2008, <http://www.cicc.com.cn/CICC/english/about/page52.htm> (last visited Jan. 20, 2010).

Consequently, the investment activities of the CIC and its subsidiaries probably indicate a consolidating investment strategy of the state that might be triggered by the financial crisis. As described by Mr. Gao Xiqing, the Vice Chairman, President, and Chief Investment Officer of the CIC, the CIC sees itself as a "farmer," instead of a "hunter."⁶⁷⁰ When asked what might constitute "a good buy," Mr. Gao Xiqing responded that the "farmer is willing to plant everything."⁶⁷¹ There are two possible ways to interpret the answer, "we plant everything."⁶⁷² First, the CIC, as a financial investor, does not intend to restrict its investment solely to one sector, but endeavors to invest in various industries globally. A second, broader interpretation of Mr. Gao Xiqing's answer, may also be plausible. The broader interpretation is that the state is in the process of "planting" a consolidating and comprehensive sovereign investment mechanism that will incorporate "everything" related to sovereign wealth, with the CIC being its ultimate vehicle. Through this mechanism, the state will be able to accomplish its national development goals by actively managing its SWF and state-owned enterprises. Significantly, it is possible to have an investment strategy that is economically-driven but also targeted to the political interests of the sovereign investor.⁶⁷³ Therefore, the "either-or" framework employed by the conventional conception of the "problem" of SWFs and SOEs as outbound investors may miss the mark.

In this complex scenario, sophisticated approaches to sovereign investing regulation, which are broken down in separable SWF and SOE sectors, and are grounded in the notion that political and commercial objectives are incompatible, at best appear irrelevant to the actual operations of these entities. It appears that the global community has begun to build a large regulatory matrix into which few leading sovereign investors might fit. Indeed, to the extent that other important sovereign investors begin to model their operations on the Chinese framework more aggressively, it is less likely that the regulatory matrix will prove effective. On the other hand, perhaps the point is to construct a phantom regulatory framework that assuages the fears of Western electorates in host states, while permitting such public-private constructs to participate in global capital and other sector markets. But that is unlikely. The Chinese experience suggests that, while there is fundamentally little to fear from well-operating public-private constructs, that model requires a different regulatory approach. It demands an approach that recognizes and rethinks the relationship between the public and private

⁶⁷⁰ Gao Xiqing Interview, *supra* note 1.

⁶⁷¹ *Id.*

⁶⁷² *Id.*

⁶⁷³ See Chen Chao, *Sovereign Wealth Funds, Macroeconomic Policy Alignment and Financial Stability* (China Inv. Corp., Working Paper Series 2008), available at <http://www.ssrn.com/abstract=1420614> (examining the impact of SWFs on home country macroeconomic policies).

sectors and the limitations of the states to protect the integrity of global markets and the free movement of capital and economic activity.

VI. CONCLUSION

"The rise of four new financial power brokers is causing a good deal of unease around the world. Increasingly influential, but traditionally secretive, these players—investors from oil-exporting nations, Asian central banks, hedge funds, and private-equity firms—are stirring fears of the wealthy outsider everywhere they turn."⁶⁷⁴ The global legal orders thus find themselves back where they started at the beginning of the 20th Century. However, the nature and identity of the principal actors have changed. The SWFs are an integral part of this rising new set of international financial players. They do not act in isolation, nor are their activities unconnected to related sovereign entities, especially SOEs. There are a number of insights that can be drawn from this necessarily complicated approach to an appropriate regulatory framework for SWFs, an issue that should be straightforward in the complex global economic system, which is built on principles of free movement of capital and private markets.

Sovereign investment straddles the intersection of public and private law. On the one hand, they may be understood as the vehicles through which states invest their reserves or other funds that will be required for public purposes. On that basis, SWFs and SOEs are the instrumentalities of a state. In this traditional role, their operations are grounded in the regulatory requirements and public policy goals of the investor state, and their use of funds are closely tied to the political agenda of such states. On the other hand, SWFs and SOEs may be understood principally as economic vehicles in which states own a controlling (or the sole) interest for the purpose of maximizing their value to their owners. On that basis, SWFs and SOEs can be understood as private investment vehicles with public owners. As a consequence, their operations can be treated as grounded in the regulatory web applicable to all investment funds or economic enterprises. Under this "equivalent treatment" framework, the state owners can be reached for

⁶⁷⁴ Diana Farrell & Susan Lund, *Power Brokers*, NEWSWEEK INT'L, Oct. 20, 2007, available at <http://www.mckinsey.com/mgi/mginews/powerbrokers.asp>. According to Farrell and Lund:

The oil investors are a diverse group, including hundreds of wealthy individuals, sovereign wealth funds, and central banks in the Persian Gulf, Norway, Russia, Nigeria, Venezuela, and Indonesia. Dubai International Capital is one example, a private-equity-like investment fund that bought Tussauds theme-park empire and the Travelodge hotel chain. . . . Asian central banks have been the cautious giants in global capital markets, investing their burgeoning reserves chiefly in U.S. dollar-denominated assets. . . . But they are starting to be more adventurous; China, South Korea, and Singapore have announced plans to shift as much as \$480 billion into state-owned, diversified sovereign wealth funds.

breaches of these rules to the same extent as private owners of similar enterprises, at least to the extent that the controlling sovereign owner overreaches.

And so a century's worth of worry brought the community of nations closer to a solution that they can both understand and control. That solution is also grounded in a simple mechanic—to acquire a significant stake within those very markets that defy territorial limits. In this way, states, like private economic actors, might be able to overcome the regulatory barriers of territory,⁶⁷⁵ but for a wholly different purpose. For states on the verge of being overwhelmed by aggregations of private power, there appeared an alternative to subordination to transnational private economic power. That alternative was to acquire as large a portion of that transnational private economic power as possible. That approach had the benefit of not upsetting the form of economic organization currently in place. But it also had a salutary consequence for the preservation of state power; it reduced complications in international relations by reducing the power of intruders on the traditional stage of power conflicts, leaving (again) the state in substantial control of that stage. In a global system in which military campaigns are no longer morally and legally justifiable to any significant extent (except perhaps when pursued under the protection of the most powerful states), the public penchant for aggression and competition must be satisfied by other means. Today, those means of friendly competition, or aggressive combat, take place indirectly.

Currently, regulators focus on the public character of the owners of such funds as the basis for constructing regulatory frameworks. Funds are uninsulated by sovereign immunity because of the commercial activity exception, rather than because it is a private entity. The SWFs may invest in the securities of private entities, but they are increasingly being held to a reasonable private investor standard, which requires articulating a crude set of parameters to distinguish between public and private investment conduct. The fundamental difference appears to be the need to justify investment on the basis of some sort of financial or wealth maximization objective. Many of these developments have taken the form of soft law originating in large, supranational governance organs, principally the IMF and the OECD. But states, particularly the United States and the European Union, have begun to develop and impose similar regimes in bilateral arrangements.⁶⁷⁶

This Article presented a critical review of these developments. This critique has looked to both traditional SWFs and the related problem of the foreign investments of state-owned enterprises. The initial course of the

⁶⁷⁵ See, e.g., Larry Catá Backer, *The Autonomous Global Corporation: On the Role of Organizational Law Beyond Asset Partitioning and Legal Personality*, 41 TULSA L. REV. 541 (2006).

⁶⁷⁶ See, e.g., U.S. Dep't of the Treasury, SWFs, *supra* note 76.

economic crisis that began in earnest in 2008 sharpened both the dissonance produced by current regulatory approaches to SWFs and the reality of their operations. Indeed, the financial downturn has contributed in significant ways to the conflation of the public and private in a globalized, market-driven, and political economy. This conflation has begun to evidence new conceptions of state public and private power in the construction and operation of market-participatory vehicles by public actors. As pioneered by China, SWFs and SOEs represent the center of networks of public-private investment coordination in which financial or wealth maximization is blended with political objectives directed by the state. China's sovereign investment architecture now suggests that the divisions on which the current regulatory framework is based—public versus private, political versus financial/commercial—may no longer serve as a touchstone of economic activity by states.⁶⁷⁷ The consequences may be most profoundly felt in developed states. As one analysis put it, "[A]s the focus of Chinese [outward foreign direct investment] shifts toward commercial operations in advanced economics rather than the traditional focus on resources extraction in developing countries," it will generate more problems and ambiguities in OECD countries' investment review processes.⁶⁷⁸

Sovereign investment vehicles are playing an important part in that development, and in the consequential reconceptualization of notions of public and private power. In the form of SWFs, one can abandon the old distinction between public and private power to build a new legal matrix founded on the distinction between regulatory and participatory power. Within that matrix, the character of the actor is less dispositive than the quality of power asserted.⁶⁷⁹ Just as law has moved from status to contract distinctions in the West, so it is evolving from public/private to a

⁶⁷⁷ Jiang Xiang, et al., *Inevitability and Necessity to Develop SWFs in China*, 4 INT'L J. BUS. & MGMT. 82, 83 (2009) (stating that for China, sovereign investing thus represents a fiscally sound method of driving macroeconomic policy for political ends: "support for national development strategy, optimization of resource allocation all over the world, cultivation of world top companies and representation of national benefits in international economic activities.").

⁶⁷⁸ ROSEN & HANEMANN, *supra* note 283, at 1.

⁶⁷⁹ Daniel Drache, *Introduction: The Fundamentals of Our Time: Values and Goals That are Inescapably Public*, in *THE MARKET OR THE PUBLIC DOMAIN? GLOBAL GOVERNANCE AND THE ASYMMETRY OF POWER* 1, 4 (Daniel Drache ed., 2001). There has been some recognition of this notion, if only obliquely, within a discourse that seeks to reinvigorate the public sector in the face of the privatization pressures that appear to flow from the current global economic order that privileges free movement of capital across borders. *Id.* With material and institutional dimensions that are large, complex, and with overlapping aspects, the public domain should not be used interchangeably with the public sector, with which it is often confused. *Id.* Nor should it be limited to the provision of public goods, a staple of modern economic liberalism. *Id.* In the primary sense of the term, the public domain is about the resources carved out from the market that empower and transform both the state and non-state actors. *Id.*

regulatory/participatory distinction.⁶⁸⁰ Within these dichotomies, the status of the actor as a state or as a corporation will count for less than an understanding of the nature of the actor's particular intervention—regulatory or participatory.

Accordingly, just as the central problem of the last century was to conceptualize distinctions between public and private law based on the status of the actor, so the central problem of law in this century will be to conceptualize distinctions between regulatory and participatory legal regimes. For this framework, the status of the actor will matter less than the nature of the exercise of power by that actor. The actions of states, corporations, and other actors (for example non-governmental organizations like Amnesty International and the like) that assert regulatory power ought to be regulated under the same sets of norms with respect to those actions. Likewise, corporations and states that act within regulatory systems ought to be subject to the rules of those systems in equal measure. The character of the action, rather than the status of the actor, ought to be the basis of legal systems where the object is to regulate actors who intervene in areas once deemed to be the sole preserve of states. To the extent that public bodies continue to cling to the antiquated and forced legal distinctions based on status, they will continue to fail in efforts to conceptualize properly, and to intervene effectively, in the new power realities on the ground.

In a sense, the problem of SWFs, like that of SOEs engaging in investment activities abroad, can be reduced to issues of abuse. These include the abuse of power, abuse of corporate form, abuse of the corporate franchise, and abuse of the market. Much of what is required, then, are rules that ensure that, like the abuse of their private or individual counterparts, SWF abuse is controlled and the integrity of markets is preserved. This is both a tall order and a manageable task. But to that end, a solution requires a new conception of states when they engage in market-participatory activities.

⁶⁸⁰ Carol Harlow, "Public" and "Private" Law": *Definition Without Distinction*, 43 MOD. L. REV. 241, 257 (1980) (The "[N]ight-watchman" state is rapidly being replaced by a state whose functions range from welfare to commercial activities and from law and order to education.").