

# **Sovereign Wealth Funds, Global Markets and Fragility in Complex Cooperative Regulatory Regimes—Norway, Responsible Investing, Active Shareholding and Financial Markets Regulation From Within.**

Larry Catá Backer

**Abstract:** Markets have begun to emerge as the locus of regulatory activity, serving a role once reserved for national legislatures, and providing an alternative to multiannual governance through the mechanics of public international law. Under the logic of economic globalization, any state may project its power beyond its borders, including its legal and policy regimes, through investment activity undertaken in private markets. This chapter considers the way in which states are contributing to a fundamental re-orientation of the relationship between state, market, one in which the market for corporate securities begins to substitute for legislature or public international governance mechanisms. The chapter posits that this re-orientation is most acutely apparent in the form of state activity in the form of sovereign wealth funds (SWFs). SWFs have been transformed from mere objects of public domestic and international regulation to sources of governance in their own right effected through private financial markets. The model of this transformation is the Norwegian sovereign wealth fund (NSWF). Part II provides the context and framework within which it is possible to theorize public governance within private financial markets, one grounded in the principles of globalization amalgamated with the strategic use of corporate governance principles. Part III examines the legal and regulatory framework within which the NSWF is organized and operated to produce a conscious program of regulatory objectives in private financial decision-making through “responsible investing” and “active ownership” principles. Part IV analyzes the ways in which these principles of responsible investing and active ownership have been used to fashion complex cooperative regulatory regimes that coordinate public, private and international norms through state interventions in private investment markets, and their fragility in light of regulatory changes operational in 2015.

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<sup>1</sup> W. Richard and Mary Eshelman Faculty Scholar & Professor of Law, Professor of International Affairs, Pennsylvania State University, University Park, PA 16802 (814.863.3640 (direct) (email: lcb911<AT>me.com. This paper was first presented at the conference: “A Market is a Market is a Market: Financial Regulation and the Role of Law in an Era of Globalization,” International Conference hosted by the University of Ferrara, Italy, Nov. 9-10, 2012. My great thanks to Alessandro Somma (Ferrara), Bertram Keller (Rostock/Berlin), and Peer Zumbansen (Osgode Hall) for the organization of an excellent conference event. Thanks also to my research assistant, Joseph Henry (SIA MIA 2012) for his exemplary work on this project.

## I. INTRODUCTION

“Sovereign wealth funds (SWFs) have recently been recognized as well-established institutional investors and important participants in the international monetary and financial system.”<sup>2</sup> This form of investing by sovereigns has become an important new element in emerging patterns of governance in this century.<sup>3</sup> “As a result of the SWFs’ increasing level of assets invested in public and private equity holdings, they are exercising greater influence on corporate governance practices.”<sup>4</sup> SWF have become an object of great concern as they have grown in size and as they have become more visible actors within financial markets outside of their territories—either by investing in securities markets or through efforts to acquire companies abroad.<sup>5</sup> Sovereign investing through SWFs remains controversial, even as its allure remains powerful.<sup>6</sup> They adhere to the forms of free market investor activity but in reflecting investor preference they permit states to project power privately in new ways that threaten the assumptions on which the current economic order is based.<sup>7</sup> But SWFs are no longer merely instruments of state investment in markets—they have increasingly been used as instruments of hybrid investing—focusing especially in developing states on development and infrastructure investment.<sup>8</sup> In all these roles, SWFs evidence a great collision between two tectonic forces—the state system and public law making on one side, and private consent based governance structures on the other side. This

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<sup>2</sup> International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds: Generally Accepted Principles and Practices “Santiago Principles”* 1 (October 2008) (hereafter *Santiago Principles*) (Introduction).

<sup>3</sup> See, e.g., Clark, G.L., Monk, A., Dixon, A., Pauly, L.W., Faulconbridge, J., Yeung, J.W. and Behrendt, S. Symposium: sovereign fund capitalism. *Environment and Planning, A*, 42: 2271-2291 (2010); Ronald Gilson and Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 *STANFORD LAW REVIEW* 1345 (2007-08).

<sup>4</sup> *Santiago Principles, supra*, 3 (Santiago Principles: Objective and Purpose). See also John Kay, *Sovereign Wealth Investment is a Force for Stability*, *Fin. Times (Asia)*, Feb. 27, 2008, at 11.

<sup>5</sup> See, e.g., Paul Rose, *Sovereigns as Shareholders*, 87 *N.C. L. REV.* 83, 84-89 (2008).

<sup>6</sup> For a recent consideration from Australia, see, Vivienne Bath, *Foreign Investment, The National Interest and National Security--Foreign Direct Investment in Australia and China*, 34 *SYDNEY L. REV.* 5, 19 (2012).

<sup>7</sup> See, e.g., Lawrence Summers, *Funds that Shake Capitalist Logic*, *FIN. TIMES*, July 29, 2007.

<sup>8</sup> Discussed in Alan Gelb, Silvana Tordo and Åvard H. Holland, *The World Bank, Sovereign Wealth Funds and Domestic Investment in Resource Rich Countries: Love Me or Love Me Not?* (2014), available at

<http://siteresources.worldbank.org/EXTPREMNET/Resources/EP133.pdf>. See also Ashby Monk, *The Rise of Sovereign Development Funds*, *Institutional Investor* (Apr. 10, 2013, 1:00 PM), <http://www.institutionalinvestor.com/blogarticle/3189172/Blog/The-Rise-of-Sovereign-Development-Funds.html>; Larry Catá Backer, *International Financial Institutions (IFIs) and Sovereign Wealth Funds—SWFs as Instruments to Combat Corruption and Enhance Fiscal Discipline in Developing States*, 2014(4) *International Review of Law* — (Qatar University) available <http://www.qscience.com/doi/pdf/10.5339/irl.2015.swf.5>.

collision is producing a new normative framework of governance and power.<sup>9</sup> The resulting tension suggests both the frameworks for understanding the way in which SWFs may be managed through regulation,<sup>10</sup> and the ways in which SWFs may themselves manage the environment through which they are managed.

Sovereign investing takes a number of forms that reflect this collision. Two of the most innovative and dynamic are those of China<sup>11</sup> and Norway.<sup>12</sup> Both have changed the fundamental assumptions about the way in which states regulate internally and project power externally, by using the logic of globalization and its markets to project power beyond their borders.<sup>13</sup> The Chinese have tended to project economic power, aligning investment objectives to state policy.<sup>14</sup> The Norwegians have sought to project regulatory power, and in the process shape the national law of states in which they invest, private corporate governance culture globally, and the development of international law and norms for the conduct of economic activity within globalization.<sup>15</sup> Other forms are developing at the margins.<sup>16</sup> These point to a form of cooperative governance that has been emerging in the global regulation of markets and finance over the last half-decade especially.<sup>17</sup>

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<sup>9</sup> Larry Catá Backer, Review Essay: Taking a Step Toward a Law for Sovereign Wealth Funds (September 7, 2012). Consortium for Peace Ethics Working Paper No. 2012-9/1; Penn State Law Research Paper No. 17-2012. Available <http://ssrn.com/abstract=2143452>.

<sup>10</sup> FABIO BASSAN, *THE LAW OF SOVEREIGN WEALTH FUNDS* ((Cheltenham, Eng.: Edward Elgar, 2011). see also Yvonne C.L. Lee, *The Governance of Contemporary Sovereign Wealth Funds*, 6 HASTINGS BUS. L.J. 197, 226 (2010); Efraim Chalamish, *Global Investment Regulation and Sovereign Wealth Funds*, 13 THEORETICAL INQUIRIES L 645 (2012).

<sup>11</sup> See, Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience*, 19(1) Transnational Law & Contemporary Problems 3-144 (2010).

<sup>12</sup> See, Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41(2) Georgetown Journal of International Law 425-500 (2010).

<sup>13</sup> Steve Schifferes, *Lifting the Lid on Sovereign Wealth Funds*, BBC News Online, June 3, 2008) available <http://news.bbc.co.uk/2/hi/business/7430641.stm>.

<sup>14</sup> See, e.g., Willy Kraus, *Political Power and the Power of Market Dynamics in China*, in *THE STUDY OF MODERN CHINA* 93-119 (Eberhard Sandschneider, ed., Tobia Schumacher and Petra Dreiser, trans., London: Hust & Co., 1999).

<sup>15</sup> See, e.g., Simon Chesterman, *The Turn to Ethics: Disinvestment From Multinational Corporations for Human Rights Violations—The Case of Norway*, 23 AMERICAN UNIVERSITY INTERNATIONAL LAW REVIEW 577-615 (2008); Gordon L. Clark and Ashby H. B. Monk, *The Legitimacy and Governance of Norway's Sovereign Wealth Fund: The Ethics of Global Investment*, *Environment and Planning, A*, 42(7): 1723-1738.

<sup>16</sup> See, Chatham House, *Africa's Sovereign Wealth Funds: Demand, Development and Delivery*, Africa Programme Conference Summary 5 Sept. 2014. Available [http://www.chathamhouse.org/sites/files/chathamhouse/field/field\\_document/20140905SovereignWealthFunds\\_0.pdf](http://www.chathamhouse.org/sites/files/chathamhouse/field/field_document/20140905SovereignWealthFunds_0.pdf).

<sup>17</sup> See, e.g., Larry Catá Backer, *Private Actors and Public Governance Beyond the State: The Multinational Corporation, the Financial Stability Board and the Global Governance Order*, 18(2) INDIANA JOURNAL OF GLOBAL LEGAL STUDIES 751 (2011).

The Norwegian SWF, then, presents an important context for understanding the conditions of the alleged “return of the state,”<sup>18</sup> and the *focus of this chapter: the emergence of SWFs as a means of effectuating public regulatory power through private financial markets*. Undertaken through its sovereign wealth fund, the Government Pension Fund-Global (the NSWF),<sup>19</sup> Norway is not merely to projecting public wealth into private global markets, but is also attempting the construction of a complex rule-of-law centered framework that blends the imperatives of a state based public policy with a rules based governance system that incorporates domestic and international norms. To this Norway adds a policy-oriented use of traditional shareholder power to regulate the behavior and governance of companies in which the NSWF has invested. The object is not merely to maximize the welfare of the funds ultimate investors, the people of Norway (through its state apparatus), but also to use the fund to advance Norwegian public policy in the international sphere and within the domestic legal systems of other states to achieve a measure of horizontal harmonization of corporate governance.

This investment activity with legislative effect, undertaken through the framework of responsible investing provides the foundation for the *thesis* of this study: Sovereign wealth funds embody a new and important for of cooperative governance, one that (1) bridges public and private government spheres, (2) blends law, custom, contract and non-state governance regimes, and (3) mediates between the national and international systems. The functionally directed governance activities of the NSWF do not serve as a convergence of law project undertaken by Norway. Rather its objective is to position Norway as a nexus point for the mediation of governance polycentricity inherent in globalization. As a consequence the state assumes the role of a chameleon,<sup>20</sup> adopting actions and objectives in line with the role it plays in a particular governance system. Yet this complex cooperative regulatory regime is also quite fragile, reflecting both its youth and its inherent instability in the tectonic collisions that made the regime possible. This essay considers both the possibilities and fragilities of this emerging system embedded within the governance structures and operation of the NSWF.

Part II of this study turns to a brief description of the legal and regulatory framework within which the NSWF is organized, introducing the innovative institutionalization of responsible investing and active ownership. Part III then examines the ethical component of responsible

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<sup>18</sup> See David Grewal, *The Return of the State*, Harvard International Review (Feb. 1, 2010). Available <http://hir.harvard.edu/big-ideas/the-return-of-the-state>.

<sup>19</sup> Ministry of Finance, *The Management of the Government Pension Fund in 2011*, Meld. St. 17 (2011-2012) Report to the Storting (white paper), at Section 1.

<sup>20</sup> This was a concept I introduced earlier. See, Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons*, *supra* note 11.

investing, through the substantive provisions of the Ethical Guidelines, and their implementation through the Ethics Council pointing to the construction of a polycentric and hybrid jurisprudence effected through markets. Part IV then suggests a generalizable analytical framework for framing the market as market and as regulatory spaces and its systemic fragility, considering the reforms of late 2014 for its implications for the emerging regimes of cooperative inter-systemicity, especially in the context of financial regulation of markets.

## II. THE OPERATION OF THE NORWEGIAN SOVEREIGN WEALTH FUND: PRIVATE ACTOR, INTERNATIONAL ACTOR, AND SOVEREIGN

The Norwegian Sovereign Wealth Fund, the Government Pension Fund Global (NSWF) is a peculiar commercial creature of state. Its principal object is to protect the income generated from Norway's exploitation of its petroleum reserves.<sup>21</sup> This section first introduces the formal organization of the NSWF and then turns to an analysis of the systems developed to structure both investment and regulatory activity through market transactions.

### A. Organization of the NSWF.

The NSWF, established in 1990 as the Petroleum Fund,<sup>22</sup> assumed its present form in 2006 as one of two investment funds operated by the Norwegian state.<sup>23</sup> One, formally known as the Government Pension Fund Global is a continuation of the Petroleum Fund and the object of this Chapter.<sup>24</sup> The other, is the more domestically focused Government Pension Fund Norway.<sup>25</sup> Both domestic and international parts of the Pension Fund have two principal objectives: (1) to support programs of government savings directed to the financing of the Norwegian National

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<sup>21</sup> See, e.g., Norway Ministry of Finance, Investment Strategy of the GPF (last updated April 2013), available <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/government-pension-fund-global-gpfg/investment-strategy.html?id=696849>.

<sup>22</sup> Government Pension Fund Law (no. 36 of June 1990). It was established "as a fiscal policy tool to support a long term management of the petroleum revenues." Government Pension Fund Global—Fact Sheet (March 2010). Available [www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/PFG\\_summary\\_march2010.pdf](http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/PFG_summary_march2010.pdf).

<sup>23</sup> Currently operated under the Government Pension Fund Act (no. 123 of 21 December 2005) (Hereafter GPFA).

<sup>24</sup> Explored in substantially more detail in Larry Catá Backer, *Sovereign Investing and Markets-Based Transnational Rule of Law* □ *Building: The Norwegian Sovereign Wealth Fund in Global Markets*, 29(1) AMERICAN UNIVERSITY INTERNATIONAL LAW REVIEW 1-121 (2013).

<sup>25</sup> Government Pension Fund Act (No. 123 of 20 December 2005), in Provisions on the Management of the Government Pension Fund—Global, Ch. 1§2.

Insurance Scheme's pension expenditures; and (2) to "support long-term considerations in the use of petroleum revenues."<sup>26</sup>

The NSWF is structured as a governmental entity operating in autonomous form but not constituted as either a private or public corporate entity (GPFA § 2). It exists substantially in the form of a record of deposits and investments operated through the Norges Bank,<sup>27</sup> into which NSWF funds are deposited (domestic funds are managed through the *Folketrygdfondet*) (GPFA §2). The Ministry of Finance is empowered to adopt supplementary regulations to implement the act establishing the NSWF (GPFA §7).

The Storting allocates funds for the NSWF from the "net cash flow from petroleum activities," as and when such may be transferred from the central government budget. The NSWF is also permitted to fund its operations from "the results of financial transactions associated with petroleum activities and the return of the Fund's capital" (GPFA §3). Beyond that, NSWF income is defined as the return of capital under management (GPFA §4), though the Storting, by resolution, may transfer the NSWF's capital (GPFA §5).

The Ministry of Finance regulates, but does not actively manage, the NSWF. The current regulatory framework came into force January 1, 2011,<sup>28</sup> as modified in 2014.<sup>29</sup> The current regulatory framework vests both physical custody of the actual fund and management of the assets represented by the Fund, in Norges Bank.<sup>30</sup> The Norges Bank is charged with a specific set of obligations that define its relationship with the Finance Ministry, including a duty to inform the Finance Ministry of its strategic plan, of significant changes in the value of the Fund or in the management of the Fund by the Bank, and of any incidents that trigger a duty to inform,<sup>31</sup> and to produce a series of public reports on its management of the Fund.<sup>32</sup>

The Norges Bank manages the NSWF through its asset management unit, the Norges Bank Investment Management (NBIM). Established in 1998, NBIM is an integrated global organization with several hundred employees from many nations, and with offices in Oslo, London, New York, Shanghai and Singapore.<sup>33</sup> NBIM uses external managers to handle

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<sup>26</sup> *Id.*, §1.

<sup>27</sup> Norges Bank, About Norges Bank. Available <http://www.norges-bank.no/en/about/>.

<sup>28</sup> *Ibid.*

<sup>29</sup> Discussed *infra* Part V.

<sup>30</sup> See Government Pension Fund Act (No. 123 of 20 December 2005), Ch. 1, § 2(1).

<sup>31</sup> *Ibid.*, §8.

<sup>32</sup> *Ibid.*, §7.

<sup>33</sup> Norges Bank Investment Management (NBIM) About Us. Available <http://www.nbim.no/en/About-us/>.

parts of the Government Pension Fund Global. Oversight of the NBIM is vested in a supervisory council with "15 members appointed by Norway's parliament. It supervises Norges Bank's operations and compliance with the rules for these operations."<sup>34</sup>

## **B. Responsible Investing and Active Ownership**

The Finance Ministry established two goals for NSWF management:<sup>35</sup> (1) to achieve the highest possible return, and (2) to make investment decisions independently of the Ministry.<sup>36</sup> These may be undertaken directly by Norges Bank or through retained outside managers.<sup>37</sup> The "highest possible return" obligation is defined in the regulation as an amount net of management costs "measured in the currency basket of the actual benchmark index."<sup>38</sup> Management costs are regulated as well.<sup>39</sup> The Finance Ministry retains indirect control through its control of an investment strategy<sup>40</sup> approved by the Ministry and to some extent reflected in "Management Mandate" formulated in consultation with the Norges Bank.<sup>41</sup>

"Responsible Investing" is the Ministry of Finance's core macro investment strategy, one grounded in "good corporate governance and environmental and social issues in investment activities."<sup>42</sup> The premise is to extend the state authority to bind business to an "ethical and social responsibility that extends beyond directives to comply with laws and regulations."<sup>43</sup> Responsible investing, it was thought, could be harmonized

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<sup>34</sup> NBIM, About Us, Governance Structure, Supervisory Council. Available <http://www.nbim.no/en/About-us/nbim-organisation/Supervisory-council/>.

<sup>35</sup> The regulations are set out in Management Mandate for the Government Pension Fund Global, issued by the Ministry of Finance 8 Nov. 2010 pursuant to Act. No. 123 of 21 Dec. 2005. Available <http://www.nbim.no/en/About-us/governance-model/management-mandate/>.

<sup>36</sup> *Ibid.*, §1-1. For a description of the Finance Ministry overall investment strategy, under which the Norges Bank operates, see, Norway Ministry of Finance, Investment Strategy, available <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/government-pension-fund-global-gpfg/investment-strategy.html?id=696849>.

<sup>37</sup> Management Mandate for the Government Pension Fund Global, *supra* note 35, Sec. 1-4.

<sup>38</sup> *Ibid.*, Sec. 1-1.

<sup>39</sup> *Ibid.*, Ch. 6

<sup>40</sup> *Ibid.* § 2.

<sup>41</sup> *Ibid.*, §1-5.

<sup>42</sup> *Ibid.*, §2-1. The importance of responsible management in the operation of the NSWF was emphasized by the enactment of the *Guidelines for Norges Bank's work on responsible management and active ownership of the Government Pension Fund Global (GPFG)* (Adopted by the Ministry of Finance on 1 March 2010 pursuant to Act no. 123 of 21 December 2005 relating to the Government Pension Fund, section 2, paragraph 2, and section 7) that modified portions of the Management Mandate, *supra* note 35..

<sup>43</sup> Ministry of Finance, Report No. 10 to the Storting (2009-2010), *supra* note 48, Section 10.1.



with the “core of investment management: managing capital with the aim of achieving the highest possible financial return within an acceptable risk, in line with shareholders' interests.”<sup>44</sup>

That harmonization is possible, in part, because of the adoption of a quite specific definition of “highest possible return,” one that is grounded on sovereign investment policies turned outward to market behaviors. Section 2-1 of the Management Mandate for the NSWF<sup>45</sup> suggests that the term is embedded in the notion of a “good return in the long term.” That “is regarded as being dependent upon sustainable development in economic, environmental and social terms, as well as well functioning, legitimate and effective markets.” It is also affected by a legislated time horizon for evaluating investment decisions—“the bank shall give priority to a long term horizon for investments.” The mandate to incorporate investment strategies grounded in advancing Norwegian principles of good corporate governance in the objects of investment is particularly important. For this purpose, the Norges Bank is charged with the development of internal guidelines for “integrating considerations of good corporate governance and environmental and social issues in investment activities.” These are to be constructed, per Section 2-1, in “line with internationally recognized principles for responsible investment.”

It is these “internationally recognized principles for responsible investment” that provide the foundation for the concept of NSWF “active ownership” rules.<sup>46</sup> Subject to the Bank’s principal obligation—to safeguard the NSWF’s financial interests<sup>47</sup>--the Bank is required to incorporate a core set of international standards as the basis for the exercise of its ownership rights.<sup>48</sup> This set of key international soft law norms governing behavior expectations of enterprises includes the U.N. Global Compact, the OECD Guidelines for Multinational Enterprises and the OECD Principles of Corporate Governance.<sup>49</sup> The Bank is expected, in its application decisions, to *actively* contribute to the development of “good international standards in the area of responsible investment and active ownership.”<sup>50</sup> It is also meant to be a political process, grounded in Norwegian policy.<sup>51</sup>

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<sup>44</sup> Ibid.

<sup>45</sup> Management Mandate for the Government Pension Fund Global, *supra* note 35, Sec. 2-1.

<sup>46</sup> Ibid, §2-2.

<sup>47</sup> Ibid, §2-2(1).

<sup>48</sup> Ibid., §2-2(2).

<sup>49</sup> Ibid.

<sup>50</sup> Ibid., §2-3.

<sup>51</sup> Management Mandate for the Government Pension Fund Global, *supra* note 35, §2-2(3).



Active ownership is thus meant to have regulatory effects. The management guidelines specify that the “Bank shall actively contribute to the development of good international standards in the area of responsible investment activities and active ownership.”<sup>52</sup> Together these incremental changes to the conventional Norwegian position reminds us of the importance of public policy in the operation of the private investment activities of the Norwegian sovereign wealth fund.<sup>53</sup> It also serves as a reminder of the substantial irrelevance of international efforts to draw a strong connection between public and private investment in private markets through instruments like the Santiago Principles.<sup>54</sup>

Active ownership is tied to the NSWF's notions of universal ownership. “An important prerequisite for influencing companies to change their behaviour is that such a change is also in the companies' interest, if not the results may soon become arbitrary. Where it is difficult to find a solution in isolation at the company level, a broader industry approach may be relevant.”<sup>55</sup> Active ownership also suggests the ways in which the state can access non-public law based avenues of regulation through its shareholder power. “Such an approach should look at the need and possibilities for reducing the short- and long-term welfare losses by «lifting» the quality of the investment universe. It should also look at the dynamic need to «adapt» to the issues through changes in the investment strategy.”<sup>56</sup>

The active part of active ownership is manifested through a set of ordered techniques. These include, beyond voting its shares, “Voting at annual general meetings, Shareholder proposals, Dialogue with companies, Legal steps, Contact with regulatory authorities, [and] Collaboration between investors.”<sup>57</sup> The Norges Bank has been aggressive in meeting its obligation in this regard.<sup>58</sup> Indeed, that role is quite deliberately instrumental. It includes lobbying, in the capacity of a shareholder, for changes in the laws of host states, including the United States.<sup>59</sup> It also

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<sup>52</sup> Norway, Ministry of Finance, Guidelines for Norges Bank's work on responsible management and active ownership of the Government Pension Fund Global (GPF), supra, at Sec. 3.

<sup>53</sup> Ministry of Finance, Report No. 10 (2009-2010), supra note 48, Section 10.3.

<sup>54</sup> International Working Group of Sovereign Wealth Funds, Generally Accepted Principles and Practices (GAPP)—Santiago Principles, Oct. 2008. Available <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

<sup>55</sup> Ministry of Finance, Report No. 10 (2009-2010), supra note 48, §11.4.

<sup>56</sup> Id., at §11.6.

<sup>57</sup> Ministry of Finance, Government Pension Fund Global: Responsible Investment (Brochure Publication Code R-0623 E) at 22.

<sup>58</sup> See, e.g., NBIM, Press Release: *Norges Bank Investment Management, Pension funds urge chocolate industry to end child labour*, May 31, 2010 available <http://www.nbim.no/en/press-and-publications/feature-articles/2010/pension-funds-urge-chocolate-industry-to-end-child-labour/>.

<sup>59</sup> This from the 2012 Report of the NSWF fund manager: “Norges Bank decided to submit share- holder proposals in six US companies. The proposals call for amendments to articles

includes the development of shareholder strategies in concert with other investors and industry initiatives that are then used to further governance behavior modification objectives.<sup>60</sup> As a large shareholder, even with relatively small stakes, the NSWF is able to affect corporate governance behavior among those companies in which it has invested.<sup>61</sup> Norges Bank has focused on issues of equal treatment of shareholders, shareholder influence and board accountability, standards for well functioning and efficient markets, children's rights, climate change and water management.<sup>62</sup>

The focus on responsible investments is not solely the province of the Norges Bank in its managerial and investment functions. In addition to the obligations of the Norges Bank as Fund manager, the Storting has created a set of Ethical Guidelines.<sup>63</sup> These Guidelines bind on the Ministry of Finance and the Norges Bank, but are administered through an Ethics Council. It is to the place of the Ethics Council, the Ethical Guidelines, and the juridification of private market investments that we turn to next.

### **III. JURIDIFICATION OF INVESTMENT: THE EMERGING JURISPRUDENCE OF THE ETHICS COUNCIL**

It is now a commonplace that globalization of governance bodies has been accompanied by a trend toward juridification.<sup>64</sup> The NSWF system extends this juridification process beyond its exercise by non-judicial bodies within states<sup>65</sup> to the processes of the financial market itself. Within governance models of hybrid public-private activities, especially those of sovereign wealth funds, the move toward regulation of the investment decisions of the fund through the application of an ethics code by a disinterested panel of experts designated for that purpose, provides a

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to enshrine a right for shareholders to submit proposals for alternative board candidates for inclusion in the notice of general meeting. The proposals were submitted in 2011, and will not be voted over until 2012.” Ministry of Finance, The Management of the Government Pension Fund in 2011, Meld. St. 17 (2011-2012), *supra* note 17, at Box 4.8.

<sup>60</sup> *Ibid.*, Section 4.4.2.

<sup>61</sup> “Companies are particularly interested in how Norges Bank will vote in general meetings and how the Bank reacts to special situations that might arise during the course of the year.” *Ibid.*

<sup>62</sup> Ministry of Finance, Government Pension Fund Global: Responsible Investment (Brochure) at 24.

<sup>63</sup> Guidelines for the observation and exclusion of companies from the Government Pension Fund Global’s investment universe, Adopted by the Ministry of Finance on 1 March 2010 pursuant to Act no. 123 of 21 December 2005 relating to the Government Pension Fund, section 7.

<sup>64</sup> Lars Chr. Blichner and Anders Molander, What is Juridification?, Arena, Centre for European Studies University of Oslo Working Paper No. 14, March 2005).

<sup>65</sup> See, e.g., Ran Hirschl, *Toward Juristocracy: The Origins and Consequences of the New Constitutionalism* (Harvard University Press, 2007), though I quite prefer the now quite ironical Edouard Lambert, *Le gouvernement de juges et la lutte contre la législation sociale aux États-Unis* (Paris Giard, 1924).

variant of the juridification model applied to the commercial activities of the state. The framework for that effort, like that of the active shareholder principles, is the regulation of responsible investment.<sup>66</sup> For the Ethics Council, those efforts are centered on the Ethical Guidelines and the jurisprudence it is constructing around it.

### **A. The NSWF Ethical Guidelines.**

The Ethics Guidelines<sup>67</sup> replaced the Ethics Guidelines for the Government Pension Fund--Global, which had been adopted in 2004, and came into effect on March 1, 2001.<sup>68</sup> The Ethics Guidelines bind the Ministry of Finance, the Council on Ethics and Norges Bank with respect to investments in the NSWF's equity and fixed income portfolio, as well as instruments in the Fund's real-estate portfolio issued by companies that are listed in a regulated market.<sup>69</sup>

The Ethics Guidelines is grounded in notions of ethical investing that necessarily conflates public and private activities in ways that privilege the state and its choices, and suggests that such choices ought legitimately to be extended to the limits of the actual ability of the state to control activity--directly through legislation or indirectly through ownership. "Just as politics is not an end in itself, but a means of promoting social change for the benefit of the people and the environment, a company's profits or activities are not goals that can be viewed in isolation from other considerations."<sup>70</sup>

The Guidelines are based on two premises: (1) that the NSWF must be managed to extract a "sound return in the long term,"<sup>71</sup> and (2) that the first objective is contingent on a number of policy factors, including "sustainable development in the economic, environmental and social sense."<sup>72</sup> The Ethical Guidelines are implemented in three ways--through the exercise of ownership rights, negative screening of companies, and exclusion of companies from the investment pool.<sup>73</sup> The Ethics Guidelines forbid investment in companies that engage in a broad range of economic

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<sup>66</sup> Cf. Daniel Brooksbank, NBIM outlines misgivings on UK Stewardship Code, Responsible Investor.com, Oct. 20, 2010.

<sup>67</sup> Guidelines for the observation and exclusion of companies from the Government Pension Fund Global's investment universe, Adopted by the Ministry of Finance on 1 March 2010 pursuant to Act no. 123 of 21 December 2005 relating to the Government Pension Fund, section 7.

<sup>68</sup> Ethics Guidelines, *supra*, note --, Section 9. For the history see From Council on Ethics for the Government Pension Fund Global, Annual Report 2009, at 8).

<sup>69</sup> Ethics Guidelines, *supra*, Sec. 1.

<sup>70</sup> *Ibid.*, at 1.1.

<sup>71</sup> See, Report of the Ministry of Finance. Ministry of Finance, Norway, Report No. 20 to the Storting (2008-2009), *supra* note 78, at Par. 1, subpart 1.

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

activity, some of which are legal in the states in which they are undertaken, including companies that “a) produce weapons that violate fundamental humanitarian principles through their normal use; b) produce tobacco; c) sell weapons or military material to states mentioned in section 3.2 of the guidelines for the management of the Fund.”<sup>74</sup>

Before 2015, the Finance Ministry was provided a discretionary power to exclude another group of companies from the Fund's investment universe.<sup>75</sup> The Finance Ministry has adopted an "there is an unacceptable risk that the company contributes to or is responsible for" standard for the exercise of its exclusion power.<sup>76</sup> In making this discretionary assessment, it considered a number of factors, including probability of future violations, severity of violation, extent of connection with the company, and mitigation efforts.<sup>77</sup>

Tying the active ownership principles of the management guidelines to the exclusion power under the ethics guidelines, the Ministry of Finance was also given authority to determine whether it might make greater sense for it to seek to change the behavior of the offending corporation through assertion of active ownership principles rather than to exclude the company from the investment universe. This is an important structural principle. This included a power to "put a company under observation."<sup>78</sup> Observation may be chosen if there is doubt as to whether the conditions for exclusion have been fulfilled, uncertainty about how the situation will develop, or if it is deemed appropriate for other reasons. Regular assessments shall be made as to whether the company should remain under observation.<sup>79</sup>

While decisions on exclusion of companies from the investment universe was reserved to the Ministry of Finance, the Ethics Guidelines was authorized to make reasoned determinations of eligibility of exclusion and the form in which such determinations were to be made.<sup>80</sup> It is to the form and powers of the Ethics Council and its process for exclusion that we turn to next.

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<sup>74</sup> Ethics Guidelines Sec. 2(1). For example, cluster munitions fall within the category of weapons that the Norwegian Pension Fund is not allowed to invest in From *Norway Pension Fund Reinstates Thales and DRD Gold*, Blog: Norway.com, Sept. 10, 2009, available <http://blog.norway.com/2009/09/10/norway-pension-fund-reinstates-thales-and-drd-gold/> .

<sup>75</sup> From Council on Ethics for the Government Pension Fund Global, Annual Report 2009, at 16.

<sup>76</sup> Ethical Guidelines, sec. 2(3).

<sup>77</sup> *Ibid.*, Sec. 2(4).

<sup>78</sup> *Ibid.*, Sec. 3.

<sup>79</sup> *Ibid.*

<sup>80</sup> Ethics Guidelines, Sec. 2(2); 4-5)

## **B. Operationalizing the Ethics Guidelines--The Structure and Functions of the NSWF Council on Ethics.**

The Ethics Guidelines (“Guideline”) confer on the Ministry of Finance the authority to appoint a Council on Ethics of five members (Guidelines §4(1)), with its own secretariat (Guidelines §4(1)) financed by the Ministry. The Council members are drawn from academia and related areas.<sup>81</sup> The Ethics Council apparatus appears to be well funded, though its strain on both time and finances is acknowledged.<sup>82</sup>

The Ethics Council is vested with four principle functions described in Sections 4(2)-(5) of the Guidelines. The Council is to “monitor the Fund’s portfolio with the aim of identifying companies that are contributing to or responsible for unethical behaviour or production” (Guidelines §4(2)). The Council also advises the Finance Ministry “on the extent to which an investment may be in violation of Norway’s obligations under international law” (Guidelines §4(3)) and on exclusion from the Fund ((Guidelines §4(4)). Lastly, the Ethics Council can invoke the Norges Bank’s active shareholder function, by giving advice “on whether a company should be put under observation (Guidelines §4(5)). Only one of the Ethics Council’s functions is expressly mandatory, the obligation to monitor companies in the Fund’s portfolio for compliance with the normative ethics standards set out in Section 2 (products based exclusion and conduct based exclusion). The rest of its obligations are, to some extent either triggered on request or discretionary. It is obligated to give legal advice on the extent to which an investment may violate international law at the request of the Ministry of Finance or on its own initiative (Guidelines §5(1)).

A principal operational function of the Ethics Council is the harvesting of information. It is given broad, though unspecified authority, to “obtain the information it deems necessary and ensure that the case has been properly investigated before giving advice on exclusion from the investment universe” (Guidelines §5(2)). The obligation to harvest information extends not only through the process of determining exclusion from the investment universe but continues thereafter. “The Council shall routinely assess whether the basis for exclusion still exists and may, in light of new information, recommend that the Ministry of Finance reverse a ruling on exclusion” (Guidelines §5(5)). The nature of the Ethics Council’s charge appears to have affected its approach to its duties in a

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<sup>81</sup> See, Ministry of Finance, The Council on Ethics for the Government Pension Fund – Global. Available <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/the-council-on-ethics-for-the-government.html?id=447010>.

<sup>82</sup> From Sibylle van der Walt, Bringing human rights into pension finance. Interview with Gro Nystuen, Norway Govt Pension Fund, Responsible Investor.com, April 21, 2009).

particular way: "The biggest difference between us and anybody else is the amount of resources we use and the level of distrust we have when we screen companies. We do not just rely on service providers who claim they can make sure that our portfolio is ethical. We think that nobody actually can do this better than ourselves. So although we use initial information from screening companies, we always check the quality of the information ourselves."<sup>83</sup>

The Ethics Guidelines set out a rudimentary system of procedural protection applicable to the process of determining the appropriateness of Fund exclusion. The process system balances qualitative minimum protections of the rights of those affected against the needs of the Ministry of Finance for efficiency in the operation of the system.<sup>84</sup> Companies subject to Ethics Council investigation are given a general opportunity to present information and arguments to the Council "at an early stage of the process" (Guidelines §5(3)). The Council is under an obligation, as well, to make clear the basis on which it is proceeding with the exclusion investigation. "If the Council decides to recommend exclusion, its draft recommendation shall be presented to the company for comment" (Guidelines §5(3)). The Ethics Council has listed some of the factors it weighs in reaching its decision whether a company by its conduct "could expose the Fund to an unacceptable risk of contributing to grossly unethical practices" the touchstone standard for conduct based exclusion under the Ethical Guidelines (§2(2)). The standards touch on causation, frequency, seriousness, extent of proof and mitigation.<sup>85</sup>

Once it has reached a decision, the Ethics Council is required to produce a written opinion describing the grounds for its recommendations (Guidelines §5(4)). These include a presentation of the case, the Council's assessment of the specific basis for exclusion and any comments on the case from the company. The description of the actual circumstances of the case shall, insofar as possible, be based on material that can be verified, and the sources shall be stated in the recommendation unless special circumstances indicate otherwise.

The quasi-judicial character of the process is made clear in the specification for the assessment of the basis for exclusion: "The assessment of the specific basis for exclusion shall state relevant factual and legal sources and the aspects that the Council believes ought to be accorded weight" (Guidelines §5(4)). The Ethics Council has some

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<sup>83</sup> From Sibylle van der Walt, Bringing human rights into pension finance. Interview with Gro Nystuen, Norway Govt Pension Fund, Responsible Investor.com, April 21, 2009).

<sup>84</sup> Cf. *Mathews v. Eldridge*, 424 U.S. 319 (1976); *Case 17/74 Transocean Marine Paint v. Commission* [1974] ECR 1063).

<sup>85</sup> See, Ministry of Finance, Ethics Council, Frequently Asked Questions, No. 5. Available [http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics\\_council/frequently-asked-questions.html?id=605599](http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/frequently-asked-questions.html?id=605599).

latitude in the character of the information used in its proceedings, limited only by the "verifiable" standard of Guidelines §5(4).

The evidentiary rules for the work of the Council on Ethics are simple: the information taken into account must be verifiable.<sup>86</sup> Moreover, the Ethics Council has chosen to limit the citation of its information sources under certain circumstances.<sup>87</sup> The internal routines for managing proceedings to reverse exclusion, described as "cases" in the English translation of the Ethical Guidelines are to be publicly available and the affected companies informed (Guidelines §5(6)). And the Ministry of Finance is required to publish Ethics Council recommendations "after the securities have been sold, or after the Ministry has made a final decision not to follow the Council on Ethics' recommendation" (Guidelines §5(7)). There are limits to transparency, both to protect companies and to protect the state as well.

Beyond that, the Ethics Guidelines frames the structure of cooperation between the Norges Bank, the Ministry of Finance and the Ethics Council (Guidelines § 6). The framework for that cooperation is the responsible investment norm. The three entities meet regularly to exchange information, focusing on the Norges Bank's active ownership functions and the Ethics Council's portfolio monitoring function (Guidelines §6.1). Procedures for coordinating communication with companies are required (Guidelines §6(2)). And the Norges Bank and Ethics Council are expected to consult with reach other with respect to their respective obligations. "The Council on Ethics may ask Norges Bank for information about how specific companies are dealt with through active ownership [and] to comment on other circumstances concerning these companies. Norges Bank may ask the Council on Ethics to make its assessments of individual companies available" (Guidelines §6(3)).

While Norges Bank functions like a shareholder, the Ethics Council functions like a judicial body. The Ethics Council itself has suggested the structure of its own jurisprudence, a structure that these essays will take as a starting point for analysis. This structure suggests the way in which the substantive jurisprudence has been organized. It also suggests the development of procedural mechanics that help shape the decision mechanics. Principles of *legality* (all regulation must be clear, ascertainable and non-retrospective), *legal certainty* (legal rules must be clear and precise), *proportionality* (sanction should be in proportion to the severity of the act punished), *margin of appreciation* (range of interpretive discretion a function of strength of consensus among legal actors), *predictability* (similar facts should produce similar results) and the like are legal concepts essential to a legitimate jurisprudence.

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<sup>86</sup> Evidentiary rules are described at Ministry of Finance, Ethics Council, Frequently Asked Questions, No. 16)

<sup>87</sup> Id., "in order to protect personal safety).



The Ethics Council has developed a series of additional procedural rules for the determination of exclusion cases. Among the most important is a rule that that's as dispositive all statements produced by a company in its official filings and on its internet and social media sites.<sup>88</sup> This reduces need to compel companies to participate in proceedings but also diminishes the right of companies subject to exclusion to participate in the proceedings. Another evidentiary standard treats past activity as creating a presumption of the possibility of similar future activity, to determine whether a company's breach is likely to be ongoing.<sup>89</sup> Yet another limits exclusion under two circumstances. The first is that an exclusion recommendation may not follow from a violation of the Ethics Guidelines where such a determination might *undermine* the Norges Bank's application of its active ownership procedures.<sup>90</sup> The second is where remediation has also reduced the severity of the damage.<sup>91</sup> The Ethics Council has also begun to develop rules for interpretive hierarchies; for example, "in a situation of contradictory interpretations of international law, treaty law would prevail over a legal opinion."<sup>92</sup>

A number of substantive rules have also been developed. Among the most important are the following. First, determinations of international judicial and quasi-judicial bodies can be taken as authoritative for application of the Guidelines.<sup>93</sup> Second, the Council could fill in gaps in the Guidelines to apply them under appropriate circumstances, especially where technology or circumstances change.<sup>94</sup> Third, conformity with the laws of the states in which a company operates is no defense against exclusion; this incorporates a basic principle of polycentricity.<sup>95</sup> Third, the Council is free to blend determinations of international bodies, national courts within and

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<sup>88</sup> Recommendation of the Council on Ethics. October 22, 2009. (Alliance One International Inc., Altria Group Inc., et al.).

<sup>89</sup> Recommendation of November 16th, 2009, on the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. [23.08.2010]

<sup>90</sup> Monsanto Redetermination, 7.

<sup>91</sup> Monsanto Redetermination, 7.

<sup>92</sup> 01.09.2006 Exclusion of Kerr-McGee reversed along with 06.06.2005 Kerr-McGee Corporation at 4.

<sup>93</sup> Recommendation of September 20, 2005 concerning whether the weapons systems Spider and Intelligent Munitions System (IMS) might be contrary to international law. Letter to the Ministry of Finance from the Advisory Council on Ethics [20.09.2005]

<sup>94</sup> Recommendation on Exclusion of Cluster Weapons from the Government Petroleum Fund. Letter to the Finance Ministry from the Advisory Council on Ethics for the Norwegian Government Petroleum Fund, Oslo [02.09.2005] (Alliant Techsystems Inc. et al.); Poongsan Corporation, Recommendation of 6 September 2006 To the Ministry of Finance From the Council on Ethics; Hanwha Corporation, Rheinmetall AG, Recommendation of 15 May 2007 to the Ministry of Finance from the Council on Ethics; Textron Corporation, Recommendation of 26 August 2008 from the Finance Ministry to the Council on Ethics.

<sup>95</sup> BAE Systems Plc., Boeing Co., Finmeccanica Sp.A., Honeywell International Inc., Northrop Grumman Corp., United Technologies Corp., Safran SA, Recommendation of 19 Sept. 2005 (exclusion Jan. 1, 2006) (nuclear weapons).

outside Norway and Norwegian policy to determine the lawfulness of an activity for purposes of the Guidelines.<sup>96</sup>

The rules for exclusion based on complicity are complex. With respect to weapons sales to state actors, a fairly narrow standard is adopted. First, there must be a connection between the company's operations and the relevant violations. Second, there must be an unacceptable risk for the company, and thus also, for the Fund, of contributing to future violations.<sup>97</sup> But with respect to complicity in serious or systematic human rights violations, exclusion will be based on the actions of the entire supply chain of which the excluded company is a part<sup>98</sup> and exclusion will be based on a linkage between the company and the Guidelines breach, the violations must have been carried out to serve the company's interests, the company must have knowledge of the violations, and the violations must be ongoing or likely to recur.<sup>99</sup> Complicity for environmental damage is subject to a different rule)—which include: the damage is significant; the damage causes irreversible or long-term effects; the damage has considerable negative consequences for human life and health; the damage is the result of violations of national law or international norms; the company has failed to act in order to prevent damage; the company has not implemented adequate measures to rectify the damage; and it is probable that the company's unacceptable practice will continue.<sup>100</sup>

Corruption seems to have been the most troublesome for the Council. This is one of the most interesting of the cases, and one in which the tension between the juridification within the Council of Ethics and the political agendas of the Ministry of Finance are most clearly illustrated.<sup>101</sup> After its initial determination the Ethics Council was asked to re-evaluate its original exclusion determination. The Ethics Council refused, despite substantial evidence of efforts by Siemens to change its practices and deal directly with the underlying issues of corruption.<sup>102</sup> The Finance Ministry

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<sup>96</sup> 03.09.2009 Elbit Systems Ltd (interpreting judicial decisions of states and international bodies to which it added its own interpretative application of the Ethics Guidelines, producing a standard for exclusion on the basis of complicity that is broader than prior Ethics Council decisions). Recommendation of November 16th, 2009, on the exclusion of the companies Africa Israel Investments Ltd. and Danya Cebus Ltd. [23.08.2010] (using Israeli and ICJ sources to determine the legality of construction fo Israeli separation barrier).

<sup>97</sup> Recommendation of 14 November 2005, Total S.A.; Recommendation of November 14, 2008, on exclusion of the company Dongfeng Motor Group Co. Ltd., [13.03.2009].

<sup>98</sup> Recommendation of 20 Nov. 2006 concerning Monsanto Co.,.

<sup>99</sup> Recommendation of 14 November, 2005, concerning whether investments in Total, due to the company's operations in Burma, are contrary to the Petroleum Fund's ethical guidelinesMade public: 5 January 2006, [14.11.2005].

<sup>100</sup> Recommendation of February 15, 2006 on exclusion of Freeport McMoRan Copper & Gold Inc., 15.02.2006].

<sup>101</sup> Recommendation of November 15, 2007, on exclusion of the company Siemens AG, [13.03.2009].

<sup>102</sup> Ibid.

disagreed.<sup>103</sup> This is the first time that the Ministry of Finance has come to a conclusion that is contrary to that of the Council.

But what does this all mean? It is to that question that the essay turns to next.

#### IV. COOPERATIVE AND INTER-SYSTEMIC GOVERNANCE; ITS STRENGTH AND FRAGILITY.

Social control, a significant obligation of the state exercised traditionally through law, has now entered the global age. Where the state can no longer control directly through its organs within its territory, it can now seek to control through its organs and beyond its territory in competition with other organs participating in markets. The state becomes an institution, one among a variety of others, in which social control is a matter of market power. The Norwegian Finance Minister, Kristen Halvorsen, has nicely summarized the Norwegian premise underlying the operations of the NSWF and the development of its structures: “In a global economy, ownership of companies is the most important way to have influence,” Ms. Halvorsen said.”<sup>104</sup>

Norway effectively acknowledges three intertwined but autonomous governance realms. The first is the traditional territorially based law-state. The second is the governance sphere of the corporation--affecting not only relationships within its operations but also the rules that reflect the choices it makes about how it deals with others. The third is the international governance sphere, where common traditions are developed that has a direct and indirect effect on both domestic legal orders and corporate behavior choices. Norway has sought to operate within and between these three governance realms, and to some extent affect their content, through the investment strategies of the NSWF. This intertwining suggests an inter-systemic governance project that is unique.<sup>105</sup>

At the center of the construction of this inter-systemic project is a curious mix of instrumentalities and techniques of private and public power. The NSWF governance regime acknowledges three simultaneously operating governance regimes--the law-state system, the social-norm system of

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<sup>103</sup> Ministry of Finance, Recommendations on the company Siemens AG, 2007 - 2012. In June 2012, the Council on Ethics recommended to the Ministry of Finance that Siemens be removed from the observation list. Recommendation to remove Siemens AG from the watch list of the Norwegian Government Pension Fund Global, 15 June 2012. Available [http://www.regjeringen.no/upload/FIN/etik/2013/siemens\\_eng.pdf](http://www.regjeringen.no/upload/FIN/etik/2013/siemens_eng.pdf).

<sup>104</sup> Mark Landler, *Norway Keeps Nest Egg From Some U.S. Companies*, NEW YORK TIMES, May 4, 2007.

<sup>105</sup> On the emerging trend toward inter-systemic governance, see, Larry Catá Backer, ‘Inter-Systemic Harmonization and Its Challenges for the Legal-State,’ in Sam Muller, Stavros Zouridis, Morly Frishman and Laura Kistemaker (eds), *The Law of the Future and the Future of the Law* (Torkel Opsahl Academic EPublisher 2011)

private actors, and the international law-custom system of the community of states (and their partner-constructs). It seeks to both mediate between these governance systems and to actively participate within them. First, the NSWF asserts private regulatory power toward public governance. Second, the NSWF asserts public regulatory power toward private governance. Third, the NSWF serves as the governance space through which international norms for corporate behavior is domesticated and then applied extraterritorially through private market investment. It represents another and more complex layer of fundamental notions of contemporary research on the European Administrative Space in its four analytical dimensions—*independence, integration, co-optation, and institutionalization*.<sup>106</sup>

The object is to shape the external behavior of enterprises by creating private incentives toward the conformity to law, and more problematically, to domestic and international norms. The resulting process effectively permits Norway to enforce soft law frameworks for corporate governance, as well as international law and norms against non-state enterprises whose organization and operations exist outside the territorial boundaries of Norway, and whose home states may reject those norms. Though that effect is limited to the private market behavior of Norway, it may produce an effect functionally similar to the legislative process traditionally used for this purpose.

But the construction of this cooperative regulatory regime is fragile. And that fragility is as much a reflection of the great contradictions on which it is built as it is on the power of regulatory inertia. In November, 2013 government-appointed commission, issued a report that recommended the abolition of the Ethics Council system, established by Royal Decree 19th November, 2004, and the transfer of some of its functions to the fund administrator--Norges Bank and NBIM.<sup>107</sup>

The basis for this recommendation was in some sense unreflexively simple—benchmarking.

In particular, we reviewed the approaches to responsible investment followed by a number of funds that may be regarded as comparators to GPFG because of their size, purpose and interest in responsible investing. We considered standard setters and guidelines relevant for institutional investors. Finally, we

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<sup>106</sup> See, e.g., Jarle Trondal and B. Guy Peters, *The Rise of European Administrative Space: Lessons Learned*, University of Oslo Centre for European Studies ARENA Working Paper No. 1 (Feb., 2012).

<sup>107</sup> Elroy Dimson, Idar Kreutzer, Rob Lake, Hege Sjo, and Laura Starks, *Strategy Council 2013, Responsible Investment and the Norwegian Government Pension Fund Global, Main Report* (November 2013)).

reviewed how asset managers and sell-side analysts respond to clients' ownership preferences.<sup>108</sup>

That benchmarking appeared to suggest that the Ethics Council system was somewhat unique and ought to be abandoned so that the Norwegian Fund should resemble the "average" or "conventional" fund.

"Other large sovereign wealth funds or major public pension funds do not have such an approach to responsible investing. Yet, even within our sample of funds, it is clear that responsible investment has no singular motivation and that there is no single strategy or set of approaches that is followed universally."<sup>109</sup>

This is a curious turn--a report recommending that a state cede its political, economic and international interests in the name of perhaps marginally larger financial gains. The innovative features of the NSWF, and especially its Ethics Council structures have served Norway well in advancing and leveraging its political as well as economic interests. This is especially true of the published reports of Ethics Council.

In other words, the council's reports serve a shaming function as well as a financial one. Furthermore, the publication of the Ethics Council's recommendations has helped focus international attention on corporate social responsibility and business and human rights. A number of other investors follow the council's recommendations, which compounds the impact — and heightens the deterrent effect of — the Ministry's decisions. Hiding the reasoning from view would lessen the shaming effect and give some investors cover for keeping Fund-excluded companies in their portfolios.<sup>110</sup>

Thus, "as World Wide Fund for Nature Norway chief executive Nina Jensen points out, "every decision Norway makes on this fund sends signals around the world."<sup>111</sup>

Yet that is precisely the political charge with which the Ministry of Finance set the Strategy Council to work in 2013.

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<sup>108</sup> Ibid.

<sup>109</sup> Ibid., ¶ 2.2.

<sup>110</sup> The Ethical Work of Norway's Sovereign Wealth Fund, Triple Pundit, March 20, 2014. Available <http://www.triplepundit.com/2014/03/ethical-work-norways-sovereign-wealth-fund/>.

<sup>111</sup> Charlotte Wood, Lessons for Australia from Norway's petro-wealth debate, *Climate Spectator*, April 14, 2014, available <http://www.businessspectator.com.au/article/2014/4/15/policy-politics/lessons-australia-norways-petro-wealth-debate>.

In January 2013, the Ministry of Finance requested the Strategy Council for the GPFG to assess how the joint resources and competencies of the Ministry of Finance, the Council on Ethics and Norges Bank can best be exploited to strengthen responsible investment practice. The mandate called on the Strategy Council to build on the previous responsible investment experience of the GPFG, as well as to compare it to other funds. The Council was instructed to examine how one might eliminate any deviation from best international practice, thus making the Fund a driving force for responsible investment development. The mandate allows for the Strategy Council to propose any changes it believes may strengthen responsible investment practice, including operational and institutional changes.<sup>112</sup>

Beyond the political language of obfuscation what emerges is a desire to conform, and by conforming, leading among the bench-marked group of funds into whose pack the Fund would insert itself.<sup>113</sup> Thus, in the name of conventionality, it seems, then, the Report recommended that the functions of the Ethics Council might produce regulatory incoherence and might be as well undertaken, at least as to its objectives by the Fund managers. Indeed, reduced to insight, the work of the Ethics Council was viewed as better undertaken by Norges Bank and the Ethics Guidelines be integrated with its management objectives. "The Council on Ethics possesses valuable expertise about the issues that are governed by the current Guidelines for Observation and Exclusion. We recommend that these guidelines be integrated into the Investment Mandate from the owner to the Board of Norges Bank."<sup>114</sup> The Report concluded:

We believe the recommendations will further contribute to strengthening the work on responsible investment in GPFG. Applying a more unified and holistic approach will give the Fund a more powerful and influential responsible investment strategy. This is achieved through our recommendations to integrate the resources and insights developed by the Council on Ethics and Norges Bank, by utilising one overarching set of responsible investment principles, and one common procedure for ownership activities including portfolio monitoring and analysis. Our recommendations on research into issues relevant to long-term returns, and on initiatives to address relevant policy and regulatory issues, will strengthen the approach further.<sup>115</sup>

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<sup>112</sup> Ministry of Finance, Report No. 19 to the Storting (2013-2014) Report to the Storting (white paper) The Management of the Government Pension Fund in 2013, April 4, 2014, § 2.5.1. Available [http://www.regjeringen.no/pages/38671176/translation1\\_2.pdf](http://www.regjeringen.no/pages/38671176/translation1_2.pdf).

<sup>113</sup> (See, e.g., Ibid., Box 2.5)

<sup>114</sup> Elroy Dimson, et al., Main Report, *supra*, p. 30.

<sup>115</sup> Ibid. p. 31.

The report also called for more research on the performance of ethical investments, saying a lack of such studies made it difficult to assess how the fund's stance compared with other strategies.

The Report produced a spirited defense of the Ethics Council system by the Ethics Council itself in its 2013 Annual Report.<sup>116</sup> What is most interesting is the way in which the Ethics Council quite rightly saw in the report an effort to reduce the political effectiveness of the GPFG as an actor, through private markets, in the development of corporate governance and social responsibility standards. More importantly, the Ethics Council correctly suggested that the turn toward less transparency and a greater masking of the political work of SWFs itself might be considered bad practice. Most importantly, the Ethics Council response nicely illustrates the tension within SWFs of the political and policy objectives of sovereign activity and its financial goals, especially in states in which the norms and standards of international governance are, as a matter of state policy, an important objective of state activity, including investment activity.

Though the Ethics Council continued to develop a defense of its work in its 2014 Annual Report,<sup>117</sup> there was also an acceptance of the reality of the changes.<sup>118</sup> Outsiders noted the underlying politics of both the Strategy Council and the Ethics Council's defense--the desire to uncouple investment decisions from human rights norms. "There needs to be a strong and independent player who performs the screening of a company and comes with a recommendation about the impact it should have on an investment," Beate Ekeloeve-Syldal of Amnesty International told Reuters.<sup>119</sup>

Despite fears that the Norwegian government would eliminate the Ethics Council in light of the report and its positive reception,<sup>120</sup> in the end the government chose only to shift authority over final actions from the Foreign Ministry to the Norges Bank establishment.<sup>121</sup> The Ethics Council

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<sup>116</sup> Council on Ethics for the Government Pension Fund Global, Annual Report 2013, pp. 6-40, available [https://www.regjeringen.no/contentassets/e15746148471492c86660a5d665a12b8/annual-report\\_2013.pdf](https://www.regjeringen.no/contentassets/e15746148471492c86660a5d665a12b8/annual-report_2013.pdf).

<sup>117</sup> Council on Ethics for the Government Pension Fund Global, Annual Report 2014, pp. 6-40, available <http://etikkradet.no/files/2015/01/Council-on-Ethics-2014-Annual-Report.pdf>.

<sup>118</sup> *Ibid.*, pp. 29.

<sup>119</sup> Norway's \$800 bln fund should lose independent ethics panel -report, Reuters Nov. 11, 2013. Available <http://www.reuters.com/article/2013/11/11/norway-sovereignwealthfund-ethics-idUSL5N0IT23S20131111>.

<sup>120</sup> Richard Milne, Norway scraps oil fund ethics committee, Financial Times, April 4, 2014, available <http://www.ft.com/intl/cms/s/0/92cef506-bbe3-11e3-84f1-00144feabdc0.html#axzz2zCLufMPT>.

<sup>121</sup> Guidelines for observation and exclusion from the Government Pension Fund Global Translation from the Norwegian version. Adopted 18 December 2014 by the Ministry of



retains its character as an independent council. It hailed this decision as a potential means of creating the opportunities for faster decisions and greater integration of the financial and ethical obligations of the NSWF. “Now that the responsibility for exclusion has been transferred to Norges Bank, it should also be easier to achieve a continuous chain of tools. This simply depends on the expedient organisation of the work and allocation of resources.”<sup>122</sup> However, the new rules also appear to make it clear that the Norges Bank will assert potentially more control over the activities of the Ethics Council. The bank and Council are to meet regularly to coordinate their work (Guidelines §6(1), (4)). The Bank now appears to take the lead in corporate communications and may keep the Council on a much shorter leash. “The Bank shall exercise the Fund’s ownership rights. The Bank shall seek to integrate the Council’s communications with companies into its general company follow-up. The Bank shall have access to the Council’s communications with companies, and may participate in meetings between the Council and companies” (Guidelines §6(2)). It also appears that the Council should seek information on companies through the Bank (Guidelines §6(3)).

Taken together, the changes suggest some potentially substantial changes to the way in which the Norwegian sovereign investment system is operated. Though the Council retains its autonomy, its independence of action appears now to be much more constrained. The Norges Bank now takes the lead not just in decision-making—once the preserve of the Finance Ministry, but also acts as the intermediary between company and Council. It will be harder for the Council to act independently, especially in opposition to the desires of the Norges Bank. Whether that changes the character of responsible investing and active shareholding remains to be seen.

## V. CONCLUSION

The NSWF evidences that State has returned; but it has returned to the global private market and as a nexus between private and international flavored with national interest. That return to the market is transforming both the market as a center of law making and the state as a stakeholder in regulatory governance beyond the state. Market power now substitutes for public legislative power, and the techniques of market behavior now serve as the vehicle for the implementation of law and norms. The distinctions between public and private, between public regulation and market behavior, distinctions that are grounded in a well developed formal system

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Finance pursuant to the Royal Decree of 19 November 2004 and section 2, second paragraph, and section 7 of Act No. 123 of 21 December 2005 relating to the Government Pension Fund, §§ 1(4), 6; available <https://www.regjeringen.no/globalassets/upload/fin/statens-pensjonsfond/guidelines-for-observation-and-exclusion-14-april-2015.pdf>.

<sup>122</sup> Council on Ethics, Annual Report 2014, *supra.*, p. 29.

of state and market, gives way here to the rise of a system best characterized as functional and hybrid. This will impact substantially on international regulations, the regulatory context of sovereign wealth funds, the development of transnational standards for corporate social responsibility and the emergence of substantive standards for corporate behavior consonant with emerging human rights standards. In this sense, responsible investment in general, and the work of the Ethics Council in particular, serves as a means of leveraging the public power of Norway through private markets.<sup>123</sup>

The NSWF experiment reminds us of the importance of public policy in the operation of the private investment activities of the Norwegian sovereign wealth fund. It also serves as a reminder of the substantial irrelevance of international efforts to draw a strong connection between public and private investment in private markets through instruments like the Santiago Principles. More importantly, it suggests the implausibility of the distinction between public and private when states seek to enter global markets as participants.<sup>124</sup>

The NSWF provides evidence of the rise of an aspect of a new phenomenon that has become more pronounced in the last quarter century—the destruction of the old boundaries between state and enterprise, between public and private spheres and between law and non-public regulation. Where Banks and Finance Ministry become interchangeable, the result of the modifications of late 2014, then one can only speak to cooperative regulatory regimes.

Norway has consciously sought to bridge the gap between the public, private and international spheres of governance.<sup>125</sup> The Norwegians are not alone; and the mix of finance and politics has now become quite pronounced.<sup>126</sup> The way in which sovereign wealth funds are used to govern are now as important as the way in which the global community might seek to regulate, or at least manage the behaviors, of sovereign wealth funds. Norway engages in the process of international law making through

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<sup>123</sup> See, e.g., Oil Funds Give Israeli Outfits the Boot, Upstream Online.org, Aug. 23, 2010. Available <http://www.upstreamonline.com/live/article1198664.ece>.

<sup>124</sup> Thus, for example, the Norwegians may formally comply with its provisions, especially GAAP 19, but it substantially avoids its spirit. Santiago Principles, supra, Prin. 19. See, NORWAY MINISTRY OF FINANCE, THE NORWEGIAN GOVERNMENT PENSION FUND GLOBAL'S ADHERENCE WITH THE SANTIAGO PRINCIPLES 18 (Oslo: Norwegian Government Administration Services, April 2011).

<sup>125</sup> See, e.g., Anita M. Halvorssen, Addressing Climate Change Through the Norwegian Sovereign Wealth Fund (SWF)--Using Responsible Investments to Encourage Corporations to Take ESG Issues Into Account in Their Decision-Making 13-14 (Univ. of Oslo Faculty of Law Research Paper Series, Paper No. 2010-06), available at <http://ssrn.com/abstract=1712799>.

<sup>126</sup> See, e.g., Mostafa Mahmud Naser, *Climate Change, Environmental Degradation, And Migration: A Complex Nexus*, 36 WM. & MARY ENVTL. L. & POL'Y REV. 713 (2012).

its market activities, and engages in the process of private regulation through its incorporation of public law into its market activities, effectively politicizing shareholder power. The market becomes a parliament of sorts, and parliament becomes a stakeholder in market activities. The result is the sort of complex, cooperative, regulatory regimes that that may continue to mark new means of managing behavior and developing conduct norms in this century. But it is a very fragile system as well. And as likely to be stymied by the state the created it as it might serve as a model to others. It is far too early to tell.