

SPECIAL FOCUS ISSUE NOTE

State-Owned Enterprises in International Investment

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Abstract—This note conducts a survey of recent academic and professional commentary across multiple disciplines regarding the involvement of State-owned enterprises (SOEs) in the global economy with a view to illuminating considerations pertinent to the interpretation and application of international investment law in the context of SOE activity. A number of potentially problematic conceptual complexities raised by the interaction of SOE activity and international investment law are also highlighted.

When first faced with the honour of preparing a note for this important anniversary edition of the *ICSID Review*, introducing sovereign participation in international investment and the issues such participation raises under international investment law, I was struck by two somewhat contradictory realizations. The first was that my assignment could hardly be clearer. The second was that it raised a number of issues of great intricacy.

Sovereign participation in international investment is in many respects without complication. The last several decades—and the last decade in particular—have witnessed a tremendous growth in the number, capitalization and influence of State-owned enterprises (SOEs) engaging in overseas investment, whether in the form of State-owned companies,² sovereign wealth funds (SWFs)³ or similar sovereign commercial vehicles.⁴ The concerns such sovereign investment raise with host governments have received much attention and include the concern that SOEs will pursue political objectives rather than purely commercial objectives, that

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² State-owned enterprises (SOEs) can generally be understood to include business enterprises ‘in which the state has significant control, through full, majority, or significant minority ownership’ and are often involved in the infrastructure and utilities sectors, including energy, transportation and telecommunication. See Kathryn Gordon and David Gaukrodger, ‘Foreign Government-Controlled Investors and Host Country Investment Policies: OECD Perspectives’ in Karl P Sauvart and others (eds), *Sovereign Investment: Concerns and Policy Reactions* (OUP 2012) 496, at 497.

³ The term ‘sovereign wealth funds’ has come to be used to refer to ‘special purpose investment funds or arrangements’ that are State-owned, whether at the central or sub-national level, and that are ‘commonly established out of balance of payment surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses and/or receipts resulting from commodity exports’. *ibid.*

⁴ Some other State-owned investment vehicles sometimes included in discourse regarding SOEs include public pension plans and public pension reserve funds. *ibid.* 497–8.

their ties to foreign governments may pose national security risks and that they may be more likely to engage in anti-competitive behaviour.⁵ SOEs, on the other hand, have fears of their own, including that such host State anxieties may lead to ‘discriminatory or arbitrary governmental, regulatory or administrative treatment motivated more by political considerations than by genuine cause to be concerned with the nature, scope or purpose of their operations’.⁶

Beyond these high-level observations, however, what synopsis could be either certain or comprehensive? Invariably, my survey would be speculative, selective or incomplete.⁷ SOEs diverge too widely in their histories, organization, mandates and operations. International investment law is in many ways equally disparate, varying significantly from jurisdiction to jurisdiction and even among international investment treaties. Moreover, the exact tensions that may arise where SOE activity intersects with international investment law cannot be predicted with specificity in advance—many material details will likely turn on the particular circumstances.

With this in mind, I thought it would be useful to consider the most recent academic and professional commentary on the involvement of SOEs in the global economy. In particular, I hoped that a broad survey of contemporary commentary across multiple disciplines would be of use to those seeking to interpret and apply international investment law to the activity of SOEs. And as I began on this endeavour, the degree to which SOEs and their participation in international investment has rapidly become the subject of an immensely wide array of scrutiny and analysis became instantly apparent. Indeed, SOEs and SOE activity are the subject of much complex thinking and debate not only among experts in law but also in economics, political science, international finance, international development and business management, among many others.

With respect to identifying or defining government control, some observers stress that undue focus on the fact of State ownership can stymie a holistic understanding of a SOE’s activities to the extent that such fixation diverts attention from other relevant governmental interfaces and networks within which SOEs operate.⁸ Power and influence are obscure concepts, it is highlighted, and ‘focusing on equity structures [is unlikely to] capture the full picture’.⁹ Influence can exist in the absence of ownership, including through senior executives and directors who simultaneously hold positions within the State’s political apparatus or through other governmental affiliations.¹⁰ By contrast, the effects of State ownership can be neutralized through ‘institutional buffers’ charged with isolating a SOE from the ‘regulatory, political and policy-making functions’ of its home

⁵ *ibid* 498–506. Note that host governments may also approach (and react to) the possible consequences of SOE activity on their domestic markets and national security not only through SOE activity in their own territory but also through SOE activity in overseas jurisdictions, including different jurisdictions that have varying levels of regulatory sophistication and resources (in addition to varying regulatory policies in regard to SOE investment). See Paul Rose, ‘Sovereigns As Shareholders’ (2008) 87 NC L Rev 84, 88–9; Gordon and Gaukrodger (n 2) 505.

⁶ Paul Blyshak, ‘State-Owned Enterprises and International Investment Treaties: When Are State-Owned Entities and Their Investments Protected?’ (2011) 6(2) J Intl L & Intl Rel 1, 14.

⁷ For a review of existing approaches to SOE investment activity under both national and international policy frameworks, see Yuri Shima, *The Policy Landscape for International Investment by Government-Controlled Investors: A Fact Finding Survey*, OECD Working Papers on International Investment 2015/01 (OECD Publishing 2015).

⁸ See Filippo Belloc, ‘Innovation in State-Owned Enterprises: Reconsidering the Conventional Wisdom’ (2014) 48 J Econ Issues 821.

⁹ Gil Lan, ‘Foreign Direct Investment in the United States and Canada: Fractured Neoliberalism and the Regulatory Imperative’ (2014) 47 Vand J Transnatl L 1261, 1297.

¹⁰ See Hao Liang and others, ‘An Anatomy of State Control in the Globalization of State-Owned Enterprises’ (2015) 46 J Intl Bus Stud 223.

government.¹¹ We should also remember that the economic activity of States ‘can be substantially separated from [their] public policy objectives’,¹² with the result that various forms of sovereign investment ‘are indistinguishable in form and motivation from that pursued by wholly private parties’.¹³ Alternatively, the reality is that some SWFs have an express mandate not only to seek economic returns on investments but also to advance their home State’s public policy abroad (that is, to also seek ‘regulatory returns’, so to speak).¹⁴ There may even be instances where it is appropriate to pierce the corporate veil of a SOE to look through to its sovereign owner.¹⁵

Regarding SOE investment activity in the capacity of shareholders themselves, it is underscored that sovereign equity investment vehicles are essentially ‘constrained investors’ that will typically (and very consciously) ‘refrain from taking an active corporate governance role in target companies’—whether by means of ‘offensive’ or ‘defensive’ shareholder activism—to avoid attracting host State regulatory backlash.¹⁶ This apprehension raises complicated questions for SWFs regarding the rules of engagement with their portfolio companies, including how to hold management accountable for lacklustre performance in ways that will not alarm regulators.¹⁷ Other writers note that the traditional view of SWFs as conservative long-term investors is beginning to wane in light of ‘an increasing trend amongst state capital actors... towards investment diversification and a growing desire and capacity for risk’.¹⁸ For host governments, the question remains the appropriate balance between the oversight of foreign sovereign financial interests within their borders and maintaining a comparatively attractive and predictable inbound investment climate.¹⁹ Notable compromises to date include the ‘Santiago Principles’, a set of voluntary guidelines regarding disclosure and transparency intended to help assuage host State trepidation that SWFs will not operate in a benign fashion (that is, in the pursuit of ‘purely commercial objectives or risk-adjusted financial returns’).²⁰ Where a SOE adopts, but fails to comply with, the Santiago Principles, some have cautioned that, given the ‘inherent political nature of SWFs’, the appropriate response is consideration of ‘when and why... certain non-disclosures are legitimate, or more importantly, when and why transparency in one domain may diminish the significance of

¹¹ See WM Wolfe and AS Leung Evans, ‘China’s Energy Investments and the Corporate Social Responsibility Imperative’ (2011) 6 *J Intl L & Intl Rel* 83.

¹² Larry Catá Backer, ‘Sovereign Wealth Funds As Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance through Private Global Investment’ (2010) 41 *Geo J Intl L* 425, 500.

¹³ José E Alvarez, ‘Sovereign Concerns and the International Investment Regime’ in Sauvant and others (n 2) 258, 282. See also Gordon and Gaukrodger (n 2) 499–501.

¹⁴ See Larry Catá Backer, ‘Sovereign Investing and Markets-Based Transnational Rule of Law Building: The Norwegian Sovereign Wealth Fund in Global Markets’ (2013) 29(1) *Am U Intl L Rev* 1.

¹⁵ See Albert Badia, *Piercing the Veil of State Enterprises in International Arbitration* (Wolters Kluwer 2014). According to Badia, although tribunals commonly pierce the corporate veil of privately held corporations, this practice is far less common (if not unheard of) with respect to SOEs. However, Badia continues to argue that there are a number of different scenarios in which piercing the corporate veil of a SOE may be warranted, particularly where the Articles on Responsibility of States for Internationally Wrongful Acts fall short or fail to apply. International Law Commission, Articles on Responsibility of States for Internationally Wrongful Acts, UN Doc A/56/83 (2001).

¹⁶ Paul Rose, *Sovereign Shareholder Activism: How SWFs Can Engage in Corporate Governance*, Bocconi SWF Investment Lab Annual Report 2013, Ohio State Public Law Working Paper No 264 (1 July 2014).

¹⁷ *ibid*; Paul Rose, ‘Sovereign Wealth Funds: Active or Passive Investors?’ (2008) 118 *Yale L J Pocket Part* 104, 107.

¹⁸ George Gilligan and Megan Bowman, ‘State Capital: Global and Australian Perspectives’ (2014) 37 *Seattle U L Rev* 597, 610.

¹⁹ Alvarez (n 13) 269; Edwin M. Truman, ‘Do the Rules Need to Be Changed for State-Controlled Entities? The Case of Sovereign Wealth Funds’ in Sauvant and others (n 2) 404.

²⁰ Adam D Dixon, ‘Enhancing the Transparency Dialogue in the “Santiago Principles” for Sovereign Wealth Funds’ (2014) 37 *Seattle L Rev* 581. See also Joseph J Norton, ‘The “Santiago Principles” for Sovereign Wealth Funds: A Case Study on International Financial Standard-Setting Processes’ (2010) 13(3) *J Intl Econ L* 645.

disclosure in other areas, thus reducing the significance of non-disclosure in those areas'.²¹ Others have more simply argued that the appropriate solution to sovereign investment as shareholders is to temporarily suspend the voting rights of equity acquired by foreign SOEs for so long as such equity is held by a SOE.²²

Additional illuminating insights are nearly limitless. The investment patterns and motivations of SOEs have been studied and compared to those of their privately held counterparts, including, for example, in the contexts of resource exploration and development²³ and technological innovation.²⁴ Different varieties of SOEs from the same jurisdiction have been analysed and contrasted, including in consideration of the different 'institutional pressures' to which they may be subject, either at the national or local level, and how the strength or absence of such pressures can significantly impact international investment decisions and objectives, including investment structure, location and whether to expand heretofore exclusively domestic operations internationally in the first place.²⁵ It is emphasized that many SOEs increasingly face the difficult task of balancing global public and political support for corporate social responsibility, sustainable development and environmental protection with the policies and prerogatives of their home governments as well as with profit-generation directives.²⁶ Similarly, it is argued that home governments are increasingly appreciating that the overseas activities of their SOEs and 'national champions' can impact the public perception of their country's 'brand' globally.²⁷ It is also noted that some SOEs have grown to such a stature that they can be described as 'states within states' capable at times of 'so dominating national politics that, rather than defending government interests, their agendas have come to direct government affairs'.²⁸

Other analysts are somewhat more dismissive in their critiques, asserting that 'the spread of SWFs best resembles the diffusion of a fashion or a fad', considering that observable evidence fails to support the theory that governments create them 'as effective solutions to the challenges generated by reserve accumulation'.²⁹ Here, the submission is that 'peer group emulation has... been crucial in shaping the decision of many countries to create SWFs—especially in fuel-exporting countries' and that the proliferation of SWFs can be taken as proof of 'a decline in confidence in free-market economics in favour of state-orientated economic policies'.³⁰ By contrast, other publicists more conventionally attempt to draw correlations between the prevalence of SOEs and political ideology as well as with trends in income inequality, including gauging the effectiveness of SOEs in

²¹ Dixon (n 20) 584.

²² See Ronald J Gilson and Curtis J Milhaupt, 'Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism' (2008) 60 *Stan L Rev* 1345.

²³ See A Erin Bass and Subrata Chakrabarty, 'Resource Security: Competition for Global Resources, Strategic Intent, and Governments As Owners' (2014) 45 *J Intl Bus Stud* 961.

²⁴ See Belloc (n 8).

²⁵ See Ming Hua Li and others, 'Varieties in State Capitalism: Outward FDI Strategies of Central and Local State-Owned Enterprises from Emerging Economy Countries' (2014) 45 *J Intl Bus Stud* 980; Liang (n 10).

²⁶ See Wolfe and Evans (n 11); Juliet Roper and Michèle Schoenberger-Orgad, 'State-Owned Enterprises: Issues of Accountability and Legitimacy' (2011) *Mgmt Comm Q* 693; May Tan-Mullins and Giles Mohan, 'The Potential of Corporate Environmental Responsibility of Chinese State-Owned Enterprises in Africa' (2013) 15 *Env, Dev & Sust* 265; Anita M Halvorsen and Cody D Eldredge, 'Investing in Sustainability: Ethics Guidelines and the Norwegian Sovereign Wealth Fund' (2013–14) 42 *Denver J Intl L & Poly* 389.

²⁷ Wolfe and Evans (n 11).

²⁸ Blyschak (n 6) 7, referring to Paul Stevens, 'National Oil Companies and International Oil Companies in the Middle East: Under the Shadow of Government and the Resource Nationalism Cycle' (2008) 1 *J World Energy L & Bus* 5, 18.

²⁹ Jeffrey M Chwieroth, 'Fashions and Fads in Finance: The Political Foundations of Sovereign Wealth Fund Creation' (2014) 58(4) *Intl Stud Q* 752.

³⁰ *ibid.*

shouldering the ‘income redistribution’ and ‘social welfare’ responsibilities with which they are sometimes charged.³¹ A not dissimilar chorus maintains that SOEs should be viewed as tools of development and as affording the countries of their origin ‘an opportunity to achieve something more [than] simply accumulating wealth for its own sake: equitable participation in the wealth of all nations’.³² Regardless of the analytical perspective, a common issue raised points to the various ‘methodological difficulties’ involved in researching sovereign investment as well as the ‘importance of acknowledging and responding to these methodological challenges in public discourse and policy development on foreign direct investment’.³³

Interestingly, some thinkers approach SOEs and SOE activity not as topics of study in their own right but, rather, as valuable tools for understanding broader developments in international development, trade and geopolitics. For example, Adam Dixon and Ashby Monk argue that ‘SWFs offer a unique and powerful lens for studying the changing dynamics of contemporary capitalism, global economic integration and state sovereignty’, and, towards this end, the authors advance a ‘stylised typology’ of SWFs, which is intended to ‘provide further understanding to the potential long-term significance of SWFs and the factors that might underpin further development of new SWFs in different countries’.³⁴ ‘Postcolonial SWFs’, according to the authors, are aimed at providing their sovereign—a postcolonial State—with a means to increase their ability to engage with other ‘more powerful’ States and international market players.³⁵ ‘Rentier SWFs’ are said to hail from States whose (often authoritarian) governments depend heavily on resource exports to satisfy public welfare expectations and are thus relied on to ‘provide long-term assurance that domestic sovereignty’ and the status quo can be maintained.³⁶ By contrast, ‘productivist SWFs’ attempt to ‘build the Westphalian and domestic sovereignty’ of their State through strategic investments in value-generating networks. These SWFs are described as having a very sophisticated understanding of value capture and extraction amid global production systems and are therefore those SWFs ‘that inspire the most protectionist rhetoric’ in host jurisdictions.³⁷

Even deeper theoretical explorations into the significance of SOEs can be identified. In particular, it is posited that SOEs are ‘conceptually problematic because they blend elements of hitherto separate categories’ and that such complexities have led to certain policy responses based on two incorrect assumptions.³⁸ The first is that private enterprise is without any regulatory or

³¹ See Veysel Avsar and others, ‘State-owned Enterprises, Inequality, and Political Ideology’ (2013) 25 *Econ & Pol* 387, 388.

³² Rumu Sarkar, ‘Sovereign Wealth Funds As a Development Tool for ASEAN Nations: From Social Wealth to Social Responsibility’ (2010) 41 *Geo J Intl L* 621, 645. See also Organisation for Economic Co-operation and Development, *State-Owned Enterprises in the Middle East and North Africa: Engines of Development and Competitiveness?* (OECD Publishing 2013).

³³ See Gilligan and Bowman (n 18) 598. Such methodological difficulties include often-limited publically available information and the lack of applicable disclosure requirements.

³⁴ Adam Dixon and Ashby HB Monk, ‘Rethinking the Sovereign in Sovereign Wealth Funds’ (2012) 37 *Transactions of the Institute of British Geographers* 104, 105.

³⁵ *ibid* 109.

³⁶ *ibid* 110.

³⁷ *ibid* 111–12.

³⁸ Lan (n 9) 1266–7, referring to Larry Catá Backer, ‘The Private Law of Public Law: Public Authorities As Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Element in Private Choice of Law’ (2008) 82 *Tul L Rev* 1, 62; Backer (n 12).

political influence or motivations.³⁹ The second is that the behaviour of ‘private’ actors is a reliable benchmark for distinguishing between benign sovereign activity and sovereign activity warranting special regulatory attention or treatment.⁴⁰ Advocates of this doctrine cite the commitment of leading financial institutions to the ‘Equator Principles’,⁴¹ the growth of social impact investing and the legitimization of non-profit maximizing behaviour in traditional corporations as evidence that SOEs ‘are not the only entities that seek to advance non-commercial objectives within an entrepreneurial framework’.⁴² So too do such theorists view the contemporary proliferation of corporate lobbying practices and corporate political advertising and promotion of the type sanctioned by *Citizens United v Federal Election Commission*⁴³ as proof that attempts to distinguish SOEs from privately held market players on the basis that SOEs may act politically are at least partially misguided.⁴⁴ It is suggested, in other words, that SOEs and SOE activity is reflective of ‘the growing irrelevance of the public/private distinction’ and the ‘increasing merger of public and private law’, with the result that the ‘easy separation of economic and political activity is now more difficult’.⁴⁵

In summary, a review of the contemporary analysis of SOEs and SOE activity reveals a multi-layered tapestry of overlapping and at times competing theories, at least some of which will likely need to be navigated in the institution, interpretation or application of international investment law, whether at the national (for example, legislative) or international level. This challenge may at times be daunting; if the research surveyed has made anything clear, it is that modern SOEs and SOE activity defy facile categorization while simultaneously inviting a series of conceptual complexities to be balanced against one another.

On one level, the increased importance or influence of SOEs internationally over the last several decades stands in stark contrast to a coincident global trend of privatization. On another level, the ‘rhetoric’ of SOE sceptics has been characterized as ‘ironically reminiscent of arguments advanced by developing countries against the “free trade and market” and “freedom of capital flows and investment” argument of developed countries’.⁴⁶ On yet another level, much of the international investment law regime instituted by investment protection treaties was arguably built on outmoded ‘distinctions between the state and the market and between capital exporting and capital importing states’.⁴⁷ Finally, it must be noted that in many ways ‘the challenges to national governance prompted by sovereign investment do not differ fundamentally from those posed by [foreign direct investment] generally’.⁴⁸

³⁹ Backer (n 12) 430–1.

⁴⁰ *ibid.*

⁴¹ The ‘Equator Principles’ are a voluntary risk management framework for financial institutions designed to identify, assess and manage environmental and social risks presented by projects.

⁴² Lan (n 9) 1306.

⁴³ *Citizens United v Federal Election Commission*, 558 US 310 (2010). In this US constitutional law decision, the US Supreme Court held that the First Amendment’s guarantee of free speech prohibited the restriction of independent political expenditures by corporations (both non-profit and for-profit), labour unions and other associations.

⁴⁴ Lan (n 9) 1306–7.

⁴⁵ Backer (n 12) 434, 499–500. See also Alvarez (n 13) 258.

⁴⁶ Yvonne C Lee, ‘The Governance of Contemporary Sovereign Wealth Funds’ (2010) 6(1) *Hastings Bus L J* 167, 167.

⁴⁷ Alvarez (n 13) 260.

⁴⁸ *ibid.* 262. See also A Edward Safarian, ‘The Canadian Policy Response to Sovereign Direct Investment’ in Sauvant and others (n 2) 431–3.

The cumulative result is a set of circumstances that are poised to test the abilities of policy makers, regulators, government administrators and arbitral tribunals alike in at least a couple of different, but very important, ways. On the one hand, SOEs and SOE activity look set to strain many of the principles and boundaries of international investment law. On the other hand, international investment law and arbitration may prove a valuable ‘check and balance’ on what continues to be a relatively fragmented and often politically charged regulatory response to SOE activity.