STATES AS FOREIGN INVESTORS

DIPLOMATIC DISPUTES AND LEGAL FICTIONS

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During the colonial era, power politics and economic interests were closely aligned in the development of international investment law. European trading companies were key players in imperial politics – including the politics of international law - and they invested considerable efforts in establishing legal standards to protect their international activities.[1] The Dutch East India Company famously hired Grotius as a legal advisor, for instance, and some of his works were initiated to legitimise activities of the Company. Legal doctrines on international commerce, territory, and property were not just used but also partly developed by sovereign or quasi-sovereign investors from the West. Today, the tables are turning. Western countries are increasingly playing host to sovereign investors from the developing world, who enjoy protections from treaties initially tailored to serve Western interests in Africa, Latin America, and Asia. And while investment treaty arbitration is supposed to 'de-politicize' investment disputes by reducing the role of home governments, is that really feasible when home governments themselves are the investors?

This article draws in part on L. Poulsen, "Investment Treaties and the Globalization of State Capitalism: Opportunities and Constraints for Host States," In: R. Echandi and P. Sauvé (eds.), *Prospects in International Investment Law and Policy* (Cambridge: Cambridge University Press, 2013). I am grateful to Jonathan Bonnitcha, Martins Paparinskis, Jason Yackee, Rachel Wellhausen and two anonymous reviewers for comments on earlier drafts.

[1] K. Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (Cambridge: Cambridge University Press, 2013).

The globalization of State capitalism

Although the context and nature of state capitalism is different from the Imperial era, states remain key sources of foreign investment. They can be classified under four abbreviations: SOEs, SWFs, SOFIs, and SIEs. State-owned enterprises (SOEs) are most important. They own or control more than 15,000 foreign affiliates and control more than $2 trillion worth of foreign assets around the world.[2] Sovereign wealth funds (SWFs) also play a role with more than $100 billion of foreign investment stock – most of which is in developed countries. Even when investments are made by pure private entities their project finance often hinges, at least in part, on public money. State-owned financial institutions (SOFIs), a sub-category of SOEs, account for a quarter of total assets in global banking systems and governments own most major pension funds.[3] In addition, government involvement can take place through direct influence on investment activities. An example of such state-influenced enterprises (SIEs)[4] is when the Russian state guides activities of conglomerates owned by Russian oligarchs. In Iran, as well, the Revolutionary Guards has influence on a wide range of companies,[5] and in a country like Pakistan the army is deeply embedded in the country's major companies and banks.[6] To the extent these SIEs invest abroad, they also engage in what can loosely be described as sovereign FDI. Governments thereby support a wide range of foreign investors from around the world, directly or indirectly, actively or passively. Defining the very concept of sovereign FDI itself is bound to be a difficult challenge. For just as clear distinctions between home and host

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[2] UNCTAD, World Investment Report 2014 (Geneva: United Nations, 2014), ix.

[3] Ibid., 155.

[4] See Daniel Shapiro and Steven Globerman, "The International Activities and Impacts of State-Owned Enterprises." In: Karl Sauvant, Lisa Sachs, and Wouter Jongbloed, eds. 2012. Sovereign Investment. New York: Oxford University Press.

[5] Babak Dehghanpisheh and Yeganeh Torbati, "Firms linked to Revolutionary Guards to win sanctions relief under Iran deal," *Reuters* August 9, 2015. The Iranian state itself has made investments in Western companies at least since the 1970s; Wouter Jongbloed, Lisa Sachs, and Karl Sauvant, "Sovereign Investment: An introduction," In: Sauvant, Sachs, and Jongbloed.

[6] For a critical account, see; Ayesha Siddiqa Military Inc.: Inside Pakistan's Military Economy, Pluto Press, 2007. On Pakistan's investment treaty program, see e.g. Lauge Poulsen and Damon Vis-Dunbar, "Reflections on Pakistan's investment treaty program after 50 years." *Investment Treaty News,* 16. March, 2009; Lauge Poulsen, 2015. Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries. Cambridge: Cambridge University Press, pp. xiv-xv, 127-30.

states are disappearing in the international investment regime, the distinction between investors and their home states is often blurred as well.

This can result in political headaches. Eyebrows have been raised, in particular, over acquisitions of Western assets by sovereign investors from China and the Middle East. Questions are asked about the motives of sovereign investors (do they have a political agenda?) as well as their funding (does cheap government credit distort competition?). In most circumstances, these questions should be economically irrelevant for host states seeking to attract foreign capital. Politically, however, they are highly contentious. This is particularly the case when state-sponsored acquisitions have potential security implications for the host state. The Dubai Ports debacle is a famous case in point, when American politicians were concerned about a state-owned Arab company seeking to acquire six major US seaports.[7] Some Chinese FDI has raised security concerns in the United States as well. For instance, US security agencies and the House Intelligence Committee have been suspicious that telecom-giant Huawai may be engaging in cyber-espionage on behalf of the government in Beijing.[8]

Despite grumbles about such investments, no Western governments want to keep sovereign investors out altogether. Apart from providing an important source of financing, particularly European governments have large SOEs with significant assets abroad. Defensive and offensive state interests need to be balanced, so rather than opposing sovereign FDI most governments are seeking to regulate it through international codes of conduct and domestic reforms. If these efforts are to be effective and coherent in regulating sovereign FDI, they may have to be complemented with reforms of investment treaties as well.

Sovereign investors as private investors

Although there has been a growing tendency to include language on sovereign investors in investment treaties over the last decade, an OECD survey of more than

[7] Deborah Mostaghel, "Dubai Ports World Under Exxon-Florio: A Threat to National Security or a Tempest in a Seaport," *Alb. L. Rev.* 70 (2006): 583.
[8] "Chinese Telecom Firm Tied to Spy Ministry," *Washington Times,* October 11, 2011; "China Tech Giant Under Fire," *Wall Street Journal,* October 8, 2012.

1800 treaties found that only 16% explicitly mentioned sovereign investors in otherwise broad investor definitions.[9] Most of these mentioned only SOEs, a few mentioned governments themselves, and less than 1% mentioned sovereign investment funds.

There are significant variations across countries (Figure 1). United States, Australia, Canada, Japan, and the United Arab Emirates have routinely mentioned SOEs in their investor definitions. Some of these treaties also include explicit references on competition between sovereign and private investors. In the United States, for instance, explicit references to sovereign investors in early investment treaties were not intended to protect American sovereign investments abroad but to ensure non-discrimination between American private firms and SOEs in host countries. As far back as Friendship, Commerce, and Navigation (FCN) treaties this was an explicit policy of the State Department. In negotiations with Denmark, for instance, the Danish government asked in 1950 to preserve certain privileges for state-owned enterprises. Washington responded that the treaty was initiated partly to secure American companies in Denmark competing with local competitors subsidized by the Danish government.[10] The agreement thus also directly addresses activities of state owned- or controlled enterprises, as was standard practise in American FCN practise and later BITs.[11] The most advanced treaty language seeking to establish competitive equality between sovereign and private investors was recently agreed in a separate

[9] Y. Shima, "The Policy Landscape for International Investment by Government-controlled Investors," *OECD Working Papers on International Investment 2015/01.*

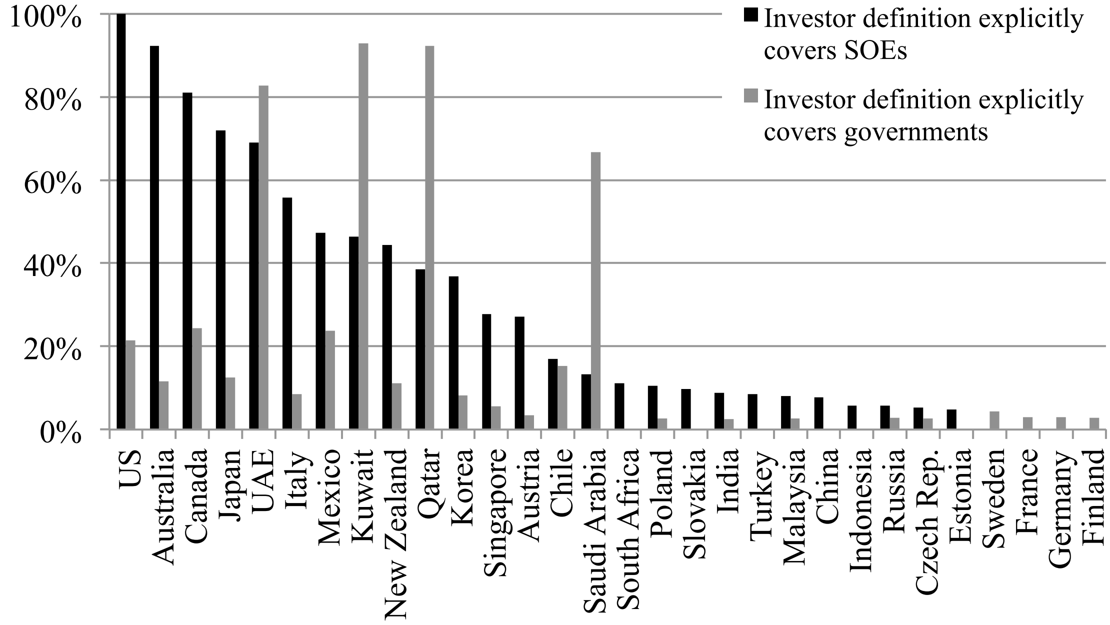
[10] Kenneth Vandevelde, The First Bilateral Investment Treaties: U.S. Friendship, Commerce and Navigation Treaties in the Truman Administration. PhD-dissertation, University of California, San Diego, 2012, 338

[11] Article XVII of the Danish FCN agreement reads:

> 1. Each Party undertakes (a) that enterprises owned or controlled by its Government, and that monopolies or agencies granted exclusive or special privileges within its territories, shall make their purchases and sales involving either imports or exports affecting the commerce of the other Party solely in accordance with commercial considerations including price, quality, availability, marketability, transportation and other conditions of purchase or sale; and (b) that the nationals, companies and commerce of such other Party shall be afforded adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases and sales.
> 2. Each Party shall accord to the nationals, companies and commerce of the other Party fair and equitable treatment, as compared with that accorded to the nationals, companies and commerce of any third country, with respect to: (a) the governmental purchase of supplies, (b) the awarding of concessions and other government contracts, and (c) the sale of any service sold by the Government or by any monopoly or agency granted exclusive or special privileges.

1951 Treaty of friendship, commerce, and navigation between the United States and Denmark, 421 UNTS 105. Similar clauses can be found in other FCN agreements, e.g. US-Togo 1966, article XII; US-Japan 1953, article XVII.

chapter of the Trans-Pacific Partnership (TPP) agreement.[12] Importantly, however, this chapter is not subject to investor-state dispute settlement (see further below).



NOTES: Survey of 1.813 investment treaties. Not all treaties are in force.

SOURCE: adapted from Yuri Shima. (2015), 'The Policy Landscape for International Investment by Government-controlled Investors: A Fact Finding Survey', *OECD Working Papers on International Investment*, 2015/01, OECD Publishing. http://dx.doi.org/10.1787/5js7svp0jkns-en.

FIGURE 1. SHARE OF INVESTMENT TREATIES THAT EXPLICITLY COVER SOVEREIGN INVESTORS, BY COUNTRY

By contrast with American treaty practise, most European countries do not mention sovereign investors in their treaties at all. Similarly, whereas some Arab countries have often included governments themselves in their investor definitions (as well as sovereign investment funds), this has not been the case with most other countries. Interestingly, China has rarely included any references to sovereign investors in its investment treaties, despite most of Chinese outward FDI originating from SOEs.[13]

Even without explicit text on sovereign investors, however, arbitrators have repeatedly decided that the investment treaty regime covers them nevertheless.[14] This

[12] Text available at tpp.mfat.govt.nx/text. Last accessed 13 November 2015.
[13] Shapiro and Globerman.
[14] See generally C. Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties', *Chinese Journal of International Law* 10 (2011), 531–564. This was also the perception of several delegations, when the issue of investing state enterprises came up in the context of the negotiations over the Multilateral Agreement on Investment (MAI). See Negotiating Group on the

is important. For although sovereign investors tend to be large and resourceful, they often operate in highly capital-intensive industries with large sunk costs - such as natural resources, infrastructure industries, and public utilities – which make them more likely to experience investment disputes with host states. For instance, two of the most controversial investment treaty claims brought to date were filed against Germany by Vattenfall, a company fully owned by the Swedish government. The claims were pursued on the basis of the Energy Charter Treaty, which follows the vast majority of investment treaties by not explicitly mentioning sovereign investors but not excluding them either. Vattenfall took both disputes to ICSID, an organization put in place as a facility for the resolution of disputes arising from *private* foreign investments, but which nevertheless cover sovereign investors if their function and nature can be considered commercial.[15] As Vattenfall was not acting as an agent of the Swedish government or performing an essential government function, previous arbitral decisions meant the company's lawyers were safe to assume they could use ICSID to pursue the claim.

ICSID claims have also been filed by investors with a much closer relationship to a government apparatus than Vattenfall.[16] Yet in those cases, arbitrators rarely even addressed the issue and respondents were surprisingly quiet on the topic.[17] The bulk of claims proceeded as if nothing could be more natural than allowing sovereign investors to make use of rights put in place to protect private investment.[18] The effect is that a large number of sovereign investors are likely to have recourse to treaty-based arbitration when running into disputes with host states. This gives arbitrators considerable power in determining what host governments can, and cannot do, when seeking to regulate sovereign FDI. But although some arbitrators may welcome this development, it leaves them in what could become treacherous territory.

Multilateral Agreement on Investment, 'Report to the Negotiating Group', DAFFE/MAI/DG3(96)3, 6 (1996).

[15] Aron Broches, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States' in *Collected Courses of The Hague Academy of International Law,* Part II, 136 (1972), 334–335. See also Christoph Schreuer, 2009. The ICSID Convention: A Commentary Cambridge: Cambridge University Press, pp. 160–161.

[16] See e.g. *CSOB v. Slovak Republic,* ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction (24 May 1999) para 20.

[17] Feldman 2016.

[18] Ibid.

Leave it to the arbitrators?

One of the main justifications for the modern investment arbitration regime is that it can assist with 'de-politicizing' investment disputes. Lowenfeld notes:

> [T]he essential feature of investor-[s]tate arbitration, as it has developed since the ICSID Convention ... is that controversies between foreign investors and host states are insulated from political and diplomatic relations between states. In return for agreeing to independent international arbitration, the host state is assured that the state of the investor's nationality (as defined) will not espouse the investor's claim or otherwise intervene in the controversy between an investor and a host state, for instance by denying foreign assistance or attempting to pressure the host state into some kind of settlement. Correspondingly, the state of the investor's nationality is relieved of the pressure of having its relations with the host state disturbed or distorted by a controversy between its national and the host state. ... The paradigm in investor-States disputes, ... is a dispute between the first party (nearly always the investor) as plaintiff, and the second party (nearly always the host state or state agency) as respondent. There is no third party.[19]

The extent to which this justification for investment arbitration is accurate is unclear, both conceptually (is it meaningful to distinguish politics from law in this way?)[20] and empirically (is there actual evidence for the proposition?).[21] But even assuming that the promise of de-politicization is meaningful and has been met in practice, what about instances when it is in fact a third party – a government - that is using an entity to file a claim against another government? The Vattenfall claims were delicate enough already, but what if they had been brought by a company with even deeper government ties? And what if that government had not been a Western liberal democracy?

Giving investors direct standing against host states "allows the true complainant to face the true defendant," which according to Paulsson, "has the immense merit of clarity and realism."[22] But when faced with sovereign investors operating in low-transparency environments it can be more than difficult to identify who the true complainant actually is. Was Chinalco operating as a private investor when acquiring

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[19] *Corn Products. Int'l, Inc. v. Mexico*, ICSID Case No. ARB(AF)/04/01 (NAFTA), Separate Opinion of Andreas Lowenfeld, par 1–4 (Jan. 15, 2008). See similar arguments in; Stephen Schwebel, "A BIT about ICSID," *ICSID Review* 2008 23(1).

[20] See Martins Paparinskis, "Limits of Depolitization in Contemporary Investor-State Arbitration," (2010) 3 *Select Proceedings of the European Society of International Law.*

[21] See Srividya Jandhyala, Geoffrey Gertz, and Lauge Poulsen, "Legalization and Diplomacy: Evidence from the Investment Regime." *Working paper* 2015.

[22] Jan Paulsson, 'Arbitration Without Privity', *ICSID Review – Foreign Investment Law Journal* 10 (1995), 256.

a large share of Rio Tinto, which happened to correspond closely with the interests of the Chinese government? Similarly, China's plans of a "New Silk Road" with billions of dollars of investments in infrastructure and energy in Asia would primarily be implemented through SOEs.[23] Many of the countries involved in what the Financial Times has called China's "road to a new empire" have investment treaties with Beijing, which potentially allow investment projects made by the Chinese government officials to be treated as if they are private operations. Outside of China other examples abound. The Abu Dhabi Investment Authority owns 75% of the Chrysler building and Borse Dubai owns a significant stake in the NASDAQ stock market. But are these private investors or instruments of the Sheikh? And what about the new sovereign "Seven Sisters": Petronas, Petrobas, Gazprom, the National Oil Company of Iran, Petróleos de Venezuela, CNPC/Petro China and what could be the world's largest company – Saudi Aramco.

Treaty drafters have not given arbitrators much to go by in answering these questions. The investment chapter in TPP, for instance, follows standard US practise by allowing sovereign investors to file claims against host states but includes no clarification on how arbitrators should draw the public-private distinction in practise.[24] This lack of specificity is contrasted with the 36 page long chapter in the same agreement seeking to promote market-based practises for SOEs and designated monopolies. The latter chapter includes very specific rules governing sovereign entities operating in the Pacific Rim – including a range of exceptions and carveouts - whereas the investment chapter leaves it up arbitrators to determine the core question of whether sovereign investors should be considered private or public for the purpose of investment disputes. The relatively few other investment treaties that mention sovereign investors provide no detailed guidance either.

One can only speculate as to why treaty drafters have not sought greater clarity on this point. One explanation could be that the public-private distinction has yet to be a salient issue in a controversial investment treaty dispute and we know that treaty drafting in the investment regime largely takes place through the rear-view mirror:

[23] Charles Clover and Lucy Hornby, "China's Great Game: Road to a new empire." *Financial Times,* October 12, 2015.
[24] Article 9.1 of TPP notes that "investor of a Party means a Party, or a national or an enterprises of a Party, that attempts to make, is making, or has made an investment in the territory of another Party."

governments seem more keen on clarifying provisions that came up in past disputes, rather than prepare for disputes of the future.[25] No-matter the explanation, however, the lack of specific treaty language leaves arbitrators with little to go by, except perhaps customary international law on state attribution. Here, the public-private distinction should be made by assessing whether an entity is under the direction or control of the home state or is exercising elements of state authority.[26] These are useful principles but without further guidance they can be more than difficult to follow in practise, and arbitrators therefore have very significant flexibility in where to draw the line between public and private activities.

That could be a risky political choice. This is for two reasons. Firstly, Lowe reports "an increasing perception that courts and tribunals are not at all well-equipped for dealing with certain kinds of international disputes."[27] This echoes the observations of Jennings, who in the context of the International Court of Justice notes that:

> a Court, in deciding the legal question in legal terms, might in effect be prejudicing or indeed frustrating decisions of policy, which it may not itself be in a position even to understand, other than perhaps marginally. The Court has no expertise or even experience in the … criteria that a political body would expect to apply to this kind of political decision.[28]

Some disputes arising from the contentious nature of globalized state capitalism could very well fall under this category, in which case it would be unwise to refer them to arbitration practitioners specialised in the worlds of private investment and commerce.

Secondly, before the explosion in investment treaty claims, Paulsson noted that:

> [a]rbitration without privity is a delicate mechanism. A single incident of an adventurist arbitrator going beyond the proper scope of his jurisdiction in a sensitive case may be sufficient to generate a backlash.[29]

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[25] See generally Poulsen 2015. See also e.g. Yoram Haftel and Alexander Thompson, "When Do States Renegotiate International Agreements? The Case of Bilateral Investment Treaties." *working paper,* 2013; available at: www.cidcm.umd.edu/workshop/papers/Thompson_CIDCM_2013.pdf (last accessed 16 November 2015).

[26] Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, *in* Report of the International Law Commission on the Work of its Fifty-third Session, UN Doc. A/56/10 (2001). See further in Feldman 2016, including references in his ftn. 17.

[27] Vaughan Lowe, "The Function of Litigation in International Society," *International and Comparative Law Quarterly,* 61:1, 2012, 210.

[28] Robert Jennings, "The Role of the International Court of Justice," *BYIL* 68:1, 1997, 51.

[29] Paulsson, 257.

The backlash against adventurous arbitrators has already begun, of course, but it could intensify if arbitrators are also seen to unduly interfere in the already sensitive politics of sovereign investment. Few would argue that investment arbitration is the proper arena to judge what may ultimately be a diplomatic dispute. But it would only take a single tribunal getting the public-private distinction wrong – or be perceived to be wrong - before the backlash against the investment treaty regime takes on yet another dimension by unduly interfering with inter-state affairs. This would not be in the interest of supporters of investment treaty arbitration – even if they find many of the political responses to sovereign FDI overly alarmist.

This has important implications for arbitrators faced with sovereign claims – as outlined by Feldman and others[30] – but it also means that governments otherwise supportive of the investment treaty regime may want to consider whether they are comfortable with giving arbitrators wide discretion to determine the scope of protections afforded to sovereign investors. The now infamous warning from the U.S. Department of Justice to Judge Mikva in the Loewen case is worth keeping in mind: "You know judge, if we lose this case we could lose NAFTA."[31] Right or wrong, consider the political fears if Loewen had not been a private funeral-home company from Canada, but a sovereign investor from Asia or the Arab world operating in a core utility sector?

In short; even governments that support investment treaty arbitration must be mindful of the potential risks when creative arbitrators enter into political minefields. With current treaty drafting, 'adventurous arbitrators' have ample opportunity to generate legal fictions, where inter-state disputes about diplomatic relations are morphed into investor-state disputes about law. The risks of this happening may not be high, and indeed many of the claims brought by sovereign investors thus far do seem very 'commercial' in nature. Yet, a single decision "gone wrong" can further erode public

[30] See Mark Feldman, "State-owned Enterprises as Claimants in International Investment Arbitration," *ICSID – Foreign Investment Law Journal,* vol. ?, no. ? 2016. See also; Moshe Hirsch, The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes. The Hague: Martinus Nijhoff, 1993, 64–66.

[31] David Schneiderman, "Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes," *Northwestern Journal of International law and Business,* 30:2, 2010, 405.

support for the regime as a whole. As in other areas of international investment law, governments therefore need to manage the tension between delegating difficult questions to international tribunals, while ensuring that the same tribunals don't encroach so far into sensitive areas of public policy that their very existence becomes politically impossible to sustain.

Options

Several options are available to manage this tension in the area of sovereign investments. One is to simply state that sovereign entities should only be allowed to adjudicate investment treaty claims through diplomatic espousal – and thus outside of ICSID. Brazil has recently suggested that its future investment treaties should rely only on inter-state arbitration for all dispute resolution,[32] and at least some observers welcome a greater reliance on inter-state dispute settlement in the investment treaty regime.[33] Yet, even for governments that want to keep investment arbitration in place for private investments could refer disputes involving investors owned or controlled by states to inter-state dispute resolution, even if it is unclear whether their investments are taken for commercial purposes or not. Such an approach would clearly acknowledge that investor–state arbitration is not a suitable arena for what could be perceived to be diplomatic disputes.[34]

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[32] See Pedro Cavalcante, "The Brazilian Investment Facilitation and Co-operation Agreement." Presentation at the Columbia-Oxford series on *New Thinking of Investment Treaties*, available at: www.youtube.com/watch?v=cV7SYzSS3-E. Last accessed 9 October 2015.

[33] E.g. Anthea Roberts, "State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretative Authority," *HJIL* 55(1), 2014; Jan Kleinheisterkamp and Lauge Poulsen, "Investment Protection in TTIP: Three Feasible Proposals." Policy Brief, Oxford Global Economic Governance Programme, 2014.

[34] One reviewer raised concerns about the impact this suggestion would have on global FDI flows. The bulging literature on the investment-impact of investment treaties is considerable and beyond the scope of this article, but much evidence suggests that investment treaties only on rare occasions have a substantial impact on the destination and volume of foreign investment. For reviews for studies and surveys up until 2010, see Lauge Poulsen, "The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence," in Sauvant K (ed), Yearbook on International Investment Law & Policy 2009/2010 (Oxford University Press 2010). See also e.g. Clint Peinhardt and Todd Allee, "Failure to Deliver: The Investment Effects of US Preferential Economic Agreements," (2012) 35 *The World Economy* 757 (finding no effect from US treaties); Andrew Kerner and Jane Lawrence, "What's the Risk? Bilateral Investment Treaties, Political Risk and Fixed Capital Accumulation," *British Journal of Political Science*, 44, 1 (2014), 107-121 (finding a positive, but very limited, effect).

Another option is a government filter similar to those related to taxation in NAFTA: sovereign investors would have access to investor–state arbitration if neither home or host state vetoes the claim in which case disputes would have to be settled in domestic courts or between the treaty parties themselves. This would act as an effective barrier to sensitive political claims that investment arbitrators may be ill-equipped to decide. It could also be a useful filter for state parties to distinguish between different types of sovereign investment activities: those considered too contentious to be resolved by investment arbitrators, and those that can reasonably be considered commercial and should proceed to investor-state arbitration.

Alternatively, and as alluded to above, treaty drafters could be better in guiding arbitrators asked to determine whether a sovereign investor should be allowed to file an investment treaty claim. For instance, states may want to include clarifying language in their treaties regarding how arbitrators should determine state control and delegated government authority in practise.

Substantive treaty protections may have to be revisited as well. Here two core questions could be addressed: security and corporate governance. With respect to security concerns, the U.S. is arguably the country most insulated from sensitive claims due to its' self-judging security carveouts in recent BITs. These clauses indicate that American policy-makers do not trust investment arbitrators with matters of national security. And although self-judging 'safety-valve' provisions open up the possibility of hidden protectionism,[35] they can nevertheless be worth the candle when exceptionally sensitive cases have potential to undermine the support for investment treaty arbitration as a governing institution. The clauses thus avoid arbitrators striking down domestic legislation giving wide and discretionary powers to block sovereign investments, such as the 2007 US Foreign Investment and National Security Act.[36] Again; some may disagree with this act as a matter of policy,[37] but it is difficult to argue that three private lawyers should be allowed to undermine it through investment arbitration.

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[35] See generally; Peter Rosendorff and Helen Milner, "The Optimal Design of International Trade Institutions: Uncertainty and Escape," *International Organization* 55:4, 2001.
[36] L. Hsu, 'SWFs, Recent US Legislative Changes, and Treaty Obligations', *Journal of World Trade* 43 (2009) 451–477.
[37] See, e.g. Jose Alvarez, "Sovereign Concerns in the International Investment Regime," in Sauvant, Sachs, and Jongbloed.

European countries could consider following the same path as the U.S. Take the case of Huawei again. Danish politicians recently realised that the Chinese company has access to hordes of sensitive information through its operation of Denmark's 4G network.[38] The investment was made under protest by the Danish Defense Intelligence Service due to concerns about espionage given Huawei's alleged links to the Chinese government. If the Danish government decides to restrict Huawei's operations based on such security concerns, it would be well advised to insist on a self-judging security carveout in on-going investment treaty negotiations between China and the EU. Otherwise any potential claims by Huawei against the Danish government could potentially provoke a broader backlash in Denmark against investment treaties as such.[39] As long as shifting Danish governments remain supportive of investment treaty arbitration, this would not be in their interest.

Another concern relates to corporate governance. Here the core question is whether investment restrictions based on anxieties about non-commercial motives could conflict with investment treaty standards. In extreme cases, this is unlikely. If a sovereign entity uses a foreign enterprise to try and destabilise the financial system of a host state, for instance, the investor would clearly not have acted in good faith and most likely loose it's investment treaty protections as a result. In practice, however, it is difficult for host state regulators to determine the motives of sovereign investors. A prudent policy response to this lack of transparency could be significant disclosure requirements for sovereign investors. This is standard practise in some countries, such as Canada.[40] Yet arbitrators could argue that if other investors with opaque governance structures and strategies – like hedge funds or private equity investors – are not subject to similar transparency obligations, why should sovereign investors be? One tribunal stated that:

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[38] www.dr.dk/nyheder/penge/nervoese-politikere-om-huawei-i-danmark-vores-frygt-gik-i-opfyldelse. Article is in Danish. Last accessed 9 July 2015.

[39] Denmark and China signed a BIT in 1985, which – like other Chinese BITs of that era – includes a very restrictive investment arbitration clause. If concluded, the EU-China BIT is likely to significantly expand the extent to which Chinese investors can file claims against European governments. See generally; Lauge Poulsen, Jonathan Bonnitcha, and Jason Yackee, "Costs and Benefits of an EU-China Investment Protection Treaty," *Report for UK Department of Business, Innovation and Skills,* April 2013; available at: www.italaw.com/sites/default/files/archive/costs-and-benefits-of-an-eu-china-investment-protection-treaty.pdf. Last accessed 9 November 2015.

[40] See, Sauvant, Sachs, and Jongbloed.

> [i]t is both unreasonable and unrealistic to posit an obligation upon an investor to disclose its ultimate objectives in making a particular investment, whether through the purchase of shares or otherwise. Ultimate objectives will […] often be highly speculative and not susceptible to precise articulation, and will be subject to change over time.[41]

Even if a clear case can be made that an investment is conducted for non-commercial motives,[42] tribunals may not agree that this in itself is sufficient reason to exclude the investment from treaty coverage. Some investment treaties explicitly cover investments made for non-profit motives,[43] but even those that don't arguably cover such investments as well except if clearly stated otherwise. And arbitrators could argue that restrictions of sovereign investors based on vague notions of non-commercial motives conflict with standards of equity as a range of other investors also have motives other than profit when investing abroad.[44] If a pension fund, for instance, seeks to engage in 'sustainable' investment by focusing on political, social, and environmental factors in addition to the bottom line, this is also a non-commercial motive. So why, the arbitrator may ask, should sovereign investors be targeted?

This implies, again, that if lawmakers are not more clear in their treaty language, national laws and regulations targeting sovereign investors could come under serious scrutiny by investment arbitral tribunals for being arbitrary and/or discriminatory. But given the political stakes, the question again arises whether investment tribunals should be allowed to question these often-sensitive political decisions. What an arbitrator may consider arbitrary may be anything but from the perspective of domestic policy-makers concerned with balancing legitimate policy-objectives. Even if arbitrators should be allowed to question such decisions, treaty drafters could consider making references to the OECD Guidelines for Multinational Corporations,[45] where section III refers to the obligation of all companies to disclose information on

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[41] *Saluka v Czech Republic* (UNCITRAL Arbitration Partial Award), 17 March 2006, para. 232.

[42] In the SOE chapter of TPP, commercial activities "means activities which an enterprise undertakes with an orientation toward profit-making and which result in the production of a good or supply of a service that will be sold to a consumer in the relevant market in quantities and at prices determined by the enterprise." (article 17.1). The definition further clarifies that (i) "For greater certainty, activities undertaken by an enterprise which operates on a not-for-profit basis or on a cost-recovery basis are not activities undertaken with an orientation toward profit making." And (ii) "For greater certainty, measures of general application to the relevant market shall not be construed as the determination by a Party of pricing, production, or supply decisions of an enterprise."

[43] E.g. 2005 German model BIT article 1(3)(a); and article 1(b) in US BITs with Kazakhstan and Kyrgyzstan.

[44] A. Rozanov, "Definitional Challenges of Dealing with Sovereign Wealth Funds," *Asian Journal of International Law* 1 (2011), 262.

[45] Norway draft Model BIT, preamble and Article 32; IISD Model BIT, Article 16.

matters such as ownership and voting rights, intra-group relations, governance policies, and enterprise objectives.[46] An alternative would be to explicitly target sovereign investors by making reference to the OECD's Guidelines for Corporate Governance of SOEs[47] as well as the Santiago Principles on the structure and management of SWFs.[48] Investment treaty language inspired by these agreements would send a clear signal that regulation based on internationally recognised standards on corporate governance should be part of the legitimate expectations of sovereign investors. In addition, the SOE chapter in TPP also include significant provisions on transparency and commercially oriented management practises that could serve as useful inspiration.

Concluding thoughts

Responding to sovereign investors in treaty drafting is going to be a challenge. The pure logistics of the exercise can seem daunting. One obvious question is what to do about the thousands of existing treaties in place. Re-negotiation is often costly, so past treaties would probably have to be addressed with binding interpretative statements.[49] This could be done jointly among two or more treaty partners – as the NAFTA parties have done on occasion – or plurilaterally, for instance in the context of UNCTAD or UNCITRAL. Even that is going to be an uphill battle, however, as striking the proper balance between legitimate policy concerns and the legitimate rights of many sovereign investors is bound to be delicate. And some of the options mentioned above arguably involve actual amendments rather than interpretation.

Even so, policy-makers and other stakeholders in the investment regime would be well advised to query whether arbitrators should be given such considerable lee-way in resolving what could be highly politically charged disputes surrounding sovereign investment. Ultimately, it comes down to a question of trust in the arbitration practitioners themselves, which – in recent years – has been questioned in a growing

[46] OECD, *OECD Guidelines for Multinational Corporations* (Paris: OECD, 2011), section III, available at: www.oecd.org/corporate/mne/. Last accessed 9 November 2015.
[47] OECD, *Guidelines on Corporate Governance of State-Owned Enterprises* (2005).
[48] IWG, *SWFs*, n 8. For an assessment of the Santiago Principles, see E. Truman, 'Making the World Safe for Sovereign Wealth Funds,' Peterson Institute for International Economics, 14 October 2008.
[49] See generally; Anthea Roberts, "Power and Persuasion in Investment Treaty Arbitration: The Dual Role of States." *AJIL* 104:2, 179-225.

number of countries. As one arbitrator has lamented, "the more [people] find out what we do and what we say, and how we say it, the more appalled they are."[50] If that is true for disputes involving private investors, it might be prudent to leave the high politics of sovereign investments outside the reach of investment arbitration for a while.

[50] Comments by Johnny Veeder QC at Wilmer Hale seminar on international arbitration, 23 April 2014. Available at: www.youtube.com/watch?v=fQPllmURi24. Last accessed 11 September 2015.