
**DEMYSTIFYING PUBLIC SECURITY EXCEPTION AND
LIMITATIONS ON CAPITAL MOVEMENT: HARD LAW,
SOFT LAW AND SOVEREIGN INVESTMENTS IN THE EU
INTERNAL MARKET**

JULIEN CHAISSE*

* Associate Professor, Faculty of Law, Director of the Centre for Financial Regulation and Economic Development (CFRED), Chinese University of Hong Kong. This research was supported by the General Research Fund (GRF) Project No. 14605915 of the Hong Kong SAR Research Grants Council (RGC). The GRC research projects are subject to a rigorous peer review process via the RGC's five subject panels supported by an international network of expert reviewers. The Author would like to thank Panagiotis Delimatsis, Christoph Hermann, Mark Feldman, Karl P. Sauvant, and Dini Sejko for comments on earlier drafts of this Article. I am also grateful to the editors and staff at *the University of Pennsylvania Journal of International Law* for their hard work and skillful editing. The views expressed herein by Author are his own personal ones.

TABLE OF CONTENTS

1. INTRODUCTION	585
2. SOVEREIGN WEALTH FUNDS IN THE CONTEXT OF RISING STATE CAPITALISM.....	589
2.1. <i>Operations of SWFs in Europe</i>	589
2.2. <i>European concerns about SWFs</i>	591
3. BALANCING CAPITAL FLOWS AND NATIONAL SECURITY: THE EU INTERNATIONAL COMMITMENTS.....	596
3.1. <i>Implications for SWF Investment from the General Agreement on Trade in Services</i>	597
3.2. <i>The International Investment Treaties Approach</i>	602
4. THE HARD LAW DIMENSION OF THE EU INTERNAL MARKET.....	608
4.1. <i>The principle of the free movement of capital</i>	610
4.2. <i>The exception to the free movement of capital</i>	612
5. THE SOFT LAW DIMENSION OF THE EU INTERNAL MARKET	614
5.1. <i>Design and Main Feature of the EU Common Approach</i>	615
5.2. <i>The EU's Support for a Multilateral Regulation</i>	622
6. ASSESSING THE RISKS OF EUROPEAN PROTECTIONISM.....	633
6.1. <i>Control of foreign takeovers in the United Kingdom</i> ...	636
6.2. <i>Control of foreign takeovers in France</i>	638
6.3. <i>Control of foreign takeovers in Germany</i>	642
7. CONCLUSION.....	644

1. INTRODUCTION

With the increasing number of transnational investment transactions worldwide, many countries have signed different international investment agreements (IIAs), bilateral or multilateral, with other countries to stimulate market openness and attract more foreign direct investments (FDI) to improve their economies.¹ These terms contain obligations. National security is one of the exceptions that exempts states from the obligations assumed.² As such, the national security exception mainly assuages the protectionist concerns of participants in sovereign wealth funds (SWFs).³ The fundamental concern is how to balance national security against market liberalization.⁴ On one hand, the host state has to protect its

¹ International investment or capital flows fall into four principal categories: commercial loans, official flows, foreign direct investment (FDI), and foreign portfolio investment (FPI). Foreign direct investment (FDI) pertains to international investment in which the investor obtains a lasting interest in an enterprise in another state. See U.N. Conference on Trade and Development (UNCTAD), World Investment Report 2015, U.N. Doc. UNCTAD/WIR/2015 (2015) available at <http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1245> (reporting that the global expansion of FDI is currently being driven by over 65,000 transnational corporations with more than 850,000 foreign affiliates).

² See, e.g., Cathleen H. Hartge, *China's National Security Review: Motivations and the Implications for Investors*, 49 STAN. J. INT'L L. 239 (2013) (exploring the Chinese decision to review foreign investments in domestic companies to ensure there are not national security implications).

³ See generally Rumu Sarkar, *Sovereign Wealth Funds: Furthering Development or Impeding it*, 40 GEO. J. INT'L L. 1181 (2008); see also Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 103 (2009) [hereinafter Backer, *Sovereign Investing in Times of Crisis*] (describing the evolution of attitudes towards SWFs and foreign sovereign's involvement in domestic markets); Xiaolei Sun et al., *China's Sovereign Wealth Fund Investments in Overseas Energy: The Energy Security Perspective*, 65 ENERGY POL'Y 654 (2014) (exploring how China focuses investments on energy sectors and how that affects the energy security of the state).

⁴ See MARTIN A. WEISS, CONG. RESEARCH SERV., RL34336, SOVEREIGN WEALTH FUNDS: BACKGROUND AND POLICY ISSUES FOR CONGRESS 1 (2008) (showing the benefits and issues of SWFs and the hopes for guidelines to be established by international institutions like the IMF); Robert M. Kimmitt, *Sovereign Wealth Funds and the World Economy*, 87 FOREIGN AFF. 119 (2008) (setting out the questions associated with SWFs and hoping to set up a better understanding of the issues which would promote stability in the global economy); see also Yvonne C. L. Lee, *The Governance Of Contemporary Sovereign Wealth Funds*, 6 HASTINGS BUS. L. J. 197 (2010) (considering the current world of foreign investments and how SWFs increase in prevalence coincides with increased flow from 'non-Western' countries); Joel Slawotsky, *The Regulation of Sovereign Wealth Fund Investments in the United States*, 29 BANK. & FIN. SERV. POL'Y REPORT 1 (2010) (looking at possible ways for the United States to improve its regulatory scheme with respect to SWFs); Brendan J. Reed, *Sovereign Wealth Funds:*

own citizens; while on the other hand, the foreign investors are concerned about being discriminated against due to an abuse of protective measures by the host state. Such protective acts may also bring further political tensions.⁵ The issue of sovereign investment has attracted attention because of its opaqueness.⁶ Because governments are involved, some suspect that the true motives of sovereign investment are politically driven. Many SWFs lack transparency, so the host state cannot determine whether the intentions of such investment are genuinely commercial or whether the investment will jeopardize national security and financial stability.⁷ Governments believe that if strategic industries fall under foreign control, the foreign government will take advantage of this control to attack the host state.⁸ For instance, assuming that a foreign state acquires a telecommunication company, it is reasonable to assert that there could be a leak of confidential information by surveillance.⁹ Especially after the 9-11 terrorist attack, these concerns have prompted some countries to regulate and restrict sovereign investment in certain sectors, such as

The New Barbarians at the Gate? An Analysis of The Legal and Business Implications Of Their Ascendancy, 4 VA. L. & BUS. REV. 97 (2009) (analyzing the pros and cons of SWFs); Paul Rose, *Sovereign Wealth Funds Investment in the Shadow of Regulation and Politics*, 40 GEO. J. INT'L L. 1207 (2009) (probing the increase in SWFs and the assorted interests of all of the relevant parties).

⁵ See, e.g., Justin O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, 42 INT'L LAW 1231 (2008) (evaluating the concerns and hopes of SWFs and the reaction from governmental regulators); Javier Santiso, *Sovereign Development Funds*, 58 POL'Y INSIGHTS 1 (2008) (investigating the incredible possibilities for SWFs if they choose to start focusing on development finance and helping the developing world); Doug Palmer, *Rise of China State-Owned Firms Rattles U.S. Companies*, REUTERS, Aug 17, 2011, <http://www.reuters.com/article/2011/08/17/us-usa-china-bigcompanies-idUSTRE77G3Z320110817> (comparing the relative power in the global economy between America and China).

⁶ See generally Yvonne C. L. Lee, *A Reversal of Neo-Colonialism: the Pitfalls and Prospects of Sovereign Wealth Funds*, 40 GEO. J. INT'L L. 1103 (2009); Adrian B. Wignall et al., *Sovereign Wealth and Pension Fund Issues*, FINANCIAL MARKET TRENDS 117 (2008).

⁷ See Gordon L. Clark & Eric R. W. Knight, *Temptation and the Virtues of Long-Term Commitment: The Governance of Sovereign Wealth Fund Investment*, 1 ASIAN J. INT'L L. 321 (2011) (advocating for a more long-term perspective in response to SWFs and using the Australian SWF as an example of what should be done).

⁸ See Patrick J. Keenan, *Sovereign Wealth Funds and Social Arrears: Should Debts to Citizens be Treated Differently than Debts to Other Creditors*, 49 VA. J. INT'L L. 431 (2009) (showing that SWFs treat "two masters with very different agendas").

⁹ See Maurizia D. Bellis, *Global Standards for Sovereign Wealth Funds: The Quest for Transparency*, 1 ASIAN J. INT'L L. 349 (2011) (presenting the impact of SWFs using two focuses: global standards and transparency).

telecommunication and commodities.¹⁰ Even though there are studies which indicate that such restrictions are unnecessary, governments should always guard against such harm.¹¹ Some argue that these measures are over-protective and discriminatory against FDIs, and the measures are a breach of international economic law.

The European Union (EU) is the world's largest outward foreign direct investor and, at the same time, the world's leading recipient of such foreign direct investment (FDI).¹² The flows of international investments into Europe reflect the EU's open policies regarding the movement of capital.¹³ Importantly, while these inward investment flows include capital from SWFs these represent only a minor share of the total FDI transactions per year. Nevertheless, the EU and its members have abandoned their liberal approach towards foreign FDI when it comes to SWFs. In recent years, some EU member states have even expressed the fear¹⁴ that SWFs are lining up for a shopping spree that would bring many EU companies under the heavy influence of foreign governments.

¹⁰ See generally Michael Knoll, *Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?* 82 S. CAL. L. REV. 712 (2009); Matthew A. Melone, *Should The United States Tax Sovereign Wealth Funds*, 26 B. U. INT'L L. J. 143 (2008) (exploring the possible ways for the US to react to the increase in SWFs in its economy, particularly using tax policy); see also Mark E. Plotkin, *Foreign Direct Investment by Sovereign Wealth Funds: Using the Market and the Committee on Foreign Investment in the United States Together To Make the United States More Secure*, 118 YALE L. J. 88 (2008) (studying the protections that are available to ensure the SWFs act appropriately).

¹¹ See generally Arina V. Popova, *We Don't Want To Conquer You; We Have Enough To Worry About: The Russian Sovereign Wealth Fund*, 118 YALE L. J. 109 (2008).

¹² In 2013, the inward flows (into the EU) amounted to 327€ billions while the outward flows (EU to the rest of the world) amounted to 341€ billions. In terms of percentage, EU inward stock (34% of world inward investment) while the outward stock (46% of world outward investment). For the official EU statistics, see Eurostat Portal available at <http://epp.eurostat.ec.europa.eu/newxtweb>.

¹³ Such a liberal policy was recalled in the October 2015 strategy communication published by the European Commission. See European Commission, *Trade for All: European Commission presents new trade and investment strategy* (Oct. 14, 2015) (Press Release) (available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1381>) [hereinafter Trade for All], the full text of the Communication is available at http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf; See generally Ramon Torrent, *The Contradictory Overlapping of National, EU, Bilateral, and the Multilateral Rules on Foreign Direct Investment: Who is Guilty of Such a Mess?*, 34 FORDHAM INT'L L.J. 1377-99 [hereinafter Torrent].

¹⁴ See Lars-Hendrik Röller & Nicolas Véron, *SAFE AND SOUND: AN EU APPROACH TO SOVEREIGN INVESTMENT* (2008) [hereinafter Röller & Véron] (describing the double-edged sword of SWFs, the need for the money to be flowing in and a general aversion to the potential implications of allowing a foreign sovereign to invest within a state).

These concerns are worrying politicians, and national regulations are now in place to screen investments from SWFs. Reacting to this trend, the European Commission decided to promote a common European approach to sovereign investment, *i.e.*, to define at the EU level what policy responses and regulations should and should not be allowed for member states to utilize.¹⁵ Such an intergovernmental approach aims at supplementing national regulatory responses by supranational efforts that intend to remain voluntary in nature.

Why a EU approach? As usual the Commission states that “a common EU approach would maximize European influence in these wider discussions.”¹⁶ Even more important is the fact that, if the EU fails to agree on a common line, individual member states will possibly resort to measures of their own. These resulting barriers would very likely impede the fundamental free movement of capital, not only from outside the EU but also within common European market. Such an “un-coordinated series of responses would fragment the internal market and damage the European economy as a whole.”¹⁷

This article seeks to analyze the existing legal regime applicable to SWFs in the EU and to assess its capacity to answer the call for control, while maintaining the attractiveness of the EU market as an investment location. Firstly, we define the concept of SWFs and present the main trends of SWF investment in Europe as well as the main concerns regarding their effects. Secondly, we critically analyze the current regulatory framework within the EU and this will lead us to suggest particular amendments to the relevant Treaty provision. Thirdly, we explore the EU contribution to promoting a multilateral approach for the regulation of the SWFs’ operations.

¹⁵ For a political and legal examination of the EU decision-making process in external economic policy, see Julien Chaisse, *Promises and Pitfalls of the European Union Policy on Foreign Investment – How Will the New EU Competence on FDI Affect the Emerging Global Regime*, 15 J. INT’L ECON. L. 51 (2012) [hereinafter Chaisse, *Promises and Pitfalls*] (analyzing the effects of moving the decision-making on investment treaties from individual countries to the EU).

¹⁶ A Common European Approach to Sovereign Wealth Funds, EUR. PARL. DOC., COM (2008) 115 provisional, 6 [hereinafter *Commission Communication 2008*].

¹⁷ *Id.* at 7.

2. SOVEREIGN WEALTH FUNDS IN THE CONTEXT OF RISING STATE CAPITALISM

'State capitalism' is usually described as an economic system in which commercial economic activity is undertaken by the state in the form of state-owned enterprises (SOEs). Also, the management and organization of these SOEs' means of production is in a capitalist manner. Ming Du stated that state capitalism is the Chinese economic system, and that it is fundamentally different from Western liberal market capitalism. Also, the substantial reason that state capitalism has been developed in China is because the Chinese government has transformed the nation's economy from a command one to a market one (*i.e.*, socialism with Chinese characteristics). The way that the Chinese government exercises 'state capitalism' is that it directly or indirectly controls a large number of powerful SOEs, especially in the strategic and key sectors (*e.g.*, China Sinopec).¹⁸ Kratsas and Truby argue "the interests of sovereign and private investors clash" through state-directed capitalism and accept Keynes's maxim that "international cash flows are always political," and Kratsas and Truby have stated that it is problematic.¹⁹

2.1. Operations of SWFs in Europe

The increasing presence of SWF investment in the EU, much as in the United States, has given rise to various concerns regarding sovereign investment in the EU market.²⁰ Protectionist tendencies, already an area of concern in the EU, could be further provoked by this rise in SWF activity.²¹ Owing to the geography and historical

¹⁸ See Ming Du, *China's State Capitalism and World Trade Law*, 409 (2014) (exploring how China's use of state owned enterprises has completely overtaken the Chinese economy and how this could be a major problem with the WTO's interpretations of the legality of state owned enterprises).

¹⁹ See Georges Kratsas & Jon Truby, *Regulating Sovereign Wealth Funds To Avoid Investment Protectionism*, 95 J. FIN. REG. 114, 121 (2015) [hereinafter Kratsas & Truby] (evaluating the issues with the current responses to the increases in SWFs globally and specifically in the US).

²⁰ See Backer, *Sovereign Investing in Times of Crisis*, *supra* note 3 (exploring the flow of Chinese savings to finance the US' current account deficit).

²¹ See Julien Chaisse, Debashis Chakraborty, & Jaydeep Mukherjee, *Emerging Sovereign Wealth Funds in the Making: Assessing the Economic Feasibility and Regulatory*

rivalry on the European continent, however, EU governments are perhaps more concentrated on investments from Russia.²² At the same time, the US market remained a more attractive destination for foreign investors during the Global Financial Crisis. These two variables explain to some extent the different perceptions on the two sides of the Atlantic and the differences in terms of regulatory approach. The important difference lies in the fact that the EU, in terms both of regulation and policy, declares, as a principle, that all restrictions on the movement of capital involving member states (both with other States in the EU and with states outside the EU) should be banned.²³ It thus extends the liberalization of capital movements to and from third countries whatever the investor class. This traditional positive perception of foreign investments explains to a large extent why the EU has expressed a general trust with few concerns and has also largely welcomed SWFs investments over the last few years. Concerns, however, exist and they have contributed to generating tensions between national governments and the supra-national level.

Investments of SWFs in international capital markets, including in Europe, have increased greatly in recent years. While the lack of transparency makes it very difficult to have fully comprehensive analysis of SWFs' operations, reports suggest that Europe is an important destination for SWFs' investments.²⁴ As a result of the financial crisis and the ensuing recession, the need for international investment in the EU has also been growing and will continue to grow as suggested by the recently announced EU "Investment Plan."²⁵ Some of these investments come from countries whose political regimes are considerably less liberal than those in EU

Strategies, 45 J.W.T. 837 (2011) (exploring the issues a government may face as they begin to set up a SWF).

²² See Stephen Jen & Oliver Weeks, *Celebrating the Birth of Russia's SWF 1* (2008) (estimating that while Russia's new SWF is relatively small at the beginning it will become a massive SWF in just a few short years if oil prices remain high).

²³ This principle of freedom movement of capital between member states and between member states and third countries is subject to limited exceptions. See TFEU, *infra* note 104, at Article 65 § III(B).

²⁴ See *infra* note 26.

²⁵ The Investment Plan for Europe aims to revive investment in strategic projects around Europe to ensure that money reaches the real economy. See Jyrki Katainen, *Investment Plan*, EUROPA.EU (last visited Dec. 3, 2015), http://ec.europa.eu/priorities/jobs-growth-investment/plan/index_en.htm (describing the Investment Plan for Europe as a package of measures to unlock public and private investments in the real economy of at least € 315 billion through 2017).

countries. There is, however, an informational problem with SWFs, which is partly due to a lack of transparency and clear communication on the part of the funds themselves. There are no exhaustive figures of SWF activities in the EU common market.²⁶ However, it has been reported by many newspapers that many of the larger and more prominent SWFs, including the Abu Dhabi Investment Authority (ADIA), the Government of Singapore Investment Corporation (GIC), the Qatar Investment Authority (QIA), and the Libyan Investment Authority (LIA), are active in Europe. However, the value of their investments, although important, remains at a lower level than the investments made in the US market.²⁷ SWFs invest in very diverse sectors and industries, although there is a certain predominance of investment in services. Primarily, it appears that investments of SWFs in Europe are less frequent than in the United States.²⁸ Consequently the security issues in the EU are not as pressing as they are in the United States. This explains to a large extent the soft position adopted in Europe, balancing concerns with foreign investment with an overall trust for SWFs.

2.2. European concerns about SWFs

In the particular case of Europe, four concerns are brought to the fore by SWF investments. Firstly, the role and involvement of governments in SWF strategies is called into question. Secondly, the

²⁶ A study on the investment operations of 18 SWFs in 2014 found that the European Union received \$16.4 billion, making the EU the second most important destination for SWFs' investments. The same study suggests that \$11.7 billion goes to UK, which leads the recipient EU countries, followed by Italy, Netherlands, France, Spain and Germany. TOWARDS A NEW NORMAL: SOVEREIGN WEALTH FUND ANNUAL REPORT 2014, Bocconi University, 28-29, http://www.unibocconi.it/wps/wcm/connect/83cfaeaa-d5fd-4021-8021-15104503a863/SIL_Report_2015.pdf?MOD=AJPERES. Another study, which uses a different methodology, suggests that Spain has been the main recipient, receiving \$ 8.34 billion, ahead of France, the UK and Germany. Sovereign Wealth Fund Report 2014, ESADEgeo, 8, <https://www.kpmg.com/ES/es/Actualidad/Novedades/Articulos/Publicaciones/Documents/sovereign-weath-funds-v2.pdf>.

²⁷ See generally WILLIAM MIRACKY *et al.*, ASSESSING THE RISKS: THE BEHAVIORS OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL ECONOMY (2008).

²⁸ See Steffen Kern, *SWFs and Foreign Investment Policies – An Update 8* (2008) (assessing the current outlook for SWFs and looking at the policies that have gotten them here).

lack of transparency of SWFs is also a cause for concern. Thirdly, the alleged political objectives of SWFs are feared because they may turn SWFs into secretive government investment vehicles. Finally, some might find the shift in the balance of power in the world economy from Western industrialized countries to new emerging market giants difficult to accept.²⁹ These four issues are considered below.³⁰

Firstly, liberals advocate free market forces and commercial activity. In a free market, the relationship between supply and demand will work itself out and weed out those goods and services that are less profitable. This market, with freedom of choice as to what an individual buys, does not need any interference by the state.³¹ Since the inception of the Treaty of Rome in 1957, EC policies have shunned the role of the states and have discouraged government intervention in economic and financial affairs; a decisive step was achieved with the 1987 Single European Act (SEA) the main effect of which was to set a deadline for the creation of an encompassing single market by 1992.³² The 20-year period following deregulation and the removal of border restrictions in the Common Market provided fertile ground for corporate activity, and private corporations have grown rapidly in size and influence. As a result, the activity of SWFs is a cause for concern since it contradicts

²⁹ See Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, 14 L. & BUS. REV. AMS. 5 (2008) (exploring the growth of SWFs in the past 60 years).

³⁰ See Matthew Saxon, *It's Just Business, Or Is It?: How Business and Politics Collide With Sovereign Wealth Funds*, 32 HASTINGS INT'L & COMP. L. REV. 693 (2009) (analyzing how political interests are being infused into businesses with SWFs and the potential dangers this causes); see also Heike Schweitzer, *Sovereign Wealth Funds: Market Investors or "Imperialist Capitalists"? The European Response to Direct Investment by Non-EU State-Controlled Entities*, 2 EUR. Y.B. INT'L ECON. L. 79 (2011) [hereinafter Schweitzer] (considering the ways in which Europe has responded to the explosion of SWFs globally).

³¹ See Bryan Druzin, *Restraining the Hand of Law: A Conceptual Framework to Shrink the Size of Law*, 117 W. VA. L. REV. 100, 110-12 (2014) (evaluating the complexity of governmental intrusion into the market and showing the view of many right-leaning economists that informational complexity of the market "fundamentally precludes the possibility of successful central market planning").

³² The Single European Act (SEA), 1987 O.J. (L 169) 1; see Ingolf Pernice, *The Treaty of Lisbon: Multilevel Constitutionalism in Action*, 15 COLUM. J. EUR. L. 349 (2009) (showing the new structure created by the Treaty of Lisbon which unites countries in a supranational way without hopes of forming a state).

the trend of reducing the involvement of governments in the EU and global economy.³³

Secondly, the operations of SWFs are often obscured, with disclosure limited to the regulatory compliance obligations imposed by host states. However, the same is true for hedge funds, which are a relatively lightly regulated investment fund. The light regulation applicable – or even sometimes the absence of any regulation – means that they may not be obliged to disclose their holdings either completely or in part.³⁴ Further, it has been argued that SWFs, although similar to hedge funds without long-term investment objectives, are less transparent than hedge funds and therefore more worrying.³⁵ One can also observe significant inconsistencies in the SWF disclosures. The Norwegian SWF (The Government Pension Fund–Global) provides perhaps one of the few exceptions to the practice of limited disclosure.³⁶ Overall, SWFs usually lack transparent structures and management processes that are domestically and internationally accountable. They work in an opaque way, publishing neither statistics on their composition nor

³³ See also Remarks of Nathalie B. Osterwalder, EUR. PARL. HEARING ON FOREIGN DIRECT INVESTMENT (Nov. 9, 2010) (presenting a new way of looking at foreign investments and hoping to increase transparency in these arenas).

³⁴ The EU is proposing to tighten the regulatory regime of its hedge fund industry by: (1) limiting hedge funds' borrowing; (2) imposing a registration requirement for funds with more than US\$134 million under management; and (3) imposing limits on pay, among other regulations. See Nikki Tait & Martin Arnold, *European Union Hedge Fund Plans Under Fire*, FIN. TIMES, Sept. 19, 2010, available at <http://www.ft.com/cms/s/0/e7a4df78-c416-11df-b827-00144feab49a.html> (reporting that considerations of regulating hedge funds and private equity had the potential to be a big problem in Europe); see also Nikki Tait, Ben Hall, & Tom Braithwaite, *French Pave Way for EU Hedge Fund*, FIN. TIMES, Oct. 7, 2010, available at <http://www.ft.com/cms/s/0/c3c5e8b2-d15a-11df-96d1-00144feabdc0.html> (stating that France and Germany are in favor of the proposed legislation and outlining how France's dissipating opposition allowed for passage of regulating hedge funds).

³⁵ See, e.g., Edwin M. Truman, *Four Myths about Sovereign Wealth Funds*, VOXEU.ORG 1 (2008), available at <http://www.voxeu.org/index.php?q=node/1539> (debunking four popular myths about SWFs).

³⁶ See Simon Chesterman, *The Turn to Ethics: Disinvestment From Multinational Corporations for Human Rights Violations – The Case of Norway's Sovereign Wealth Fund*, 23 AM. U. INT'L L. REV. 577, 577-82 (2008) (evaluating how Norway, one of the world's largest petroleum exporters, has invested its oil wealth in a fund with a market value, at the time, of more than US\$ 350 billion making it Europe's largest SWF, and second only to the UAE); see also Anthony Wong, *Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations*, 34 BROOKLYN J. INT'L L. 1081 (2009) (exploring possible solutions to the problems that the world faces with the increasing prevalence of SWFs).

on their investments and strategies.³⁷ For this reason, even the International Monetary Fund (IMF) has had to rely on a collection of estimates by private financial institutions to assess the size of these funds.³⁸ There has been a slight, yet very important and positive improvement since 2014 (when the International Forum of Sovereign Wealth Funds first published a partial compliance-assessment of fifteen SWFs with the Santiago Principles).³⁹

Thirdly, if the role of governments, through and within SWFs, is more utilized than classical economic theory requires, it follows that investment decisions by public investors, and by the SWFs in particular, are not made solely in search optimal risk-adjusted rates of return.⁴⁰ Currently there is no evidence that SWFs have or will control firms to implement governmental policy. However, host countries cannot summarily assume that SWFs investments will *never* be guided by political objectives or that the management of SWFs will *never* be motivated by 'nationalistic considerations' deviating from conventional wealth maximization.⁴¹ One may wonder, can a government use its SWF as a financial instrument to achieve a political objective? Russia and China are regularly singled out as countries with major strategic and political interests shown in

³⁷ The scope and scale of SWFs further increases the potential for deliberate or accidental financial disruption. In a period of global financial turmoil such as at the present, concerns as to the responsibility of SWF managers to act in a stabilising manner will continue to be prominent.

³⁸ See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-946, SOVEREIGN WEALTH FUNDS: PUBLICALLY AVAILABLE DATA ON SIZES AND INVESTMENT FOR SOME FUNDS ARE LIMITED 11 (2008) (finding that that only thirteen countries separately reported their SWF holdings in public IMF documents). In the absence of official national or international public reporting, much of the available information about the value of holdings for many SWFs is from estimates by private researchers who project funds sizes by adjusting any reported amounts to reflect likely reserve growth and asset market returns. *Id.* at 17.

³⁹ See Santiago Principles: 15 Case Studies, International Forum of Sovereign Wealth Funds (Nov. 2014) <http://www.ifswf.org/pst/SantiagoP15CaseStudies1.pdf>.

⁴⁰ See Roland Beck & Michael Fidora, *The Impact of Sovereign Wealth Funds on Global Financial Markets*, European Central Bank Occasional Paper Series, No. 91, at 14 (July 2008) (examining how the increase of SWFs impacts the flow of global currencies).

⁴¹ See Joshua Aizenman & Reuven Glick, *Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance* 23 (National Bureau of Economic Research, Working Paper No. 14562, 2008) (outlining how the goals of the SWF will dictate how risky the assets it invests in will be).

their SWF usage.⁴² These countries also have strategies to control critical assets, such as infrastructure, and this raises issues of market integrity as well as concerns over national security.⁴³

Fourthly, the rise of SWFs is a sign of the shift in the world economic balance of power away from Western industrialized countries and towards new emerging market giants like China, the oil-rich Middle East, and perhaps even India.⁴⁴ According to Philipp Hildebrand, capital has:

[H]istorically tended to flow from the core of an economic system to its periphery . . . sovereign wealth funds play a potentially important role in this apparent reversal. The sense that capital is increasingly flowing from the periphery to the core is raising a variety of political sensitivities in the core countries.⁴⁵

The rise of SWFs is more than the addition of a new asset class. The growth in size and importance of SWFs is a reflection of the new role of developing economies which illustrates a shift in emphasis in the global economy. In recent decades, the rule was for Western companies and portfolio investors to invest in developing countries, while now one may observe that “the growing capital surpluses in developing countries will seek out profitable investment

⁴² See Julien Chaisse et al., *Expansion of Trade and FDI in Asia: Strategic and Policy Challenges* 40 (2009) (discussing how companies engaged in industries of strategic importance to the development of China, such as natural resources and infrastructure, have been supported so actively by government authorities that one may consider that China ‘built’ some of its Multinational Enterprises (MNEs) and how the acquisition of strategic assets and capabilities such as brands, distribution networks, and foreign capital markets, and so on, is often supported by the Chinese government).

⁴³ See Edward Greene & Brian Yeager, *Sovereign Wealth Funds – A Measured Assessment*, 3 CAP. MKTS. L. J. 247 (2008) [hereinafter Greene & Yeager] (exploring the different objectives of different state actors in their having SWFs).

⁴⁴ See Sanjay Dutta, *Government Plans Sovereign Wealth Fund*, TIMES OF INDIA, Sep. 17, 2013, <http://timesofindia.indiatimes.com/business/india-business/Govt-plans-sovereign-wealth-fund/articleshow/22643338.cms> (detailing plans for an Indian SWF to materialize as indicated by Indian officials); see also Archana Chaudhary, *Coal India to Use Planned Sovereign Fund to Buy Mines*, BLOOMBERG (July 8, 2010, 12:40 AM), <http://www.bloomberg.com/news/articles/2010-07-07/coal-india-may-use-proposed-sovereign-fund-to-acquire-mine-assets-overseas> (reporting that any proposed Indian SWF would be set up with the clear intention to help state companies compete for overseas energy assets with China).

⁴⁵ Philipp M. Hildebrand, *The Challenge of Sovereign Wealth Funds*, VOX: CEPR'S POLICY PORTAL (January 21, 2008), <http://www.voxeu.com/index.php?q=node/881>.

opportunities in developed economies.”⁴⁶ In some cases this is achieved through private sector investment, but since many emerging and developing countries do not (for various reasons) have privately owned companies of sufficient size to invest significantly in industrialized countries, this is increasingly done by SWFs.

3. BALANCING CAPITAL FLOWS AND NATIONAL SECURITY: THE EU INTERNATIONAL COMMITMENTS

National security is the idea that a state must keep its property safe in order to protect its citizens. This is a concept that a government, along with its law-making bodies (*e.g.*, parliament(s)), should protect the state and its citizens against all kinds of ‘national’ crises through a variety of power projections. Projections of power may manifest itself in such ways as political power, diplomacy, economic power, military might, and so on. In this respect, there is a unique national security challenge for policy-makers posed by SWFs due to concerns about their legitimacy and integrity as investors.⁴⁷ SWFs may be used for political purposes by those sovereign owners, which might threaten the political and economic security of the states in which they invest. Christopher Cox, the chairman of the US Securities and Exchange Commission, commented that these government-controlled funds may not be created for investment returns and could be in pursuit of other government interests.⁴⁸ Some have expressed a fear that these investments could give those state investors access to sensitive security information of the host state in the infrastructure, energy, and technology sectors. At least, those state investors may gain control of those critically important industries, acquire proprietary knowledge, sensitive technology and scarce resources by

⁴⁶ See Julien Chaisse et al., *Expansion of Trade and FDI in Emerging Asia: Strategic and Policy Challenges* 84 (2009).

⁴⁷ See Meg Lippincott, *Depoliticizing Sovereign Wealth Funds Through International Arbitration*, 13 CHI. J. INT'L L. 649, 651 (2013) [hereinafter Lippincott] (positing that accountability through international arbitration motivates SWFs to behave as private investors).

⁴⁸ See Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440, 513 (2009) (noting that significant investments by the Abu Dhabi fund in the United States threaten American policy-makers’ “future ability to oppose Abu Dhabi on matters related to the Israeli-Palestinian conflict, terrorism or military concerns, or other diplomatic efforts” for fear of economic retaliation).

purchasing a controlling stake in those companies. In order to address these issues, the international economy provides some principles that must be respected by the EU and its member states.⁴⁹ As such, WTO law, and its specific agreement on trade in services – the GATS – provides a first regulatory framework which is complemented by the international investment agreements that have been concluded by the EU and its member states.

3.1. *Implications for SWF Investment from the General Agreement on Trade in Services*

Since most countries involved in FDI are WTO members, WTO law becomes a principal method of solving any legal problems. This applies to EU member states, which are all WTO members and hence bound by the rules of the multilateral organization.⁵⁰ This section will first discuss why the GATS is more relevant and when the GATS is applicable in the context of SWFs, then it will illustrate some major roles of the national security exception under the GATS, and lastly it will examine some underlying problems. Within the WTO treaties, the GATS is more relevant and important in the context of SWFs because it is the only legally binding law in relation to investment.⁵¹

Although the General Agreement on Tariff and Trade (GATT) does contain an article about ‘security exception,’⁵² and thus is theoretically applicable, its principles are relatively limited. Some scholars consider that GATT is too general.⁵³ Even with its investment-related reference treaty, the Agreement on Trade-Related Investment Measures (TRIMs), the GATT is still short of specific discipline. It means that the general principles provided may not be applicable to some specific investments, whereas the

⁴⁹ See generally Torrent, *supra* note 13.

⁵⁰ *Id.*

⁵¹ See Bart de Meester, *International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State*, 20 EUR. BUS. L. REV. 779, 801 (2009) [hereinafter de Meester] (evaluating the global legal framework for SWFs).

⁵² Article X, General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

⁵³ See generally Aaditya Mattoo & Arvind Subramanian, *Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization 1* (Peterson Institute, Working Paper No. 08-2, 2008).

TRIMs do not give enough additional support and reference.⁵⁴ On the contrary, the GATS is more relevant when talking about FDIs like SWFs because FDI nowadays trends towards the service sector.

The purpose of GATS is to make sure the service sectors are liberalized for foreign investment,⁵⁵ including state investments like SOEs and SWFs, by “facilitating the freedom of capital inflows in the service sector.”⁵⁶ Hence, it is more specific yet flexible to be applied to service-related FDIs.⁵⁷ The GATS is applicable to FDI when the investment takes the form of ‘commercial presence’ mode in the service sectors in the EU economy, meaning that the foreign investor holds at least 50% ownership.⁵⁸ Therefore, only when SWFs tend to take control of the target company in the EU will the GATS be applicable.⁵⁹

To promote market liberalization in service sectors to foreign investors, the GATS imposes obligations on the host states.⁶⁰ However, these obligations are subject to the general exceptions and specific exceptions that allow the EU and its member states to deviate from the rules. The GATS Article 14*bis* ‘security exception’ is the illustration of the general exceptions regarding national security that the host state can rely on to refuse foreign investments. The purpose of this exception is to ‘preserve members’ freedom of

⁵⁴ See Fabio Bassan, *Host States and Sovereign Wealth Funds, Between National Security and International Law*, 21 EUR. BUS. L. REV. 165, 172 (2010) [hereinafter Bassan] (examining the efficacy of current regulations on SWFs).

⁵⁵ See de Meester, *supra* note 51, at 800-01 (detailing the reduction in cross-border trade barriers instituted by GATS).

⁵⁶ See Efraim Chalamish, *Global Investment Regulation and Sovereign Funds*, 13 THEORETICAL INQ. L. J. 645, 661 (2012) [hereinafter Chalamish] (determining that governmental attempts to block cross-border investment by SWFs violates commitments in international law).

⁵⁷ Bassan, *supra* note 54, at 173.

⁵⁸ Chalamish, *supra* note 56, at 660-61.

⁵⁹ Bassan, *supra* note 54, at 174.

⁶⁰ See Julien Chaisse et al., *Deconstructing Service and Investment Negotiating Stance: A Case Study of India at WTO GATS and Investment Fora*, 14 J. WORLD INV. & TRADE 44, 54-55 (2013) (observing that general obligations are imposed on the host states based on the most-favored nation (MFN) principle, whereas obligations related to market access and national treatment are imposed only in specific service sectors); see also Julien Chaisse, *Assessing the Relevance of Multilateral Trade Law to Sovereign Investments: Sovereign Wealth Funds as “Investors” under the General Agreement on Trade in Services*, INT’L REV. L. 1 (2015), available at <http://dx.doi.org/10.5339/irl.2015.swf.9> [hereinafter Chaisse, *Assessing the Relevance of Multilateral Trade Law*] (analyzing the impact of GATS as a liberalizing device for SWFs).

action in areas relating to national defence and security.⁶¹ The article provides that the states are excepted from the non-discriminatory obligations imposed when the investment concerns 'essential security interest.'⁶² It is reasonable for the host states to enforce necessary actions to restrain the access of FDI to defend their national security interests and uphold public safety and stability.

The GATS plays an important role in the context of sovereign investment because it liberalizes markets for foreign investments.⁶³ It is suggested that the GATS "provides a useful framework for avoiding national measures that restrict investments by SWFs endanger an open investment client, while at the same time ensuring that WTO Members can protect important interests."⁶⁴

The GATS promotes market liberalization by imposing obligations upon the members, including the EU, while allowing the states to make exceptions, including the national security exception, under GATS Article 14*bis*, when there is a need for national protection. In the context of SWFs, the national security exception helps to balance the control of national security and investment opportunities.

Originally, foreign investments were genuinely for commercial purposes, but because governments fund the foreign investments, some states will be suspicious of the true purpose behind them. There are two possibilities: that the government in control of the SWFs truly tends to attack the host state via SWFs and SOEs, or that the SWFs and SOEs are purely for commercial purposes but the host government abuses the national security exception to reject the investment because of political reasons. Under the former scenario, the exception is a shield for the host state to block potential threats to its national security; under the latter scenario, the exception acts like a protector to escort the SWF throughout the process. Studies show that most sovereign investments are purely for commercial purposes because there is no meaningful benefit in spending so much money and time to indirectly attack another sovereignty via

⁶¹ Chaisse, *Assessing the Relevance of Multilateral Trade Law*, *supra* note 60, at 12.

⁶² Art. XIV*bis*, General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183.

⁶³ See Chaisse, *Assessing the Relevance of Multilateral Trade Law*, *supra* note 60, at 4-5 (detailing how GATS encourages liberalization through positive list approaches).

⁶⁴ de Meester, *supra* note 51, at 811.

SWFs.⁶⁵ Hence, the rejected cases are considered an abuse of the security exception.⁶⁶ So, some scholars believe that the exception would “level the playing field with other investors and prevent host states from politically retaliating against a state by denying SWF investments. This is an important aspect of liberating SWFs from becoming political battlefields.”⁶⁷ Therefore, the national security exception is a protector that depoliticizes SWFs and encourages trade liberalization.

Some scholars believe that the national security exception under WTO law provides a forum to cope with protective measures against SWFs.⁶⁸ Because the GATS is legally binding between the WTO members and the WTO, the WTO may exercise its political influence/control towards those who breach the law, and it offers a preferred platform for sovereignties to tackle related issues and to make appropriate decisions or concessions accordingly. With the power and influence of WTO and the treaty, both parties can negotiate and end up with a win-win solution. However, the national security exception can only be a very partial solution to the matters raised by protective measures against SWFs. The exceptions should be “interpreted in conjunction with other provisions in the same treaty” but not alone⁶⁹ because the GATS Article 14*bis* is only one of the articles and it addresses only the exceptions. In addition, the exception under the GATS does not specifically give exemptions to sovereign investments.⁷⁰ There may be other general exceptions or even specific exceptions in the GATS or even other provisions in the GATT or TRIMs that contradict the national security exception. As a result, it is uncertain whether the national security exception

⁶⁵ See, e.g., David Murray, *SWFs: Myths and Realities*, (Keynote Address) Global Sovereign Funds Roundtable, May 5, 2011, <http://www.ifswf.org/pst/london11.pdf>.

⁶⁶ See Kratsas & Truby, *supra* note 19, at 98-102 (detailing the relative opacity and history of investment patterns among SWFs).

⁶⁷ Lippincott, *supra* note 47, at 664.

⁶⁸ See Chalamish, *supra* note 56, at 663-65 (surveying the various means by which GATS-issued exceptions applies to investments by SWFs); see also Locknie Hsu, 43 J. WORLD TRADE 451, 457 (2009) [hereinafter Hsu] (assessing the impact WTO agreements have on SWFs).

⁶⁹ See Susan Rose-Ackerman & Benjamin Billa, *Treaties and National Security*, 40 N.Y.U. J. INT'L L. & POL. 437, 465 (2007-2008) [hereinafter Rose-Ackerman & Billa] (weighing the impact of GATS Article XXI on a 1985 trade embargo between Nicaragua and the United States).

⁷⁰ See Hsu, *supra* note 68, at 457 (noting the limited scope of the WTO's Agreement on Trade-Related Investment Measures binding participating members).

article will prevail over the others. Therefore, the national security exceptions can provide only limited guarantees to the SWFs.⁷¹

However, the exception creates another underlying matter, which limits the achievement of the liberalization goal. Most authors agree that the phrase 'essential security interest' creates a degree of uncertainty regarding reliance on the exception. The causes of the uncertainty are that the WTO has not provided any clear definition in clarifying the scope of the term "essential security,"⁷² and also because different states hold different notions regarding the phrase.⁷³ It is uncertain when the host states will reject the foreign investments in breach of any obligations.⁷⁴ It is unclear what kinds of FDI will prompt the host states to invoke the security exception.⁷⁵

This lack of clarity results both in unpredictability for foreign investors to plan their future investments and an unfriendly investment environment that may discourage further sovereign investment. Because of the uncertainty, either the host state or the foreign government can easily rely on and easily make use of the exception.⁷⁶ Firstly, the WTO has not clarified the scope of the national security exception. Secondly, there is inadequate case law to illustrate the correct use of the exception, to what extent, and to which service sectors the exception is applicable.

The unpredictability of the WTO law and the protective measures imposed by the host state create a barrier to entry for SWFs in the EU and elsewhere. Hence, this will possibly result in counter-effects, which do not harmonize the market but worsen the relationships between the member countries, or even foster political revenge.

⁷¹ See Bassan, *supra* note 54, at 196 (detailing the policy rationale behind the limited applicability of GATT and TRIMs rules to SWFs).

⁷² See Hsu, *supra* note 68, at 464 (considering the implications of the vagueness in defining "essential security" for foreign investors).

⁷³ See Bassan, *supra* note 54, at 190 (detailing various state interpretations of the ambiguity behind "essential security").

⁷⁴ See Claudia Annacker, *Protection and Admission of Sovereign Investment under Investment Treaties*, 10 CHINESE J. INT'L L. 531, 551-554 (2011) (discussing the multiple theories of jurisdiction concerning investor-state relations).

⁷⁵ See Chaisse, *Assessing the Relevance of Multilateral Trade Law*, *supra* note 60, at 13-14 (affirming the difficulty of defining what categories of investment are applicable to the GATT national security exception).

⁷⁶ See Bassan, *supra* note 54, at 177 (detailing the ambiguity of the GATS Annex on financial investors and SWFs).

3.2. *The International Investment Treaties Approach*

In addition to the WTO law, IIAs have become popular between countries to promote market liberalization and to create more investment opportunities. This section focuses on discussing how the national security exception in IIAs deals with SWFs by looking at some significant examples.

Since December 2009, investment is part of the EU's common commercial policy.⁷⁷ As a consequence, the European Commission may legislate on investment. The European Commission outlined its approach for the EU's future investment policy in its Communication "Towards a comprehensive European international

⁷⁷ See, e.g., Marc Bungenberg, *The Division of Competences between the EU and Its Member States in the Area of Investment Politics*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW, SPECIAL ISSUE: INTERNATIONAL INVESTMENT LAW AND EU LAW 29-42 (Bungenberg et al. eds., 2011) (discussing the reasons for the 2009 EU transfer of competencies with member states in international investment policy); Marc Bungenberg, *Going Global? The EU Common Commercial Policy After Lisbon*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 123-51 (Christoph Herrmann et al. eds., 2010) (describing the challenges EU policy after the Treaty of Lisbon faces in light of economic competition with the U.S. and China); Marc Bungenberg, *The Politics of the European Union's Investment Treaty-Making*, in THE POLITICS OF INTERNATIONAL ECONOMIC LAW 133-61 (Tomer Broude et al. eds., 2011) (detailing the interaction of law and politics in EU bilateral investment treaty making); N. Jansen Calamita, *The Making of Europe's International Investment Policy: Uncertain First Steps*, 39 LEGAL ISSUES OF ECON. INTEGRATION 301-30 (2012) (evaluating main issues facing EU in developing international investment policies); Jan Ceysens, *Towards a Common Foreign Investment Policy? - Foreign Investment in the European Constitution*, 32 LEGAL ISSUES OF ECON. INTEGRATION 259-91 (2005) (assessing that European Constitution's foreign investment policy will lead to greater cooperation between EU and member state policies); Joachim Karl, *The Competence for Foreign Direct Investment: New Powers for the European Union?*, 5 J. WORLD INV. & TRADE 413-448 (2004) (addressing the possible implications of an EU competence for foreign direct investment on member states); Marcus Klamert & Niklas Maydell, *Lost in Exclusivity: Implied Non-Exclusive External Competences in Community Law*, 13 EUR. FOREIGN AFF. REV. 493-513 (2008) (asserting the existence of implied exclusive competencies is affirmed by recent opinions from the European Court of Justice); Jan Kleinheisterkamp, *The Future of the BITs of European Member States after Lisbon*, 29 ASA BULLETIN 212 (2011) (contending European Commission's claim of exclusive competence will politicize discussion in investment treaty arbitration); Markus Krajewski, *External Trade Law and the Constitution Treaty: Towards a Federal and More Democratic Common Commercial Policy?*, 42 COMMON MARKET L. REV. 91-127 (2005) (determining whether European Constitution Treaty democratizes and federalizes EU common commercial policy); Torrent, *supra* note 13 (asserting that the bilateral investment treaties of EU member states contradict the EU Court of Justice's jurisprudence).

investment policy” in 2010.⁷⁸ This policy contributes to the objectives of smart, sustainable and inclusive growth, set out in the Europe 2020 Strategy.⁷⁹ However, since 2009, a dual regime exists which provides for the existence of both EU member states’ investment treaties and newly negotiated EU investment treaties.⁸⁰

⁷⁸ *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, and the Committee of the Regions: Towards a Comprehensive European International Investment Policy*, COM (2010) 343 final (July 7, 2010) [hereinafter *Communication from the Commission to the Council*].

⁷⁹ *Communication from the Commission: Europe 2020 – A Strategy for Smart, Sustainable, and Inclusive Growth*, COM (2010) 2020 final (March 3, 2010).

⁸⁰ In three judgements, the CJEU sided with the Commission by ruling that Austria, Sweden, and Finland did not take appropriate steps required by ex-Article 307(2) EC (now Article 351 TFEU) to remove incompatibilities of their pre-accession BITs provisions on free transfers related to investment (transfer clause) with regard to restrictive measures the Council may take under the Treaty Articles on the free movement of capital ex-Articles 57(2), 59 and 60 (1) EC. Case C-205/06, *Comm’n v. Austria*, CURIA (2009), available at http://curia.europa.eu/juris/document/document_print.jsf?doclang=EN&text=&pageIndex=0&part=1&mode=lst&docid=72640&occ=first&dir=&cid=62326; Case C-249/06, *Comm’n v. Sweden*, CURIA (2009), available at <http://curia.europa.eu/juris/document/document.jsf?text=&docid=72641&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=62508>; Case C-118/07, *Comm’n v. Finland*, CURIA (2009), available at <http://curia.europa.eu/juris/document/document.jsf?text=&docid=73856&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=62669>. This relatively complex regime is not discussed here. Interested readers may refer to a rich literature on the topic. For a critical review, see Torrent, *supra* note 13 (asserting that EU member states’ BITs contradict the CJEU’s jurisprudence concerning the distribution of competences among the European Community and its member states); see generally P. J. Kuijper, *Foreign Direct Investment: The First Test of the Lisbon Improvements in the Domain of Trade Polity*, 37 LEGAL ISSUES OF ECON. INTEGRATION 261 (2010); see also Lars Markert, *The Crucial Question of Future Investment Treaties: Balancing Investors’ Rights and Regulatory Interests of Host States*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW, SPECIAL ISSUE: INTERNATIONAL INVESTMENT LAW AND EU LAW 145-71 (Bungenberg et al. eds., 2011); Niklas Maydell, *The European Community’s Minimum Platform on Investment or the Trojan Horse of Investment Competence*, in INTERNATIONAL INVESTMENT LAW IN CONTEXT 73-92 (August Reinisch & Christina Knahr eds., 2008); Carsten Nowak, *Legal Arrangements for the Promotion and Protection of Foreign Investments Within the Framework of the EU Association Policy and European Neighbourhood Policy*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW, SPECIAL ISSUE: INTERNATIONAL INVESTMENT LAW AND EU LAW 105-38 (Bungenberg et al. eds., 2011); Federico Ortino & Piet Eeckhout, *Towards an EU Policy on Foreign Direct Investment*, in EU LAW AFTER LISBON 312 (Andrea Biondi et al. eds., 2012); August Reinisch, *The Division of Powers Between the EU and its Member States “After Lisbon,”* in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW, SPECIAL ISSUE: INTERNATIONAL INVESTMENT LAW AND EU LAW 43-54 (Bungenberg et al. eds., 2011); Mavluda Sattorova, *Return to the Local Remedies Rule in European BITs? Power (Inequalities), Dispute Settlement, and Change in Investment Treaty Law*, 39 LEGAL ISSUES OF ECON. INTEGRATION 223-24 (2012); Chaisse, *Promises and Pitfalls*, *supra* note 15, at 52; Wenhua Shan, *Towards a Common European Community*

These investment treaties provide a layer of regulation on SWFs' investment that the EU and the member states must respect.⁸¹

There are two major types of IIAs to be discussed: bilateral investment treaties (BITs), and preferential trade agreements (PTAs). BITs are signed by two countries bilaterally; PTAs, however, are multilateral and usually take forms of free trade agreements (FTAs). One significant FTA is the North America Free Trade agreement (NAFTA), concluded between North American countries. Since IIAs are signed by a number of countries, there usually are negotiations between parties before the agreement is concluded. The IIAs are therefore mostly customized based on the needs and conditions of the relative parties, and this increases the transparency of the regulations and restrictions. Hence IIAs more realistically protect both foreign investors and host countries.⁸²

Such features of IIAs help to promote and encourage FDI around the world. The IIAs also promote FDI by compromising on the dispute settlement mechanisms. Firstly, clearer definitions of investors in some BITs give predictability and certainty to foreign investors.⁸³ This brings comfort to the foreign investors on how the IIAs protect them in case of disputes. Also, due to the rise of SWFs, some BITs even contain clauses about state-state dispute resolutions with a narrower scope.⁸⁴ The state-state disputes provision with a narrower scope, yet greater certainty not only encourages negotiations instead of arbitrations, but also allows SWFs to claim

Policy on Investment Issues, 2 J. WORLD INV. & TRADE 603-25; Wenhua Shan & Sheng Zhang, *The Treaty of Lisbon: Half Way Toward a Common Investment Policy*, 21 EUR. J. INT'L L. 1049-73 (2010); Jörg Philipp Terhechte, *Art. 351 TFEU, the Principle of Loyalty and the Future Role of the Member States' Bilateral Investment Treaties*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW, SPECIAL ISSUE: INTERNATIONAL INVESTMENT LAW AND EU LAW 79-94 (Bungenberg et al. eds., 2011).

⁸¹ The strategy, announced in October 2015, points to the next steps for the new EU approach to investment protection. See Trade for All, *supra* note 13, the full text of the Communication is available at http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf.

⁸² See Lippincott, *supra* note 47, at 660-61 (examining the protective benefits of bilateral investment treaties).

⁸³ See Chalamish, *supra* note 56, at 652-53 (discussing how the definition of an 'investor' varies across BITs and how the different definitions can affect the likelihood of foreign direct investment).

⁸⁴ See Lippincott, *supra* note 47, at 662-63 (analyzing the narrower scope of the state to state disputes provision in contrast to the investor-state disputes provision).

for damages due to any violation of IIAs.⁸⁵ Therefore, the additional transparency, predictability and certainty achieved by the customized features of IIAs and the clear procedural dispute settlement mechanisms provided give a higher level of protection to either party.⁸⁶ This helps investors to plan carefully and wisely in order to achieve higher return. Thus, IIAs help to encourage FDIs.

The aim of IIAs is to promote trade liberalization between countries.⁸⁷ In this respect, the EU's investment policy is focused on providing EU investors and investments with market access and with legal certainty and a stable, predictable, fair, and properly regulated environment in which to conduct their business.⁸⁸

The clauses are based on the principles of most-favored nation (MFN) or national treatment (NT). However, countries still have to be wary of any investments that may jeopardize their national safety. Therefore, most IIAs also explicitly include national security exceptions to ensure that the treaties protect themselves. However, the difficulty is how the parties strike a balance between national security and MFN/NT obligations by control. The following examples show their positions in the context of the exception under different situations. NAFTA is one of the most significant of all the IIAs. It was signed by the United States, Canada and Mexico to promote trade liberalization. NAFTA contains an explicit national security exception under Article 2102. The provision construed is very similar to that of WTO law, GATT Article 10 and GATS Article 14*bis*. It is suggested that "the explicit security provision in NAFTA gives parties considerable discretion in defining their national security interests."⁸⁹ The terms related to the national security

⁸⁵ *Id.*; see also Chalamish, *supra* note 56, at 667 (highlighting how investment agreements cover investments by entities without referring specifically to state-owned entities).

⁸⁶ See Christian Tietje, *Bilateral Investment Treaties Between EU Member States (intra-EU-BITs) – Challenges in the Multilevel System of Law*, 10 *TRANSNAT'L DISP. MGMT. J.* 1 (2013) (discussing the recent progress made in promoting greater transparency in investment law and investment arbitration).

⁸⁷ See Julien Chaisse, *Exploring the Confines of International Investment and Domestic Health Protections—Is a General Exceptions Clause a Forced Perspective?*, 39 *AM. J. L. & MED.* 332 (2013) (analyzing the growth of international law of foreign investment and its effects on trade between countries and dispute resolution).

⁸⁸ See *Communication from the Commission to the Council*, *supra* note 78, at 4 (stating the goal of establishing a "common international investment policy" that fosters stability and therefore encourages international investment).

⁸⁹ See Rose-Ackerman & Billa, *supra* note 69, at 470 (claiming that the explicit security provision in NAFTA is a "ceiling rather than a floor" and cannot be used to manufacture a wider, implicit national security exception).

exception under NAFTA – “any actions that it considers necessary for the protection of its essential security interests”⁹⁰ – suggest that the exception is “self-judging,”⁹¹ especially with the phrase “it considers necessary.” It means that when the host state suspects or believes that the foreign investment tends to be a threat to its public interest, the government may reject or restrict such an investment project under this exception in “good faith.”⁹² Another provision from NAFTA seems to suggest that the national security exception is self-judging. Article 1138 provides that if it is an action to restrict investments, the decision by the host party is not subject to any dispute settlement provision under the treaty. Some commented that “if the Parties had agreed that Article 2102 were entirely self-judging, Article 1138 would not be necessary.”⁹³ Therefore, any prohibition or restriction imposed on investment-related SWFs invoked by the national security exception will be a final decision and not subject to dispute settlement provisions under NAFTA. The use of such a treaty is very limited in the context of SWFs.

The United States–Singapore Free Trade Agreement (USSFTA) is worth studying in the context of SWFs and national security not only because Singapore has recently been active in making sovereign investments in foreign countries and because it is one of the most influential economies in Asia, but also because the form of this BIT is quite significant and typical. Singapore has also invested in several major financial institutions in the United States. The typical negative list approach is used under the USSFTA, meaning that the non-applicable service sectors are listed in the Annex.⁹⁴ The definition of “investor” is clearly stated in the agreement under Article 15.1, which does not exclude a SWF as a type of investor. The most relevant section is Chapter 15 (Investment) in the context of SWFs. Similar to other BITs, the USSFTA also contains provisions related to MFN, NT, and the national security exception regarding expropriation and compensation etcetera in the said chapter.

⁹⁰ North American Free Trade Agreement, U.S.-Can.-Mex., art. 2102(b), Dec. 17, 1992, 32 I.L.M. 289 (1993).

⁹¹ See Rose-Ackerman & Billa, *supra* note 69, at 469 (describing the national security exception in NAFTA article 2102, and its similarities to the exception available in GATT).

⁹² *Id.*

⁹³ See *id.* at 470 (providing evidence that NAFTA article 2102 is “not entirely self-judging”).

⁹⁴ See Hsu, *supra* note 68, at 460 (showing examples of obligations under the investment and financial services chapters of the USSFTA).

This raises an issue regarding the national security exception. Most of the BITs and FTAs that the United States has entered into have been drafted based on the language from the Treaty in Friendship, Commerce and Navigation (FCNs) or the US Model BIT 2004. These two treaties use the phrase “essential security” instead of “national security,” as used in the Foreign Investment and National Security Act (FINSAs), which regulates foreign investments in the United States. The question is whether the BITs or FTAs can be relied on when it comes to investment disputes.⁹⁵ The phrase “essential security” used under the USSFTA Article 21.2 is made with reference to the GATT Article 10 and GATS Article 14*bis*. However, the ambiguous scope and meaning of this term under WTO law, as mentioned above, does not give sufficient assistance in interpretation and clarification. Such reference only cycles the issue of uncertainty and lack of certainty of the term back to the original starting point. Another question is about remedies after the prohibition or restriction is made against SWFs.⁹⁶ Some scholars have argued that the IIAs focus only on the post-establishment remedies.⁹⁷ This is not realistic enough because SWF investors would usually inject large amounts of capital into the host state for the establishment before the decision.⁹⁸ It is uncertain whether this will be treated as “expropriation” and what remedies the SWF investors, *i.e.*, the governments, will correspondingly receive. Sometimes, it appears that IIAs are customized and thus they tend to provide more certainty and protection to investors. However, there are still some realistic clarifications required when they refer back to an unclear term.

After the Argentine economic crises in 2002, Argentina was involved in a series of lawsuits. The most significant dispute dealing with the national security exception was between Argentina and the United States. Like most recent BITs, the Argentine–US BIT allows state–state dispute settlement concerning the national security exception. The BIT does contain a security exception provision with

⁹⁵ See *id.* at 463 (questioning the applicability of the national security exception as it relates to BIT or FTA obligations).

⁹⁶ See *id.* at 468 (pointing out the weaker negotiating position of the foreign investor in negotiating risk mitigation agreements arising from national security concerns).

⁹⁷ See Chalamish, *supra* note 56, at 670 (positing that BITs do not really apply to SWFs pre-establishment, but only post-establishment).

⁹⁸ See Hsu, *supra* note 68, at 468 (detailing the national security provisions of FINSAs 2007).

the use of the phrase “the protection of its own essential security interests.”⁹⁹ In one of the cases, it was held that major economic emergencies are considered to be “essential security interests.”¹⁰⁰ So, *prima facie*, Argentina could invoke the exception. However, the court continued to express that the article is not self-judging.¹⁰¹ The decision clearly shows that the court is reluctant to allow the states to determine whether they can invoke the exceptions.¹⁰² The judgment also provides a framework that when either party would like to justify its breach of obligations based on the exception of the BIT, one of the parties should show the relationship between the measures adopted and the “resolution of the crisis.”¹⁰³

The Argentine cases provide directions on how the decision would likely be made, and this increases certainty. The decisions give more clarifications on how to interpret the security exception provision of a BIT with the key terms being unclear. The case law provided lessons to the states for clearer terms and it has assisted the countries in negotiating and concluding new BITs. After the Argentine case, the United States updated its treaty language based on the US Model BIT. The United States has ensured that the exception is self-judging so it can be invoked easily. Therefore, the claims actually fill in the existing gap and further help to better the investment law and promote sovereign investments.

4. THE HARD LAW DIMENSION OF THE EU INTERNAL MARKET

The EU law is extraordinary compared to other multilateral treaties. Not only does it cater to the member states but it also helps to promote world trade with the EU by extending its protection to third countries.¹⁰⁴ Another important feature of the EU approach is

⁹⁹ Treaty with Argentina Concerning the Reciprocal Encouragement and Protection of Investment art. 11, U.S.-Arg., Nov. 14, 1991, S. TREATY DOC. NO. 103-2 (1993).

¹⁰⁰ CMS Gas Transmission Co. v. The Republic of Argentina, para. 360 - ICSID Case ARB/01/8, Award May 12, 2005.

¹⁰¹ *Id.*

¹⁰² Rose-Ackerman & Billa, *supra* note 69, at 469.

¹⁰³ *Id.* at 486.

¹⁰⁴ The Treaty of Rome provided for the free movement of capital, but the abolition of capital restrictions between member states was to be ‘to the extent necessary to ensure the proper functioning of the common market.’ Despite initial progress in the 1960s, there was a lot of later backtracking as many member states introduced safeguard measures. Many financial operations with other member states

the application of existing EU laws to SWFs. It serves as a useful reminder that the free movement of capital is a fundamental freedom in the European common market, and as such can be restricted only in clearly limited cases.¹⁰⁵ The scope of these restrictions determines the leeway given to member states to regulate sovereign investments in their respective territories.¹⁰⁶ Most countries have laws and regulations in place that restrict FDI in industries considered sensitive to national security or sovereignty.¹⁰⁷ Some national regulations give the government a right to review proposed foreign investment. Any national legislation that establishes mechanisms to control SWFs is, by its very nature, an exception to the principles of free movement of capital and freedom of establishment—free movement of capital and freedom of establishment being integral features of the EU's approach to SWFs.¹⁰⁸

The Treaty of Functioning of European Union (TFEU), with a fundamental principle of the movement of capital, is the focus in the

were subject to prior authorization requirements known as “exchange controls.” This situation persisted until the early 1990s. Recognizing the damage that this was doing to the delivery of a single market, the Council adopted a capital liberalization directive, in 1988, providing for the removal of all remaining exchange controls by mid-1990 for most of those countries maintaining this mechanism. (Council Directive 88/361/EEC of June 24, 1988 for the implementation of Article 67 of the Treaty, O.J. (L. 178) 5–18. There were, though, transition periods provided for Spain, Ireland, Portugal and Greece.) As part of the drive towards Economic and Monetary Union, the freedom of capital movements gained the same status as the other Internal Market freedoms with the coming into force of the Maastricht Treaty. From January 1, 1994 not only were all restrictions on capital movements and payments between EU member states prohibited, but so were restrictions between EU member states and third countries. In subsequent EU accession rounds, exchange controls have been progressively eliminated in the period before EU membership. In general, all capital movements have now been fully liberalized across the EU, although some transitional periods have been granted to some newer member states for capital operations involving the purchase of real estate (second homes or agricultural land).

¹⁰⁵ See Frank Hoffmeister, *Litigating Against the European Union and its Member States - Who Responds Under the ILC's Draft Articles on International Responsibility of International Organizations?*, 21 EUR. J. INT'L L. 723 (2010) (discussing the role of the EU and its relationship to its member states in the course of their execution of EU law); see also Markus Burgstaller, *European Law and Investment Treaties*, 26 J INT'L ARB. 181 (2009) (writing about the growing importance of the changing dynamic between investment treaties and European law).

¹⁰⁶ See generally Julien Chaisse, *Adapting the European Community Legal Structure to the International Trade*, 17 EUR. BUS. L. REV. 1615 (2006).

¹⁰⁷ One example is France. See generally Décret 2005-1739, *infra* note 230.

¹⁰⁸ See Schweitzer, *supra* note 30, at 301 (discussing the difficulties of completing the EU common market principle of freedom of movement of capital).

context of SWFs in the EU. The TFEU Article 64 allows the EU member states to adopt measures dealing with foreign investments in their territories, including IIAs. It also extends its benefits to other third-party foreign investors. Out of the two sets of limits provided to restrain the members from prohibiting or restricting FDIs, derogations pursuant to the TFEU Article 65 deal with the national security exception regarding FDIs. The phrase used is “justified on grounds of public policy or public security.”¹⁰⁹ Instead of ‘essential security’ like NAFTA, which follows the WTO law, the EU law is more concerned about “public security” or public order. In addition, this exception is held to be applicable in the situation regarding FDIs made by non-member states.¹¹⁰

4.1. *The principle of the free movement of capital*

The free movement of capital is not absolute. Although a fundamental principle of the TFEU, the movement of capital can be regulated in two ways at the European level. According to Article 64 of the TFEU, the EU may: (1) adopt, by qualified majority, “measures on the movement of capital from third countries involving direct investment,” and (2) “it is not excluded that the Communication can introduce (by a unanimous decision) measures that restrict direct investments.”¹¹¹ Thus, Article 64 of the TFEU

¹⁰⁹ Consolidated Version of the Treaty on the Functioning of the European Union art. 65(1)(b), 2012 O.J. (C 326) at 26 [hereinafter TFEU].

¹¹⁰ Joined Cases 163/94, 165/94 and 250/94, *Sanz de Lera and Others*, 1995 E.C.R. I-4823 [hereinafter *Sanz de Lera and Others*].

¹¹¹ TFEU art. 64, *supra* note 104, at 72. The terms “direct investment” appeared in the Chapter on capital movements and payments of the EC Treaty and now in Articles 63–66 of the TFEU. In that context, they have been interpreted by the Court of Justice in light of the Nomenclature annexed to Directive 88/361/EEC of June 24, 1988 for the implementation of Article 67 of the Treaty (1988 O.J. (L 178).5–18), which in turn is largely based on widely accepted definitions of the IMF and the OECD. Case C-446/04, *Test Claimants in the FII Group Litigation v. Comm’rs of Inland Revenue*, 2006 E.C.R. I-11869 [hereinafter *Test Claimants in the FII Group Litigation*]. For different contexts in which the Court has recognized the framework established in Directive 88/361/EEC as valuable for the implementation of Article 67, *see generally* Case C-157/05, *Holböck v. Salzburg-Land*, 2007 E.C.R. I-4051; Case C-112/05, *Comm’n v. Germany*, 2007 E.C.R. I-8995; Case C-101/05, *Skatterverket v. A*, 2007 E.C.R. I-11584; Case C-194/06, *Staatssecretaris van Financiën v. Orange European Smallcap Fund N.V.*, 2008 E.C.R. I-3819; Case C-274/06, *Comm’n v. Spain*, CURIA (February 14, 2008), <http://curia.europa.eu/juris/document/docu->

gives the EU the competence to adopt measures with regard to the establishment of foreign investors in the EU. This includes the adoption of internal EU legislation and conclusions of IIAs such as EU's FTAs. Further, because the TFEU explicitly covers relations between member states *and* third party countries, foreign investors are able to benefit from important rights vis-à-vis their investments in the EU. Since SWF investments have to be treated in the same way as any other FDI, SWFs benefit from the free movement of capital.¹¹² There are, however, two sets of limits on the principle of free movement of capital: (1) safeguard clauses, and (2) derogations. The scope of these limits will determine the room governments have to maneuver when attempting to restrict FDI in their territories. The broader these exceptions are, the easier it will be for governments to limit SWFs' access to the Common Market. The more narrowly these limits are conceived, the easier it will be for SWFs to come into the EU market.

Safeguard clauses are contained in Articles 66 and 75 of the TFEU. These articles apply only to third countries and are of a temporary nature, intended for application in exceptional circumstances.¹¹³ The derogations are laid down in Article 64 of the Lisbon Treaty and Article 65 of the TFEU.¹¹⁴ Article 64 concerns only

ment.jsf?text=&docid=71570&pageIndex=0&doclang=ES&mode=1st&dir=&occ=first&part=1&cid=898306; Case C-326/07, *Comm'n v. Italy*, 2009 EUR-Lex CELEX LEXIS ¶ 35.

¹¹² See generally *Torrent*, *supra* note 13, at 1378-99.

¹¹³ Source substantiated intent for limited application.

¹¹⁴ See generally *Treaty of Lisbon*, *infra* note 125; see also *TFEU*, *supra* note 109, at Article 65. Article 65 states that:

The provisions of Article 63 shall be without prejudice to the right of Member States:

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

2. The provisions of this Chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with the Treaties.

relations with third countries and covers the movements of capital when regarded as particularly sensitive. These are typically movements of capital involving direct investment, the right of establishment, the provision of financial services, or even the admission of securities to capital markets.

4.2. *The exception to the free movement of capital*

Article 65 of the TFEU, perhaps the most important article when it comes to potential obstacles SWFs face to investment in the EU, describes the powers retained by member states. Specifically, it enables member states to restrict the movement of capital to or from other member states or third countries when given grounds as a matter of ensuring public order or public security.¹¹⁵

Under Article 65, a member state is entitled to restrict Treaty freedoms on the basis of legitimate national security concerns. Free movement of capital, unlike the other freedoms of movement

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63.

¹¹⁵ TFEU, *supra* note 109, at Article 65(1)(b). The ECJ has expanded the derogations possible to the principle of free movement of capital for a number of “public interest” reasons. *See e.g.*, *Skatteverket v. A.*, *supra* note 106 at I-11575 (citing the need to guarantee the effectiveness of fiscal supervision); Case C-452/01, *Ospelt v. Schlössle Weissenberg Familienstiftung*, 2003 E.C.R. I-9790 (citing the need to preserve agricultural communities, maintain a distribution of land ownership which allows the development of viable farms and sympathetic management of green spaces and the stateside, encourage a reasonable use of the available land by resisting pressure on land, and prevent natural disasters);

Case C-436/00, *X & Y v. Riksskatteverket*, 2002 E.C.R. I-10864 (citing coherence of the tax system, prevention of tax avoidance, effectiveness of fiscal supervision, and maintaining for regional planning purposes, a permanent population and an economic activity independent of the tourist sector, may be regarded as contributing to an objective in the public interest). This finding can only be strengthened by the other concerns which may underlie those same measures. For examples of these other concerns, *see* *Joined Cases 515, 519, 524, & 526-540/99, Reisch v. Others*, 2002 E.C.R. I-2005 (citing the need to protect the environment); Case C-222/97, *Trummer & Mayer*, 1999 E.C.R. I-1680 (citing the need to ensure that a mortgage system clearly and transparently prescribes the respective rights of mortgagees *inter se* as well as the rights of mortgagees as a whole vis-à-vis other creditors); Case C-302/97, *Konle v. Austria*, 1999 E.C.R. I-3135 (maintaining, in the general interest, a permanent population and an economic activity independent of the tourist sector in certain regions); *Joined Cases C-282 & 283/04, Comm'n v. Netherlands*, 2006 E.C.R. I-9161 (guaranteeing a universal postal service).

established by the TFEU, does not apply solely between member states – it prohibits restrictions on the movement of capital between member states and third countries. This is true in respect of all investments, be they from SWFs, state-controlled companies, private companies or others.

Furthermore, a number of member states have measures in place that, for example, restrict investments in the defense sector.¹¹⁶ In the light of the precise and unconditional nature of that Article 65, the European Court of Justice (ECJ) held in *Sanz de Lera and Others* that the codified principle of free movement of capital prohibits both restrictions between member states and between member states and third countries.¹¹⁷

The list of justification measures in Article 65(1)(b) TFEU is, however, not exhaustive. Whatever state invokes the coverage of Article 65(1)(b) on the grounds of ensuring public order or public security, that state *must* demonstrate that the means it used do not go beyond what is necessary to attain the stated end – this essentially establishes a proportionality test.

In *Test Claimants in the Franked Investment Income (FII) Group Litigation* case, the ECJ held that it may be the case that a member state will be able to demonstrate that a restriction on capital movements to or from third countries is justified for a particular reason. However, this must be in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between member states.¹¹⁸ To this end, the ECJ adopted in *Commission vs. Belgium* a test which is based on four criteria. In substance, the national measures must first aim at the protection of a legitimate general interest, and, secondly, must foresee strict time limits for the exercise of opposition rights. Thirdly, the assets or management decisions targeted must be specifically listed, and, fourthly, the system's objective and stable criteria must be subject to an effective review by the domestic courts.¹¹⁹

¹¹⁶ Several European countries (especially France, Italy, Germany, and Spain) actually maintain significant controls on foreign investment, such as overall limits on foreign shareholdings or the need for board members to be national citizens. See KATINKA BARYSCH & MARINA C. O'DONNELL, *FINMECCANICA, SOVEREIGN INVESTMENTS IN SENSITIVE SERVICES: THE CASE OF DEFENCE INDUSTRIES 27* (2010) (looking at European countries' controls and restrictions on investment in defense companies, e.g. France and the UK).

¹¹⁷ See generally *Sanz de Lera and Others*, *supra* note 110.

¹¹⁸ *Test Claimants in the FII Group Litigation*, *supra* note 111, at I-11753.

¹¹⁹ Case C-503/99, *Comm'n v. Belgium*, 2002 E.C.R. I-4809.

In analyzing whether such restrictions are justified, different considerations may apply than in the case of purely intra-Community restrictions.¹²⁰ For example, as of mid-2015 Article 65 of the TFEU has never been invoked in the context of SWFs. In other words, no member state has ever adopted a law restricting FDI from SWFs, nor has a member state ever enforced a decision rejecting an SWF investment while arguing the validity of the decision as an exception, under Article 65 of the TFEU, to the principal of freedom of capital movement under Article 64 of the Treaty of Lisbon. The infrequent use of Article 65 in this manner does not, however, lessen the need for a clarification of the scope of Article 65 of the TFEU's two exceptions. Because no member state has, as of yet, passed national-level legislation that would limit the SWFs, it is worthwhile ensuring that member states will not be tempted to make extensive use of it. To this end, a short-list of sensitive sectors where "enhanced scrutiny" is exercised over inflows of funds could be developed, as the French government has done,¹²¹ concerning whether investment is private or comes from a SWF, subsequently cementing free entry to all other sectors. Such a short-list could take the form of a paragraph added to Article 65 of the TFEU.

5. THE SOFT LAW DIMENSION OF THE EU INTERNAL MARKET

Because of such concerns among EU member states, the main European Institutions – the Council, the Commission, and the Parliament – decided in 2008 to formulate the basic principles that should shape the EU approach to SWFs investments in the internal market. In this respect, a consensus emerged among EU member states, electing not to create a new mechanism of control *ex nihilo*. Rather, members chose to rely on existing rules of the Common Market that enable member states to derogate from the principle of

¹²⁰ The reason is that the movements of capital to or from third countries take place in a different legal context from that which occurs within the Community. Particularly, the degree of legal integration that exists between member states of the European Union is not comparable to that of economic activities involving relations between member states and third countries. Test Claimants in the FII Group Litigation, *supra* note 111, at I-11831.

¹²¹ For a further discussion on the activities of the French government, see discussion *infra* Section 6.2.

freedom of movement of capital.¹²² In part, the consensus is the result of the incapacity of member states and the European Institutions to produce a new framework at the supra-national level. Confronted with this situation, the EU Institutions demonstrated a will to formulate an EU approach, albeit a minimal one, which has all the characteristics of a soft law approach.¹²³

5.1. Design and Main Feature of the EU Common Approach

SWF investment raises concerns because it highlights the importance of state activity in the global economy, which is perceived as detrimental to the role of market forces. SWFs may not make investment decisions for economic reasons, but instead may choose to invest for political purposes. Further, most countries that have set up SWFs are located in the developing world. This may ultimately result in a politicization of capital flows vis-à-vis SWFs. The range of reasons articulated by host countries for scrutinizing SWFs and State-Owned Entities (SOEs) more than private investors is indicated as follows.

Main Reasons to Scrutinize SWFs more than Private Investors

- Fears that countries, as controlling authorities of SWFs, invest in companies with a view to acquiring 'know how' (e.g., dual-use (civil and military) items and technologies; research, produce or trade in weapons; intellectual property);
- Danger of foreign investment in companies that are directly or indirectly involved with issues of national security (e.g., wire

¹²² See generally Julien Chaisse & Mitsuo Matsushita, *Maintaining the WTO's Supremacy in the International Trade Order: A Proposal to Refine and Revise the Role of the Trade Policy Review Mechanism*, 16 J. INT'L ECON. L. 9 (2013).

¹²³ For a fascinating, highly theoretical treatment of supranational legal standards, specifically the context in which commercial norms may self-standardize, see Bryan Druzin, *Anarchy, Order, and Trade: A Structuralist Account of Why a Global Commercial Legal Order is Emerging*, 47 VAND. J. TRANSNAT'L L. 1049, 1079-80 (2014) (contending that network effect pressures implicit in trade spontaneously stimulate the uniformity of legal standards). For earlier work in this vein, see Bryan H. Druzin, *Buying Commercial Law: Choice of law, Choice of Forum, and Network Effect*, 18 TUL. J. INT'L & COMP. L. 131, 149-56 (2009) (arguing that network effects induce standardization in choice of law and choice of forum clauses in transnational commercial contracts).

tapping and mail interception equipment; cryptology services; activities of firms entrusted with national defense secrets);

- Danger of foreign 'political' investments that create dependencies (e.g., in the energy sector; water);
- Lack of transparency in the investment policy of SWFs;
- The reciprocity issue: How can countries that invest in foreign companies via SWFs be prompted to adopt a less restrictive policy with regard to foreign investment in their own country (e.g., Russia, China and Vietnam)?

Source: Author, based on concerns frequently mentioned in the political debate

The European concerns about sovereign investments provide the background necessary to scrutinize the EU and member state reactions. Specifically, concerning EU integration, the most important question to ask is whether or not there is a need to regulate SWF investment at the international, supra-national (EU), or domestic level. And, if so, should legislators proceed through hard or soft law? From a substantive law perspective there are certain fundamental aspects of SWFs that must be addressed by the EU such as transparency, governance, and even SWFs investment criteria.

The proposals and policy initiatives from the stakeholders have varied widely – from calls for reciprocity in market access and for increased transparency in investment strategies, to full disclosure of assets. All these options have their own attendant risks. However, they each suffer from the fact that they send “a misleading signal – that the EU is stepping back from its commitment to an open investment regime. They would also be difficult to reconcile with EU law and international obligations.”¹²⁴

For instance, Röller and Véron have called for the EU to establish a committee on foreign investments that would essentially mirror arrangements in the United States.¹²⁵ They have also called for an EU-wide screening mechanism or some “golden shares”¹²⁶

¹²⁴ See *Commission Communication 2008*, *supra* note 16, at § 4.1.

¹²⁵ See Röller & Véron, *supra* note 14, at 7-8.

¹²⁶ These are non-standard shares, the ownership of which confers special rights on the holder. Recent landmark decisions of the European Court of Justice (ECJ) regarding compatibility of 'golden shares' with EC law are a clear indication that the concept of 'golden shares' violates one of the four fundamental freedoms

mechanism for non-EU foreign investment.¹²⁷ Röller and Véron argue that the EU should draw up legislation to regulate SWFs and other investment vehicles from emerging economies not classified as 'free' by Freedom House.¹²⁸ Such a mechanism is not anticipated at the EU supra-national level because member states wish to retain their power to screen foreign investments¹²⁹. This state of affairs may, however, change in the coming years when the Treaty of Lisbon¹³⁰ extends the scope of external trade policy to issues of investment. The implications of these essential innovations in EU international

conferred on individuals by the EU Treaty, namely the free movement of capital. The ECJ has held that an actual exercise of any rights attached to a 'golden share' by any public body must be based on criteria of non-discrimination and an effective legal remedy must be guaranteed. However, the ECJ's jurisprudence on golden shares does not present a straightforward prohibition of them. Instead, they set out strong limits on the use of golden shares. For consideration of golden shares under Belgian law, see Case C-503/99, *Comm'n v. Belgium*, 2002 O.J. (C 169) 4. For a judgment concerning golden shares under Portuguese law, see Case C-367/98, *Comm'n v. Portugal*, 2002 O.J. (C 169) 1 (in the view of the Court, Portugal could not plead any permissible ground for justification so the ECJ denied the justification in this case). For a judgment concerning golden shares under French law, see Case C-483/99, *Comm'n v. France*, 2002 O.J. (C 169) 3 (ECJ was confronted with a decree that allowed the French state, by means of a golden share, to secure influence over the *Société nationale Elf-Aquitaine* in such a manner as to require prior approval from the minister for economic affairs when a person's ownership in a company, acting alone or in conjunction with others, exceeded certain percentages of the total capital or voting rights of that company. As these gave too great a discretion to the decision makers, given the lack of sufficiently precise and objective criteria for authorization and consent, the ECJ rejected the justification both with regard to the prior authorization for certain stock acquisitions exceeding the ceilings and the right to oppose the transfer of certain assets or their use as security). See most recently Case C-543/08, *Comm'n v. Portugal (Energias de Portugal)*, 2010 O.J. (C 13)3 (providing judgment that Portugal's holding of golden shares in Energias de Portugal is contrary to EU law). See also Case C-98/01, *Comm'n v. United Kingdom*, 2003 O.J. (C-158) 4 (providing judgment concerning golden shares under English law); Case C-174/04, *Comm'n v. Italy*, 2005 O.J. (C 205) 4; Case C-284/04, *Comm'n v. The Netherlands*, 2006 O.J. (C 294) 6. For commentary, see Case C-463/00, *In re Golden Shares IV (Comm'n v. Spain)*, 2003 E.C.R. I-4581 (Ruiz-Jarabo Colomer, Advocate Gen.) (stating that share capital constitutes a restriction on the free movement of capital except if those restrictions can be justified). See generally Larry Catá Backer, *The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law*, 82 TUL. L. REV. 1801 (2008).

¹²⁷ See Röller & Véron, *supra* note 14, at 5.

¹²⁸ *Id.* at 2 and 5.

¹²⁹ See Frederic V. D. Berghe, *The EC's Common Commercial Policy Revisited: What Does Lisbon Add*, 4 GLOBAL TRADE & CUST. J. 277 (2009).

¹³⁰ Treaty of Lisbon: Amending the Treaty on European Union and the Treaty Establishing the European Communities, December 13, 2007, 2007 O.J. (C 306) [hereinafter Treaty of Lisbon] (came into force on December 1, 2009).

treaty-making powers, both on the international stage and in EU bilateral relations, might be significant and raise the question as to whether or not a US-style Committee on Foreign Investment (CFIUS) should be established in the EU.¹³¹

There is a clear consensus among the EU Institutions concerning the adoption of a common approach. The Commission took the initiative in a communication released in February 2008, which was supported by the European Council and the European Parliament in March 2008.¹³² This will be briefly described in the following paragraph. The substance of the EU approach will be discussed in the subsequent parts of this article.

The United States and the EU first discussed the question of SWFs at the meeting of the Transatlantic Economic Council held in Washington on November 9, 2007. At this meeting, both parties agreed to formally launch an Investment Dialogue to promote open investment regimes globally.¹³³ In February 2008, the Commission presented a communication, titled *A Common European Approach to Sovereign Wealth Funds*.¹³⁴ According to this 2008 Communication, new legislative measures at the Community level are unnecessary.

The Commission recommended a common approach premised on five key principles: (1) commitment to an open investment environment; (2) support of multilateral work; (3) use of existing instruments; (4) respect of EC Treaty (ECT) obligations and international commitments; and (5) proportionality and transparency. Further, the Commission set out some of the options vis-à-vis regulating SWF operations within the EU common market.

The strategies, data, and general information that funds agree to make available tend to differ enormously both in terms of scope and quality. These differences exacerbate the fear that SWF investment

¹³¹ Such an interesting research question would however raise a host of other issues, such as: Which EU institutions should be involved in the screening mechanism? Should the EU's highest authority in charge of rejecting FDI be the EU Council (subject to unanimity)? Should there be cooperation with National governments? Which intelligence services in the EU would be capable of alerting EU Institutions?

¹³² Presidency Conclusions, Brussels European Council ¶¶ 30-36 (March 13-14, 2008) [hereinafter Presidency Conclusions].

¹³³ As per the Report: "We note the growth of investments by government-controlled investors such as sovereign wealth funds. We welcome commercially-driven investment from these investors and note the importance of transparent investment policies." US-EU Summit, June 10, 2008, Brdo, Slov., *Transatlantic Economic Council Report to the E.U.-U.S. Summit 2008*, available at <http://georgewebush-whitehouse.archives.gov/news/releases/2008/06/20080610-4.html>.

¹³⁴ *Commission Communication 2008*, supra note 16. Note that Commission Communications to other EU Institutions are not legally binding.

could give foreign governments' excessive political influence over domestically active firms. Alternatively, if SWFs are transparent and comply with clear rules of accountability, then the mere fact of state-ownership should not give cause for concern. The Commission's communication advocates a common European approach based on cooperation between the countries hosting the SWFs, the funds themselves, and those responsible for them, all with a view to establishing "a set of principles ensuring the transparency, predictability and accountability of SWFs investments."¹³⁵ Further, all investors in the market should have to observe the same set of regulations that cover competition, the internal market, and employment law.¹³⁶ In addition, the various instruments that control foreign investments that the member states adopt in order to protect public security, law, and order must not conflict with EU primary law and directives. Further, the ECJ shall ultimately be the body tasked with scrutinizing conformity with the aforementioned principle.¹³⁷

By issuing the 2008 Communication, the Commission sought to avoid legislative action. Instead, it strove for soft measures – such as guidelines – accompanied by efforts at the international level to increase the transparency of SWFs. Since the Global Financial Crisis, there has been an increased need to attract liquidity to both Europe and the United States. In this regard, regulation is hardly the best response, as few requirements could be usefully imposed on SWFs. The EU has traditionally been an open investment environment that promotes a Common Market. The fundamental principle of free movement of capital, a cornerstone of the Common Market, was codified in the Treaty on European Union, popularly known as the Maastricht Treaty.¹³⁸ The basic tenet of this central principle is that companies that are authorized to conduct activities in one of the member countries (the state of origin)¹³⁹ must be able to sell their services or establish branches throughout the EU – thereby ensuring a common and accessible market. It is also important to note that the

¹³⁵ *Id.* at § 4.1.

¹³⁶ *Id.*

¹³⁷ *Id.* at § 3.1.

¹³⁸ Treaty on European Union, February 7, 1992, O.J. (C 191) 1. The full liberalization of capital movements in the EU was initially established in the Council Directive 88/361, 1988 O.J. (L 178) 5-18.

¹³⁹ For the scope and definition of the state of origin principle, see Armin Hatie, *Services Directive – A Legal Analysis*, 6 EUR. COMMUNITY STUD. ASSOC. AUS. PUB SERIES 1 (discussing the challenge of identifying the state of origin).

2008 Communication suggests that the common European approach is intended to merely complement the regulatory regimes adopted by member states governing transactions in their particular jurisdictions.

On March 4, 2008, the Council of the EU¹⁴⁰ held an exchange of views on issues relating to SWFs,¹⁴¹ with the purpose of furthering the discussion by the European Council¹⁴² at its spring meeting (March 13–14, 2008). The delegates agreed on the need for the EU to form a common position, as a means of ensuring that their shared objectives are met through the work of international fora. They further agreed that commitments by SWFs, in particular with regard to the separation of the management of SWFs from political authorities, should be central to any agreement at the global level. Ultimately, they determined that if international negotiations did not develop satisfactorily, further action should be considered at the EU level.

The European Council adopted the ideas set out by the Commission, clarifying two of the five principles encapsulated in the 2008 Communication. The Council's position differed in that, rather than expressing its support for the multilateral approach in general, it commented specifically on the work underway in the IMF and the OECD. Further, rather than referring to the use of the existing instruments, and once again taking a more general approach, the European Council thought it more appropriate to adopt use of national instruments and EU instruments.

At the Spring Summit on March 13 and 14, 2008, the European Council welcomed the Commission's communications on SWFs.¹⁴³ While taking into account national prerogatives, the European Council agreed on the need for a common European approach in line with the five principles proposed by the Commission, namely: (1) commitment to an open investment environment; (2) support for ongoing work in the IMF and the OECD; (3) use of national and EU

¹⁴⁰ The Council of the EU (also known as the Council of Ministers) is the EU's main decision-making body and has legislative power, which it shares with the European Parliament.

¹⁴¹ Council of the European Union, Economic and Financial Affairs, 2857th Council meeting, 7192/08, March 4, 2008.

¹⁴² The European Council is the supreme body of the European Union, the highest political representatives (Prime Ministers or Presidents) from all member states attend the Council's meetings. The European Council is responsible for defining the general political direction and priorities of the Union.

¹⁴³ Presidency Conclusions, *supra* note 132.

instruments if necessary; (4) respect for EC Treaty obligations and international commitments; and (5) proportionality and transparency. The European Council supported the objective of forming a consensus at the international level on a voluntary Code of Conduct for SWFs and defining principles for the recipient countries. In this respect, they reiterated the EU's "support for [the] ongoing work in the IMF [International Monetary Fund] and the OECD".¹⁴⁴ There was a clear rejection of a Europe-wide screening mechanism that would echo the system in the United States.

With the aim of providing coordinated input to this ongoing debate, the European Council invited¹⁴⁵ the Commission and the Council of the EU to continue their work along these lines, stressing the importance of a common EU approach to SWFs during debate at the international level. However, the European Council also strongly insisted that governments should be allowed to "make use of national and EU instruments if necessary" to counter foreign investments not justified for commercial reasons.¹⁴⁶

The European Parliament (EP) welcomed the 2008 Communication. The EP expressed its concern that:

[T]he lack of transparency of certain SWFs may not allow an accurate understanding of their structure and motivation requests the Commission to acknowledge the fact that transparency and disclosure are the key principle for the establishment of a truly level playing field and the smooth running of markets in general.¹⁴⁷

Somewhat earlier in the year, the EP had stated that the FTA, with the Gulf Cooperation Council, should seek to "promote increased transparency and accountability with regard to investments made by sovereign wealth funds".¹⁴⁸

Likewise, the European Economic and Social Committee (EESC) added its support for the European Commission's proposal. The EESC underscored that "the Commission should work together with the Member States and the supervisory authorities to improve

¹⁴⁴ *Id.* at ¶ 36.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ Resolution on Sovereign Wealth Funds, EUR. PARL. DOC.NO. P6_TA-PROV(2008)0355 (2008) at ¶E (translation from French).

¹⁴⁸ Resolution on the Free Trade Agreement between the European Community and the Gulf Cooperation Council, EUR. PARL. DOC. NO. P6_TA(2008)0355 (2008), at ¶ E12.

the transparency of these funds, understand their motives, and make sure they are not pursuing political objectives".¹⁴⁹ Prior to 2008, the EESC had noted that generally it "would urge the Commission to present, as soon as possible, its draft legislative provisions aimed at stepping up the information provided by institutional investors with regard to their policies in respect of investment and voting".¹⁵⁰

5.2. The EU's Support for a Multilateral Regulation

The first important feature of the EU approach towards SWFs is its support for multilateral solutions. This approach has been accepted and supported by all EU Institutions. Because SWFs are conceptualized as a global phenomenon rather than simply an intranational one, the EU perspective is that binding regulation needs to happen at a level above the EU itself. Given SWFs' international scope, the EU cooperates with other hosts on the one hand, and with SWFs and those responsible for them on the other. The European approach – the proposal encapsulated in the 2008 Communication and supported by all the other European Institutions – acknowledges this analysis and is well in-line with the EU's historical preference for multilateral bodies having a unilateral approach. Ultimately, the analytical inroad taken by the EU is important because it provides support for the work by the IMF and the OECD.

Unilateral action by the EU could be disastrous for many reasons. Obviously, it can be seen as, or even strategically argued that it is, necessarily, a protectionist policy. Further, unilateral actions have the potential to proliferate, contributing to the creation of a multitude of irreconcilable standards across jurisdictions. This could impose undue compliance costs on SWFs, which would in turn affect the efficient flow of capital.

For the aforementioned reasons, some argue that it not opportune to adopt a narrow European approach. Rather, the 2008 Communication seeks an international and global solution. The EU is thus playing an active role in ensuring that the work of the

¹⁴⁹ Opinion of the Section for Economic and Monetary Union and Social Cohesion, European and Social Committee, on 'Financial Integration: The Case of European Stock Markets', CESE 283/2008 ¶ 1.5, available at <http://www.eesc.europa.eu/?i=portal.en.eco-opinions.14069>.

¹⁵⁰ Opinion of the Section for Single Market, Production and Consumption, European Economic and Social Committee, on 'Review of the Single Market' ¶ 1.1.15, 2007 O.J. (C 93).

multilateral bodies moves forward. The Commission strives towards finding a code of conduct that would be developed at the global level both by the host countries and the SWFs themselves. A voluntary code of conduct that enshrines basic standards for governance and transparency would ensure greater clarity in the functioning of SWFs. The 2008 Communication clearly recognizes the import of “obtain[ing] greater clarity and insight into the governance of SWFs . . . [and] deliver[ing] greater transparency on their activities and investments”,¹⁵¹

In October 2007, the G7 Finance Ministers made a call for major multilateral organizations to reflect upon the growing role of SWFs and regulatory issues. The G7 specifically mentioned the IMF and the OECD.¹⁵² Since March 2008, when the Council signaled its support for this approach, the Commission has been actively involved in the work of the IMF and the OECD concerning the establishment of SWF best practices.¹⁵³ Since the G7 summit, the activities of the IMF and the OECD have run parallel and, while they are not dealing with exactly the same themes, they are generally complementary. The OECD Working Group’s efforts have complemented the above – they have attempted to determine how host countries should respond to the SWFs investments. It has more or less determined that most host countries want to identify the best practice with respect to SWF investment frameworks, building on

¹⁵¹ *Commission Communication 2008*, *supra* note 16, at § 4.3.

¹⁵² Statement of G7 Finance Ministers and Central Bank of Governors, Washington, D.C. (October 19, 2007), *available at* <http://www.g8.utoronto.ca/finance/fm071019.htm>. In the statement, the G7/8 Finance Ministers noted that:

Cross-border, market-based investment is a major contributor to robust global growth. In this context, we agreed that sovereign wealth funds (SWFs) are increasingly important participants in the international financial system and that our economies can benefit from openness to SWF investment flows. We see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability. For recipients of government-controlled investments, we think it is important to build on principles such as nondiscrimination, transparency, and predictability We ask the IMF, World Bank, and OECD to examine these issues.

¹⁵³ Since 1960, the Commission of the European Community has had quasi-member status with the OECD. The members of the EC delegation thus sit in on the OECD’s various specialized committees that monitor the work of the Secretariat. Further, the signatory states decided that the Commission of the European Community “shall take part in the work” of the OECD. OECD, Convention on the OECD, December 14, 1960.

the key principles of non-discrimination, accountability, transparency, and predictability.¹⁵⁴

At the OECD Ministerial Council Meeting in Paris, the Ministers adopted the OECD's Declaration on SWFs and Recipient State Policies. The *Declaration* reiterated, "SWFs have become a key player in the new financial".¹⁵⁵ The Ministers formally recognized the financial benefits that SWFs bring to the home and the host economies. Such a statement clearly implies that protectionist barriers to foreign investments, be they from SWFs or otherwise, would hamper the growth which is vital to many economies. They underscored the value of the Investment Committee report on SWFs, which should guide the investment policies of recipient countries with a view to preserve and even expand an environment for SWFs that is as open as possible, while protecting national security interests.

The OECD's *Declaration on Sovereign Wealth Funds and Recipient State Policies* was published in October 2008.¹⁵⁶ These guidelines draw on the OECD's extensive work on the treatment of foreign investment in the OECD economies. OECD work also draws on the 2005 OECD Guidelines for Corporate Governance of State Owned Enterprises.¹⁵⁷ The OECD guidance on host state policies regulating SWFs plays a pivotal role in shaping the fundamental principle of non-discrimination. Ultimately, governments should be guided by the principle of non-discrimination when making decisions on SWF investment, as well as by the principles of transparency, regulatory proportionality, and accountability.

Another important issue is that of *investment reciprocity*. Currently, there are concerns about both the quantity and quality of restrictions on investments which EU firms may face when they want to invest abroad, such as in China or Russia. This ultimately poses the question: How can countries that invest in foreign companies via SWFs be moved to adopt less restrictive policies

¹⁵⁴ For dissection of the work of the OECD, see Edwin M. Truman, *OECD Guidance on Sovereign Wealth Funds: Still Falling Short* (2008), available at <http://www.pie.com/realtime/?p=189> (praising the OECD for their improved treatment of SWFs but expressing continuing disappointment that they did not "move further to strengthen the openness of their investment regimes").

¹⁵⁵ OECD, DECLARATION ON SOVEREIGN WEALTH FUNDS AND RECIPIENT STATE POLICIES 1 (2008) [hereinafter GUIDELINES 2008].

¹⁵⁶ *Id.*

¹⁵⁷ OECD, GUIDELINES FOR CORPORATE GOVERNANCE OF STATE OWNED ENTERPRISES 1 (2005) [hereinafter GUIDELINES 2005], available at <http://www.oecd.org/dataoecd/46/51/34803211.pdf>.

concerning foreign investment in their own countries? Luxembourg's Finance Minister Jean-Claude Juncker has led the charge in the EU, clearly tying his resistance to SWFs from Russia to fears concerning investment reciprocity. Juncker has stated that it is unacceptable for the Russian government's fund to be welcomed in the Common Market while European companies are unable to undertake similar activities in Russia.¹⁵⁸ Further, Juncker has argued that the EU should respect the principle of reciprocity and that it would be dangerous to leave everything up to the market.¹⁵⁹ He has gone on to say that it is necessary to take strong political action to strengthen surveillance and to ensure transparency in financial markets.¹⁶⁰

Some countries that sponsor SWFs impose severe restrictions on Inward Foreign Direct investment (IFDI) by individuals and firms from the EU and other OECD countries such as Russia and China. Ultimately, the prerogative of SWFs to invest a large portion of their assets in the EU creates an opportunity to press restrictive home countries to open up their respective economies to inward foreign investment. Currently, the EU wants to ensure that there is a level playing field across every aspect of economic cooperation – with particular attention to the energy sector as a prime area of cooperation between the EU and Russia. Whereas Russia wants each sphere to be treated separately in terms of volumes of investments.¹⁶¹

Furthermore, both the European Commission and the European Council have stressed the necessity of guaranteeing independence of management, as well as transparency of both ownership structure and the interests of SWFs.¹⁶² Discussions about SWFs and their investments in the EU can potentially create leverage to limit Russian investments in the EU if the EU's views on reciprocity are not taken into account. Because many SWFs are located in countries

¹⁵⁸ Robert Amsterdam, *Europe Wary of Russia's Sovereign Wealth* (2008) (quoting Juncker), available at http://robertamsterdam.com/2008/02/europe_wary_of_russias_sovereign_wealth_funds/.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ Edwin M. Truman *et al.*, *SOVEREIGN WEALTH FUNDS: THREAT OR SALVATION* 67 (2010).

¹⁶² See *Commission Communication 2008*, *supra* note 16 (outlining the EU approach to SWFs and its attempt to encourage them while managing the concerns they raise); see also Council of the European Union, Economic and Financial Affairs, 2857th Council meeting, 7192/08, March 4, 2008 (stating the EU's desire to establish a common approach to SWFs and their intention to do so at a later meeting).

that are financially less open to foreign investment than typical OECD countries, the immediate effect of a strict application of the reciprocity principle could be to place strong limitations on some SWFs' investment.

During OECD discussions on SWFs, the European Commission did not offer any proposals speaking to its previously discussed interest in reciprocity. One reason why the EC did not include any proposals addressing reciprocity is perhaps linked to the fact that the EU is the biggest international investor.¹⁶³ Thus, there would be no significant gain for EU investors as they already seem to have secured adequate access to foreign markets. Further, the reciprocity requirement could potentially be interpreted as negative – demands for reciprocity could potentially be perceived as an excuse for engaging in protectionism. Restricting investment risks retribution from countries with SWFs – this includes Russia and China, where European companies are active. Further, avoiding reciprocity has been an important OECD policy prerogative – as a result, OECD guidance on host state policies covering SWF investment does not include any demand for reciprocity.¹⁶⁴

The European Community is not a member of the IMF. However “the creation of the euro [(€)] gave a strong impetus to”¹⁶⁵ coordinate policy with the IMF. Thus, EU member states have “set up a multi-layered structure of coordination, composed of a Brussels-based committee”¹⁶⁶ and an informal group of member states' officials who meet in Washington, D.C.¹⁶⁷ This system, driven by the United States and the EU, strives to draw up a code of best practice that includes a renunciation of political motives; however, it has stirred resentment among some countries with SWFs,

¹⁶³ By 2014, the EU's outward FDI totaled US\$ 3.88 trillion, down from US\$ 9.15 trillion, while EU inward FDI amounted to US\$ 3.6 trillion, down from US\$ 5.36 trillion. See most recent data from UNCTAD data July 2015, *available at* <http://unctadstat.unctad.org/>.

¹⁶⁴ The OECD instruments are based on the philosophy that liberalization is beneficial to all, especially countries that undergo liberalization. *E.g.*, GUIDELINES 2008, *supra* note 155.

¹⁶⁵ ADS INSIGHT, EUROPEAN COORDINATION AT THE WORLD BANK AND INTERNATIONAL MONETARY FUND: A QUESTION OF HARMONY? 8 (2006), *available at* http://www.eurodad.org/uploadedfiles/whats_new/reports/eurodad%20euifigovernance.pdf.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

particularly in China and some Gulf countries.¹⁶⁸ This code was criticized at the 2008 World Economic Forum, where representatives of some of the Gulf funds deemed it both unnecessary and intrusive, as “the investment funds had never done anything to arouse suspicion”.¹⁶⁹ Similarly, “Chinese officials have also been quoted as saying that the best practice idea [is] unnecessary”.¹⁷⁰

The IMF’s challenge from the onset has been to find the best way to advance calls for increased SWF disclosure. This concern has gained traction in the wake of the Global Financial Crisis. The IMF has, *inter alia*, wrestled with determining the best way of addressing calls for increased SWF disclosure. This issue cannot simply be framed as a threat to withdraw the privilege of investing in Western markets. Ultimately, many countries with large SWFs are tired of being lectured to. Further, given global imbalances and the funding needs of a capitalist economic system, such threats are likely to be ineffective. In the same vein, the International Working Group of Sovereign Wealth Funds (IWG) has had to overcome objections by members that articulate the fear that the adoption of any set of principles will in effect validate overarching concerns *vis-à-vis* the activities of SWFs. Ultimately, SWFs have been reluctant to adopt practices that put them at a comparative disadvantage with other investors, particularly concerning the confidentiality of their investments.¹⁷¹

In October 2008, despite the difficulties described above, the IMF issued a set of twenty-four voluntary principles, popularly known as the *Santiago Principles*, for SWFs to follow. These *Principles*

¹⁶⁸ See Suwaidi *Critical of IMF Attempt to Monitor SWF Investments in West*, EMIRATES 24/7, May 9, 2008, available at <http://www.emirates247.com/2.291/suwaidi-critical-of-imf-attempt-to-monitor-swf-investments-in-west-2008-05-09-1.226998>. (reporting that “[t]he UAE [United Arab Emirates] has criticized the International Monetary Fund (IMF) for its decision to interfere in the activities of the sovereign wealth funds (SWFs), branding it a politically motivated move. Central Bank Governor Sultan bin Nassir Al Suwaidi said the IMF lacks sufficient experience in such issues and its involvement following Western pressure could discourage further SWF investment in the United States Al Suwaidi’s address was on behalf of the UAE and other Arab central bank governors representing their countries at the meeting. The states he represented included Bahrain, Egypt, Qatar, Jordan, Kuwait, Iraq, Lebanon, Libya, Oman, Syria, and Yemen.”).

¹⁶⁹ Steven R. Weisman, *Government Funds Promise to Avoid ‘Geopolitical Goals’*, N.Y. TIMES, Mar. 21, 2008, available at <http://www.nytimes.com/2008/03/21/business/worldbusiness/21iht-sovereign.1.11312313.html>.

¹⁷⁰ *Id.*

¹⁷¹ Mehmet Caner & Thomas J. Grennes, *Sovereign Wealth Funds: The Norwegian Experience*, 33 THE WORLD ECON. 597 (2010) [hereinafter Caner & Grennes].

address some of the concerns raised by host countries while ensuring SWFs' competitiveness in global financial markets.¹⁷² The *Santiago Principles* encourage SWFs to explain their investment criteria¹⁷³ as well as recommend that host countries set-up investment policies for the SWFs, so that they can avoid buying stakes in sensitive companies,¹⁷⁴ such as Western defense contractors. At the same time that the IMF approved the *Santiago Principles*, the IWG also voted to create a standing committee charged with updating the *Santiago Principles* over time as well as liaising with Western governments and institutions, such as the World Bank and IMF, on issues of concern.¹⁷⁵ The *Santiago Principles* make repeated reference to the need for greater transparency.¹⁷⁶ The *Principles* include recommendations that sovereign funds coordinate their activities with their respective governments and central banks to avoid interfering with domestic economic policy.¹⁷⁷ Further, they urge SWFs to disclose their sources of funding as well as the conditions under which their controlling authorities can withdraw the committed funds.¹⁷⁸ They also urge SWFs to ensure that SWF managers are independent of the fund-controlling authorities, but fully accountable, *e.g.*, that they publish annual reports and undergo annual audits.¹⁷⁹

Throughout the IMF negotiations the EU's position mainly covered issues of transparency and governance. As reported by the European Commission, "[s]ince SWFs are managed independently

¹⁷² INT'L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS GENERALLY ACCEPTED PRINCIPLES AND PRACTICES: "SANTIAGO PRINCIPLES" 3 (2008), available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf> [hereinafter SANTIAGO PRINCIPLES].

¹⁷³ *Id.* at 4, 22-23 (explaining Principle 21 and the purpose of the GAPP [Generally Accepted Principles and Practices]).

¹⁷⁴ *Id.* at 20, (Principle 18 explains that the investment policy should give guidance on the SWF's risk tolerance by covering topics such as: permissible asset classes, investment parameters, "concentration risk with regard to individual holdings, liquidity, and geographical and sectoral concentration", and strategic asset allocation).

¹⁷⁵ IMF, *International Working Group of Sovereign Wealth Funds Presents the "Santiago Principles" to the International Monetary and Financial Committee*, Press Release No. 08/06, Washington, D.C., October 11, 2008.

¹⁷⁶ See, *e.g.*, SANTIAGO PRINCIPLES, *supra* note 172 (referencing the need for greater transparency 14 times in total).

¹⁷⁷ SANTIAGO PRINCIPLES, *supra* note 172, at 11 (Section A: Legal Framework, Objectives and Coordination with Macroeconomic Policies).

¹⁷⁸ *Id.* at 13 (Principle 4).

¹⁷⁹ *Id.* at 16 (Principle 9).

from a state's foreign exchange reserves, they are excluded from transparency mechanisms such as the IMF maintains for foreign exchange reserves"¹⁸⁰ However, looking at the available data on SWFs, an SWF's general lack of transparency has some correlation with whether the government controlling the fund is democratic or autocratic.¹⁸¹ Democratic governments typically have to meet, in their governance and in their institutions, transparency standards that dictatorships do not. But because a fair number of countries with SWFs can be considered 'non-democratic,' SWFs' general lack of transparency makes host countries fear that non-commercial strategic, political, and social factors may overwhelmingly inform their investment decisions. Transparency, as stipulated by the Commission, can be understood as a requirement for the publication of statistics and data as follows.

Transparency as Suggested by the EU Approach

- Transparency practices that could be considered would include:
 - Annual disclosure of investment positions and asset allocation, in particular for investments for which there is majority ownership;
 - Exercise of ownership rights;
 - Disclosure of the use of leverage and of the currency composition;
 - Size and source of an entity's resources;
 - Disclosure of the home state regulation and oversight governing the SWF.

Source: Author's elaboration on principles and policies encapsulated by the 2008 Communication, supra note 1.

The Santiago Principles have been taken into account very seriously by the EU. Notably, the EU-Singapore FTA gives special attention to SWFs, which are included in the Institutional, General and Final Provisions Chapters. Article 17.8 of the FTA indicates "[e]ach Party shall encourage its sovereign wealth funds to respect the Generally Accepted Principles and Practices – Santiago

¹⁸⁰ *Commission Communication 2008, supra note 16, at 10.*

¹⁸¹ *Sovereign Wealth Funds, Foreign Policy Consequences in an Era of New Money: Hearing Before S. Foreign Relations Comm., 110th Cong. 9-10 (2008), (prepared statement of Jagdish Bhagwati, Senior Fellow, Int'l Economics, Council on Foreign Relations).*

Principles."¹⁸² This is important, as the soft law rules developed by the IMF are now incorporated in a binding treaty signed by the EU and may further encourage parties to respect the international guidelines.

More generally, the criteria mentioned in the EU approach are fundamental because they could serve to effectively reinforce the transparency requirement. The Singaporean SWFs, Temasek, and Government of Singapore Investment Corporation (GIC) were the first SWFs set up by national governments and both are notorious for their lack of transparency.¹⁸³ Their main purpose was to recycle Singapore foreign reserves through state investment vehicles with a goal of underpinning an overall vision of national economic development.¹⁸⁴ Temasek in particular has been exporting this strategic investment approach overseas; the Singaporean approach has been a major influence on China's emerging overseas investment strategy.¹⁸⁵

It is tempting to also refer to successful models that have proved to be even more transparent. One such example is the Norwegian Pension Fund (NPF), which is often held up as the benchmark for higher transparency and governance. Information on its global performance and risk exposure is reported quarterly and its holdings in approximately 3,500 companies are detailed annually¹⁸⁶— in most cases, its investment in any one company amounts to less than 1% of available shares.¹⁸⁷ The NPF does not seek to control companies through buy-outs. By its own rules the fund restricts its ownership in any company it invests in by limiting

¹⁸² European Commission, EU-Singapore Free Trade Agreement (June 29, 2015), <http://trade.ec.europa.eu/doclib/press/index.cfm?id=961>.

¹⁸³ *Id.* at 10.

¹⁸⁴ Garry Rodan *et al.*, *THE POLITICAL ECONOMY OF SOUTH-EAST ASIA: AN INTRODUCTION 1* (2006).

¹⁸⁵ See, e.g., John Burton, *Singapore's Wealth Fund Flattered by Imitation*, *FIN. TIMES*, Sept. 5, 2007, available at <http://www.ft.com/intl/cms/s/0/0a50515c-5b4b-11dc-8c32-0000779fd2ac.html#axzz3pYLhsCf6>.

¹⁸⁶ Norwegian Pension Fund Public reporting obligations are detailed in Government Pension Fund Act (no. 123 of December 21, 2005). The Act is further detailed by supplementary provisions on the management of the Government Pension Fund, especially Section 7-1: Public reports on the management of the Fund available at <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/the-guidelines-for-the-management-of-the.html?id=434605#7> (last visited Jan. 1, 2011).

¹⁸⁷ Norwegian Ministry of Finance, *The Management of the Government Pension Fund in 2010*, at 10 and 38 available at http://www.regjeringen.no/Upload/FIN/Statens%20pensjonsfond/2011/NBIM_2010_eng.pdf.

the acquisition of any rights to 10% of the outstanding shares.¹⁸⁸ Thus, the NPF's investment objectives are purely financial in nature and focused on safeguarding assets for the long term.¹⁸⁹

Another prime example is the Irish National Pension Reserve Fund (INPRF), which publishes its investment strategy in an annual report.¹⁹⁰ Although relatively modest, as of mid-2015 it has assets totaling approximately USD 20.8 billion, the INPRF publishes its investment strategy every quarter. These quarterly publications detail its investment conduits and agents, as well as an audited annual report of its holdings in every company. Commitment to publications such as these is fundamental to any measure of transparency; it ensures that both the information regarding the shares which a fund holds as well as the strategy which the fund employs is readily available.

However, beyond requirements of transparency, issues concerning the nature of state influence on SWFs are bound to surface. For example, a powerful state may establish a degree of order in business and state affairs. In such a case, a formal requirement of transparency will lead to *actual* transparency. However, this situation is different in Middle Eastern countries¹⁹¹ and in Russia¹⁹² where the states are perhaps not capable of guaranteeing that there will be no problems, notably because of the limits of the rule of law.

In any case, transparency cannot be unilateral—the ideal equation requires a bilateral process. For SWFs themselves, clarity

¹⁸⁸ The Ministry of Finance decided to increase the limit on ownership stakes from the initial 5% to 10%, but that does not alter the NPF's role as a financial investor. Indeed, on average in 2010, the Fund owned considerably less than 1% of each company in the portfolio. *Id.*

¹⁸⁹ See generally Caner & Grennes, *supra* note 171.

¹⁹⁰ For annual reports on the Irish National Pension Reserve Fund see ANNUAL REPORTS, IRISH NAT'L PENSION RESERVE FUND 1, available at <http://www.nprf/Publications/annualReports.htm> (last visited July 28, 2015).

¹⁹¹ See Eugene Cotran et al., THE RULE OF LAW IN THE MIDDLE EAST AND THE ISLAMIC WORLD: HUMAN RIGHTS AND THE JUDICIAL PROCESS 168 (2000) (explaining that the rule of law is still at an embryonic stage in the Middle East and that the 2011 upheaval sweeping the Middle East was driven by the people's demand for a voice in the decisions that affect their lives and for a society that abides by the rule of law).

¹⁹² The issue in Russia is not the existence of the laws, which actually are numerous and well drafted, but rather the need to improve judicial institutions (lack of respect for courts decisions, subsequent shortcomings in implementing laws, and corruption). See generally Jeffrey Kahn, *The Search for the Rule of Law in Russia*, 37 GEO. J. INT'L L. 353 (2006).

will mean stability and will reduce the risk of serious setbacks. For those national economies in which the SWFs are investing, a stable, predictable, and non-discriminatory framework will eliminate the risk of important investors voting with their feet—in other words, leaving Europe and investing elsewhere. The EU approach could further gain in popularity if it is revised to place a greater emphasis on the reasons undergirding the need for transparency.

In terms of governance, some international standards already exist. For example, the IMF's Guidelines for Foreign Exchange Reserve Management lay down important principles that could be extended to SWFs.¹⁹³ Likewise, the OECD's Guidelines on Corporate Governance of State-Owned Enterprises put forward principles relevant for SWFs that undertake cross-border investments¹⁹⁴ as underscored by the European Commission communication on SWFs.¹⁹⁵

Additionally, it has been observed that "SWFs do not meet the standards set by local financial institutions, which demand rigid governance structures and disclosure. As a result, we can infer that if SWFs align their governance practices with those of the local financial institutions, legitimacy would be granted."¹⁹⁶

The standards for SWFs should clearly set out: (1) the role of the government as well as the managers of the investment mechanism; (2) the entity to set the policies; and (3) ultimately provide benchmarks for accountability measures and how those policies are executed. In its approach, the EU has identified four principles of good governance as follows.

EU Principles of Good Governance Applicable to SWFs

- Principles of good governance include:
 - The clear allocation and separation of responsibilities in the internal governance structure of a SWF (e.g., operational

¹⁹³ INT'L MONETARY FUND, GUIDELINES FOR FOREIGN EXCHANGE RESERVE MANAGEMENT 1 (2001), available at <http://www.imf.org/external/np/mae/ferm/eng/index.htm>.

¹⁹⁴ GUIDELINES 2005, *supra* note 157.

¹⁹⁵ *Commission Communication 2008*, *supra* note 16, at 9.

¹⁹⁶ Ashby Monk, RECASTING THE SOVEREIGN WEALTH FUND DEBATE: TRUST, LEGITIMACY, AND GOVERNANCE 13 (Oxford Univ. Ctr. For the Env't Working Papers in Emp't, Work and Fin. No. WPG08-14, 2008) (providing a case study of the China Investment Corporation and ultimately criticizing it in the quoted conceptualization of how governance affects and is informed by legitimacy).

- autonomy of the SWF; disclosure of the general principles of internal governance that provide assurances of integrity);
- The development and issuance of an investment policy that defines the overall objectives of SWF investment (e.g., disclosure of investment positions; disclosure of the currency composition of investments; operational autonomy to achieve SWF defined objectives);
 - The disclosure of the general principles governing a SWF's relationship with governmental authority (essentially the separation of the management of SWF from political authorities); and
 - The development and issuance of risk-management policies (e.g., policies, procedures and models used by the risk managers).

Source: Author's understanding of the principles and policies enunciated in Commission Communication 2008, supra note 16.

6. ASSESSING THE RISKS OF EUROPEAN PROTECTIONISM

The recurring debate concerning SWFs may suggest that there are few rules that are presently in place to regulate them. However, this is not the case. As underscored in its 2008 *Communication*, EU law provides a comprehensive regime to regulate both the establishment and the actions of foreign investors, which ultimately "covers SWFs in exactly the same way as any other foreign investor."¹⁹⁷ This regime has not been weakened by the Treaty of Lisbon.¹⁹⁸ Further, the TFEU provides the EU with the legal framework and tools necessary to meet future challenges.¹⁹⁹

Recent experience shows that the opaque structures of some SWFs' risk prompting defensive reactions from host countries. In 2008, the Italian government announced that SWFs wanting to buy shares in Italian companies should generally stay below 5%, suggesting that a new law would be passed to this effect.²⁰⁰ This was

¹⁹⁷ *Commission Communication 2008, supra note 16, at 7* (§ 3.1).

¹⁹⁸ Treaty of Lisbon, *supra note 130*.

¹⁹⁹ Herein we adopt the renumbering of provisions of the Treaty on the Functioning of the European Union. TFEU, *supra note 109*.

²⁰⁰ Guy Dinmore, *Italy Set to Curb Sovereign Wealth Funds* FIN. TIMES Oct. 21, 2008, available at <http://www.ft.com/intl/cms/s/0/1709cf92-9f09-11dd-98bd-000077b07658.html#axzz3pYLhsCf6>.

a reaction to the purchase by Libya, a former Italian colony, of a 4.23% stake in the second largest Italian bank, UniCredit SpA.²⁰¹ However, shortly after this announcement, Foreign Minister Franco Frattini said that there is no need for a threshold, but rather that there is need for transparency.²⁰² Such an abrupt change in direction can be interpreted as the abandonment of any plan to pass a new domestic law (confirmed by the fact that, since 2008, no relevant change in Italian law has occurred), and to refer to the multilateral approach supported at the supranational level by the EU. In fact, Italy waited until March 2012 before deciding to introduce a new law that gives special power to review foreign investment to the Government.²⁰³ The law distinguishes between two sectors, which receive different types of scrutiny and consequences. The law does not define the sectors clearly but requires that the government specify which are the strategic security activities for the defense sector²⁰⁴ and which are the networks, power-plants and assets of strategic relevance for the energy, transportation and communications a minimum of every three years.²⁰⁵ In the case of a real threat to the essential interests of defense and national security, the government can impose conditions with respect to the security of the procurements, transfer of technology, etc.,²⁰⁶ veto mergers and acquisitions,²⁰⁷ and oppose the transfer of ownership of shares from a company that operates in strategic activities relevant for the national security to entities that might acquire ownership and voting rights in order to compromise defense and national security.²⁰⁸ The government can also veto board and shareholder decisions or transactions that pose a serious threat to the public interest in the safety and operation of the networks and plants, and to the continuity of the procurement of the service.²⁰⁹ At this stage,

²⁰¹ *Id.*

²⁰² *No Need to Cap Sovereign Fund Holdings*, REUTERS, Oct. 23, 2008, available at <http://in.reuters.com/article/2008/10/23/italy-funds-frattini-id-INRAT00420320081023>.

²⁰³ Law decree 21/2012 amended and converted into law L. 11 maggio 2012, n. 56, GAZZETTA UFFICIALE, May 11, 2012, available at <http://www.gazzettaufficiale.it/gunewsletter/dettaglio.jsp?service=1&datagu=2012-03-15&task=dettaglio&numgu=63&redaz=012G0040&tmstp=1332753773322>.

²⁰⁴ *Id.* at Art. 1.

²⁰⁵ *Id.* at Art. 2.

²⁰⁶ *Id.* at Art. 1, comma 1.

²⁰⁷ *Id.* at Art. 1, comma 2.

²⁰⁸ *Id.* at Art. 1, comma 3.

²⁰⁹ *Id.* at Art. 2, comma 3.

the analyzed provisions do not seem to create a serious protectionist barrier to foreign investors because the law has been enforced in many operations involving State-Controlled Entities (SCEs) have occurred in Italy.²¹⁰

The United Kingdom and France, however, have already introduced legislation that would allow them to fend off investments from SWFs.²¹¹ Germany passed a new law that came into force in April 2009. All three examples are further explored below.

We think that any discussion of foreign investment by SWFs must recognize the differences in investment objectives between different types of SCEs.²¹² These differences in investment objectives justify, at the European level, permitting countries to adopt minimal safeguard provisions. Accommodating for such minimal safeguard provisions would provide a means of oversight for the few exceptional cases, and filter out possible threats to national security interests. In other words, the twenty-seven member states of the EU should have the power to block investments only in sensitive, security-related sectors. Restricting the flow of capital for other reasons will lead to infringement proceedings launched by the Commission against any member state that fails to comply with EU law and regulations.²¹³

Such national measures should not contradict the common European approach advocated by the Commission on the basis of

²¹⁰ See *Mubadala Completes 100% Takeover of Piaggio*, ARABIAN AEROSPACE, Sept. 18, 2015, available at <http://www.arabianaerospace.aero/mubadala-completes-100-takeover-of-piaggio.html> (reporting that the Mubadala Development Company has acquired total control of Piaggio Aereo SpA); Francesca Landini, *CDP Inks Final Deal to Sell Italy's Grid Assets to China*, REUTERS, Nov. 27, 2014, available at <http://www.reuters.com/article/2014/11/27/italy-china-grid-assets-idUSI6N0T002220141127> (reporting that the State Grid corporation of China has signed a preliminary agreement for the acquisition of 35% shares in CDP Reti).

²¹¹ In the UK, Enterprise Act of 2002, 2002, c. 40 (U.K.) [hereinafter Enterprise Act] (stating multi fair competition related objects and purposes of the Act). In France, Décret 2005-1739, *infra* note 230. In Germany, Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung vom [Thirteenth Law Amending the Foreign Trade and Payments Act], April 18, 2009, BGBl. I at 1150 (Ger.), available at http://www.hohmann-partner.com/rechtsvorschriften/2010/awg_englisch-2009.pdf. Both were enacted as of mid-2011.

²¹² Greene & Yeager, *supra* note 43, at 247.

²¹³ Article 258 TFEU regulates the infringement proceedings against a Member State, which in the opinion of the Commission infringes Community law. The Commission can try to bring the infringement to an end, and, if necessary, may refer the case to the ECJ.

the principles supported by the European Council. All national measures must be envisaged in the context of a common European approach, which they should complement. Europe must avoid any uncoordinated responses that could send the wrong message about the EU stepping back from its commitment to being a welcoming environment for investments.

For these reasons there is a need for the Commission to analyze the existing initiatives, establish effective coordination, and ensure that that coordination does not encroach upon national prerogatives and competences in terms of protection. This analysis of European practices should be undertaken and directed by the European Commission Directorate General for Economic and Financial Affairs. We will detail existing laws in three countries of the EU: the United Kingdom, France, and Germany. These three countries appear to be the most relevant examples because they are the main destinations for investment within the EU, while simultaneously being three important actors in the decision-making process within the EU. Whether or not a United States-style regime—encapsulated by the CFIUS—should be established in the EU, any such decision would require the support of these three countries.

6.1. Control of foreign takeovers in the United Kingdom

In the United Kingdom, corporate M&As can, in principle, be reviewed for the purpose of protecting investors and ensuring fair competition through the Enterprise Act of 2002.²¹⁴ A merger situation can be considered under the competition legislation if either or both of the following tests are satisfied: (1) an acquisition of a UK enterprise valued in excess of £70 million, or (2) the resulting combined business will account for more than 25% of a supply market of a good or service within the United Kingdom or a substantial part of it. The substantive test applied to the merger is whether it may be expected to result in a substantial lessening of competition as a result of the transaction.²¹⁵

The government can intervene in M&As in areas of national security and the media if acquisition is deemed to be against the

²¹⁴ See Enterprise Act, *supra* note 212 (stating multi fair competition related objects and purposes of the Act); see generally Cosmo Graham, *The Enterprise Act 2002 and Competition Law*, 67 MOD. L. REV. 273 (2004) [hereinafter Graham].

²¹⁵ See Graham, *supra* note 215, at 277.

public interest.²¹⁶ Among many other things,²¹⁷ the Enterprise Act 2002 makes the United Kingdom's Competition Commission determinative in merger cases and in market investigations – which replace the complex monopoly investigations established under the Fair Trading Act 1973—and which change the substantive question for these investigations. While the inquiry used to be whether particular matters operate or might operate against the public interest,²¹⁸ the Enterprise Act of 2002 changes the inquiry to turn on one of four tests. The first is a *qualified public interest test*, which applies in cases that raise specific public interest issues (e.g., national security or media).²¹⁹ The second is a *test of prejudice in the context of water enterprises*, which is applied by the Office of Water Supply's ability to make comparisons between water enterprises in the context of mergers between water companies.²²⁰ This test is particularly relevant in relation to increasing investment by SWFs in the water services sector.²²¹ The third test is a *substantial lessening of competition test*. It applies to all other mergers not covered by the first two tests.²²² The final test is an *adverse effects on competition test*. This

²¹⁶ See Enterprise Act, *supra* note 212, at § 58 (U.K.) (stating the statutory provisions for the United Kingdom's merger regime); The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008, 2008, SI 2008/2645 (adding the category 'the interest of maintaining the stability of the UK financial system' as a new consideration.); Dep't for Business, Enterprise & Regulatory Reform press notice, 2008, s42(3) (confirming the intention to amend the Act and empowering it to instruct the Office of Fair Trading to report on its assessment of the merger to the Secretary of State). NB: The department was created on June 28, 2007 on the disbanding of the Department of Trade and Industry (DTI), and was itself disbanded on June 6, 2009 on the creation of the Department for Business, Innovation and Skills, see <https://www.gov.uk/government/organisations/department-for-business-innovation-skills>.

²¹⁷ See generally Daniel Prentice, *Bargaining in the Shadow of the Enterprise Act 2002*, 5 EUR. BUS. ORG. L. R. 153 (2004).

²¹⁸ The Enterprise Act 2002 (Specification of Additional Section 58 Consideration) Order 2008, 2008, SI 2008/2645.

²¹⁹ Enterprise Act, *supra* note 200, at §§ 58(A)–(C).

²²⁰ *Id.* at § 89 (1).

²²¹ Thames Water Holding Plc., the company that provides water and sewerage services in the areas of London, Berkshire, Buckinghamshire, Gloucestershire, Kent, Oxfordshire, Surrey and Wiltshire, has among its shareholders China Investment Corporation and Abu Dhabi Investment Authority, holding almost nine and ten percent, respectively. *China's CIC Buys 8.68% Stake in U.K.'s Thames Water Utilities*, BLOOMBERG NEWS, Jan. 20, 2012, available at <http://www.bloomberg.com/news/articles/2012-01-20/china-s-cic-acquires-8-68-stake-in-u-k-s-thames-water-utilities>.

²²² *Id.* at §§ 47, 63.

test applies in market investigations where it is believed that market features have an adverse effect on competition.²²³

Even if traditionally more liberal than continental Europe, the United Kingdom, through its Chancellor, Alistair Darling at the time of writing this Article, supported the pursuit of the G7 to toughen its stance towards SWFs.²²⁴ Darling warned foreign governments that the United Kingdom would not tolerate politically motivated investments in key UK companies. These comments were intended as a warning to Russia that the United Kingdom would not tolerate Russia's state-owned energy company taking a stake in Centrica, the majority shareholder of British Gas.²²⁵ The Russian state-owned gas and oil conglomerate, GazProm who already supplies around a quarter of the EU gas demand and has re-acquired most of the pipelines running from Central Asia to Europe, would not be a welcome bidder for United Kingdom gas grid operator Centrica.

6.2. Control of foreign takeovers in France

In 2004 France modified its Monetary and Financial Code.²²⁶ The new Article L 151-3 strictly limits the field of control to the reasons expressly indicated in Article 346 of the TFEU (national defense)²²⁷ and Article 65-1 (public order and public security). Following the 2005 rumor of a takeover of *Danone* by the American company *PepsiCo*,²²⁸ the French Economy Minister announced the publication of a Decree allowing French authorities to control foreign inward

²²³ *Id.*

²²⁴ Larry Elliot, *Chancellor Backs G7 Move to Get Tough on Sovereign Wealth Funds: 'Political' Investments Not Tolerated, Says Darling: Concerns Grow Over Asset Power in China and Russia*, THE GUARDIAN, Oct. 19, 2007, available at <http://www.theguardian.com/politics/2007/oct/20/1>.

²²⁵ Michael Harrison, *Could Russia's Gazprom Go for National Grid? It's Not Quite As Far-Fetched As It May Seem?*, INDEPENDENT, Oct. 20, 2011, available at <http://www.independent.co.uk/news/business/comment/michael-harrisons-outlook-could-russias-gazprom-go-for-national-grid-its-not-quite-as-far-fetched-as-433748.html>.

²²⁶ Loi 2004-1343 du 9 décembre 2004 de simplification du droit [Law 2004-1343 of December 9, 2004 on the Simplification of the Law], JOURNAL OFFICIEL DE LA REPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE] 20875 (2004).

²²⁷ TFEU, *supra* note 109, at art. 346.

²²⁸ Carol Matlack, *Could PepsiCo Digest Danone?*, BLOOMBERG BUSINESS, July 20, 2005, available at <http://www.bloomberg.com/bw/stories/2005-07-20/could-pep-sico-digest-danone>.

investments in France. Decree 2005-1739 delimits the sectors concerned and ensures full respect for the EU principle of proportionality.²²⁹ For the purposes of the Decree, an *investment* is defined as: (1) acquiring control, within the meaning of Article L. 233-3 of the Commercial Code, a company whose headquarters is in France; (2) to either directly or indirectly acquire all or part of an industry of a company whose headquarters is in France; and (3) or crosses the threshold of 33.33% of direct or indirect ownership of the capital or voting rights of a company whose headquarters is based in France.²³⁰

Decree 2005-1739 introduces disparate treatment of investments on the basis of the origin of the investment—*i.e.*, investments of member states versus third-state investments. The scope of this authorization procedure is more extensive for investments originating from third countries—this is possible under Article 64 of the Treaty—as this measure existed prior to November 30, 1993, when the Maastricht Treaty came into force.²³¹ However, because indirect investments are also subject to authorization, the procedure could also foreseeably create a restriction on investments for third-state investments by companies that are legally established in the EU, but which have shareholders established in third countries.

This difference in treatment, which is permitted by the rules of the WTO and TFEU Article 64, leads to a continuation of the previously applicable regime for operations originating in third countries, but with greater precision in the field of application. For EU investors, on the other hand, only those operations leading to the effective transfer of a sensitive activity will be concerned. The objective is clear: France can oppose the relocation of activities or product stocks (*e.g.*, vaccines needed in case of a bio-terrorist attack) essential to its security or defense. Moreover, Decree 2005-1739 sets out in Article R. 153-1 a clear list of eleven sectors which are considered strategic, and in which investment can be subject to

²²⁹ Décret 2005-1739 du 30 décembre 2005 réglementant les relations financières avec l'étranger et portant application de l'article L. 151-3 (V) du code monétaire et financier [Decree 2005-1739 of December 30, 2005 Regulating Financial Relations with Foreign Countries and Implementing Article L. 151-3 (V) of the Monetary and Financial Code], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE] 20779 (2005) [hereinafter Décret 2005-1739]; see also Backer, *Sovereign Investing in Times of Crisis*, *supra* note 3, at 83.

²³⁰ Décret 2005-1739, *supra* note 230, at art. 1-3.

²³¹ Treaty establishing the European Economic Community, March 1957, E.T.S. No.1. available at <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=URISERV:xy0023>.

authorization.²³² The national security rationale for this list is quite clear, although the Decree has not been formally applied so far.²³³

After an initial warning,²³⁴ the Commission has formally requested that France amend the Decree to bring it in compliance with the governing EU treaties as they apply to authorizing procedures for foreign investments in delineated sectors and activities that could affect public policy, public security, or national defense.²³⁵ The Commission considers Decree 2005-1739's restriction on investment as "incompatible with the free movement of capital and the freedom of establishment."²³⁶ The formal request sent in October 2006 signaled the start of an infringement procedure,²³⁷ which has not been implemented by the Commission. In substance, the Commission questioned whether the decree respected the free circulation of capital and the freedom of establishment within the EU because it subjects non-EU investors to a more restrictive approval regime. More precisely, the European Commission

²³² See Décret 2005-1739, *supra* note 230 (listing a total of eleven strategic sectors: money gambling and casino activities; private security services; research, development or production of pathogens or toxic substances for unlawful use or terrorist activities; wire tapping and mail interception equipment; testing and certification of the security of information technology products and systems; goods or services related to the information security systems of companies managing critical infrastructure; dual-use (civil and military) items and technologies; cryptology services; activities of firms entrusted with national defense secrets; research, produce or trade in weapons; munitions, and explosive substances intended for military purposes; any business supplying the French defense ministry with any of the goods or services described above.).

²³³ See e.g., Ben Hall, *Danaher Move for Ingenico Blocked*, FIN. TIMES, Dec. 21, 2010, available at <http://www.ft.com/intl/cms/s/2/0bfaefbe-0bc7-11e0-a313-00144feabdc0.html#axzz3qDPuL4Kr>.

(reporting that the French Government threatened to make use of the 2005 Decree during an attempted merger between US Danaher and Ingenico, but did not ultimately seek to enforce the Decree).

²³⁴ European Commission, Free Movement of Capital: Commission Scrutinises French Law Establishing Authorisation Procedure for Foreign Investments in Certain Sectors Press Release No. IP/06/438 of 4 April 2006), available at http://europa.eu/rapid/press-release_IP-06-438_en.htm.

²³⁵ European Commission, Free Movement of Capital: Commission Calls on France to Modify Its Legislation Establishing an Authorisation Procedure for Foreign Investments in Certain Sectors of Activity Press Release No. IP/06/1353 of October 12, 2006 available at http://europa.eu/rapid/press-release_IP-06-1353_en.htm [hereinafter Free Movement of Capital].

²³⁶ *Id.*

²³⁷ TFEU, *supra* note 109, at art. 258; see generally Jan-Krzysztof Dunin-Wasowicz, Note, *The Transparency Regulation in Context: A Proxy for Legitimacy or an Instrument of Regulatory Practice?*, 16 COLUM. J. EUR. L. 465 (2010).

expressed concerns²³⁸ which have been ignored by the French government until now, that some of the provisions in this Decree could discourage investments from other member states and they are in contravention of EU Treaty rules on the free movement of capital (Article 63) and the right of establishment (Article 42). These additional requirements on European companies owned or controlled by third state investors would also contravene the principle of Article 47 (former Article 48), which states that companies established in member states should be treated as nationals of such member states.

Article R153-2 “Provisions relating to foreign investments from third countries” was modified in 2009 and in 2012. The last amendment, Decree 2014-479, was introduced in May 2014 following the General Electric bid to acquire the energy branch of Alstom; the media termed this amendment the “Alstom Decree.”²³⁹ These amendments detail the requirements for foreign investors making investments in certain sensitive sectors such as gambling, private security, telecommunications, IT security, cryptology, and military and defense. The Alstom Decree further specifies the business sectors for which the foreign investor is required to attain governmental approval prior to investing, they are: a) supply of electricity, gas, oil and other energy resources, b) supply of water in accordance with public health regulations, c) operation of transportation networks, d) operation of electronic communications networks, e) activities specified in the French Defense Code, and f) protection of public health.²⁴⁰ The Alstom Decree also modified Article R153-9, making further reference to the French Defense Code on matters of protection against terrorist threats.²⁴¹

²³⁸ Free Movement of Capital, *supra* note 236.

²³⁹ See Hugh Carnegy, Michael Stothard & Elizabeth Rigby, *French ‘Nuclear Weapon’ Against Foreign Takeovers Sparks UK Blast*, FIN. TIMES, May 15, 2014, available at <http://www.ft.com/cms/s/0/1d386c96-dbeb-11e3-a460-00144feabdc0.html#axzz3tBB1qgKk>.

²⁴⁰ Article R153-2, LEGIFRANCE, available at http://www.legifrance.gouv.fr/af-fichCodeArticle.dojsessionid=53EA388BCF910EF7A172A44E421F6E27.tpDila08v_2?cidTexte=LEGITEXT000006072026&idArticle=LEGIARTI000006679886&dateTexte=20151202&categorieLien=cid#LEGIARTI000006679886.

²⁴¹ See Consolidated Article R153-9 after the 2014 Decree, Articles L. 1332-1 and L. 1332-2 of the Defense Code, available at http://www.legifrance.gouv.fr/af-fichCodeArticle.dojsessionid=365ED42A046173DF14F6C081AA5A01CE.tpDila08v_2?cidTexte=LEGITEX

6.3. Control of foreign takeovers in Germany

The ownership structure of corporations in the Deutscher Aktien Index (DAX) – a blue chip stock market index comprised of 30 major German corporations that trade on the Frankfurt Stock Exchange – demonstrates Germany's openness to foreign investments, including those by SWFs. Foreign investors hold stakes in many DAX companies. In particular, sovereign funds from Kuwait and Dubai are shareholders in leading DAX companies like Daimler and Deutsche Bank.²⁴² However, in Germany there is a growing concern that an SWF could decide to purchase a large German company such as Deutsche Telecom, Deutsche Bank, or Deutsche Bahn.²⁴³

While the above attest to recognition of the import of national security in the economic realm, this has not led to further protectionist measures. Stork reports as of mid-2010 that German government officials appear troubled by a number of diverse issues and recent developments, including: (1) the ability of SWFs to leverage cash to make large acquisitions; (2) a potential indirect takeover of one of Germany's largest banks by a foreign government; (3) state-controlled investors buying small engineering companies to siphon off intellectual property; and (4) national security concerns that may arise if parts of the German infrastructure are acquired by political investors rather than investors driven by commercial imperatives.²⁴⁴

In 2008, the Cabinet of Germany's Bundesministerium für Wirtschaft und Technologie [Federal Ministry of Economics and Technology] (BMW) issued a proposed amendment to the Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung [Foreign Trade Act and Foreign Trade Regulation] (FTA). The

T000006072026&idArticle=LEGIARTI000028936324&dateTexte=20151202&categorieLien=cid#LEGIARTI000028936324.

²⁴² Jochen Möbert & Patrick Tydecks, *Power and Ownership Structures Among German Companies: A Network Analysis of Financial Linkages*, Darmstadt Technical University, Institute of Economics (VWL), Darmstadt Discussion Papers in Economics, No. 35974 at 7 (2007).

²⁴³ Von Rudzio, *Chinesen Wollen Die Deutsche Bahn* [Chinese Want the German Railways], ZEIT ONLINE, Sept. 10, 2008, available at <http://www.zeit.de/2008/37/Macher-und-Maerkte>.

²⁴⁴ Florian Stork, *A Practical Approach to the New German Foreign Investment Regime—Lessons to be Learnt from Merger Control*, GER. L. J. 260 (2010) [hereinafter Stork].

amendment, which was subsequently accepted by the German Parliament,²⁴⁵ is aimed at protecting strategic national industries from unwanted foreign takeovers. As amended in 2009, the FTA vests Germany's federal government with the power to veto any investment from non-EU or European Free Trade Association countries²⁴⁶ amounting to 25% or more of a company's stakes if it deems that 'public security' or 'public order' is at risk²⁴⁷.

Based on the US model, Germany's plans could lead to further attempts across the across the member states aimed at blocking foreign investment incursions into sensitive industries. US inspiration is obvious in the German pre-notification procedure. Foreign investors can pre-notify the German administration, on a voluntary basis, before an intended acquisition. The administration can then clear the acquisition and provide a level of legal certainty to the investor. Under Germany's proposals, 'public order and security' are the principal criteria for triggering a review of foreign groups' investment plans.

Within Germany there seems to be a slight contradiction between private and public interests. German business associations— Deutscher Industrie- und Handelskammertag [Germany's International Chamber of Commerce as well as the Bundesverband der Deutschen Industrie [Federation of German Industries] (BDI)— did not support the government decision and expressed doubts as the decision is alleged to go against EU rules on the free movement of capital.²⁴⁸ The BDI insists that the law is in breach of

²⁴⁵ Dreizehntes Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung [Thirteenth Law Amending the Foreign Trade and Payments Act], April 18, 2009, BGBl. I at 1150 (Ger.), *available at* http://www.hohmann-partner.com/rechtsvorschriften/2010/awg_englisch-2009.pdf. For a statement from the Ministry of Economy and Technology, see Bundesministerium für Wirtschaft und Technologie [Fed. Ministry of Econ. and Tech.], Kabinett beschließt 13. Gesetz zur Änderung des Außenwirtschaftsgesetzes und der Außenwirtschaftsverordnung [Cabinet Approves Thirteenth Act Amending the Foreign Trade Act and Foreign Trade Regulation], Aug. 8, 2008, *available at* <http://www.bmwi.de/BMWi/Navigation/Presse/pressemitteilungen,did=266018.html> (acceptance of the amendment). For analysis of the Act, see generally Stork, *supra* note 245.

²⁴⁶ The European Free Trade Association (EFTA) is comprised of Iceland, Liechtenstein, Norway, and Switzerland.

²⁴⁷ Thirteenth Law Amending the Foreign Trade and Payments Act, Apr. 18, 2009, Section 7 § 1 Article 4, *available at* http://www.hohmann-partner.com/rechtsvorschriften/2010/awg_englisch-2009.pdf.

²⁴⁸ *Germany Moves to Protect Companies from Foreign Takeovers*, DEUTSCHE WELLE, Aug. 20, 2008, *available at* <http://www.dw.com/en/germany-moves-to-protect-companies-from-foreign-takeovers>.

EU Treaty rules on the free movement of capital (Article 63) and the right of establishment (Article 42), which it interprets as being equally applicable to EU and non-EU investors. The BDI further argues that the FTA's definition of national security is too broad.²⁴⁹

In 2014, Michael Glos, Germany's Economics Minister, insisted that the mechanism would be used only in "extremely rare" cases²⁵⁰ and that "Germany is and remains open to [foreign] investors."²⁵¹ The government further argues that the law merely brings Germany into line with existing legislation in France, the United Kingdom, and the United States.²⁵² In other words, just as other countries have already done, Germany is creating governmental means of oversight for few exceptional cases and to rule out a possible threat to national security interests. Investment protectionism or an overall rejection of investments by sovereign funds, now and in the future, will not and cannot occur in Germany.

7. CONCLUSION

The European Commission expected member states to strongly signal their readiness to take joint action to avoid a repeat of the financial turmoil that hit the global economy after the US mortgage crisis in summer 2007. As the current financial turmoil of 2008–2009 demonstrated, financial liquidity is vital for Western economies.²⁵³ We have recently witnessed how firms on both sides of the Atlantic— *e.g.*, Barclays and Citibank—have sought out sovereign funds. Investments by SWFs were needed to allow these companies

protect-companies-from-foreign-takeovers/a-3580978 (reporting on Germany's International Chamber of Commerce (ICC) decision to defend the view that "[f]oreign investment brings many advantages such as economic growth, employment and as a result rising living standards" and The Federation of German Industry (BDI) saying that German law would send "the wrong signal for Germany as a place to invest").

²⁴⁹ *Id.*

²⁵⁰ Bertrand Benoit, *Berlin Foreign Investors' Bill Clears Hurdles*, FIN. TIMES, Aug. 20, 2008, available at <http://www.ft.com/intl/cms/s/0/ac2762d6-6eff-11dd-a80a-0000779fd18c.html#axzz3qDPuLAKr>.

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ See Brendan J. Reed, Note, *Sovereign Wealth Funds: The New Barbarians at the Gate? Analysis of the Legal and Business Implications of their Ascendancy*, 4 VA. L. & BUS. REV. 97, 103 (2009) (discussing how sovereign wealth funds affect liquidity and thus affect the secondary market).

to fulfill their strategic aims and, as a result, attitudes towards SWFs shifted sharply in 2008. Whereas SWFs had been initially greeted with outright suspicion, they ultimately became a pre-eminent source of global capital in the post-crisis era.

However, SWFs have yet to take great strides in purchasing EU strategic assets. For example, Russian SWFs have not attempted to buy into any strategic assets; instead, they have taken very limited stakes in companies. Even this action piques the curiosity of the European Commission and the member state governments. But there is no evidence at the moment that these SWFs are being used for any nefarious purpose. Of course, it cannot be ignored that national security is a potentially crucial concern, even when the proposed buyer is a potentially crucial concern, even when the proposed buyer is a private company (e.g., where the state and the private sector are heavily intertwined in the buyer's home state).

SWFs are not newcomers to the investment scene; rather, they have been investing in Europe for decades.²⁵⁴ SWFs, as responsible and reliable investors, have pursued a long-term and stable policy towards investment that has stood the test of time during the Global Financial Crisis. Moreover, these funds provided capital just when it was most desperately needed during the initial stages of the crisis. Given the aforementioned, investing countries may well be entitled to seek the best way to invest their reserves in foreign currency. Overall, SWFs improve the liquidity of the financial markets and create growth and jobs. They also contribute to investment for the longer term and create stability for the companies in which they invest.

Over the years, the free movement of capital has contributed to growth in the Common Market and in other markets around the world. Thus, it is important that the EU does not adopt policies that may endanger market stability in the future, such as overregulation and protectionism. Instead, it should abide by free market principles. Hence, two clear conclusions can be drawn at this stage.

²⁵⁴ See, e.g., *Interview with the Head of the Kuwait Investment Authority: We Are Being Punished*, DER SPIEGEL, May 19, 2008, available at <http://www.spiegel.de/international/business/spiegel-interview-with-the-head-of-the-kuwait-investment-authority-we-are-being-punished-a-554042.html> (reporting that the Kuwait Investment Authority (KIA)—one of the oldest and richest SWFs, has been a major shareholder of the German car manufacturer Daimler since 1974); see also Jim Henry, *Abu Dhabi Becomes Biggest Daimler Shareholder*, CBS NEWS, Mar. 24, 2009, available at <http://www.cbsnews.com/news/abu-dhabi-becomes-biggest-daimler-shareholder/> (noting that the Emirate of Abu Dhabi and the State of Kuwait are the biggest shareholders of German car manufacturer Daimler, with equity stakes of 9.1% and 6.9%, respectively).

First, it appears that a new wave of protectionism against foreign ownership represents a reinvigoration of protectionism from years past. Second, any domestic or EU regulation would undermine any message that the EU (or individual member states) is a good place to invest. Europe must remain an attractive place for investment. SWFs are the by-products of increasing globalization and of the benefits of international trade. Thus far, they have only proved to be good shareholders. They are interested in the long-term, positive development of their business and, as a result, also interested in obtaining a good, long-term rate of return on their investments. The EU should, therefore, continue to allow SWFs to invest in the Common Market.

These funds can, however, pose threats and both the types of investments they are making and whether those investments meet the transparency requirements should be scrutinized. Without continued inward investment, the EU economy will stagnate. The EU has no interest in erecting barriers to investment and it considers sovereign investment as an important engine for worldwide economic growth. If the EU were to restrict the activities of SWFs within the European borders, it might find itself at an economic disadvantage, with significant investment dollars going to other parts of the world. There is a risk of seeing a strategy being implemented in each of the member states that, ultimately, would not help to tackle the reality. There is a need to clarify, at the European level, which sectors should be protected from foreign takeovers beyond the vague criteria of public order and public security, as enunciated. Such a list of EU strategic sectors could, and in fact *should*, be drafted so that energy, technologies, and other relevant sectors are set apart from the regulation of sectors subject to competition regulation. In addition, public mistrust of overseas investment and isolationist sentiment could cause an overreaction to the question of regulation. This could have far-reaching consequences not only financially, but also in terms of diplomatic and economic relationships with other nations. For example, European leaders have not adopted different policies when dealing with Russia as from when they are dealing with the United States. To this extent, there is a need to clarify the interpretation of Article 65 TFEU, which provides for restrictions on the free movement of capital on the grounds of public order. Although never employed *vis-à-vis* SWFs, it is worthwhile ensuring that member states will not be tempted to make extensive use of it.