Depoliticizing Sovereign Wealth Funds Through International Arbitration

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Depoliticizing Sovereign Wealth Funds Through International Arbitration
Meg Lippincott

Abstract

Since their inception in the 1950s, Sovereign Wealth Funds (SWFs) have dramatically expanded with the purpose of investing government revenue and maximizing returns for states with surplus funds. While SWF investments benefit their sovereign owners and can bring stability and growth to the economies they invest in, concerns about the use of investments for political gains and about the defense of national security have led to calls for regulation of SWF investment worldwide. But rather than entangle these investments in a series of varied and complex domestic law solutions, this Comment argues that SWF investment can be effectively monitored through international arbitration. If SWFs are held accountable in international arbitration, they will increasingly behave as private investors and politically motivated investing will be more easily identified and prevented. The International Centre for Settlement of Investment Disputes (ICSID) provides just the forum for resolution of disputes regarding SWF investments. Through ICSID arbitration, international standards can be developed and enforced to protect commercially minded investing and to condemn politically motivated investing.

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I. INTEGRATING A NEW CLASS OF INTERNATIONAL INVESTORS

In an economic climate defined by the passage of Dodd-Frank\(^1\) and drastically increased spending on monitoring and enforcement in the financial sector, regulation has become an expected and accepted tool of national governments to sustain and protect the economy. However, regulation is not always the most effective means of stabilizing or stimulating investment. Rather than deter foreign investors like Sovereign Wealth Funds (SWFs) with the threat of increased and uncertain regulation, nations should rely on a well-established alternative dispute resolution body such as the International Centre for Settlement of Investment Disputes (ICSID) to monitor and enforce accepted practices of foreign investors.

SWFs are a diverse class of investors. Some are familiar and accessible, such as the Alaska Permanent Fund, established by the state constitution and managed by the Alaska Permanent Fund Corporation with legislative oversight to invest the profits from mineral leases and sales and pay out dividends to

\(^1\) Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L No 111-203, 124 Stat 1376 (2010).
Alaska residents. Others, like the China Investment Corporation (CIC), are relatively new investors seeking to invest government surpluses, but less transparent in their investments and subject to considerable skepticism about their possible political motivations. The difference between these two types of investors is the center of much regulatory debate. Host states want to encourage an influx of capital from commercially-minded SWFs while discouraging political investments from others.

Scholars and international institutions have struggled to produce a single definition of SWFs that can encapsulate their multifariousness: "All in all, SWFs are 'private sovereign entities' (entities with sovereign owners operating in private sectors)." Beyond that, their investment strategies, size, activities, and purposes differ considerably. SWFs move trillions of dollars through the global market and invested nearly $40 billion in American financial institutions in 2007 alone. Discussions have even extended to whether the US should create its own national SWF. But as a result of the diversity and recent rapid growth of SWFs, the international community has not developed effective investment regulations and dispute resolution options.

SWFs also pose a unique national security challenge for policymakers due to concerns about their legitimacy and integrity as investors. SWFs could potentially be used to promote the political goals of their sovereign owners and threaten the political and economic security of the states in which they invest. For example, significant investments by the Abu Dhabi fund in the US threaten American policymakers' "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. Some have also expressed a fear that these investments could give sovereigns access to sensitive security information of the host state in the infrastructure, energy, and technology sectors. As a result of these and similar investments, there has been a push to

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regulate SWFs through domestic law. There is international pressure for more transparency and accountability of SWFs, in the belief that forcing more disclosure will root out political investments.

These concerns have been challenged in some studies that indicate "there is no difference between the investments of SWFs and mutual funds in terms of political regime or corporate governance. This reinforces the finding that sovereign wealth funds are in fact more oriented towards risk-return and profit-maximisation objectives than commonly held." After initial skepticism toward SWFs, now many argue that SWFs should not be singled out and treated differently from other investments. Yet some still maintain that "the evidence suggests SWFs would pay a heavy premium for political gains" and calls for regulation of all investors have not ceased. This debate will extend beyond policymakers' attempts to identify political motives to litigators and arbitrators who seek to determine the correct forum and procedures for SWF dispute resolution, which would promote investment while preventing these investments from becoming political leverage and circumventing diplomacy.

Regulators must weigh the risk that SWFs will use investments as political leverage or will push private investors out because they are willing to pay a premium price for the non-monetary benefits of their investments against the potential benefit of opening the host state's markets to a significant amount of capital. These debates routinely play out in international forums as they involve competing conceptions of capitalism and sovereignty. Though SWFs have been often debated in terms of additional domestic regulatory measures, it is time to recognize that there is a large role for international law to play and much room for it to develop in regulation and dispute resolution. First, rather than assume that this group of investors requires tailor-made laws and regulations, states should look to the mechanisms already available in international investment law and to the benefit of integrating SWFs into the existing system. Second, there is

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9 See, for example, Benjamin J. Cohen, Sovereign Wealth Funds and National Security: The Great Tradeoff, 85 Intl Aff 713 (2009).


12 David Murray, SWFs: Myths and Realities 3 (Keynote Address London, May 5, 2011) ("It is not the case that as a group, they are different from other commercially-focused investors.").

13 Rose, Sovereign Wealth Funds at 108 n 13 (cited in note 6).
a growing need to identify comprehensive dispute resolution mechanisms against or available to SWFs and determine the extent to which these should recognize the unique and potentially politically-charged nature of SWFs or treat them as any other private investor. These issues are not going away; “[i]n the United States alone, there have been more than 200 reported court cases filed against foreign sovereigns since 2004,” raising issues of sovereignty and attachability, national security, and efficiency.\(^\text{14}\)

This Comment seeks to analyze SWFs from a dispute resolution perspective advocating a regime that will minimize the potential for important stabilizing capital to be invested toward political ends. This regime would recognize that encouraging political investments between sovereigns privileges wealth in politics above all else and undermines diplomatic efforts, but would avoid imposing a cumbersome regulatory mechanism. Global investments will help link national economies and align the motives of different sovereignties, but host states will still be able to guard against Trojan horse investments\(^\text{15}\) since “foreign sovereigns are not committed to acting only according to economic motives.”\(^\text{16}\)

Identifying the appropriate forum and mechanics of potential arbitration of investment disputes against and by SWFs can assist in depoliticizing SWF investments and significantly reduce the need for regulation. When host states demonstrate a willingness to pursue neutral international dispute resolution in a highly-publicized arena against SWFs, their receipt of SWF funds will be recognized as nothing but a commercial transaction whose terms will be enforced and monitored like any other investor. Leveling the playing field will also make political side deals easier to identify against a backdrop of predictable investment behavior. ICSID offers one such forum for contracting states that consent to arbitration. ICSID arbitration tribunals avoid some of the domestic law issues of neutrality, sovereignty and enforcement and take advantage of


\(^{15}\) Trojan horse investment strategies, employed most notably by China, seek to achieve political ends under the guise of being profit-maximizing investments to avoid raising questions by host state regulators. See, for example, Nasos Mihalaks, Chinese 'Trojan Horse'—Investing in Greece, or Invading Europe? (Part I) (Foreign Policy Association Jan 15, 2011), online at http://foreignpolicyblogs.com/2011/01/15/chinese-%E2%80%98trojan-horse%E2%80%99-investing-in-greece-or-invading-europe-part-i/ (visited Oct 12, 2012) (perhaps overstating the problem as: “The Chinese government has been making all kind[s] of business acquisitions throughout the world; from oil and mineral rights deals in Africa, to the purchase of car manufacturing companies in Europe and the U.S. Everything the Chinese government does commercially on the international[ ] stage is part of a larger strategy with a broader objective.”).

\(^{16}\) Fleischer, 84 NYU L Rev at 483–84 (cited in note 8).
preexisting international agreements. This Comment also seeks to explore some of the alternatives to ICSID arbitration, most saliently US litigation, to highlight the advantages or disadvantages of each forum.

To this end, the Comment will be structured as follows: Section II examines the current legal structure of SWFs including their origin, how they are defined, applicable investment law, and the recent Santiago Principles. Section III takes a closer look at ICSID as a possible venue for SWF arbitration by elucidating its origin, jurisdiction, and current function. Section IV addresses the viability of arbitration involving SWFs in ICSID and the potential impact on SWF investing. Section V offers alternative dispute resolution mechanisms to ICSID arbitration for SWFs. Finally, Section VI concludes with projections about the relationship between ICSID and SWFs.

II. CURRENT LEGAL STRUCTURE OF SWFs

A. Origin

SWFs are a diverse group of investors that employ different investment strategies and arise out of different countries’ circumstances.17 The first SWFs arose in the 1950s, when the Kuwait Investment authority and the Kiribati Revenue Equalisation Reserve Fund were established to invest surplus government funds.18 Historically, they have reduced export product price fluctuations and facilitated distribution of raw material price increases, benefitting international institutions.19 These benefits, the absence of harmful effects, and the relative unpopularity of SWFs meant that they were largely ignored.

After fifty years of existence, SWFs attracted attention. In 2005, the term “Sovereign Wealth Fund” was coined.20 By this time there had been “spectacular growth in official sector assets all over the world,” a new Korean fund was established, and an aggregate total asset pool of at least $895 billion raised eyebrows.21 Also in 2005, the China National Offshore Oil Corporation bid on

17 Murray, SWFs: Myths and Realities at 4 (cited in note 12).
20 Wharton Leadership Center, The Brave New World of Sovereign Wealth Funds 8, online at knowledge.wharton.upenn.edu/papers/download/052810_Lauder_Sovereign_Wealth_Fund_rep ort_2010.pdf (visited Oct 12, 2012).
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the US-based Unocal Oil Company.\textsuperscript{22} While this was not a proposed investment by an SWF, this and similar investments raised the profile of politically sensitive sovereign investors and led to a demand for regulations that would extend to SWFs.\textsuperscript{23}

Since 2005, twelve new SWFs have been established.\textsuperscript{24} The establishment of Chinese and Russian SWFs in 2007 increased concern that SWFs could operate as political tools and heightened awareness of the new major players in international capital markets.\textsuperscript{25} For example, the board of the CIC has significant ties to the existing Chinese financial bureaucracy. Thus, the CIC investment strategy takes into account the political goals of China's leadership, who have expressed interest in embedding the Chinese government in Western financial networks. This increases how much the CIC is willing to pay for the equity of institutions like Morgan Stanley, Blackstone, Visa, and Barclays and allows them to outbid other private investors.\textsuperscript{26} Concerns about these political motivations are tempered in trying financial times when they provide a stabilizing force and offer much-needed liquidity to foreign jurisdictions.\textsuperscript{27} However, discussion of SWF regulation remains salient, in part because the large size of SWF assets makes them difficult to ignore: SWFs have grown to control $2 trillion, which may rise to $12 trillion by 2015.\textsuperscript{28}

B. The Modern Conceptualization and International Definition of SWFs

The diversity of SWFs makes any definition difficult to arrive at and complex, but a definition is necessary for international bodies to conceive a


\textsuperscript{23} Murray, *SWF: Myths and Realities* at 5–6 (cited in note 12).

\textsuperscript{24} Audit, *Barriers Against Foreign Sovereign Wealth Funds* at 1 (cited in note 18).


\textsuperscript{26} Fleischer, 84 NYU L Rev at 443, 509 (cited in note 8).

\textsuperscript{27} Efraim Chalamish, *Protectionism and Sovereign Investment Post Global Recession*, OECD Global Forum on International Investment 5 (Dec 2009); see also Interview with Knowledge@Wharton, *The Brave New World of Sovereign Wealth Funds* (May 26, 2010), online at http://knowledge.wharton.upenn.edu/article.cfm?articleid=2499&source=rss (visited Oct 12, 2012).

\textsuperscript{28} Steven Scholes and Matthew Diller, *Sovereign Wealth Funds: Regulatory and Litigation Issues in the United States* (Financier Worldwide 2010).
harmonious set of standards. Some agencies, like the Organisation for Economic Co-operation and Development (OECD), have shied away from defining SWFs at all.29 Another potential approach is not to treat SWFs as a single group of investors but rather to try to single out different kinds of investments in need of regulation. However, it will be useful for the purposes of this Comment to understand how the term is and may in the future be used in an international context. If nothing else, the government ownership of SWFs poses uniform and unique issues of jurisdiction.

The International Monetary Fund (IMF) has defined SWFs as “investment funds operated by governments to achieve various objectives, created by allocating funds intended for long-term investments.”30 This definition identifies three important commonalities among SWFs: government ownership and operation, creation through the allocation of government funds, and functionality as long-term investments. This definition has been supplemented and is reiterated by the first appendix to the Santiago Principles. This side-project of the IMF, drafted by the SWFs themselves, defined SWFs as:

[S]pecial purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies, which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.31

The first definition is functional and concise, at the cost of being overbroad. It is not clear whether the IMF definition includes government pension funds, for example. The second is much more narrow, requiring that SWFs seek to achieve macroeconomic purposes and invest in foreign financial assets. However, this might exclude smaller funds like the Alaska Permanent Fund.

For the purposes of promoting uniform treatment of SWFs, a better definition might be “funds established, owned and operated by local or central governments, [whose] investment strategies include the acquisition of equity interest in companies listed in international markets operating in sectors considered strategic by their countries of incorporation.”32 Fabio Bassan adopts

this definition of SWFs in order to cover a variety of government-operated funds, and to exclude innocuous funds that would not fall under international regulation. His definition also allows for some flexibility of states to specify the strategic investments the state would like to regulate. However, in the context of international arbitration, the requirement of operating in strategic sectors should be abandoned. All SWFs should have access to dispute resolution mechanisms regardless of the sector in which they invest, because enforceable claims may arise in all sectors and all SWFs pose questions of jurisdiction that can be uniformly addressed. Thus, for purposes of this Comment, I will define SWFs as “funds established, owned and operated by local or central governments, [whose] investment strategies include the acquisition of equity interest in companies listed in international markets.”

The IMF has also provided a classification of SWFs into: stabilization funds, savings funds, and reserve investment companies. Stabilization funds are used by countries with revenue from natural resources and agriculture to help neutralize price fluctuations. Savings funds are established primarily to diversify revenue from non-renewable sources into a variety of assets to minimize risk and promote longevity. Finally, reserve investment companies are often the least transparent and are used to reduce the costs of maintaining foreign reserves. These classifications are helpful to provide a glimpse of the diversity of SWFs, but should not be treated as the basis for different treatment in international arbitration. However, these different kinds of funds do pose different levels of risk to host states, which are likely to be more lenient on commercially-minded stabilization funds and more apprehensive about the potential misuse of reserve investment companies, which may follow political goals and take money away from domestic development in countries plagued by corruption, like Nigeria.

Another commonality between SWFs is their general reluctance to disclose financial information voluntarily. SWFs are likely to be hostile to restrictive, taxing or information-seeking regulation, which could add extra hurdles to investment and infringe on their sovereignty. And though they tend to be clandestine investors, solely owned and operated by individual states whose business dealings are not public knowledge, SWFs have organized in international bodies such as the International Working Group of SWFs (IWG) and the International Forum of SWFs (IFSWF) to contribute to the debate on

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33 Id.
34 Id at 26–28.
35 Fleischer, 84 NYU L. Rev at 493–94 (cited in note 8).
36 Epstein and Rose, 76 U Chi L Rev at 117–18 (cited in note 5).
the appropriate standards for SWF investment. Historically, SWFs have been cautious in their investments to avoid running up against regulation and investment has only recently significantly increased. Now with an influx in assets and coalescing sides to an international debate on regulation there is a significant opportunity for international disputes with these newly defined investors to arise. SWFs have branched out from treasury bonds to investments in industry and resemble private investors more and more (though they carry the added risk of political motives). However, given SWFs' long-standing adversity to disclosing information, reacting to this increase in investment with regulation is sure to dampen growth.

C. The Santiago Principles

In an attempt to better define SWFs and circumvent stricter regulation, the SWFs drafted a set of voluntary protocols—the Santiago Principles. The IWG, composed of twenty-six member countries with SWFs, met on three occasions to draft a set of twenty-four voluntary Generally Accepted Practices and Principles, known as the “Santiago Principles.” The working group relied on an IMF survey of SWF current practices and drew from accepted international practices to develop the principles, which were agreed on in Santiago, Chile, in September 2008. These were made public in October 2008, in order to calm state regulator fears. The IWG has identified four guiding objectives that underlie the Santiago Principles:

1. To help maintain a stable global financial system and free flow of capital and investment;
2. To comply with all applicable regulatory and disclosure requirements in countries in which they invest;
3. To invest on the basis of economic and financial risk and return-related considerations; and

37 Id at 121; Larry Cata Bakcer, Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience, 19 Transnatl L & Contemp Probs 3, 108 n 477 (2010).
38 Fleischer, 84 NYU L Rev at 454 (cited in note 8).
(4) To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.\footnote{IFSWF, IFSWF \textit{Members' Experiences in the Application of the Santiago Principles} at 12 (cited in note 39).}

As of July 2011, 95 percent (out of 426 responses) of members of the IFSWF reported that their practices were fully or partially consistent with the Santiago Principles.\footnote{Id at 6 (only 15 percent of these consistent practices post-date issuance of the Santiago Principles).} The Santiago Principles seek “to increase the understanding of SWFs and their operations,” and “have led to greater transparency, which has been welcomed.”\footnote{Id at 8.} The more transparent SWFs are in their investments the less likely they are to be political, or at least the more easily political motivations can be identified. Transparency allows constituencies access to investment decisions so they can more effectively demand investments for profit to increase the country’s wealth rather than for the pursuit of political goals that might only benefit the political elite. The guiding objectives also expressly commit SWFs to invest on economic and financial bases alone. Thus, the Santiago Principles can go a long way in depoliticizing SWFs.

However, critics are still skeptical that states will comply with the voluntary system of the Santiago Principles, because SWF investment is a self-interested and opaque endeavor. If a majority of states endorse and follow the Santiago Principles there is likely to be compliance across the board. However, “a distinct possibility exists that, without overwhelming state SWF compliance, the Santiago Principles will become nothing more than recommendations.”\footnote{Lindberg, \textit{Sovereign Wealth Fund Regulation in the E.U. and U.S.} at 116–18 (cited in note 40).} The only current enforcement mechanism of the Santiago Principles is a fear of reputational effects.

The Santiago Principles are not yet strictly enforced by host states or comprehensive in scope and do not offer SWFs a mechanism to bring a claim against a host state. They are ineffective for those who still seek redress through arbitration. One hope for the Santiago Principles is that they may be integrated into and enforced through the common law of international investment law by the establishment of precedent through centralized bodies like ICSID. They have supplied the basis for opinio juris and, given reported compliance, adherence may be viewed as customary. Where there is no explicit choice of law agreement between the parties ICSID tribunals are authorized under Article 42 of the ICSID Convention to apply rules of customary international law, and have frequently applied these rules in areas such as compensation, prohibition of

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denial of justice and state responsibility for injury to aliens.\textsuperscript{45} So, while the Santiago Principles offer some hope for depoliticizing SWFs, litigators should be wary that they provide self-executing enforcement in the context of international arbitration. Their most encouraging application would be implementation in international arbitration.

D. An Overview of International Investment Law Applicable to SWFs

The growing web of international investment regulation applied to SWFs includes bilateral investment treaties (BITs), WTO agreements, and national open market policies.\textsuperscript{46} These mechanisms do not treat SWFs differently from other international investors, neither privileging nor disadvantaging their investments. However, they could be used to encourage more sovereign investors or to regulate political investment.

1. The growth of BITs and their depoliticization of SWFs

The first BIT was signed in 1959 between Germany and Pakistan and made inroads as the first international agreement exclusively focusing on the treatment of foreign investments.\textsuperscript{47} BITs continue to expand in scope to cover other trade, intellectual property, and industrial policy issues as well as specifying dispute settlement procedures.\textsuperscript{48} BITs are most valuable in industrial investments, since financial investments are “guaranteed by sound international regulations.”\textsuperscript{49} In fact, the lack of BITs between the US and SWF home states might also explain why there are few SWF industrial investments in the US.\textsuperscript{50} But as SWF investment grows in industry, which it likely will continue to as the global economic crisis ebbs and there is pushback to foreign investment in the financial sector,\textsuperscript{51} BITs and their arbitration provisions are increasingly important.

BITs principally provide protection standards between nations that can be enforced in a variety of investor-state arbitral tribunals, thus giving SWFs access

\begin{itemize}
\item \textsuperscript{45} Christoph H. Schreuer, \textit{The ICSID Convention: A Commentary} 606 (Cambridge 2d ed 2009).
\item \textsuperscript{46} Chalamish, \textit{Protectionism and Sovereign Investment} at 9–10 (cited in note 27).
\item \textsuperscript{48} Id.
\item \textsuperscript{49} Bassan, \textit{The Law of Sovereign Wealth Funds} at 149 (cited in note 4).
\item \textsuperscript{50} Id.
\end{itemize}
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These standards often include most favored nation clauses, providing that a nation will not treat foreign investors and investments less favorably than their own investors or than any other state’s investors. BITs also protect investors from arbitrary or discriminatory treatment. If these provisions are extended to cover SWF investments (which they may already), they could ensure that an SWF cannot use its political leverage to benefit its investments. For example, it would be a violation of the BIT provisions for a government to bail out a company because an SWF investor in that company threatened a deterioration of other diplomatic relations with the government otherwise. This would be discriminatory treatment of private investors without political ties. BITs could also protect SWFs from host states regulating or disfavoring SWF investments in order to sanction their sovereign owners by giving SWFs recourse for differential treatment.

BITs allow customization of complex investment law provisions giving countries flexibility to tailor their standards to the unique concerns raised by each potential investor or to promote particular industries. Thus, different SWFs posing different political risks could be subject to different disclosure obligations, or as an alternative, each BIT could contain uniform language requiring transparency and fair dealing. States have so far been willing to pay the transaction costs associated with customized BITs, as evidenced by the surge in treaties that have been reached, numbering almost 2,500 by 2005. Therefore, this is an attractive alternative to domestic regulation.

BITs are likely to remain one of the primary tools for international investment because they include effective enforcement and dispute resolution provisions. These frequently take the form of arbitration provisions designating fora for investment disputes such as ICSID. In fact, “[t]he majority of BITs have continued with the traditional approach of only sketching out the main features of the investor-State dispute settlement mechanisms, relying on other arbitration conventions to deal with specific procedural aspects.”

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52 Id at 7.
53 Claudia Annacker, Protection and Admission of Sovereign Investment under Investment Treaties, 10 Chinese J Ind L 531, 546–47 (2011).
54 Audit, Barriers Against Foreign Sovereign Wealth Funds at 7–8 (cited in note 18).
55 Fleischer, 84 NYU L Rev at 485 n 173 (cited in note 8) (“[T]he majority of BITs have continued with the traditional approach of only sketching out the main features of the investor-State dispute settlement mechanisms, relying on other arbitration conventions to deal with specific procedural aspects.”).
56 UNCTAD, Bilateral Investment Treaties at 1 (cited in note 47).
57 See, for example, Itera International Energy LLC and Itera Group NV v Georgia, ICSID Case No ARB/08/7, 5 (Dec 4, 2009).
58 UNCTAD, Bilateral Investment Treaties at 101 (cited in note 47).
delegation of dispute resolution to a well-established third party reduces the costs of negotiation and promotes uniformity and the establishment of precedent for international investment. It is this added layer of enforceability that could give bite to an SWF's commitment to pursue economic rather than political goals.

The Santiago Principles could also be codified in BITs. Including references to international law (like the Santiago Principles) in the choice of law provisions of BITs would ensure compliance with international investment standards. Backed up by an international arbitration regime willing to enforce the terms of these BITs, this poses the strongest and most immediate option for depoliticizing SWFs. The uncertainty of domestic regulation of SWFs, makes internationalizing BITs “a more realistic way to protect the investors’ interests against the vagaries of the host State’s law.”59 This would also extend the benefits of additional transparency and codify a commitment to invest based on economic considerations alone.

Given the rise of SWFs and BITs, states should be careful in drafting BITs to ensure the parties delineate where SWFs fall within their scope. BITs generally have different arbitration provisions for state-state and investor-state disputes, so the classification of SWFs as states or investors will impact their potential remedies.60 Classification of SWFs as states is intuitive, since they are state-owned. This classification would also facilitate international arbitration with nationals of contracting states (though this is not likely to be a common phenomenon because of the resource constraints of individual nationals compared to states). However, if SWFs are seen as states, arbitration on the basis of terms of a BIT with other states is precluded in ICSID, which only accepts jurisdiction over investor-state disputes.61 Disputes between states are generally taken to the International Court of Justice or the Permanent Court of Arbitration.62 Furthermore, the common BIT “state-state disputes provision potentially has a narrower scope of application than the investor-state disputes provision,” because it applies only to disputes concerning the interpretation or application of the BIT rather than any dispute concerning an investment.63 Only one state-state dispute has ever been brought under a BIT, the rest having been

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62 Id.
settled in negotiation, with local remedies or submitted to investor-state arbitration.⁶⁴

On the other hand, if SWFs are seen as investors, or "national[s] of another contracting state" they will be able to invoke arbitration with other states under ICSID.⁶⁵ Just as "state-owned entities can legitimately claim a violation of the BIT; the same should be true for SWFs."⁶⁶ Therefore, the drafters of BITs should include SWFs in their definition of investor and exclude them from the category of a state. This will avoid the creation of a unique system of regulation to deal with SWFs and permit the maximum amount of international arbitration of SWFs in a forum focused on investment disputes, which will help to establish international precedent in regulation and commit SWFs to the same rules as other private international investors, rather than defining them by their sovereign owners alone. Several investment treaties already define investors to include state entities such as US, Canadian and Australian BITs.⁶⁷

BITs still have clear drawbacks as a solution to investment regulation. By and large BITs are uniform, but formally their common standards have not coalesced into binding foreign investment law.⁶⁸ Thus, they have weak precedential value and tenuous acceptance. Their potential to establish a stable, long-term solution to regulating SWF investment behavior is limited. In addition, each BIT requires renewed negotiations between each different pair of sovereignties looking to enforce international investment standards. BITs may also run into complications with other agreements.

However, if implementation of the Santiago Principles continues voluntarily, the prospect of domestic or international regulation of SWFs decreases. As a result, fewer disputes arising out of unfavorable treatment of SWFs will reach arbitration tribunals and the debate over regulating SWF investments would be unnecessary. As of yet, the conversation about SWF regulation has not disappeared and there is continued skepticism about the adequacy of the Santiago Principles. Therefore, BITs may still play a role in depoliticizing SWFs.

2. A role for the WTO

There is no WTO treaty that explicitly regulates international investment. However, there are a few that may be applicable to SWFs. The General

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⁶⁴ Id at 507.
⁶⁵ Schreuer, The ICSID Convention at 160 (cited in note 45).
⁶⁶ Bassan, The Law of Sovereign Wealth Funds at 143 (cited in note 4).
⁶⁷ Annacker, 10 Chinese J Intl L at 537 (cited in note 53).
⁶⁸ Rudolf Dolzer and Margrete Stevens, Bilateral Investment Treaties v (Kluwer L Intl 1995).
Agreement on Trade in Services (GATS)\(^69\) contains anti-discrimination standards for investments in services. While a minority investment does not trigger GATS protection, a WTO member cannot block a majority investment by an SWF by favoring a local investor.\(^70\) GATS does not provide a broad basis for litigation pursuant to SWFs or a dispute resolution mechanism, but could be the source of a claim in international arbitration. Applying GATS to SWFs would level the playing field with other investors and prevent host states from politically retaliating against a country by denying SWF investments. This is an important aspect of liberating SWFs from becoming political battlefields.

The Agreement on Trade-Related Investment Measures (TRIMs)\(^71\) is also a source of international law governing SWFs. TRIMs prohibits performance requirements favoring domestic enterprise or restricting the quantity of imported products.\(^72\) However, TRIMs does not directly address SWFs or protect their investments from unfair or nationalistic intervention.\(^73\) In addition, BITs increasingly include their own prohibition of performance requirements going beyond the obligations of TRIMs.\(^74\) Therefore, TRIMs is unlikely to be the basis of effective regulation of SWFs, but reinforces treatment of SWFs as any other private investor.

Finally, the WTO offers the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules, which can be adopted in BITs as an alternative to ICSID arbitration.\(^75\) Thus, SWFs could end up subject to ad hoc arbitration tribunals set up according to UNCITRAL rather than ICSID provisions. However, these ad hoc tribunals are inferior to ICSID arbitration. Ad hoc tribunals require more work by the parties to the dispute and are less assured to provide a binding solution. ICSID provides a secretariat to administer arbitration while UNCITRAL does not. ICSID has no judicial review, while UNCITRAL arbitrations can be reviewed in two jurisdictions.\(^76\) Allowing any state where judgment is sought to be enforced to review an arbitration decision

\(^{69}\) 1869 UNTS 183.

\(^{70}\) Chalamish, *Protectionism and Sovereign Investment* at 7 (cited in note 27).

\(^{71}\) Reprinted in Uruguay Round Trade Agreement, Statement of Administrative Action 1, art 9, HR Doc 316, 103d Cong, 1448 (1994).

\(^{72}\) UNCTAD, *Bilateral Investment Treaties* at 78 (cited in note 47).


\(^{74}\) UNCTAD, *Bilateral Investment Treaty* at xii (cited in note 47).

\(^{75}\) See, for example, UNCTAD, *UNCITRAL Arbitration Rules*, General Assembly Res No 31/98, UN Doc A/RES/31/17 (1976).

conducted under UNCITRAL adds an element of uncertainty to the arbitration, and thereby an additional cost, that might defer claimants from pursuing arbitration. The absence of judicial review under ICSID arbitration limits the length and cost of arbitration by ensuring that the parties will be bound by a judgment. The more open-ended UNCITRAL rules also allow more opportunities for broader political fights to seep into an investment arbitration.

The WTO plays a quite limited role in new regulation and arbitration of SWFs, but application of its existing international law gives support to the depoliticization of SWFs by treating them like any other commercially-minded investor and not equating them with their sovereign owners.

3. Progressing domestic law regimes

An understanding of the domestic laws that may affect SWFs has significant implications for international arbitration because domestic laws that treat SWFs differently from other investors or the use of domestic law to penalize SWFs are subject to claims brought under BITs or WTO treaties in international arbitration. The US “has long been open and receptive toward foreign investment,” and there are no federal laws that specifically target SWF investments in the US. However, subject to regulations that cover foreign investments more broadly and critics have led the push for additional regulation of SWFs because of their concerns for national security and competing political motives. Additional regulation could have the opposite effect—allowing SWF investments to become a place where political battles are fought through the imposition of sanctions or subsidies of their investments. For example, currently the US and UK tax systems subsidize SWFs because they equate them with their sovereign owners and often do not impose on them the same taxes as private foreign investors in order to respect their sovereignty. Thus, SWF investments become a statement about recognizing and respecting sovereignty rather than contributions to a capital market that ought to be exclusively profit-driven. Further distortions of the market would only allow for additional political debates and make Trojan horse investments easier to disguise (an SWF could claim it was paying a premium because of the tax benefit rather than because of its true political motive).

As a result of domestic regulations sensitive to foreign investment, SWFs have also avoided control over US investment opportunities. Regulations of the Committee on Foreign Investment in the United States (CFIUS) prohibit


78 Fleischer, 84 NYU L Rev at 449, 469–70 (cited in note 8).
control of nuclear assets and airlines and bring all transactions that result in control by a foreign investor under review by the agency if there is a possible impairment to national security.\textsuperscript{79} Between its inception in 1975 and 2006, CFIUS reviewed over 1,600 cases of foreign acquisitions.\textsuperscript{80} The Foreign Investment and National Security Act of 2007 (FINSA) added new requirements to CFIUS regulations.\textsuperscript{81} FINSA gives the president the power to block investment transactions that threaten US national security.\textsuperscript{82} This broad discretion could be subject to abuse, unjustly blocking SWF investments. Ultimately, "a national decision canceling a SWF investment could be challenged before an ICSID arbitration tribunal."\textsuperscript{83} While a host state is entitled to protect its national security, SWFs should be treated as any other foreign investor and rather than increase domestic investigations into their investments (which will raise diplomatic obstacles), there should be more international pressure for transparency, as through the enforcement of the Santiago Principles. CFIUS review should apply equally but no more stringently to SWF investors.

Since SWFs have avoided control, this also makes domestic investigation less likely and their investments often pass under the radar (for example, they avoid becoming a majority stakeholder subject to GATS). To expose SWF misbehavior in these more discrete investments, host states should have easy access to an international forum for dispute resolution. Creating international precedent for this kind of action would also then serve to establish global standards so that a country does not have to risk driving SWF capital out of its own market and into another while trying to protect its national security.

There are a number of other US laws that affect SWF investments.\textsuperscript{84} The scope and breadth of US regulation is an indication that any comprehensive international regime would require a great deal of negotiation to cover the same


\textsuperscript{81} Willig, \textit{Sovereign Wealth Funds and U.S. Law} at 4 (cited in note 79).

\textsuperscript{82} 50 USC App § 2170(d) (2007).

\textsuperscript{83} Audit, \textit{Bamers Against Foreign Sovereign Wealth Funds} at 10 (cited in note 18).

ground and suggests that disputes involving SWFs in international arbitration may be only a small subset of the disputes SWFs will face. Litigation under domestic regulations will likely arise in domestic courts, which will be explored in more detail in Section V. However, international bodies often take cues from domestic regulation and will apply domestic law if the parties have consented to adhere to the laws of a certain state. Domestic law still has a role to play, but international forums are necessary to fill in the gaps.

This intricate web of domestic law provides motivation for SWFs and sovereigns to opt out of the default system and continue employing BITs and selecting forums for their disputes on a more particularized, individual basis. The current uncertainty of domestic regulation also emphasizes the importance of establishing precedent in international arbitration proceedings to promote predictability and efficiency in investment.

III. The International Centre for Settlement of Investment Disputes

A. Origin and Jurisdiction

ICSID was established by the World Bank Group in 1966 to stimulate international capital investment in its member countries, thus facilitating poverty reduction.\(^{85}\) The World Bank's concern was that investments in developing countries were stagnating because investors did not trust developing countries' domestic court systems. ICSID was set up by the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States and is seated in Washington, DC to serve as a neutral arbiter between states and investors.\(^{86}\) As of July 25, 2012, 158 states have signed the Convention.\(^{87}\)

The ICSID Convention set up an arbitration forum subject to rules for selecting arbiters and compelling arbitration where the parties have executed valid consent.\(^{88}\) Recently, parties have begun including arbitration provisions designating ICSID in BITs rather than individual investment contracts, covering

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a larger number of transactions. Thus, ICSID has gained in popularity as an arbitration forum and has seen a dramatic increase in the number of filings.

Jurisdiction under ICSID is subject to three requirements. First, jurisdiction "extend[s] to any legal dispute arising directly out of an investment." Next, this dispute must be "between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State." Finally, the Convention requires "the parties to the dispute consent in writing to submit to the Centre." The first requirement does not pose a significant restriction. An "investment" is left to the parties to define as broadly or as narrowly as they wish to subject to ICSID jurisdiction. The requirement that the dispute arise between a contracting state and a national of another contracting state does limit the claims ICSID will hear and raises the same issues as BITs discussed above with respect to categorizing SWFs. Whether a party is a state or a national determines whether they may file a claim at all. Finally, because of the requirement of consent, the vast majority of cases brought before ICSID arise out of BITs with arbitration provisions, but some also arise out of multilateral agreements like the North American Free Trade Agreement (NAFTA) or Dominican Republic-Central America Free Trade Agreement (CAFTA-DR). These prior agreements constituting consent are essential, as *Maritime International Nominees Establishment v The Republic of Guineas* established that absent execution of valid consent to arbitration, US courts are powerless to compel ICSID arbitration.

89 Id.
92 See Schreuer, *The ICSID Convention* at 116 (cited in note 45). However, the term "investment" is not unbounded, as an ICSID tribunal made clear in *Zhinvak Development Ltd v Republic of Georgia*, ICSID Case No. ARB/00/1, which held that "investment" is a limited category that does not include development costs. Juliet Blanch, *ICSID Landmark Ruling*, The Lawyer (Apr 7, 2003), online at http://www.thelawyer.com/icsid-landmark-ruling/78270.article (visited Oct 30, 2012).
93 32 ILM 605 (1993).
94 43 ILM 514 (2004); Ali and de Gramont, *ICSID Arbitration in the Americas* at 6 (cited in note 90).
95 693 F2d 1094 (DC Cir 1982).
B. ICSID’s Current Function in Administering International Arbitration

In 2011, ICSID registered 32 new cases and oversaw 159 ongoing cases. Claims filed with ICSID allow countries to enforce BITs and multilateral investment treaties and can even be brought on the basis of domestic investment law. Recently, more cases are being brought to ICSID involving investors from developing nations against developed contracting states.

There is some suggestion that ICSID arbitration may be on the decline. Bolivia withdrew from ICSID in 2007, while Ecuador denounced the Convention, effective January 2010. Venezuelan President Hugo Chávez, too, is considering withdrawal from ICSID “probably because if Venezuela loses all of the 18 pending cases it has there . . . it might have to shell out more than $40bn.” Despite this decline in contracting states, “the number of arbitrations filed under NAFTA and other treaties against governments in the northern part of the hemisphere are increasing.” Withdrawing from ICSID would risk “future costs . . . far greater than anything Venezuela might have to pay out as a result of ICSID rulings.” Although, even non-contracting states can take advantage of ICSID’s Additional Facility Rules. This enables any of the nine countries with SWFs who are not parties to the ICSID Convention to still take advantage of ICSID arbitration.

100 Benedict Mander, Chávez Wants Out of ICSID (again), Financial Times (Sept 13, 2011).
101 Ali and de Gramont, ICSID Arbitration in the Americas at 8 (cited in note 90).
102 Mander, Chávez Wants Out of ICSID (again) (cited in note 100).
103 Schreuer, The ICSID Convention at 84 (cited in note 45).
104 Compare ICSID, List of Contracting States and Other Signatories of the Convention (cited in note 87) with SWF Institute, What is a SWF?: List of Sovereign Wealth Funds, online at http://www.swfinstitute.org/what-is-a-swf/ (visited Oct 12, 2012). Angola, Brazil, Equitorial Guinea, Hong Kong, Iran, Kiribati, Libya, Mexico, and Vietnam have SWFs but are not signatories to the ICSID Convention.
Latin American countries have raised concerns that ICSID is “beholden to US interests” and infringes on developing countries’ sovereignty. However, this concern does not seem widely shared given the rise in the number of claims brought by developing countries. In addition, Latin America “has not historically developed as many SWFs as other regions have,” so for the purposes of SWF arbitration ICSID remains an attractive administrator.

ICSID offers parties legitimacy, ease of administration, and binding judgments. ICSID’s fifty years of experience in arbitration and commitment to the neutrality of its arbiters lend it credibility. ICSID allows for bias challenges and maintains internal mechanisms to ensure the quality of its resolutions. Administratively, ICSID allows countries to customize arbitration proceedings: “Party autonomy allows the parties to modify the ICSID regulatory framework to achieve the best possible framework for the arbitration.” International arbitration under ICSID increases the likelihood of obtaining enforcement, because an award must be recognized by each contracting state. A national court judgment, by contrast, might be limited to reaching the assets inside that nation. ICSID maintains confidentiality both in procedure and in the resulting award.

In addition, “ICSID has been considered the least expensive institution as its fee is based on the actual cost that its subsidized staff incurs . . . [h]owever, while less expensive than other institutions, this fee can be burdensome.” Parties must pay all of ICSID’s direct expenses attributable to the arbitration in addition to an initial $25,000 fee to file an action and a $20,000 fee on an annual basis after an arbitral tribunal is formed.

IV. SOVEREIGN WEALTH FUNDS IN THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

SWFs and ICSID are a natural pairing—assisted by some of the largest international players (the IMF and the World Bank) and committed to

promoting the free flow of capital and investment, SWFs and ICSID are also both protective of investors' confidentiality and focused on ensuring an enforceable return. Promoting arbitration in ICSID disputes with SWFs will also lend consistency to international investment expectations and could help support SWFs as profit-driven investors and curtail their use as political tools. BITs are likely to include increasingly similar provisions perhaps including new provisions targeted at SWFs, or at investor transparency, which can be tested in ICSID tribunals with predictable results. Consenting to ICSID arbitration will thus imply a certain interpretation of investments and agreements reducing ambiguity in contracting and taking advantage of precedent to lower information costs when SWFs behave as ordinary investors.

A. Jurisdiction

ICSID should have jurisdiction over disputes arising with SWFs, though this requires some interpretation of consent and the categorization of SWFs. First, arbitration before ICSID requires the consent of both parties. Traditionally, consent is given in BITs. Ideally, all contracting states will include provisions consenting to arbitration in their domestic investment legislation, unilaterally submitting to ICSID. These provisions would remove the gatekeeping function from states, insulating dispute resolution from state preferences and power capabilities. This solution might be attractive to states in areas that typically end up in international arbitration because it provides certainty to investors and states generally want to encourage investment. Consent through legislation can be limited to certain specified issues and is even revocable should the states choose to change their legislation. But unilateral submission would also remove one more political fight from the table and reduce selective prosecution. Although there is a concern that this might result in more frivolous suits, this is tempered by the expense of international arbitration. Until there is sufficient international pressure for unilateral submission, BITs can also be customized to submit any subset of investment disputes to ICSID arbitration.

Assuming an SWF and a contracting state have consented to ICSID arbitration, ICSID will only have jurisdiction if their dispute is classified as one between a state and a foreign investor. ICSID was designed this way because it

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\text{Dolzer and Stevens, Bilateral Investment Treaties at 130 (cited in note 66). The first BIT including consent to ICSID arbitration was signed in 1968 between the Netherlands and Indonesia.}
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\text{Id at 131–32.}
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\text{Robert O. Keohane, Andrew Moravcsik, and Anne-Marie Slaughter, Legalized Dispute Resolution: Interstate and Transnational, 54 Intl Org 457, 488 (Summer 2000).}
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\text{Schreuer, The ICSID Convention at 196 (cited in note 45).}
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was assumed that disputes between two states would be sent to the International Court of Justice or the Permanent Court of Arbitration and that disputes between two individuals or corporations would be settled in domestic courts or other commercial arbitration bodies. If SWFs are designated as states then they cannot bring disputes against other states and states cannot bring suits against them. ICSID tribunals might be tempted to pierce the veil of SWFs and identify them with their state owners, forgoing jurisdiction. However, there are a number of advantages in designating SWFs as individuals besides retaining jurisdiction, not the least of which is that seeing SWFs as individuals will depoliticize them by allowing them to bring their own direct claims rather than relying on their governments to do this for them (which would turn these investment disputes into an opportunity for political strategizing). Recognizing SWF individual status is an important step to encouraging states to separate those who staff their SWFs from those in executive positions, allowing them to step farther out of the sovereign’s political shadow. Individual status would also level the playing field with other private investors, who are subject to and can bring claims against host states. If the goal of regulation is to make SWFs behave more like normal investors, they should be exposed to and afforded the same access to dispute resolution.

There are indications that disputes between contracting states and SWFs will satisfy ICSID jurisdiction. Already “[t]he BITs ratified by the home states of the major SWFs, in case of dispute between the investor and the other contracting party, provide for the submission of the controversy to the ICSID tribunal.” Scholars have projected that ICSID can provide a forum to resolve controversies “arising from the breach of a BIT by a state that has prohibited or conditioned an SWF’s investment in a company incorporated in the same state . . . based on the specific provision of a BIT but (also) on international customary law.” However, this also indicates that individuals or corporations will not be able to bring claims against SWFs in ICSID, because ICSID requires at least one state party. Domestic forums might still be more appropriate for these claims, as they would be for private investors.

Though some scholars postulate that “ICSID arbitration may not be available to investor states themselves and their subdivisions even if they are protected investors for purposes of an applicable investment treaty that provides

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117 See, for example, id at 130.
119 Id at 81–82; Audit, Barriers Against Foreign Sovereign Wealth Funds at 10 (cited in note 18) (“[I]t is quite likely that a ICSID arbitration tribunal would accept jurisdiction on a case founded on a BIT and in which the claimant is a SWF.”).
120 Schreuer, The ICSID Convention at 144 (cited in note 45).
for ICSID arbitration," there has not been an opportunity for an arbitral tribunal to determine jurisdiction. Negotiations leading up to the signing of the ICSID Convention show that jurisdiction over investor states was not expressly included because of concerns that inter-state arbitration would lead to political difficulties. However, this Comment argues that giving SWFs access to this arbitration will actually reduce political difficulties between states.

B. Benefits of ICSID for SWF Arbitration

ICSID arbitration provides a binding judgment that will let claimants reach assets and ensure an enforceable victory in any contracting state’s jurisdiction. Guaranteed enforcement is a significant advantage over a domestic law judgment against an SWF in a foreign jurisdiction, which may be difficult to enforce. SWFs are routine players, so they are not likely to try to evade a domestic judgment; nevertheless ICSID arbitration eliminates this concern and another area of political contention. BITs often specify that arbitration awards will be final and binding, but this is somewhat redundant since the ICSID Convention makes any award enforceable in the territory of any contracting state. The finality of ICSID judgments limits the review of domestic courts, saving claimants the time and cost of a drawn-out enforcement proceeding. Investment is likely to increase where potential investors and host states are assured that any dispute that arises will result in a readily enforceable reward. Host states do want to encourage the stabilizing investments and added liquidity contributed by SWFs.

ICSID also provides for an internal annulment proceeding to offer a measure of protection against iniquitous tribunals while maintaining insulation from local law. There may be a moral hazard concern that because there is not a rigorous appeals process (there is no review of fact and law findings, only remedies for due process type violations), that more frivolous suits will be brought. However, the monetary cost of ICSID arbitration and the international publicity are sufficient to allay these concerns.

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121 Annacker, 10 Chinese J Intl L at 554 (cited in note 53).
122 Id at 536 ("There are no published decisions or awards that have decided the question whether investor states and their subdivisions benefit from investment treaty protection.").
123 Id at 554.
124 Vandevelde, Bilateral Investment Treaties at 445–46 (cited in note 60).
125 Id at 446.
More broadly, moving arbitration into the international sphere provides an opportunity to create international precedent. It has been noted that in particular the use of ICSID tribunals “contribute[s] significantly to the long-term development of international investment law,” and that they “have significant potential for increasing their contribution.” This cohesion is valuable to investors, states, and third parties by creating a predictable legal framework in a diverse and largely neutral forum. SWFs should be particularly eager to take advantage of this potential for cohesion because of the currently unpredictable status of domestic regulation. Host states would also enjoy a measure of predictability in SWF behavior, which would make unwelcome political behavior easier to spot and eliminate.

Providing an international dispute resolution mechanism for SWFs might also encourage a less cautious investment approach and counter the threat of regulation that has led SWFs to limit their investments to minority holdings and maintain broad portfolios. States in which SWFs invest will be more cautious in enacting regulations against SWFs for fear of challenges against them under provisions of BITs. On the other hand, they may not need as rigorous of domestic regulations to protect sensitive industries from misfeasance because claims of this sort could be brought before ICSID. A shift to an international system will thus spare those states the political capital it would take to pass domestic regulations. This serves the dual purpose of increasing welcome liquidity and depoliticizing SWFs by directing their investments to profit-driven rather than distorted or political goals.

ICSID also offers parties confidentiality, which makes it an appealing forum for those dealing with sensitive investment information. Since SWFs are known for lacking transparency this is once again a natural pairing. Confidentiality might further inhibit public scrutiny of SWFs, contributing to the presumption that they operate under political motives, but may also be necessary for consent to ICSID jurisdiction. If SWFs are going to further mollify calls to regulate their investments, providing for open hearings before ICSID could be one show of good faith. The ICSID Convention by default keeps deliberations and hearings in investor-state arbitration private, but accommodates public hearings, which have been agreed to in investment treaties. Keeping ICSID hearings under wraps is also not beneficial for the development of international precedent. Making awards and deliberations public would advance a more

predictable international regime and help depoliticize SWFs, but neither SWFs nor host states are likely to have this as their foremost concern when it comes to sensitive financial information. The benefit of ICSID arbitration is that its flexible model provides for confidentiality or greater transparency depending on the goals of the state and investor parties, but the drawback is that this might conceal political motives. It might be left to BITs or the Santiago Principles to ensure greater transparency rather than the dispute resolution process itself. However, this is the same for private investors and at least bringing SWFs out from the shadows of their state owners will level the playing field and can give some force to diplomatic solutions arrived at in treaties.

A drawback of ICSID is that it is not likely to address many of the tumultuous domestic law issues presented by SWFs. For example, the Securities and Exchange Commission (SEC) investigations under the Foreign Corrupt Practices Act of 1977 (FCPA)\(^{130}\) are unlikely to result in arbitration before an ICSID tribunal, because the US would bring any resulting dispute before a domestic court. The US will likely see its own court system as more favorable to American regulation of investors and perhaps want to avoid the reputational effects of being named as a respondent in international arbitration.\(^{131}\) To the extent that ICSID is estranged from these sovereign needs and priorities, maintaining dispute resolution in both domestic and international forums strikes an important balance. The traditional view of international arbitration is that it is relegated to disputes between developed and developing countries because of a lack of confidence in some domestic courts. ICSID may still be confined to supplementing jurisdictions that lack capacity, but has room to expand to a growing demand for international investment dispute resolution.

International arbitration might be more risky and costly than domestic litigation for a state party because the arbitration can take place in a foreign jurisdiction and interpretation of domestic law might be less predictable or less biased in favor of the state. The US is less likely to initiate international arbitration proceedings, but they have given ex ante consent to ICSID arbitration in BITs and therefore must comply with demands for arbitration. For example, the US negotiated a BIT containing an ICSID arbitration provision with Kazakhstan, which operates the Kazakhstan National Fund, whose assets are mostly in the state securities of the US.\(^{132}\) The Kazakhstan National Fund

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130 15 USC §§ 78dd-1 et seq (2000).
could draw the US into ICSID arbitration under the provisions of this BIT, despite an American preference for a national court. This concern has led some states, like Norway, to call for an exhaustion of local remedies before resorting to international arbitration.\(^{133}\)

However, SWFs would particularly benefit from an international rather than domestic forum for dispute resolution even where domestic law is applied because of the suspicion and skepticism they have faced in foreign jurisdictions like the US. A tribunal decides each ICSID dispute "in accordance with such rules of law as may be agreed by the parties" and "[i]n the absence of such agreement . . . shall apply the law of the contracting state party to the dispute . . . and such rules of international law as may be applicable."\(^{134}\) Thus, ICSID arbitration has the capacity to interpret domestic laws or incorporate international law. Through its neutral administration and selection process of tribunals, ICSID could serve to insulate SWFs from some of the unfounded prejudices (like assuming that SWF investments are more politically driven than private investments) that are prevalent among domestic regimes while enforcing domestic laws. ICSID jurisdiction and awards in favor of SWFs could serve to increase the validity and legitimacy of SWF investments and entitlements. Developing countries have raised concerns that ICSID has a bias in favor of investors, but "the evidence is that investors do not fare better before ICSID tribunals than they do before other tribunals."\(^{135}\) On the other hand, domestic judicial systems are commonly subject to political interference.\(^{136}\)

ICSID has the potential to benefit host states and SWFs by providing a level playing field for investor disputes, enforcing the provisions of BITs and reducing the influence of domestic bias. Moving disputes with SWFs out of domestic courts and into a standardized, neutral, international arena is one more step toward depoliticizing how SWF investments are made and viewed.

\(^{133}\) Bassan, *The Law of Sovereign Wealth Funds* at 136 (cited in note 4).

\(^{134}\) ICSID, *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, Ch IV § 3 Art 42 at 23 (Apr 2006).

\(^{135}\) Vandeveld, *Bilateral Investment Treaties* at 439 (cited in note 60).

\(^{136}\) See, for example, Keohane, Moravcsik, and Slaughter, 54 Intl Org at 470–71 (cited in note 115).
V. ALTERNATIVE DISPUTE RESOLUTION MECHANISMS FOR SOVEREIGN WEALTH FUNDS

A. Alternatives in International Arbitration

While the most common international arbitration forums are ICSID and the ICSID Additional Facility Rules, a substantial minority of BITs specify alternative dispute resolution mechanisms. Other options include the Court of Arbitration of the International Chamber of Commerce in Paris (the ICC Court), the Arbitration Institute of the Chamber of Commerce of Stockholm (the SCC) or ad hoc arbitration under the UNCITRAL rules. The ICC Court offers the assistance of a secretariat, procedures that are not tailored or limited to investment disputes, and a mere $3,000 registration fee. Furthermore, their awards are enforceable under the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). However, the ICC Court’s membership is much smaller—at only 90 member countries—and its awards are much more vulnerable to review. The New York Convention provides “a detailed list of grounds on which recognition and enforcement may be refused,” while ICSID judgments must be treated “as if [they] were a final judgment of a court,” and are not subject to these exceptions. The ICC offers an advantageous forum to claims where neither party is a state, which might fill a gap in ICSID jurisdiction. However, the ICC does not have comparable experience with state-investor disputes, as only 10 percent of their cases involve claims where at least one party is a state.

The SCC also provides a secretariat and decisions are enforceable under the New York Convention. However, a majority of the SCC’s cases are Swedish and very few originate from investment protection treaties.

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137 Dolzer and Stevens, Bilateral Investment Treaties at 146 (cited in note 68).
140 Id.
141 Schreuer, The ICSID Convention at 1139 (cited in note 45).
The UNCITRAL rules provide no administrative support for the arbitration and are used for a wide variety of disputes. ICSID provides an experienced secretariat, a large membership base, expert arbiters, relatively low costs, and final judgments. Thus, ICSID still appears to be the most favored and most experienced forum in international arbitration of investment disputes.

B. Possibilities for Policy

An option aside from arbitration or litigation is to pursue policy changes. The OECD hosts an annual Freedom of Investment conference bringing together some 50 governments to discuss investment policies. The OECD also provides guidelines for international investment in the OECD Declaration and Decisions on International Investment and Multinational Enterprises. SWF host states could seek to influence these OECD guidelines or to execute formal treaties through the WTO to protect them from discriminatory treatment rather than rely on BITs, which were not negotiated with SWFs in mind. Another possibility would be to form a new international body to hear disputes pertaining to SWFs. However, there is not currently the demand for such an elaborate solution—as of yet no SWFs have even sought relief before ICSID or other international arbitration bodies.

C. Domestic Law Approaches to SWF Disputes

Domestic law broadly offers an alternative to international dispute resolution by confining claims to domestic courts and withholding consent from international arbitration. The US in particular is likely to seek domestic solutions, as it has been the site of “many vocal politicians and pundits warn[ing] of the dangers SWFs pose to our capitalist system,” though it is also home of academics that defend them against additional domestic regimes and benefitted in 2008 from SWF investments. Thus, this Comment addresses the possible alternatives America presents for SWF dispute resolution and why in many instances an international solution is still preferable.

147 Epstein and Rose, 76 U Chi L Rev at 119 (cited in note 5).
1. Domestic law solutions

Litigation involving SWFs in the US will likely fall into two different categories: enforcement litigation and private civil litigation. Enforcement litigation refers to actions taken by US regulatory authorities to enforce federal or state securities laws. Civil litigation refers to general litigation in American courts by private parties. Both types of litigation are unlikely to fall within the international sphere, but they establish expectations of international investment likely to influence SWF behavior worldwide.

Enforcement litigation may not offer international arbitration a role to play. For example, beginning in January 2011, US financial institutions began receiving inquiries from the SEC into whether they had violated the FCPA in their dealings with SWFs. The FCPA prohibits payments to government officials (which includes officials affiliated with SWFs and SWF employees) in order to influence their business decisions. Should the SEC or DOJ decide to take action after its investigation of the financial investments of SWFs under the FCPA, it is likely to choose a domestic forum. This is a better political choice because a lawsuit in US courts is likely to bring more positive attention to the government for holding actors involved in the financial crisis accountable. Furthermore, domestic government agencies would likely be wary of international interpretation of domestic regulations, choosing to rely instead on the customs and procedures of domestic forums. Within the US it is well-established that “a court will give great deference to an agency's interpretation of its own rules.” It might also be a more practical economic choice. In fact, the SEC might seek enforcement in the US “without any of the procedural protections, transparency, or judicial review that exist in traditional civil litigation.” The SEC can sanction without offering a chance for dispute resolution at all, thus maximizing efficiency in deterring misfeasance, though contributing little substance to an international precedent.

There are also some instances of private civil litigation that are not conducive to international arbitration. SWFs have recently been caught up in the Bernard Madoff fraud. The Madoff trustee is seeking to recover $300 million from the Abu Dhabi SWF in US Bankruptcy Court in Manhattan. Jurisdiction is predicated on the fact that the SWF purposely directed another fund to invest


149 Id.


money in New York and because it wired money through a New York bank.\textsuperscript{153} A domestic forum is preferable when an SWF is entangled in a mass of litigation like the Madoff fraud that is already before a national court. Seeking out arbitration in an international forum would incur a huge expense when the dispute involves domestic law issues that have already been initiated and consolidated in a national court. On the other hand, an international forum would avoid the precarious basis for jurisdiction and the potential that a US court will not be able to compel enforcement.

Finally, domestic law options might also be compulsory under some BITs. The Norwegian BIT model "contains a requirement regarding exhaustion of national legal remedies . . . if the investor has not reached a settlement pursuant to national law within three years, he can institute international dispute settlement."\textsuperscript{154} Where an SWF or state seeks to bring a claim under a BIT with this type of provision domestic courts are the first stop. However, it is notable that even these provisions acknowledge that domestic law options may not be sufficient for adequate dispute resolution—leaving open the potential for international arbitration after the exhaustion of domestic resources.

2. Domestic law pitfalls

While domestic law options are appealing in enforcement and private civil litigation cases and would largely treat SWFs just as any private investor, in cases involving a question of treaties or international law, ICSID has a clear role to play.

The application of domestic law tends to be a more political process than international arbitration. "A foreign investor," particularly a controversial investor like an SWF, "justifiably in many instances, will not have confidence in the impartiality of the local tribunals and courts in settling any disputes that may arise between him and the host state."\textsuperscript{155} Allowing the parties to select their own panelists on an ICSID tribunal helps to ensure that the arbitration will be judged by a group of experts or those with the technical backgrounds necessary to understand complex investment disputes rather than a randomly selected judge or jury, which may rely instead on the biases of their home country. A politically neutral process is helpful in depoliticizing the perception of SWFs.

In addition, resource constraints between the two parties can play less of a role in international arbitration because discovery is often more limited. A

\textsuperscript{153} Id.

\textsuperscript{154} Bassan, The Law of Sovereign Wealth Funds at 136 (cited in note 4).

briefer discovery period might raise the chances of overlooking a crucial piece of evidence. However, this is counterbalanced by the availability in international arbitration of expert panelists who may be able to conduct a more efficient discovery process because of their extensive background knowledge. In domestic litigation, settlement may be reached because of wealth effects rather than because an ideal compromise has been struck. As opposed to American litigation, international arbitration is widely considered less expensive.¹⁵⁶

Among other weaknesses, domestic law options generally run into greater enforcement obstacles. The debtor state’s courts can refuse to enforce a ruling in favor of an alien, or local enforcement may be rendered impracticable by legislation, adverse precedent, or other barriers.¹⁵⁷ Where a domestic court cannot compel enforcement, this may give rise to a new claim under international law: “Specifically, such circumstances may constitute a ‘denial of justice,’ or may otherwise be cognizable under an investment treaty, many of which authorize investors to bring arbitration claims against host States.”¹⁵⁸ Thus, in many instances domestic litigation will only circle back to international arbitration for enforcement. This additional layer of procedure required in domestic litigation provides even more impetus to bring claims before ICSID tribunals in the first place.

Domestic dispute resolution also runs into greater issues of sovereignty, which SWFs would like to avoid because these issues often conflate SWFs with political motives. In the US, the Foreign Sovereign Immunities Act (FSIA)¹⁵⁹ presents an initial obstacle to bringing claims against SWFs. Under FSIA, foreign government-owned entities are immune from suit in American courts. This indicates that there may be instances where SWFs are immune from prosecution in the US, but subject to a claim in ICSID. These instances will likely be rare. There are exceptions to FSIA and “[w]hile SWFs appear by formal definition to satisfy the criteria of a government-owned enterprise and thus [are] vested with immunity, not all SWFs may be entitled to such protection.”¹⁶⁰ FSIA contains a commercial activities exception that provides:

¹⁵⁶ See Peter Sherwin, Ana Vermal, and Elizabeth Figueira, Proskauer on International Litigation and Arbitration: Managing, Resolving, and Avoiding Cross-Border Business or Regulatory Disputes ch 19 (Proskauer Rose LLP 2011), online at http://www.proskauerguide.com/arbitration/19/ (visited Oct 12, 2012) (noting that international arbitration may be more expensive now than lower cost litigation in civil law countries other than the US).

¹⁵⁷ Foster, Collecting from Sovereigns at 670 (cited in note 14).

¹⁵⁸ Id.


¹⁶⁰ Joel Slawotsky, Sovereign Wealth Funds and Jurisdiction Under the FSIA, 11 U Pa J Bus L 967, 972 (2009).
Foreign states are not immune from jurisdiction in cases in which the plaintiff's claims are based on commercial activity carried on in the United States or an act performed in the United States in connection with a commercial activity elsewhere, or an act in connection with a commercial activity of a foreign state elsewhere that causes a direct effect in the United States.161

Though it is rare that an SWF will not fall within this exception, at a minimum a domestic law solution will run into higher procedural costs in determining jurisdiction than ICSID, which generally provides a clear-cut determination of consent. Finally, even if the obstacle of jurisdiction is overcome and US courts can hear a claim brought against the SWF, "[t]he FSIA permits U.S. courts to execute judgments only against sovereign 'property in the United States . . . used for a commercial activity in the United States.'"162 This limitation on reachable assets contributes to the domestic law barrier to enforcement. Raising these issues of special treatment for SWFs is a great pitfall for domestic law.

Given the benefits and downfalls outlined above, in most instances ICSID arbitration is a preferable forum for the settlement of international investment disputes involving SWFs.

VI. CONCLUSION

This Comment has outlined the ways in which three important structures in international law (SWFs, BITs, and ICSID) intersect and will continue to influence investment and regulation. SWF investments and interests are divergent, but are all subject to international investment laws, domestic law regimes, and soft law like the Santiago Principles, seeking to coordinate and gain acceptance for SWF investment as a commercial and apolitical pursuit. This new category of investors with considerable assets and limited recognition in long-standing international law deserves the scrutiny of international bodies to determine how SWFs fall into existing regimes, especially now, since “SWFs have been largely quiet investors, but that is likely to change in coming years. SWFs with considerable investments in industrial assets in mature economies . . . will want a more active role in the design and execution of corporate leadership.”163 With a more active role comes the potential for a rise in investment suits, particularly where SWFs venture outside of financial investments into more sensitive industries local governments will seek to

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163 Behrendt, Sovereign Wealth Funds and the Santiago Principles at 15 (cited in note 51).
regulate. There is no indication that SWFs are disappearing, rather they serve an important government purpose to invest surplus and have demonstrated their benefit in helping to stabilize the world economy in the recent financial crisis.

SWFs have already taken on an intricate legal structure implicating BITs and ICSID. BITs are crucial for providing dispute resolution mechanisms for SWFs because of their arbitration provisions and customization to suit the needs of host states. As the primary means for governing foreign investment and ensuring egalitarian treatment of investors, BITs will form the substantive basis of the international law governing SWFs and are foundational in promoting transparency and the disavowal of political motives. Finally, as the most popular forum for the arbitration of international investment disputes, ICSID is a logical and advantageous body for the resolution of claims brought by SWFs. It will continue to issue binding judgments and establish international precedent.

There are alternatives to ensuring fair treatment of SWF investments. There are alternative dispute resolution bodies and potential policy solutions. There is also a call to synchronize standards through regulation, but domestic law is often inadequate to ensure jurisdiction and enforcement and raises more political issues than it solves. An international agency like ICSID provides a relatively low-cost, customizable, and neutral forum for the necessary dispute resolution arising out of the investments of SWFs. While this may necessitate an increase in the number of BITs or state legislation consenting to ICSID arbitration in SWF disputes, ultimately, reliance on international institutions for dispute resolution will limit the influence of local politics and increase efficiency in investment and negotiations by reducing the number of domestic regulations that provide unique and complex obstacles, replacing them with a comprehensive international standard.

Robust trade agreements designating an arbitration regime that establishes precedent regarding acceptable practices offer a path to provide consistency and protect against misfeasance. An international body for the resolution of SWF disputes is one further step in a “better ordered system of International Law; one to which the assent of civilized peoples may be given greatly to the benefit and peace of mankind.”\textsuperscript{164}

\textsuperscript{164} Thomas Balch, \textit{International Courts of Arbitration} 27 (Philadelphia, Allen, Lane and Scott 1912).