Goettingen Journal of International Law 2 (2010) 1, 63-92

Pride and Prejudice: How the Financial Crisis Made Us Reconsider SWFs

Luca Schicho*

Table of Contents

Abstract ... 65

A. Introduction ... 65

I. Leading Concepts of the Paper ... 65

II. The Financial Crisis ... 67

III. SWFs and the Financial Crisis ... 68

B. The Pre-Crisis Situation ... 71

I. Hostile Attitudes Towards SWFs ... 71

II. Controversies Involving State-Owned Investors ... 72

1. The Unocal Controversy ... 73

2. The Dubai Ports World Controversy ... 74

3. Comparison and Conclusions ... 76

C. National Regulatory Frameworks ... 77

* Dr. iur. candidate, Universität Wien (Austria). I owe thanks to Christoph Schreuer, my thesis advisor, for encouragement and support, Jose Alvarez for his inspiring lecture and discussions concerning the topic during the Hague Academy Public International Law Programme 2009, and Wolfango Piccoli for valuable insights into SWF investment policies. Particular thanks go to Diana Ionescu and Sara Bazoobandi for sparking my interest in the topic, helpful comments on earlier drafts and a stimulating discussion at the University of Exeter last May. I would further like to thank my colleagues Jakob Wurm and Oleg Temnikov for their support, research advice and feedback.

doi: 10.3249/1868-1581-2-1-schicho

I. United States 78
II. Canada 83
III. France 85
IV. Japan 87
V. Conclusions 88
D. The Crisis or Post-Crisis Situation 90

Abstract

The article analyzes the interrelation of the financial crisis and the regulation of state-owned investors: For a number of years, Western states raised protectionist fears by publicly debating an increasingly "tough" line on state-owned investors, in particular SWFs from the Middle East and East Asia. But after the dawning of the crisis in summer 2007, SWFs made a series of substantial and urgently needed investments in the Western financial sector. This development necessitated a process of reconsideration of these protectionist tendencies and is gradually leading to a new consensus where legitimate concerns of states are fairly balanced with the indispensable freedom of investment. The article first outlines the pre-crisis situation and its protectionist tendencies, then describes the development of selected national regulatory frameworks and finally dwells on the current situation and the challenges facing states and SWFs in the future: States will have to create clear rules for regulating such investments, while state-owned investors will need to improve their transparency and independence to alloy public concerns over their activities.

A. Introduction

I. Leading Concepts of the Paper

It is a popular saying that every challenge is an opportunity. The challenge posed by the current financial crisis is no exception to the rule: It is an opportunity for Western states to reconsider their protectionist pride and prejudice towards state-owned investors, in particular Sovereign Wealth Funds [hereinafter "SWFs"].[1] After the dawning of the crisis in summer

[1] The European Central Bank defines a SWF as "A special investment fund created/owned by a government to hold assets for long-term purposes; it is typically funded from reserves or other foreign-currency sources, including commodity export revenues, and predominantly has significant ownership of foreign currency claims on non-residents.", *see* European Central Bank, Financial Stability Review (June 2009) (European Central Bank 2009), 178, available at http://www.ecb.int/pub/pdf/other/financialstabilityreview200906en.pdf?9f3acda484c1437219696695255058b8 (last visited 23 March 2010); for the debate on other possible definitions *see* B. J. Cohen, 'Sovereign Wealth Funds and National Security: The Great Tradeoff', 85 *International Affairs* (2009) 4, 713, 715; also *see* D. Ionescu, *Sovereign Wealth*

2007, SWFs have made a series of substantial and urgently needed investments in the western financial sector.[2] These investments allowed states to postpone their stabilization measures and showed the important role state-owned investors can play, in particular in a financial crisis.[3] This has lead to a reconsideration of the formerly hostile views of state-owned investors.

The purpose of this paper is to outline the interrelation of the financial crisis and regulatory tendencies: For a number of years, Western states raised protectionist fears by publicly debating an increasingly "tough" line on state-owned investors, in particular SWFs from the Middle East and East Asia. While many of the concerns raised were legitimate, e.g. concerning transparency and independence of SWFs, there was an unmistakably discriminatory element in these considerations. The financial crisis now necessitates a process of reconsideration of these hostile and discriminatory tendencies. This is gradually leading to a new consensus where legitimate concerns of states are fairly balanced with the indispensable freedom of investment. States will have to create clear rules for this purpose, while state-owned investors will be confronted with the challenge to improve their transparency and independence.

For these considerations, the following four aspects will be reviewed by the present paper. First, the impulse for the alleged change, the financial crisis; the pre-crisis situation, in particular the above mentioned controversies and underlying protectionist concerns; the development of national regulatory frameworks and their evolution during the crisis; and

Funds – The Impact of the Financial Crisis, Current Trends and Future Prospects (2009), 9.

2 F. Moshirian, Sovereign Wealth Funds and Sub-Prime Credit Problems (29 September 2008), 16, available at http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1275226_code448936.pdf?abstractid=1275226&mirid=1 (last visited 24 March 2010); European Central Bank, 'Financial Stability Review' (June 2008) 70, available at http://www.ecb.int/pub/pdf/other/financialstabilityreview200806en.pdf (last visited 24 March 2010); R. Beck & M. Fidora, 'The Impact of Sovereign Wealth Funds on Global Financial Markets', ECB Occasional Paper No. 91, (2 July 2008) 24, available at http://www.ecb.int/pub/pdf/scpops/ecbocp91.pdf (last visited 24 March 2010); Deloitte, Minding the GAPP: Sovereign wealth, transparency, and the 'Santiago Principles' (2008), 3, available at http://www.iasplus.com/dttpubs/0811sovereignwealth.pdf (last visited 24 March 2010); P. Rose, 'Sovereigns as Shareholders', 87 *North Carolina Law Review* (2008) 1, 83, 85-86, 97.

3 P. Rose, 'Sovereigns as Shareholders', *supra* note 2, 85-86, 97; V. Chhaochharia & L. A. Laeven, The Investment Allocation of Sovereign Wealth Funds (8 July 2009), 1, available at http://www.luclaeven.com/papers_files/2009_Sovereign%20Wealth%20Funds_Chhaochharia_Laeven.pdf (last visited 24 January 2010).

finally the possible post-crisis outlook. This review will cover political, legal and economic factors involved, with particular attention dedicated to the political background of the changes in regulatory frameworks.

II. The Financial Crisis

The current financial crisis began with the subprime mortgage crisis that rose into view in the summer of 2007. Since then, the crisis has been gradually evolving, resulting in volatility of global financial markets and undermining confidence in the growth perspectives of the world economy. The first result of the crisis were extensive losses from the surge in defaults suffered by financial institutions that had specialized in the mortgage and subprime mortgage sectors, starting with the more exposed and overleveraged market participants, but soon spreading to all financial institutions involved.[4] This in turn led to substantial losses for virtually every financial institution operating in the U.S. market, when the defaults started trickling into the more sophisticated securitization products based on subprime mortgages, such as Mortgage-Backed Securities and Collateralized Debt Obligations.[5]

These losses in themselves have already led to a substantial contraction of liquidity in the financial markets. The problems are aggravated by the presence of numerous overleveraged financial institutions, whose losses necessitate a deleveraging process, which forces them to sell off financial assets in their balance sheet to regain liquidity.[6] This process further lowers the value of the capital market, resulting in a liquidity squeeze and the so-called "credit crunch".[7]

4 M. Hutchinson, 'Regulating the un-regulatable', Asia Times Online, 5 March 2008, available at http://www.atimes.com/atimes/Global_Economy/JC05Dj02.html (last visited 24 January 2010).

5 A. Ferrell, *et. al.*, Legal and Economic Issues in Litigation Arising from the 2007-2008 Credit Crisis (17 November 2008), 2, available at http://ssrn.com/abstract=1096582 (last visited 24 January 2010).

6 M. Zhang & F. He, 'China's Sovereign Wealth Fund, Weakness and Challenges', 17 *China & World Economy* (2009) 1, 101, 110.

7 S. M. Yiannaki, 'Regulatory Failure and the Subprime Credit Crunch - The Importance of Basel II Regulation/Supervision', 2 *Icfai University Journal of Banking Law* (April 2009), 3, available at http://ssrn.com/abstract=1413765 (last visited 24 March 2010).

III. SWFs and the Financial Crisis

Due to the liquidity squeeze in the financial markets, the two main sources for the urgently needed capital injections are domestic measures and "external measures" in the form of foreign investment in the capital markets. Domestic measures range from the rate adjustments of the U.S. Federal Reserve[8] and other central banks to the so-called "bailouts" of threatened financial institutions.[9] An essential part of the "external measures" were capital injections by SWFs, as sketched in the table below.[10]

Recent investments by SWFs (2007-2008 Q1)	**Acquired Company**	**Transaction Value**	
		USD Billion	% of firm value
GIC (Singapore)	UBS	9.8	8.6
Abu Dhabi Investment Council	Citigroup	7.6	4.9
GIC (Singapore)	Citigroup	6.9	4.4
China Investment Company	Morgan Stanley	5.0	9.9
Temasek (Singapore)	Merrill Lynch	5.0	11.3
KIA (Kuwait)	Merrill Lynch	3.4	7.0
China Development Bank	Barclays	3.0	3.1
China Investment Company	Blackstone	3.0	10.0
Investment Corporation of Dubai	London Stock Exchange	3.0	28.0
KIC (Korea)	Merrill Lynch	2.0	4.3

8 Which occurred rapidly from July 2007 until May 2008, bringing the rate down from 5,26 % to below 2%, where it hovered until late September 2008, when the debris of the Lehman Brothers collapse necessitated another cut down towards 1% followed by further cuts throughout 2008 and 2009, see Federal Funds Reserve Statistics, Selected Interest Rates: Federal funds (effective) Daily, available at http://www.federalreserve.gov/releases/h15/data/Daily/H15_FF_O.txt (last visited 24 March 2010); J. Delasantellis, 'Bernanke running out of ammo', *Asia Times Online*, 10 October 2008, available at http://www.atimes.com/atimes/Global_Economy/JJ10Dj01.html (last visited 24 March 2010).

9 P. scobar, 'A bailout and a new world', *Asia Times Online*, 26 September 2008, available at http://www.atimes.com/atimes/Middle_East/JI26Ak02.html (last visited 24 March 2010).

10 H. Raymond, 'The effect of Sovereign Wealth Funds' involvement on stock markets', Banque de France -Occasional papers No. 7 (November 2008), 6, available at http://www.banque-france.fr/gb/publications/telechar/debats/Sovereign_Wealth_Funds.pdf (last visited 24 January 2010).

Temasek (Singapore)	Barclays	2.0	1.8
Qatar Investment Authority	London Stock Exchange	2.0	20.0
Temasek (Singapore)	Standard Chartered	2.0	5.4
Undisclosed "Middle East investor"	UBS	1.8	1.6
Abu Dhabi Investment Council	Carlyle Group	1.4	7.5
Investment Corporation of Dubai	Och-Ziff Capital Management	1.3	9.9
China Citic Securities	Bear Stearns	1.0	6.0
Borse Dubai	Nasdaq	1.0	19.9
GIC (Singapore)	Merrill Lynch Financial Centre	1.0	100.0

Sources: ECB 2008[11]

As the table shows, the years 2007 and 2008 saw a substantial surge of investments by SWFs in financial institutions, perceived, at the time, as only temporarily affected by the subprime woes. This climate of "investment opportunity" led numerous previously cautious SWFs to invest in the financial sector.[12] Many of these investments resulted in substantial losses during the crisis, when, even after receiving these capital injections from SWFs, financial institutions such as Citigroup, Merrill Lynch and UBS continued to disclose additional losses.

If the approximately U.S. $ 44.9 billion invested by SWFs in financial institutions between March 2007 and April 2008 had been invested half a year later, the investors would have been able to invest at substantially lower prices. For example, after the China Investment Corporation invested in Blackstone, the market value of the company dropped over 50 percent, thereby turning the China Investment Corporation into a prominent victim of the subprime mortgage crisis.[13] This has led to substantial domestic

11 European Central Bank, 2008, *supra* note 2, 20; Moshirian, *supra* note 2, 16.

12 S. Kerr, 'Gulf Arabs Flex Muscles for Global Buy-Outs as Funds Gain Confidence', *Financial Times*, 12 September 2007, available at http://www.ft.com/cms/589ddfb4-60c8-11dc-8ec0-0000779fd2ac.html (last visited 24 March 2010); J. B. Treaster, 'Dubai to Buy Large Stake in Nasdaq', *New York Times*, 20 September 2007, available at http://www.nytimes.com/2007/09/20/business/worldbusiness/20exchange.html?_r=1&scp=1&sq=dubai%20to%20buy%20large%20stake%20in%20nasdaq&st=cse (last visited 24 March 2010); S. R. Weisman, 'Oil Producers See the World And Buy It Up', *New York Times*, 28 November 2007, available at http://www.nytimes.com/2007/11/28/business/worldbusiness/28petrodollars.html?scp=1&sq=oil+producers+see+the+world+and+buy+it+up&st=nyt (last visited 8 March 2010).

13 Zhang & He, *supra* note 6, 110.

criticism of SWF's investment strategies, which may discourage SWFs from undertaking such substantial investments during periods of high market volatility in the future.[14]

Nonetheless, this series of investments allowed states, in particular the United States, to postpone their stabilization measures for a certain period. It was after this period, in February and March 2008, that the first large scale domestic measures became necessary: The nationalization of Northern Rock by the British government in late February[15] and the coordinated rescue of Bear Sterns by the Federal Reserve and JP Morgan in the United States in late March 2008.[16]

After this date, domestic measures to prevent the collapse of overleveraged and highly interconnected financial institutions became day-to-day business[17] in numerous Western states, which were suddenly forced to become partial or full owners of numerous financial institutions. The recently commemorated collapse of Lehman Brothers, considered by many a highly damaging but politically an inevitable reaction to public outrage over the "bailouts",[18] would have certainly occurred much sooner without the intervention by SWFs in 2007 and early 2008.

14 Cohen, *supra* note 1, 718; on the other hand, the China Investment Corporation made a recent investment of $ 1 billion. to Oaktree Capital Management, an LA firm specialized in acquiring distressed debt securities, *see* B. Powell 'It's Chinas World', *Fortune*, 26 October 2009, available at http://money.cnn.com/2009/10/07/news/international/china_natural_resources.fortune/index.htm (last visited 24 March 2010).

15 'Northern Rock now in public hands', *BBC*, 22 February 2008, available at http://news.bbc.co.uk/2/hi/uk_news/politics/7258492.stm (last visited 24 March. 2010); 'New company to manage Government's shareholding in banks' HM Treasury, 11 March 2008, available at http://www.hm-treasury.gov.uk/press_114_08.htm (last visited 24 March 2010).

16 'Bernanke Defends Bear Stearns Bailout', *CBS News*, 3 April 2008, available at http://www.cbsnews.com/stories/2008/04/03/business/main3991713.shtml?source=RSSattr=HOME_3991713 (last visited 24 March 2010); T. Tan, 'Bear Stearns Bondholders Win Big', *Seeking Alpha*, 18 June 2008, available at http://seekingalpha.com/article/70098-bear-stearns-bondholders-win-big (last visited 24 March 2010).

17 H. Askari & N. Krichene, 'G-20 fritters as crisis deepens', *Asia Times Online*, 19 March 2009, available at http://www.atimes.com/atimes/Global_Economy/KC19Dj02:html (last visited 24 March 2010).

18 For a critical assessment of that majority view, *see* P. Schiff, 'Autopsies miss Lehman lesson', *Asia Times Online*, 22 September 2009, available at http://www.atimes.com/atimes/Global_Economy/KI22Dj04.html (last visited 24 March 2010).

B. The Pre-Crisis Situation

I. Hostile Attitudes Towards SWFs

The question is whether, in the words of Prof. Ming, states should perceive an investing SWF as an "aggressive white shark or an amiable blue whale?"[19] The question is and remains controversial. Protectionist regulatory tendencies in Western states have moved in the ambivalence and contradiction between general commitments to open investment climate for SWFs as promoted by the OECD,[20] the acknowledgement of their economic importance for Western countries[21] and public statements endorsing a "tough" line on state-owned investors.[22] While some of the debates are based on entirely legitimate concerns, such as doubts about the transparency and independence of SWFs and other state-owned investors,[23] there are also discriminatory elements in these considerations,[24] as manifested in two exemplary cases, the Unocal and Dubai Ports World controversies.

19 Zhang & He, *supra* note 6, 102.

20 Secretariat of the OECD Investment Committee, Sovereign Wealth Funds and Recipient Countries - Working together to maintain and expand freedom of investment, available at http://www.oecd.org/dataoecd/0/23/41456730.pdf (last visited 24 March 2010).

21 G. S. Georgiev, 'The Reformed CFIUS Regulatory Framework, Mediating Between Continued Openness to Foreign Investment and National Security', 25 *Yale Journal on Regulation* (2008) 125, 130.

22 B. Davis, 'Americans See Little to Like in Sovereign Wealth Funds', *Wall Street Journal*, 21 February 2008, available at http://online.wsj.com/article/SB120356484 501482251.html?mod=googlenews_wsj (last visited 24 March 2010); C. Dougherty, 'Europe Looks at Controls on State-owned investors', *International Herald Tribune,* 13 July 2007, available at http://www.nytimes.com/2007/07/13/business/ worldbusiness/13iht-protect.4.6652337.html?scp=1&sq=europe%20looks%20at%20controls%20on%20state-owned%20investors&st=cse (last visited 24 March 2010).

23 United Nations Conference on Trade an Development, World Investment Report 2008, 25, available at http://www.unctad.org/Templates/Download.asp?docid=10502 &lang=1&intItemID=2068 (last visited 24 March 2010); T. Tassell & J. Chung, 'How Sovereign Wealth Funds are Muscling in on Global Markets', *Financial Times*, 24 May 2007, available at http://www.ft.com/cms/s/0/ffcc6948-0a21-11dc-93ae-000b5df10621.html?nclick_check=1 (last visited 24 March 2010);

24 Georgiev, *supra* note 21, 125.

II. Controversies Involving State-Owned Investors

Why should this and the following chapter be named “controversy” and not “affair” or “case”? Controversy is a freely chosen term, and affair or case could equally be used. However, avoiding the use of the term “case” seems appropriate to clarify that no judicial proceedings took place (which are in fact not provided for under the US regulatory framework). It is an important characteristic of both the Unocal and Dubai Ports World controversies that no such proceedings took place. The term “affair” would be another option, but due to its usual connotation of involving something illegal or illegitimate it is less precise. It is specifically the conformity of the investors conduct with the provisions and procedures established under U.S. law that makes these controversies so interesting. Finally, the term “controversy” most clearly implies the debate and conflict of opinions that played the decisive role for the failure of both the Unocal and the Dubai Ports World transactions.

While the two state-owned entities involved in the two controversies are not SWFs (they both operate businesses rather than acting as investment funds by acquiring and holding assets for long-term purposes), the concerns and objections raised concerning the transactions are very similar to those relating to investments by SWFs. In the absence of comparably controversial and highly publicized controversies relating to actual SWF investments, the author therefore uses these as reference points, in particular due to the fact that the investors were attacked explicitly due to their status as state-owned enterprises.[25]

The controversies brought to the surface lingering feelings of hostility and protectionism which equally apply to investments by SWFs, even though these generally attract less public attention due to their focus on minority share investments. Consequently, the political pressure exerted on SWFs in relation to their investments will take more subtle forms, which are less suitable for analysis compared to the Unocal and Dubai Ports World controversies.

[25] J. K. Jackson, The Committee on Foreign Investment in the United States (CFIUS), (8 April 2008), 7, available at http://www.fas.org/sgp/crs/natsec/RL33388.pdf (last visited 24 March 2010).

1. The Unocal Controversy

The Unocal Controversy took place in 2005 and involved 3 entities, the U.S. enterprises Unocal and Chevron Texaco and the state-owned Chinese National Offshore Oil Company [hereinafter "CNOOC"]. Unocal was a major petroleum explorer and marketer founded in 1890 and mainly active in the US and Central Asia. After an extended bidding contest, CNOOC topped Chevron Texaco's last $ 17,1 billion bid for Unocal with a $ 18,5 billion bid in June 2005. In July 2005, the Unocal board of directors accepted the bid and took the necessary steps to submit the decision to a vote by stockholders. Meanwhile, CNOOC was in regular contact with the Committee on Foreign Investment in the United States [hereinafter "CFIUS"] and discussing the possible conditions imposed on the transaction. However, the vote by stockholders was pre-empted by CNOOC's unexpected decision to withdraw its bid, citing the "unprecedented political opposition that followed the announcement of our proposed transaction, attempting to replace or amend the CFIUS process that has been successfully in operation for decades" and concluding that this pressure presented an "unacceptable risk to our ability to secure this transaction."[26]

The cited opposition essentially focused around a series of concerns raised by U.S. policymakers, mainly members of congress.[27] The concerns can be summarized in three main categories: Explicit security concerns arising from Unocal's possession of critical technologies;[28] trade and competition policy concerns related to alleged "unfair advantages" of CNOOC in the bidding contest due to government funding; and in particular strategic concerns about investments in the energy sector:[29] The transaction

26 'CNOOC withdraws its bid for Unocal', *Asia Times Online,* 4 August 2005, available at http://www.atimes.com/atimes/China/GH04Ad02.html (last visited 24 March 2010).

27 J. Weisman & P. S. Goodman, 'China's Oil Bid Riles Congress: Attempt to Take Over U.S. Firm Spurs Call for Retaliation', *Washington Post,* 24 June 2005, available at http://www.washingtonpost.com/wp-dyn/content/article/2005/06/23/AR2005062302065. html (last visited 24 March 2010).

28 Committee on Foreign Investment in the United States (CFIUS), One Year After Dubai Ports World: Hearing before the Committee on Financial Services US House of Representatives (7 February 2007), 164, available at http://ftp.resource.org/gpo.gov/hearings/110h/34672.pdf (last visited 24 March 2010).

29 M. R. Byrne, 'Protecting National Security and Promoting Foreign Investment: Maintaining the Exon-Florio Balance', 67 *Ohio State Law Journal* (2006) 4, 849, 852.

was attacked due to the lack of reciprocity in opening the energy sector, which remains strictly regulated in the People's Republic of China. Furthermore, Unocal was considered, due to its involvement in the highly sensitive and political Trans-Afghan pipeline project,[30] "off hands" for foreign investors, in particular when originating from competing players in the race for central Asian energy resources.[31]

2. The Dubai Ports World Controversy

The entities involved in this controversy were the British Peninsular and Oriental Steam Navigation Company [hereinafter "P&O"], the Singaporean PSA International, United Arab Emirates Dubai Ports World [hereinafter "DP World"] and the American Insurance Group's International Group. DP World is a holding company owned by the government of Dubai in the United Arab Emirates which was created by a merger between the Dubai Ports Authority and the enterprise DPI Terminals in 2005.[32]

Negotiations between DP World and P&O began in 2005. DP World, which managed numerous port facilities worldwide, intended to acquire P&Os North American port assets.[33] In October 2005, DP World approached the CFIUS to clear possible regulatory obstacles to an acquisition of these facilities. Separately, in December 2005, a group of Coast Guard officials raised the possibility of security risks associated with management of the port facilities by a company from the United Arab Emirates.

In early February 2006, the stockholders of P&O agreed to the sale to DP World after a bidding contest with PSA International. Shortly after this, in mid February 2006, Ellert & Company, a business partner of P&O North

30 T. M. Ashraf, 'China seeks an Afghan stepping-stone', *Asia Times Online*, 16 May 2008, available at http://www.atimes.com/atimes/China/JE16Ad04.html (last visited 24 March 2010); P. Escobar, 'Pipelineistan goes Af-Pak', *Asia Times Online*, 14 May 2009, available at http://www.atimes.com/atimes/Central_Asia/KE14Ag02.html (last visited 24 March 2010).

31 J. W. Casselman, 'China's Latest 'Threat' to the United States: The Failed CNOOC-Unocal Merger and Its Implications for Exon-Florio and CFIUS', 17 *Indiana International & Comparative Law Review* (2007), 155; E. Mekay, 'China oil bid tests US free market rhetoric', *Asia Times Online*, 15 July 2005, available at http://www.atimes.com/atimes/China/GG15Ad01.html (last visited 24 March 2010).

32 'About DP World', available at http://portal.pohub.com/portal/page?_pageid=761,248333&_dad=pogprtl&_schema=POGPRTL (last visited 24 March 2010).

33 Ionescu, *supra* note 1, 71.

America, became aware of the planned transaction and, feeling reluctant to become closely connected with DP World, decided to hire lobbyists to rally opposition to the transaction.[34] These rapidly contacted Senator Schumer and journalists from Associated Press. After a short but highly effective lobbying campaign, a number of senators began asking for a "more thorough review" of the transaction.[35] The campaign also attracted the White House's attention. Fearing the long-term impacts of a protectionist backlash to the transaction, President Bush joined the fray and on 22 February issued a statement threatening to veto any legislation blocking the transaction as "it would send a terrible signal to friends and allies".[36] Smelling hope, DP World started its own "charm offensive" and tried to turn the tide in Congress. It engaged its own team of lobbyists and on 23 February volunteered to postpone its takeover.

However, neither the President's nor DP World's efforts were sufficient to stop the growing opposition to the transaction.[37] Senator Levin issued a statement accusing the White House and CFIUS of having adopted a "casual approach to reviewing the sale of U.S. port facilities to a country with an uneven record of combating terrorism".[38] On 8 March, the respective House Panel voted 62-2 to block the transaction. On the following day, DP World admitted defeat, releasing a statement announcing

34 N. King Jr. & G. Hitt, 'Small Florida Firm Sowed Seed of Port Dispute', *Wall Street Journal*, 28 February 2006, A3.

35 D. M. Mostaghel, 'Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?', 70 *Albany Law Review* (2007) 2, 583-623; B. Knowlton, 'Lawmakers Increase Criticism of Dubai Deal for Ports', *International Herald Tribune*, 19 February 2006, available at http://www.nytimes.com/2006/02/19/politics/19cnd-port.html?scp=1&sq=lawmakers%20increase%20criticism%20of%20dubai%20deal%20for%20ports&st=Search (last visited 24 March 2010); 'Strong Bipartisan Push to Pass Emergency Legislation Suspending Dubai Port Deal Continues', Press Release from Office of US Senator Charles Schumer, 24 February 2006, available at http://schumer.senate.gov/new_website/record.cfm?id=259453 (last visited 24 March 2010).

36 'Bush threatens veto in ports row', *BBC News*, 22 February 2006, available at http://news.bbc.co.uk/2/hi/americas/4737940.stm (last visited 24 March 2010).

37 E. Alden *et. al*, 'Dubai cedes control in US ports battle', *Financial Times*, 10 March 2006, available at http://www.ft.com/cms/325d3dcc-af99-11da-b417-0000779e2340.html (last viewed 24 March 2010)

38 Senator C. Levin, Opening Remarks at Senate Armed Services Committee Briefing on Port Security, (23 February 2006), available at http://levin.senate.gov/newsroom/release.cfm?id=251838 (last visited 24 March 2010).

to turn over operation of U.S. ports to a "US company".[39] As became known later, this entity was American Insurance Group's International Group.

3. Comparison and Conclusions

The DP World controversy differed from the Unocal controversy in 3 decisive respects. First, it concerned an already concluded transaction and resulted in a forced sale of the already acquired company to a third entity. Second, the transaction in question did not constitute a transfer of control over an enterprise from a U.S. to a foreign company, but from one foreign company to another. Unocal had always been a U.S. enterprise and its acquisition by CNOOC would have indeed meant the transfer of control to a foreign entity. But in the case of DP World, the questioned sale took place between two foreign companies, the British P&O and the United Arab Emirates owned DP World. The debate was therefore not framed in terms of national ownership policy, but explicitly targeted DP World for being based in a Muslim and Arab country. The discrimination prevalent in the public debate was also criticized by a series of observers.[40]

Third, the concerns raised about the transaction were not of a general strategic nature, as in the case of Unocal, but in specific terms of security policy.[41] While ownership and control of infrastructure is generally considered to have important strategic implications, the DP World transaction gave rise to much more concrete concerns: The specter invoked by numerous senators and journalists was of an immediate threat of terrorist attacks in case U.S. ports were managed by an "Arab company".[42] In the exuberant words of Senator Lautenberg, "We wouldn't transfer title to the Devil; we're not going to transfer title to Dubai".[43] The security concerns raised by senators and congressmen also evidenced their desire to play a larger role in the regulation of foreign investment. The lack of involvement of Congress was most prominently criticized by Senator Levin, who complained that "[w]e weren't notified at all, unless watching CNN and

39 Byrne, *supra* note 29, 879.

40 P. Newton *et. al.*, 'Israeli shipper endorses DP World', *CNN*, 3 March 2006, available at http://www.cnn.com/2006/POLITICS/03/02/port.security/index.html?iref=allsearch (last visited 24 March 2010).

41 CFIUS, *supra* note 28, 166.

42 Byrne, *supra* note 29, 879.

43 J. Cranford, 'Defining "Our" in a New World', *CQ Weekly*, 6 March 2006, 592; E. M. Graham & D. M. Marchick, *US National Security and Foreign Direct Investment* (2006), 136.

reading the morning paper constitute notification. More to the point, Congress should have been consulted, not merely notified."[44]

Apart from creating legal uncertainty concerning the finality of decisions by CFIUS, the controversy led to substantial losses of foreign investments, including a loss of foreign investment in the United States originating from the United Arab Emirates alone of about $ 1 billion in 2006. The DP World Controversy showed that a balanced and comprehensive review mechanism is not enough: The mechanism also needs the confidence of policymakers, otherwise its more controversial decisions will always entail a risk of highly damaging political backlashes. To analyze this particular problem, the next chapter will address a series of national regulatory frameworks and their aptitude to avoid such backlashes.

C. National Regulatory Frameworks

National regulatory frameworks for foreign investment have long existed in countries open to foreign investment.[45] They are, as lawyers would put it, the inevitable and necessary companion to the liberalization of foreign investment. These regulatory frameworks vary in many respects, such as their scope of application, the authorities responsible for applying them, the timeframes provided for and, in particular, the transparency requirements for the regulating authority. Some of these frameworks, such as the CFIUS in the US, explicitly address state-owned investors while others, such as the frameworks Canada and France, do so only indirectly, by providing for criteria likely to be invoked in case of state-owned investors.

It is the author's view that the financial crisis has acted as a catalyst to the evolution of provisions relating to state-owned investors such as SWFs. The highly visible and urgently needed investments by SWFs since the outbreak of the crisis led to surprise and a public debate on the role of state-owned investors, in particular SWFs, in today's investment landscape. One defining feature of this debate was a broad consensus for creating clear legal frameworks which would allow such investment to play its useful role while addressing domestic concerns to prevent protectionist backlashes.[46]

Therefore, this chapter will be dedicated to a series of national regulatory frameworks and their historical development, including the changes these have undergone since the beginning of the crisis. The main

44 Senator C. Levin, *supra* note 38.
45 Cohen, *supra* note 1, 721.
46 Cohen, *supra* note 1, 715.

focus will be on the U.S. regulatory framework, while other national frameworks will be briefly described in comparison to the U.S. and with emphasis on recent trends. This focus is necessary both because of the particular importance of the U.S. as a case study concerning political backlashes, as evidenced by the two controversies discussed above, but also because the U.S. framework is frequently used as a reference point when assessing other regulatory frameworks.[47]

I. United States

The body responsible for the monitoring and regulation of foreign investment, including investment by SWFs, in the United States is the Committee on Foreign Investment in the United States (CFIUS), an interagency body created in 1975.[48] In 1976, the President's power to intervene to block foreign investment was formalized in the International Investment Survey Act 1976. However, the President could only act by declaring a national emergency or if regulators found a violation of federal antitrust, environmental or securities laws.

The next step in the evolution of the regulatory framework came in the 1980ies as a reaction to growing fear over Japanese takeovers in the United States.[49] To address these, a system of formal review was introduced under the 1988 Exon-Florio Amendment to the Defense Production Act of 1950.[50] Under the amendment, the President could investigate foreign acquisitions to assess their impact on U.S. national security, thereby greatly expanding the scope of his powers.

Another step came in 1992, when the Byrd Amendment imposed on CFIUS the obligation to investigate transactions where the acquirer is "controlled by or acting on behalf of a foreign government" and "seeks to acquire or merge with a U.S. firm producing defense-related

47 Georgiev, *supra* note 21, 130; Cohen, *supra* note 1, 722.

48 Exec. Order No. 11,858, 40 Fed. Reg. 20,263 (9 May 1975), *as amended by* Exec. Order No. 12,188, 45 Fed. Reg. 989 (4 Jan. 1980); Exec. Order No. 12,661, 54 Fed. Reg. 779 (9 Jan. 1989); Exec. Order No. 12,860, 58 Fed. Reg. 47,201 (8 Sept. 1993); *and* Exec. Order No. 13,286, 68 Fed. Reg. 10,619 (5 March 2003). For an overview of the early years of CFIUS activity, *see* Jackson, *supra* note 25.

49 Georgiev, *supra* note 21, 127.

50 Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418 § 5021, 102 Stat. 1107, 1425 (codified as amended at 50 U.S.C. app. §§ 2158-2170 (2000)).

technologies."[51] The amendment was a response to political pressure exerted by U.S. enterprises Martin Marietta and Lockheed, whose joint bid for the missile division of U.S. defense contractor LTV Aerospace and Defense Company had been topped by a bid by French state-owned Thomson-CSF.[52] The enterprises successfully argued that the transaction would detrimentally affect U.S. national security, forcing Thomson-CSF to withdraw its bid before the CFIUS recommendation due in July 1992.[53]

The investments subject to review by CFIUS are mergers, acquisitions, and takeovers by foreign persons which could result in foreign control of U.S. corporations. The Amendment is therefore equally applicable to SWFs, other state-owned investors or private foreign investors. The review is not limited to any specific sectors, as provided for by other regulatory frameworks – investments in any sector might be scrutinized under the Amendment, unless the transactions involve no more than 10% of shares, in which case they are exempted from review altogether.[54]

The President is empowered to block the foreign acquisitions of a U.S. company in case national security is threatened. There is a list of factors that must be taken into account in the assessment, including: domestic production needed for current and projected national defense requirements and the control of that production, potential effects of an acquisition on sales of military equipment or technology to countries supporting terrorism or raising proliferation concerns and potential effects on U.S. technological leadership in areas affecting national security.[55] The main review process is carried out by CFIUS, an interagency body consisting of twelve members and chaired by the Treasury Secretary.[56] The other members include the Secretaries of State, Defense, Homeland Security, and Commerce; the U.S.

51 E. Graham & P. Krugman, *Foreign Direct Investment in the United States*, 3rd ed. (1995), 131.

52 S. Liebeler & W. H. Lash III, 'Exon-Florio: Harbinger of Economic Nationalism?', *Cato Review of Business & Government* (1993), available at http://www.cato.org/pubs/regulation/regv16n1/reg16n1d.html (last visited 24 March 2010).

53 R. Prabhakar, 'Deal-Breaker: FDI, CFIUS, and Congressional Response to State Ownership of Foreign Firms', (13 May 2009), 9, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420790 (last visited 24 March 2010); P. Muchlinski, *Multinational Enterprises and the Law* (2007), 182.

54 However, this exemption does not apply in case the transaction involves additional rights not usually awarded to similarly situated shareholders, such as special voting rights or rights to appoint members of the Board.

55 50 U.S.C. app. § 2170(f) (2000) (pre-amendment).

56 Muchlinski, *supra* note 53, 181.

Trade Representative; the Chair of the Council of Economic Advisers; the Attorney General; the Directors of the Office of Management and Budget and of the Office of Science and Technology Policy; the Assistant to the President for National Security Affairs; and the Assistant to the President for Economic Policy.

The review process before CFIUS is usually started by a voluntary filing by the investor, which is strongly encouraged by CFIUS.[57] In case a transaction is not filed for review, CFIUS can initiate a review *proprio motu*. The standard review to determine whether a transaction could pose a threat to national security lasts up to 30 days. If after this period CFIUS concludes that no threat exists, the review process ends and the transaction can take place. Otherwise, CFIUS undertakes a 45 day investigation. After the investigation, CFIUS is required to submit a report to the President, who then has 15 days to decide on the fate of the acquisition.[58]

The President may directly grant or forbid an acquisition or impose specific conditions. In case the respective transaction has already been concluded, a negative decision means that the entire transaction has to be unwound. For this reason, foreign investors considering a review by CFIUS possible will usually file voluntarily to implement the conditions at the earliest stage or at least minimize the costs of aborting the transaction. Furthermore, CFIUS can provide an investor with guidance on taking precautions to ensure that his transaction does not raise national security concerns.[59] There are no legal remedies against and no further judicial review of the decision.

The only case that has been officially blocked by CFIUS yet occurred in 1990, when the China National Aero-Technology Import and Export Corporation, a purchasing agent for the Chinese Ministry of Defense, attempted to acquire a U.S. aerospace parts manufacturer.[60] Interestingly, it has been suggested that the main motivation behind this decision were not actual national security concerns, but a desire to rebuke the Chinese government for the Tiananmen crackdown in June 1989.[61] In 1990,

[57] US Government Accountability Office, 'Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness' (2005), available at http://www.gao.gov/new.items/d05686.pdf (last visited 24 March 2010).

[58] Jackson, *supra* note 25, 12.

[59] Georgiev, *supra* note 21, 128.

[60] S. Auerbach, 'President Tells China To Sell Seattle Firm', *Washington Post*, 3 February 1990.

[61] S. J. Tolchin, 'The Globalist from Nowhere: Making Governance Competitive in the International Environment', 56 *Public Administration Review* (1996), 1, 8.

Japanese Nikon was preparing to file its planned acquisition of the semiconductor division of U.S. firm Perkin-Elmer to CFIUS, but withdrew from even filing when it was informed of massive congressional opposition to the transaction, upon which the acquisition was made by a California-based firm.[62]

This regulatory regime was modified in 2007 by the Foreign Investment and National Security Act (FINSA). The Act was adopted by the House of Congress in its final form on 11 July 2007, and implemented by an executive order issued by President Bush on 23 January 2008.[63] Overall, the act strikes "a careful balance between the need for greater transparency and more detailed review on the one hand, and the interest in promoting foreign investment on the other."[64] By increasing transparency and public confidence in the procedure, a repetition of cases like the DP World controversy will hopefully be avoided.

The act provides for increased scrutiny of acquisitions in critical infrastructure and critical technologies,[65] which would cover sectors such as port facilities, rail networks, energy, IT and telecommunications.[66] This is achieved by expanding the factors to be considered in evaluating transactions, specifically mentioning potential effects on critical energy assets and long-term projections of U.S. energy requirements,[67] sales of military goods or technology to countries posing a regional military threat to the United States or countries with lacking track-records in their counter-terrorism efforts[68] and prevention of diversion of military technologies.[69] Earlier proposals for a ranking of countries according to their non-

62 J. Markoff, 'Perkin Unit to Remain U.S. Owned', *New York Times,* 16 May 1990.

63 Jackson, *supra* note 26, 8.

64 Georgiev, *supra* note 21, 131; *cf.* E. M. Truman, 'Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications', Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate (14 November 2007), 5, available at http://www.iie.com/publications/papers/truman1107.pdf (last visited 24 March 2010).

65 M. Steinitz & M. Ingrassia, 'The Impact of Sovereign Wealth Funds on the Regulation of Foreign Direct Investment in Strategic Industries: a Comparative View', 10 *Business Law International* (2009), 5, 12.

66 Ionescu, *supra* note 1, 79.

67 The argument implicitly used in the Unocal controversy in 2005.

68 The main argument used to stop the DP World transaction in 2006.

69 Georgiev, *supra* note 21, 131.

proliferation and counter-terrorism efforts,[70] were rejected, thereby preventing an excessive formalization of the procedure.[71]

The act also increases the role of Congress, by adding reporting requirements for CFIUS, which must now submit annual reports to Congress. Furthermore, CFIUS must report to selected members of Congress whenever a review or investigation comes to a decision allowing the transaction. These reports must elaborate on the factors leading to the Committee's decision that the transaction does not constitute a threat to national security. Calls for providing Congress with the right to block specific transactions[72] or to move the chairmanship from the Treasury Department to the Department of Defense or the Department of Homeland security[73] were, in the author's view fortunately, not needed. These changes will help CFIUS to be better prepared to face opposition from Congress in case of controversial transactions and contribute to raising confidence in its work.[74]

Another change is the codification and formalization of the involvement of intelligence agencies in the procedure: Under the new act, the Director of National Intelligence becomes a non-voting member of the Committee and has to provide an analysis of national security implications of transactions under review. Thereby, the already existing cooperation with intelligence agencies is expressly acknowledged, contributing to alleviate fears about a lack of concern for national security due to the leading role of the Treasury. [75]

Since the DP World Controversy in 2006, the number of annual filings by investors and reviews by CFIUS has steadily increased.[76] This evidences a main characteristic of the CFIUS procedure: It provides certainty to foreign investors concerned that their investment may be perceived as a "national security threat". In the light of increased political and public

70 D. Holtz-Eakin, 'You Can't Be CFIUS', *Wall Street Journal*, 13 July 2006, available at http://www.cfr.org/publication/11105/you_cant_be_cfius.html (last visited 24 March 2010).

71 Georgiev, *supra* note 21, 131.

72 Holtz-Eakin, *supra* note 70.

73 Byrne, *supra* note 29, 907.

74 Prabhakar, *supra* note 53, 24; Georgiev, *supra* note 21, 132.

75 Georgiev, *supra* note 21, 133.

76 Committee on Foreign Investment in the United States (CFIUS), 'Covered Transactions, Withdrawals, and Presidential Decisions 2006-2008', available at http://www.treas.gov/offices/international-affairs/cfius/docs/Covered-Transactions_2006-2008.pdf (last visited 24 March 2010).

attention to the topic, highlighted by events such as Unocal and DP World controversies, the number of voluntary filings therefore increased significantly. At the same time, however, the cooperation and dialogue concerning individual transactions between CFIUS and investors has suffered from the loss of credibility resulting from the DP World controversy.[77]

II. Canada

The first national regulatory authority in Canada was the Foreign Investment Review Agency, which was created by the Foreign Investment Review Act in 1974 following growing concerns about the drastic increase of foreign takeovers in the 1970's, expressed most prominently in the 1972 Gray Report.[78] The Foreign Investment Review Agency was responsible for reviewing all foreign direct investment in Canada, which could only proceed after receiving approval by the Cabinet Council after receiving a report from the agency. This restrictive framework contributed to a decrease in foreign investment inflows in the 1980's, leading to its removal in 1984 when a conservative government came to power.

The new government introduced the Investment Canada Act 1985 [hereinafter "ICA 1985"], under which transactions are reviewed to assess whether they constitute a "net benefit" to Canada.[79] The new framework was significantly more investor-friendly as it simplified and shortened procedures and raised the transaction value threshold for review. The review under the ICA 1985 is undertaken by the Ministry of Industry, whose officials may invite additional ministries to participate in the review in case the transaction specially affects their responsibilities.[80] All transactions are subject to a duty to notify the ministry, but only those surpassing an asset

77 A. P. Larson & D. M. Marchik, *Foreign investment and national security: getting the balance right* (2006), 11.

78 C. Lalonde, 'Dubai or not Dubai?: A review of foreign investment and acquisition laws in the U.S. and Canada', 46 *Vanderbilt Journal of Transnational Law* (2008), 1475 (1484).

79 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', GAO-08-320, (2008), 38, available at http://www.gao.gov/new.items/d08320.pdf (last visited 24 January 2010).

80 With the exception of cultural investments, for which the Ministry of Canadian Heritage is responsible.

value of Can $ 295 million[81] are subject to a review. The final decision to block or allow a transaction lies with the Ministry of Industry.[82]

The assessment of the "net benefit" is based on factors including the impacts on employment, competition and exports, the contribution to technological development and innovation, compatibility with Canadian national industrial, economic, and cultural policies and Canadian participation in the business enterprise.

National security is not an explicit part of the regulatory framework under the ICA 1985.[83] Instead, a series of special provisions regulate foreign investment in specific sectors, such as the requirement for government approval for investments in uranium production, financial services, transportation services and cultural businesses. In other sectors, such as telecommunications, there are ownership restrictions ranging between 25% and 33%. [84]

The review process is initiated upon submission of an application, which must be filed before undertaking the investment. The application is to contain information about the investor and the planned investment, to which the investor can further attach a part giving particular reasons why the transaction should be approved. After the filing of a complete application, the ministry has 45 days to review the investment. If the 45 days elapse and the investor has not received a notice, the application is considered approved. During the 45 days the responsible ministry can unilaterally extend the review period by 30 days. Any further extensions are only permitted in case a respective agreement is reached with the investor. Over the period from 2003 to 2007, average review periods have been 52 days for

81 For an investor from a WTO country in 2008, transactions from non-WTO countries are lower, Can$5 million for direct investments and Can$50 million for indirect transactions.

82 Or the Ministry of Canadian Heritage, respectively.

83 There was an attempt in 2005 to pass a bill including provisions to allow the government to review foreign investment based on national security concerns. The main motivation behind the bill were concerns about a growing number of attempts by Chinese firms to acquire Canadian enterprises in the energy sector. However, a change in government and opposition by officials prevented further consideration of the bill. See C. Sosnow *et al.*, 'Canada: Foreign State-Owned Investors Spark "National Security" Concerns', *Blakes Bulletin on International Trade*, 23 Oct. 2007, available at http://www.mondaq.com/article.asp?articleid=53328 (last visited 24 March 2010).

84 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', supra note 79, 39.

the Ministry of Industry and over 75 days for the Ministry of Canadian Heritage.

Investments will be approved in case the reviewing ministry is convinced that the investment will result in an overall net benefit to Canada according to factors listed above. The ministry might also impose certain conditions for approval, including Canadian participation on the acquired company's board and management, planned research and development expenditures as well as minimum employment levels.[85]

In December 2007, the Canadian Government published clarifications to the act,[86] specifying how the rules should apply to state-owned enterprises, including sovereign wealth funds. Concerning these, particular consideration should be given to the investor's adherence to Canadian corporate standards of transparency, good governance, and free market principles.[87]

Further changes were introduced after the April 2008 decision to block the takeover of the space-technology division of Vancouver-based MacDonald, Dettwiler and Associates Ltd by a U.S. company. The main motivation behind the decision was concern about the removal of research and development facilities from Canada resulting in the loss of high-paid employment opportunities. However, the transaction also raised concerns about investments in "highly sensitive sectors", such as space technology.

Therefore, an amendment to the ICA 1985 was introduced in March 2009. It provided for a special review process for investments that could be injurious to national security. The term "national security" was left ambiguous, remaining open to wide interpretation and allowing a wide discretion in deciding about investments. To balance this stricter approach, the transaction value threshold for reviews was raised.

III. France

In France, in December 2005, the Government passed Decree No. 1739 on foreign investments.[88] It provides for 11 economic sectors which might affect national interest and in which therefore the acquisition of

85 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', supra note 79, 41.

86 Cohen, supra note 1, 722.

87 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', supra note 79, 40.

88 Cohen, *supra* note 1, 722.

controlling stakes by foreign parties requires the authorization from Ministry of Economy, Finance and Employment.[89] These sectors are: defense related industries, information systems and technologies and gambling.[90] Interestingly, the energy sector is not included in the list. EU investors are exempted from the regulatory regime concerning all sectors except defense related industry.[91] No denial of a specific transaction under the decree has occurred yet.

Another recent development in the field of reacting to foreign investment was the creation of an own SWF, the Fonds Strategique d'Investissement (FSI) in November 2008. The Fund, for which plans had previously been discussed for months,[92] has the mission to invest in "strategic companies" which might otherwise need to have recourse to foreign investors.[93] It has been perceived as a measure to block foreign investments in strategic or symbolic French companies.[94] The investments by the fund are intended to be only temporary and limited to periods of falling stock prices during which such companies would be disproportionately vulnerable to takeovers.[95] The plan has been widely criticized as promoting economic isolationism[96] and as going against the principles of EU economic policy.[97] However, until now, the Fund has alleviated these concerns by concentrating on co-investments with foreign investors. In May, it signed an agreement for joint investments with

89 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', *supra* note 79, 55.

90 Ionescu, *supra* note 1, 77.

91 Steinitz & Ingrassia, *supra* note 65, 12.

92 M. Turner, 'Sarkozy unveils ambitions for €400 billion French SWF', *Wealth Bulletin*, 4 July 2008, available at http://www.wealth-bulletin.com/home/content/2451139211 (last visited 24 March 2010).

93 K. Bennhold, '$25 Billion Investment Fund Is Formed to Protect French Industry', *New York Times*, 20 Nov. 2008, available at http://www.nytimes.com/2008/11/21/business/worldbusiness/21fund.html (last visited 24 March 2010).

94 B. Hall, 'Sarkozy plans new French wealth fund', *Financial Times*, 23 Oct. 2008.

95 'Lukewarm response to French sovereign wealth fund plan', *Euronews*, 23 Oct. 2008, available at http://www.euronews.net/2008/10/23/lukewarm-response-to-french-sovereign-wealth-fund-plan (last visited 24 March 2010); Bennhold, *supra* note 93.

96 B. Keller, 'A New Breed of Sovereign Wealth Fund?', *Oxford SWF Project*, 28 Oct. 2008, available at http://oxfordswfproject.com/2008/10/28/a-new-breed-of-sovereign-wealth-fund (last visited 24 March 2010).

97 'Germany Critical of French Wealth Fund Proposal', *DW-World*, 23 October 2008, available at http://www.dw-world.de/dw/article/0,,3734577,00.html (last visited 24 March 2010).

Mubadala Development, an SWF from Abu Dhabi.[98] It is currently negotiating for a joint bid for French nuclear group Areva SA's (ARVCY, CEI.FR) transmission and distribution business together with U.S.-based General Electric Co. (GE) and private equity firm CVC Capital Partners.[99]

IV. Japan

In Japan, the Japanese Foreign Exchange and Foreign Trade Act requires investors investing in sensitive industries, including those related to national security, to notify the government. After notification, the transaction is reviewed, taking into account whether it might imperil national security, disturb public order or public safety, or adversely affect the Japanese economy. The originally restricted field of application was expanded in September 2007 to include dual use technology and accessories or equipment designed for the production of aircraft.[100] Recent measures include the block of an attempt by the UK-based "Children's Investment Fund" from increasing its shares in an electricity company under the Foreign Exchange and Foreign Trade Act.[101]

A different recent measure intends to, uncharacteristically, influence foreign investments by enticements rather than restrictions or sanctions: In the beginning of 2009, an amendment was passed to relax rules that have imposed a huge tax burden on foreign funds investing in Japan. The amendment was drafted by the Ministry of Economy, Trade and Industry and the Ministry of Finance. Under the amendment, foreign investors will be exempt from the significant burden of capital gains tax on investments, as long as their individual stake in a Japanese company remains below 25%.[102]

98 'French SWF picks Mubadala for first co-investment pact', *Top 100 Funds*, 27 May 2009, available at http://www.top1000funds.com/latest-news/strategy-news/french-swf-picks-mubadala-for-first-co-investment-pact.html (last visited 24 March 2010).

99 N. Boschat & C. Dean, 'GE,French SWF Likely In Talks On Areva T&D Bid-Sources', *The Wall Street Journal*, 21 October 2009, available at http://online.wsj.com/article/BT-CO-20091021-711212.html (last visited 24 March 2010).

100 US Government Accountability Office, 'Foreign Investment – Laws and Policies Regulating Foreign Investment in 10 Countries', *supra* note 79, 77.

101 Ionescu, *supra* note 1, 81.

102 M. Nakamoto, 'Sovereign Wealth Funds: Nobody Wants to Be First to Buy in', *Financial Times*, 17 March 2009, available at http://www.ft.com/cms/s/0/bf8e9a3c-11b7-11de-87b1-0000779fd2ac.html (last visited 24 March 2010).

The background of this measure are long-standing concerns about Japan's ability to attract foreign investment,[103] in particular due to a trend by multinational enterprises to bypass Japan in favor of the rapidly growing markets of emerging economies such as China and India.[104] Due to the financial crisis, the Japanese economy is in urgent need of additional funds which could be provided by sovereign wealth funds from Middle Eastern countries, which hitherto avoided investments in Japan as their home countries lack tax treaties with Japan that would exempt them from the capital gains tax.[105] The tax incentives intended to channel foreign investment into minority share acquisitions, thereby reducing domestic concerns and avoiding a regulatory debate which might further deteriorate Japan's attractiveness for FDI.

A 2008 proposal by senior politicians to create a sovereign wealth fund to diversify Japan's reserves (which currently rely mainly on US Treasuries) was rejected, citing the risk of public backlash in case of losses incurred by the fund and a "growing international criticism" concerning SWF's lack of transparency and their "increasingly negative image".[106]

V. Conclusions

There are some general conclusions that can be drawn from a comparison of these regulatory frameworks. A characteristic all frameworks have in common is the attempt to balance legitimate domestic concerns about foreign investment with a continued commitment to an investment-friendly climate.

The core question is that of allocation of regulatory authority. While in the ideal case, the primary responsibility could be granted to an independent body of experts under supervision of a ministry, it seems more

103 M. Nakamoto & D. Turner, 'Tokyo considers foreign enclave', *Financial Times*, 21 May 2007, available at http://us.ft.com/ftgateway/superpage.ft?news_id=fto052120071725587066&page=2 (last visited 24 March 2010).

104 M. Nakamoto, 'The doors creak open to foreign capitalism', *Financial Times*, 13 March 2007, available at http://us.ft.com/ftgateway/superpage.ft?news_id=fto031320070511077971&page=2 (last visited 24 March 2010).

105 *Id*., 'Sovereign Wealth Funds: Nobody Wants to Be First to Buy in', *Financial Times*, 17 March 2009, available at http://www.ft.com/cms/s/0/bf8e9a3c-11b7-11de-87b1-0000779fd2ac.html (last visited 24 March 2010).

106 *Id*., 'Idea of Japanese wealth fund rebuffed', *Financial Express*, 3 February 2008, available at http://www.thefinancialexpress-bd.com/2008/02/03/24315.html (last visited 24 March 2010).

realistic to expect a higher degree of political influence. This is either achieved by entrusting a joint body including officials from different branches of administration, such as the CFIUS in the review and investigation process or the Foreign Investment Promotion Board in India. Concerning the latter,[107] or by directly empowering a specific organ or ministry, such as the US President after the review and investigation process or the respective ministries in Canada, France and Japan.

The greater the influence of politics on the process, the more urgent is the need for safeguards against abuse. This is a result of the fundamental dilemma that a politician will rarely be in a position to genuinely balance his or her regard for hostile public opinion with the long-term impacts of any decision on foreign investment in his country. If, however, sufficient safeguards are in place, in particular in the form of an exhaustive list of criteria on which the decision must be based, this increased concern for public opinion can be a valuable asset: By paying heed to such concerns, even when they may be out of place in the light of the actual transaction at stake, a politician can prevent a backlash against the regulatory authority (as was seen during the DP World affair). This is essential for maintaining the bodies' authority, as each backlash or circumvention of the review process creates insecurity for potential future investors. Therefore, as authors have repeatedly emphasized in relation to CFIUS, the determining factor for the success of any regulatory framework is its ability "to inspire and maintain public confidence" in review procedures.[108]

Another important element is that foreign investors should be encouraged to file for review, as provided for under the U.S. regulatory framework, because this promotes cooperation between investors and the regulatory authority, allowing faster and more cost-effective reviews. The main incentive for filing would be the legal certainty of being able to undertake the transaction and the opportunity to include the necessary adaptations to conditions as early and effectively as possible in case conditions are attached to the authorization of the transaction. Equally, in case of a negative result, it is important for an investor to be informed of this circumstance as early as possible to minimize costs from aborting the transaction.

[107] E.g. see Steinitz & Ingrassia, *supra* note 65, 16.
[108] Georgiev, *supra* note 22, 134; Byrne, *supra* note 30, 907.

D. The Crisis or Post-Crisis Situation

Is the crisis gradually leading to a new consensus on state-owned investments, in particular by SWFs? This remains to be seen, however, it is the authors view that the crisis has functioned as a strong catalyst to resolve outstanding conflicts between policies designed to encourage foreign investments and mechanisms for the protection of national security in the wider sense. Concerning this concept of "national security in the wider sense" it must be noted that besides the financial crisis, an important factor that continues to influence changes in the regulatory framework in the US are ongoing security concerns dating back to the September 11 attacks. It has been argued that protecting national security from the threat of terrorism, in light of the attacks of September 11, inevitably comes into conflict with a commitment to an open investment policy.[109] This conflict requires legislators to strike a balance between the promotion of investment and the protection from perceived threats to national security.[110] An example for this conflict and the difficulties in balancing between investment-openness and taking into account domestic concerns is the DP World controversy, where an important factor contributing to opposition to the transaction was the fact that some of the September 11 hijackers were of the same nationality as the foreign investor involved.[111]

It is certainly true that the shock of the September 11 attacks still has great influence on threat perception and national security thinking in the US. However, rather than directly changing the domestic concerns about foreign investment, this development has expanded the already existing group of countries considered "suspicious" or possibly threatening: While, e.g. investors from the People's Republic of China always faced suspicions due to political and ideological tensions between the US and China or Japanese investors were confronted with fears of a "buyout" in the 1980's,[112] Middle Eastern investors were taken less notice of until the September 11 attacks.[113]

109 Byrne, supra note 30, 850.

110 Cohen, *supra* note 1, 714.

111 Byrne, *supra* note 30, 879.

112 Jackson, *supra* note 26, 4; Georgiev, *supra* note 22, 127.

113 A development criticized by investment analysts who argue that the greatest risk to the US is one of economic security, that is, the risk that the erection of unnecessary barriers to the free flow of capital would negatively impact the global and in particular the US economy; see E. M. Truman, 'Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications', Testimony before the Committee on Banking,

Therefore, the primary aim of the regulatory changes is to increase trust in and transparency of existing procedures. The mechanisms provided for this purpose include involving policymakers in the procedure to prevent them from pursuing a populist public debate on transactions they consider sensitive. This involvement requires a mutual effort to increase transparency, which is also the spirit permeating the International Working Group on Sovereign Wealth Funds' Santiago Principles.

First SWFs are required to respect transparency standards[114] to on the one hand ensure that they contribute to a stable financial system[115] and on the other hand to dispel national concerns[116] which in themselves could result in protectionist backlashes through intransparent policies. This is particularly evident in Principle 17:

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

The investor's lack of transparency is the cover which allows protectionism to entrench itself with these policies which lack transparency. An effective transparency policy by SWFs would show that in the vast majority of cases, SWFs consistently pursue commercial, not political objectives.[117] It would show that these entities, even though commanding undeniably vast resources, act under the same precepts and principles as all other market actors. Combined with the strong tendency of SWFs to invest

Housing, and Urban Affairs, United States Senate (14 Nov. 2007), 6, available at http://www.iie.com/publications/papers/truman1107.pdf (last visited 24 March 2010).

114 E. M. Truman, 'Sovereign Wealth Funds: The Need for Greater Transparency and Accountability', Policy Brief (2007), available at http://www.iie.com/publications/pb/pb07-6.pdf (last visited 31 January 2010).

115 International Working Group on Sovereign Wealth Funds, 'Sovereign Wealth Funds, Generally Accepted Principles and Practices ("Santiago Principles")', (2008), 22. Principle, available at http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (last visited 24 March 2010).

116 *Id*., 19.1. Subprinciple, 21. Principle; P. Rose, 'Sovereign Wealth Funds: Active or Passive Investors?', 118 *Yale Law Journal Pocket Part* (2008), 104, available at http://yalelawjournal.org/images/pdfs/725.pdf (last visited 24 March 2010).

117 E. M. Truman, 'Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States: Assessing the Economic and National Security Implications', Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate (14 November 2007), 9, available at http://www.iie.com/publications/papers/truman1107.pdf (last visited 31 January 2010).

passively,[118] this shows that SWFs do not constitute threats to "national interests" but rather bring substantial benefits to the global markets.[119]

This leads to the second part of the quest for transparency – the necessity for national regulatory frameworks to be transparent, predictable and effective. These frameworks need to balance legitimate concerns of the public with freedom of investment[120] and would result in a transparent framework preventing arbitrary and discriminatory decisions and policies.

To return to the metaphor of sharks and whales, the main challenge today is to promote clear and transparent waters. Murky waters may provide an excuse to mistake a whale for a shark, and therefore transparent waters are the precondition to allow SWFs to play the role not merely of sideline actors but of valuable pivotal players in overcoming the crisis.

118 Rose, 'Sovereign Wealth Funds: Active or Passive Investors?', *supra* note 116, 108.

119 Santiago Principles, *supra* note 121, 3.

120 E. M. Truman, 'The Rise of Sovereign Wealth Funds: Impacts on US Foreign Policy and Economic Interests', Testimony before the Committee on Foreign Affairs, US House of Representatives, (21 May 2008), 5, available at http://www.iie.com/publications/papers/truman0508.pdf (last visited 24 March 2010).