REGULATING SOVEREIGN WEALTH FUNDS THROUGH CONTRACT

NAVEEN THOMAS*

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INTRODUCTION

This Article begins by presenting the need for further investment in infrastructure and by explaining why sovereign wealth funds (SWFs) could help. It describes certain obstacles to realizing this goal, notably the lack of effective, specific regulation of SWFs. It then proposes a potential solution to this problem: host states and SWFs could enter into agreements providing that SWFs will abide by certain obligations and that any disputes

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* Lecturer at the University of Chicago Law School until July 2014 and, beginning in September 2014, Research Scholar in the Jacobson Leadership Program in Law and Business at the New York University School of Law. I would like to thank the staff of the *Duke Journal of Comparative and International Law*, particularly Doug Hollins and Angela Cherepinsky for editing this Article and Erica Kassman and Sarah Tishler for organizing the symposium at which I presented on this subject in October 2013.

will be submitted to the International Centre for Settlement of Investment Disputes (ICSID) for settlement by arbitration. After describing the legal details of this proposal, this Article identifies and evaluates certain limitations and potential problems with it.

I. BACKGROUND

A. The Need for Infrastructure Development

The importance of infrastructure to economic development is almost axiomatic. Without proper roads, bridges, water supply, electrical grids, and telecommunication networks, people are extremely limited in creating, obtaining, and providing goods and services. And when people cannot effectively engage in production and commerce, economic growth will necessarily be restricted. Developing countries around the world are hampered by insufficient infrastructure, and solving this problem is generally considered an essential element of any plan for sustained economic development in these nations.[1]

The construction and maintenance of infrastructure requires continuous and substantial investment. One recent study estimates that by the year 2030, up to $67 trillion will be needed for this purpose worldwide, with developing countries accounting for roughly half of this amount.[2] That much money would be hard to procure under any economic conditions, but the recent financial crisis has exacerbated this difficulty in various ways. For instance, banks' decreased lending capacity has made it more difficult to borrow money for investment in infrastructure projects.[3] In addition, governments across the globe have faced critical budget shortfalls,[4] which limits how much they can spend on their own countries'

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1. *See, e.g.*, WORLD ECON. FORUM, POSITIVE INFRASTRUCTURE: A FRAMEWORK FOR REVITALIZING THE GLOBAL ECONOMY (2010), *available at* http://www.weforum.org/pdf/ip/ec/Positive-Infrastructure-Report.pdf; Katherine Lewis, *Better Infrastructure Brings Economic Growth*, IIP DIGITAL (May 24, 2012), http://iipdigital.usembassy.gov/st/english/article/2012/05/201205246230.html.

2. MCKINSEY GLOBAL INST. & MCKINSEY INFRASTRUCTURE PRACTICE, MCKINSEY & CO., INFRASTRUCTURE PRODUCTIVITY: HOW TO SAVE $1 TRILLION A YEAR 10 (2013), *available at* http://www.mckinsey.com/~/media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Urbanization/Infrastructure%20productivity/MGI_Infrastructure_Full_report_Jan2013.ashx [hereinafter MGI STUDY].

3. Victoria Ivashina & David Scharfstein, *Bank Lending During the Financial Crisis of 2008*, 97 J. FIN. ECON. 319 (2010); Christopher Harress, *Bank Loans Haven't Recovered from the Financial Crisis and Current Lending Shows Slide Similar to Pre-recession Data*, INT'L BUS. TIMES (Oct. 30, 2013, 8:50 AM), http://www.ibtimes.com/banks-loans-havent-recovered-financial-crisis-current-lending-shows-slide-similar-pre-recession-data.

4. *See Cash Surplus/Deficit (% of GDP)*, WORLD BANK, http://data.worldbank.org/indicator/

infrastructure.

B. The Role of Sovereign Wealth Funds

Given these obstacles, the world's investment requirements in the infrastructure sector appear likely to go unmet. To avoid this outcome, many different changes will be necessary, none of which will be sufficient by itself. For instance, the McKinsey Global Institute considers it essential that countries improve their productivity in the infrastructure sector to lower the total amount of investment that is actually needed.[5] But even if these improvements are made, it will also be crucial to encourage increased investment in this sector by those who can afford to make it.

SWFs are among the few types of investors that can still commit funds in the amounts and timeframes that infrastructure projects require. Although there is no universally accepted definition of an SWF, the International Working Group of Sovereign Wealth Funds (the IWG) uses a general definition suitable for this Article's purposes. The IWG defines SWFs as "special purpose investment funds or arrangements" that are established and owned by governments for macroeconomic purposes to "hold, manage, or administer assets to achieve financial objectives" and to employ various investment strategies, including investment in foreign financial assets.[6]

As of March 2014, by one estimate, SWFs globally have over US$6.6 trillion in assets under management,[7] and this amount has been growing almost exponentially in recent years.[8] Compared with other types of investors—such as private equity firms, which have to respond to many different investors, and pension funds, which have regularly occurring liabilities—SWFs often have less concern for liquidity and a longer-term investment horizon, especially following the recent financial crisis.[9] As a

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GC.BAL.CASH.GD.ZS (last visited June 25, 2014) (showing a sharp increase in budget deficits between 2008 and 2009 in most countries for which data is provided).

5. MGI STUDY, *supra* note 2, at 4.

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

7. *Fund Rankings*, SWF INST., http://www.swfinstitute.org/fund-rankings/ (last visited June 25, 2014).

8. In each of the previous five years, this figure has grown by 5.6%, 11.5%, 10.9%, 16.1%, and 16.5% respectively, and in the aggregate, it has grown by over 75% since 2008. PREQIN, THE 2014 PREQIN SOVEREIGN WEALTH FUND REVIEW: SAMPLE PAGES 1 (2014), *available at* https://www.preqin.com/docs/samples/2014_Preqin_Sovereign_Wealth_Fund_Review_Sample_Pages.pdf?rnd=1 [hereinafter PREQIN REVIEW].

9. *Id.* at 2; Gerard Lyons, *A Growing Role for Sovereign Wealth Funds*, MCKINSEY ON SOCIETY, http://voices.mckinseyonsociety.com/sovereign-wealth-funds/ (last visited June 25, 2014).

result, assets such as infrastructure that provide "low risk and stable returns" are often particularly attractive to SWFs.[10]

SWFs have historically invested most of their funds in relatively liquid assets, such as public equities and fixed income.[11] Although these assets continue to constitute the majority of collective SWF assets, in recent years SWFs have been directing an increasing share of their funds toward "alternative" assets, notably infrastructure, which draws investments from over half of the world's SWFs.[12] In addition, compared with other types of investors, SWFs are more likely to invest directly in infrastructure than in passive assets such as unlisted funds.[13] This shift has occurred in part because volatility in equity markets and low fixed-income yields in the wake of the recent financial crisis have reduced the appeal of these asset classes.[14] Another advantage is that the timeframes of infrastructure projects tend to match these SWFs' long-term investment horizons.[15] In addition, although SWF allocations remain concentrated in developed countries, these funds have increasingly directed resources toward developing ones.[16]

These trends are obviously positive for those concerned with the expected shortfall in infrastructure investment, particularly in the developing world, where domestic funds are much less available. But given the formidable size of the remaining gap, it is necessary to encourage even further investment.

II. CHALLENGES TO OVERCOME

A. Concerns About Sovereign Wealth Funds

Although SWFs have displayed an increasing enthusiasm for investing in infrastructure, foreign host states sometimes object to such transactions.[17] In these cases, host states have expressed, or are suspected

10. Lyons, *supra* note 9.

11. PREQIN REVIEW, *supra* note 8, at 3.

12. *Id.* at 2.

13. Paul Bishop, *Sovereign Wealth Funds Investing In Infrastructure—July 2013*, PREQIN (July 2, 2013), https://www.preqin.com/blog/101/6921/sovereign-fund-infrastructure.

14. INVESCO, INVESCO GLOBAL SOVEREIGN ASSET MANAGEMENT STUDY 2013, at 14 (2013), *available at* http://igsams.invesco.com/downloads/IGSAMS_en.pdf [hereinafter INVESCO STUDY].

15. Lyons, *supra* note 9.

16. INVESCO STUDY, *supra* note 14, at 21.

17. Mark A. Clodfelter & Francesca M.S. Guerrero, *National Security and Foreign Government Ownership Restrictions on Foreign Investment: Predictability for Investors at the National Level*, in SOVEREIGN INVESTMENT: CONCERNS AND POLICY REACTIONS 173, 174–75 (Karl P. Sauvant et al. eds.,

to have had, concerns that SWFs are motivated not just by financial returns but by political considerations, "such as accessing military technology, controlling strategic resources or markets, or influencing public opinion."[18] Host states may also worry "that countries operating SWFs wish to accumulate assets through deliberate low currency rates, thus distorting comparative competitive advantages."[19] Many commentators believe that these concerns are not justified,[20] but whether they are is irrelevant to this Article. After all, as long as potential host states fear these ulterior motives, rightly or wrongly, they will be less likely to allow SWFs to invest within their borders. Therefore, these concerns are worth addressing for anyone seeking to promote such investment.

In addition, in some host states, if a legal dispute eventually arises from the proposed investment, SWFs could potentially claim sovereign immunity from litigation due to their status as state instrumentalities.[21] Even though such a claim may not succeed in some states' courts due to the commercial nature of the SWFs' relevant activities (or for other reasons), the mere possibility of such a claim may be enough to discourage some host states from allowing SWF investment in their domestic infrastructure.

It is impossible to determine with any precision just how often host states limit or restrict investment by SWFs. Although official processes that expressly block particular transactions due to foreign sovereigns' involvement may make news headlines,[22] these cases may represent only a portion of inhibited economic activity because it is impossible to know just how much discussion and negotiation between host states and SWFs is avoided, how many invitations for investment are not sent to SWFs, or how many SWF bids for projects are rejected by host states.

It is clear, however, that further investment in infrastructure is needed,

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2012).

18. *Id.*

19. Jørgen Ørstrøm Møller, *Nationalism or Capitalism? Sovereign Wealth Funds of Non-OECD Countries*, *in* THE POLITICAL ECONOMY OF SOVEREIGN WEALTH FUNDS 202, 203 (Xu Yi-chong & Gawdat Bahgat eds., 2010).

20. *See, e.g.*, Rolando Avendaño & Javier Santiso, *Are Sovereign Wealth Fund Investments Politically Biased? A Comparison with Mutual Funds*, *in* SOVEREIGN INVESTMENT: CONCERNS AND POLICY REACTIONS, *supra* note 17, at 221 (finding that SWFs' investment practices do not suggest political motives); Ørstrøm Møller, *supra* note 19, at 222 (concluding that EU and OECD countries have "little evidence" to support their fears that SWFs pose a threat).

21. *See* FABIO BASSAN, THE LAW OF SOVEREIGN WEALTH FUNDS 89–115 (2011) (exploring whether and how "SWFs can invoke state immunity, protecting their action or challenging the enforcement of host state measures").

22. The Dubai Ports World controversy in the United States is a notable example. *See* Bill Gertz, *Security Fears About Infiltration by Terrorists*, WASH. TIMES, Feb. 22, 2006, at A01, *available at* http://www.washingtontimes.com/news/2006/feb/22/20060222-122115-8912r/?page=all.

that SWFs represent one of the best sources to meet this need, and that, as a result, further encouragement of SWF investment in infrastructure is advisable. To accomplish this goal, it is necessary to alleviate potential host state concerns about SWF intentions, transparency, and governance.

B. Existing Regulation of Sovereign Wealth Funds

To address such concerns, in 2008 the International Monetary Fund (IMF) convened the IWG, which consisted of 26 IMF member countries with SWFs, including most of the world's largest SWFs.[23] Following several meetings throughout the year, this group adopted a set of Generally Accepted Principles and Practices known as the "Santiago Principles."[24] The IWG sought to comfort potential host states and other investment partners by codifying principles with the following "guiding objectives":

> i. To help maintain a stable global financial system and free flow of capital and investment;
>
> ii. To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;
>
> iii. To invest on the basis of economic and financial risk and return-related considerations; and
>
> iv. To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.[25]

The Santiago Principles themselves consist of 24 discrete principles that provide somewhat more specific directives regarding one or more of the four objectives listed above.[26] A few of the principles contain two or more "subprinciples" that elaborate on the main principles to which they correspond.[27] For instance, the first of these principles appears as follows:

> **GAPP 1. Principle**
>
> The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).
>
> *GAPP 1.1. Subprinciple*. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.
>
> *GAPP 1.2. Subprinciple*. The key features of the SWF's legal basis and

23. SANTIAGO PRINCIPLES, *supra* note 6, at 1.
24. *Id.*
25. *Id.* at 4.
26. *Id.* at 7–9.
27. *Id.*

> structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.[28]

Despite the best efforts of the IWG, the Santiago Principles face some inherent limitations on their ability to encourage host states to permit and promote investments by SWFs.[29] First, the principles were designed to be loose in nature, in part so that each endorsing state could implement them in the manner that best fits its particular circumstances.[30] Even if the literal fulfillment of every principle sufficed to accomplish the IWG's objectives, in reality many host states might want to see more specific, substantial, and numerous commitments from SWFs or the states to which they belong.

Second, to the extent that the Santiago Principles do provide for clear undertakings by SWFs, they do not in any way constitute binding or enforceable obligations. This is, once again, by design: the IWG expressly calls these rules "a voluntary set of principles and practices that the members of the IWG support and either have implemented or aspire to implement."[31] Hence, a mere aspiration to implement the rules is all that is required for endorsement. For a host state that is genuinely concerned about an SWF's intentions or governance, the SWF's simple endorsement of the Santiago Principles is unlikely to provide much comfort absent additional actions, disclosures, or undertakings by the SWF.

Even if the Santiago Principles were somehow made binding on SWFs, their practical enforceability would still be questionable. In this scenario, host states and SWFs might designate a forum in which the former could bring claims that the latter have breached their obligations. If they were to choose the national courts of the host state, or if they were to remain silent on the issue and those courts were the default forum under applicable law, then further concerns could arise.

For instance, under certain circumstances, SWFs might be able to claim that the doctrine of sovereign immunity precludes the national courts' jurisdiction. In addition, while making this claim, the SWF might benefit from various procedural protections or advantages. For instance, in the United States, under the Foreign Sovereign Immunities Act of 1976 (FSIA),[32]

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28. *Id.* at 7.

29. For a more detailed assessment of the Santiago Principles, see EDWIN M. TRUMAN, SOVEREIGN WEALTH FUNDS: THREAT OR SALVATION? 121–39 (2010).

30. SANTIAGO PRINCIPLES, *supra* note 6, at 5.

31. *Id.*

32. Pub. L. No. 94-583, 90 Stat. 2891 (codified in scattered sections of 28 U.S.C.).

> pre-judgment attachment of property is excluded unless immunity from such attachment has been specifically waived and there is a showing that the attachment is to secure satisfaction of later judgment, not to obtain jurisdiction. In addition, if a civil action is brought in state court against a SWF, the defendant may remove it to the federal district court in that district, where any trial will be before a judge without a jury. The SWF has a presumption of immunity under the FSIA, which the plaintiff has the burden of rebutting by showing that the action falls into one of the statute's exceptions. If the plaintiff fails to make such a showing, then the SWF will be afforded immunity, unless, of course, it has otherwise waived immunity.[33]

In many cases, if the SWF were found to be acting in a commercial capacity, thereby fitting into an exception to the host state's doctrine of sovereign immunity, the national courts might have jurisdiction after all.[34] But there does not appear to be any established case law regarding the application of these doctrines to SWFs, and in some situations, SWFs have indeed benefitted from sovereign immunity.[35] Furthermore, as described above, the mere potential relevance of sovereign immunity to any particular investment dispute might exhaust time and resources as the parties debate its applicability. For all of these reasons, in countries in which a sovereign immunity doctrine might apply, national courts might prove both unreliable and inefficient for resolving disputes that arise from SWF investments.

The choice of national courts as a forum could also negatively distort behavior through moral hazard if an SWF were to ignore the host state's laws on the assumption that it would be protected by sovereign immunity. Indeed, this might be a legitimate fear of a potential host state and might reduce the likelihood that the state would permit the SWF's investment in the first place. By contrast, if the doctrine of sovereign immunity were to not apply to an SWF's actions and if the host state's national courts were to have jurisdiction over an investment-related dispute, then the SWFs might fear that those courts would unfairly favor the state because of its "home court advantage." This too could limit investment by SWFs.

Accordingly, the Santiago Principles, as the primary form of regulation that is specific to SWFs, are too vague to provide enough

33. Clare O'Brien, Tania Mattei, & Naveen Thomas, *Sovereign Wealth Funds: Evolving Perceptions and Strategies*, BNA SEC. REG. & L. REP., Dec. 24, 2012, at 6 (citation omitted), *available at* http://www.shearman.com/~/media/Files/NewsInsights/Publications/2013/01/Sovereign-Wealth-Funds-Evolving-Perceptions-and-__/Files/View-full-article-Sovereign-Wealth-Funds-Evolvin__/File Attachment/SovereignWealthFundsEvolvingPerceptionsandStrate__.pdf.

34. *See, e.g.*, Foreign Sovereign Immunities Act of 1976 § 4(a), 28 U.S.C. § 1605(a)(2) (2012); BASSAN, *supra* note 21, at 93–96 (discussing immunity in other jurisdictions).

35. BASSAN, *supra* note 21, at 104–06.

guidance to SWFs or to alleviate the concerns of potential host states. Their non-binding nature and unenforceability also limit the comfort that host states can reasonably take in these principles. This Article proposes a different approach to regulation that is intended to address all of these issues with the ultimate goal of promoting investment and thereby development.

III. A PROPOSED APPROACH TO REGULATION

To overcome the challenges described in the previous section, effective regulation of SWF investments must provide for binding and enforceable obligations that are clear enough both to provide direction to SWFs and to reassure host states that SWFs will not cause harm. To these ends, this Article proposes a form of regulation through individual and enforceable contracts. Host states that are concerned about SWFs' intentions, governance, or other characteristics should make agreements with the SWFs (or the investor states to which they belong) in advance of their investments. Such an agreement should provide that, in exchange for the SWF's right to invest in the host state, the SWF shall abide by the Santiago Principles and comply with any more specific obligations that the host state reasonably requires. These provisions would ensure that the SWF's obligations are binding and as clear as necessary to reassure the host state that the investment can safely proceed.

To make the obligations not only clear and binding but also effectively enforceable, the parties should consent to submit any dispute arising out of or relating to the agreement (which would of course include any claim that the SWF has breached any of its obligations) to ICSID for settlement by arbitration. In addition, each party should waive any rights of sovereign immunity that might apply to the execution of any awards that may be rendered against that party.[36] As opposed to litigation in the host state's national courts, these provisions would ensure that no such rights would preclude jurisdiction over a dispute or execution of an award (reassuring the host state) and that the host state will not have an unfair "home court advantage" in its national courts (reassuring the SWF).

A. Substantive Obligations in the Agreement

As described above, one of the main limitations of the Santiago Principles as a form of regulation is their non-binding nature. An express

36. *See, e.g.*, *ICSID Model Clauses: VII. Waiver of Immunity from Execution of the Award*, INT'L CENTRE FOR SETTLEMENT INVESTMENT DISPS., https://icsid.worldbank.org/ICSID/StaticFiles/model-clauses-en/15.htm (last visited June 25, 2014).

written agreement between the host state and the SWF could overcome this limitation by imposing a binding obligation on the SWF to abide by those principles.

Another limitation of the Santiago Principles is their vague nature and potentially insufficient scope. For instance, one principle that may particularly interest host states is the third:

> Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.[37]

Depending on the nature of the investment and the relationship between the parties, the host state may wish to provide more precise requirements for coordination of the SWF's activities with domestic authorities. These requirements might, for instance, specify certain activities from which the SWF should refrain, reserve the host state's right to preapprove certain other activities, or impose specific reporting obligations on the SWF. To effect these goals, the agreement between the host state and the SWF could impose additional obligations on the SWF or place conditions (e.g., the prior written consent of an agency of the host state) on certain specified actions by the SWF.

These steps could make the SWF's obligations binding, more specific, and better-tailored to the nature of a particular investment. To have real value, however, the proposed arrangement must also have an effective and reliable enforcement mechanism. This is where ICSID comes into play.

B. International Arbitration in the International Centre for Settlement of Investment Disputes

1. Background

The World Bank established ICSID in 1965 through the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (the ICSID Convention).[38] Since then, 150 states (Contracting States) have ratified the ICSID Convention and have remained contracting parties.[39] ICSID "provides facilities for conciliation and arbitration of

37. SANTIAGO PRINCIPLES, *supra* note 6, at 7.

38. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *Introduction* to ICSID CONVENTION, REGULATIONS AND RULES 5 (2006), *available at* https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf.

39. *Member States*, INT'L CENTRE FOR SETTLEMENT INVESTMENT DISPS., https://icsid.worldbank.

investment disputes between Contracting States and nationals of other Contracting States,"[40] with the aim of removing "major impediments to the free international flows of private investment posed by non-commercial risks and the absence of specialized international methods for investment dispute settlement."[41] It is generally considered "the leading international arbitration institution devoted to investor-State dispute settlement."[42]

To date, ICSID has concluded 285 cases, nearly all of which arose from investors bringing actions against host states due to a breach by the latter of obligations contained in a bilateral investment treaty or another agreement.[43] This is characteristic of the broader international investment regime, which was assembled largely to protect foreign investors from wealthy countries against regulatory abuses by poorer host states.[44] But investments by SWFs may invert this supposed power dynamic, with host states fearing abuses by sovereign investors. This scenario calls for a different approach to regulation.

The one-sided nature of ICSID's history does not mean that it is suitable only for disputes brought by investors: nowhere do the ICSID Convention or ICSID's other rules and regulations limit its facilities to cases of this nature.[45] The overarching goal of ICSID is to promote international investment. So far it has done so by reassuring investors that they will have a viable avenue for recourse if the host state mistreats them, but now there is an opportunity for ICSID to also encourage investment by offering host states a reliable forum in which to bring actions against abusive investors, as elaborated below.

2. Jurisdictional Requirements

For ICSID's jurisdiction to extend to a dispute, the following requirements must be met: (1) the disputing parties must have consented in writing to the submission of their dispute to ICSID arbitration or

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org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=MemberStates_Home (last visited June 25, 2014).

40. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 38, at 5.

41. *About ICSID*, INT'L CENTER FOR SETTLEMENT INVESTMENT DISPS., https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home (last visited June 25, 2014).

42. *Id.*

43. *List of Concluded Cases*, INT'L CENTRE FOR SETTLEMENT INVESTMENT DISPS., https://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListConcluded (last visited June 25, 2014).

44. José E. Alvarez, *Sovereign Concerns and the International Investment Regime*, *in* SOVEREIGN INVESTMENT: CONCERNS AND POLICY REACTIONS, *supra* note 17, at 258, 259–61.

45. *See* INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 38.

conciliation, (2) the dispute must be between a Contracting State and a national of another Contracting State, and (3) the dispute must qualify as a "legal dispute arising directly out of an investment."[46] Fortunately, all of these requirements could be satisfied by disputes brought by host states against SWFs for breach of the SWFs' contractual obligations.

First, the requirement of consent would be easily satisfied in the situation under discussion. The Report of the Executive Directors on the Convention explains that "[c]onsent may be given, for example, in a clause included in an investment agreement, providing for the submission to [ICSID] of future disputes arising out of that agreement, or in a *compromis* regarding a dispute which has already arisen."[47] Therefore, an agreement containing such a dispute resolution provision made between a host state and an SWF would constitute consent to ICSID's jurisdiction.

As for the second requirement, with 150 Contracting States as of this writing, ICSID's membership would cover the vast majority of the potential pairs of host states and states with active SWFs.[48] A "national" of a Contracting State includes "any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration" (i.e., the date of the agreement including the dispute resolution clause).[49] SWFs are typically juridical persons with the nationality of the states to which they belong, so they would generally qualify as "nationals" for the determination of ICSID's jurisdiction.[50]

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46. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, Convention on the Settlement of Investment Disputes Between States and Nationals of Other States art. 25(1), *in* ICSID CONVENTION, REGULATIONS AND RULES, *supra* note 38.

47. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *Report of the Executive Directors of the International Bank for Reconstruction and Development on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States* ¶ 24, *in* ICSID CONVENTION, REGULATIONS AND RULES, *supra* note 38.

48. Of the 60 SWFs with the most assets under management, only three do not belong to Contracting States. *See Fund Rankings*, *supra* note 7; *see also* INT'L CTR. FOR SETTLEMENT OF INV. DISPS., LIST OF CONTRACTING STATES AND OTHER SIGNATORIES OF THE CONVENTION (2013), *available at* https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language=English (last visited June 25, 2014).

49. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 46, art. 25(2)(b).

50. An SWF in such a dispute might object to ICSID's jurisdiction on the grounds that it is not a "national" but instead a "State party" due to its status as a state-owned entity, but respondents who have contested jurisdiction on these grounds in the past have failed. *See, e.g.*, Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, ¶¶ 16–17 (May 24, 1999), 14 ICSID Rev. 251 (1999) (stating that "the accepted test for" determining "whether a company qualifies as a national of another Contracting State within the meaning of Article 25(1) . . . . has been formulated as follows: . . . for purposes of the Convention a mixed economy company or government-owned corporation should not be disqualified as a national of

The third jurisdictional requirement turns on the definitions of "legal dispute" and "investment." To qualify as a "legal dispute," "[t]he dispute must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation."[51] This criterion would be satisfied by a host state's claim that an SWF had breached its obligations under a legally binding agreement. As for the term "investment," the framers of the ICSID Convention made "no attempt . . . to define" it and instead deferred to the parties to "make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to" ICSID.[52] Therefore, to ensure that disputes arising from an SWF's investment can be brought in ICSID, the agreement between the host state and the SWF should define "investment" broadly to include all contemplated activities expected to arise from the transaction, and the parties should amend this definition upon any expansion of those activities beyond its previous scope.[53]

Therefore, as long as the host state and the state to which the SWF belongs are both Contracting States, parties seeking to submit any investment disputes to ICSID could straightforwardly fulfill the

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another Contracting State unless it is acting as an agent for the government or is discharging an essentially governmental function" (internal quotation marks omitted)); *see also* CHRISTOPH H. SCHREUER ET AL., THE ICSID CONVENTION: A COMMENTARY 161–62 (2d ed. 2009) (summarizing several cases that "confirm that claimants may have significant State ownership interests, but still qualify as a 'national of another Contracting State' for the purposes of Art. 25(1)").

51. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 47, ¶ 26.

52. *Id.* ¶ 27.

53. Note, however, that parties do not have unlimited freedom in defining what constitutes an investment under Article 25 of the ICSID Convention. Joy Mining Mach. Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/03/11, Award on Jurisdiction, ¶¶ 48–53 (Aug. 6, 2004), 19 ICSID Rev. 486 (2004) ("[T]here is a limit to the freedom with which the parties may define an investment if they wish to engage the jurisdiction of ICSID tribunals."). ICSID tribunals may examine *sua sponte* whether the objective requirements of jurisdiction have been satisfied. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 46, art. 41. In this manner, some tribunals have considered whether the alleged investment (i) has a certain duration, (ii) involves a certain regularity of profit, (iii) involves a certain level of risk and commitment, and (iv) is significant for the host state's development. *See* SCHREUER ET AL., *supra* note 50, at 128–34 (setting forth these criteria and examining how various tribunals have applied them "to determine whether the activities under dispute constitute an investment"). The infrastructure projects that are the subject of this Article would likely meet any such test, as ICSID tribunals in the past have found a wide range of infrastructure projects to have done so. *See, e.g.*, M.C.I. Power Grp. L.C. v. Republic of Ecuador, ICSID Case No. ARB/03/6, Award (July 31, 2007), *available at* http://www.italaw.com/sites/default/files/case-documents/ita0500.pdf (construction of electricity plants); L.E.S.I. S.p.A. v. République Algérienne Démocratique et Populaire, ICSID Case No. ARB/05/3, Decision on Jurisdiction (July 12, 2006), *available at* https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC528_Fr&caseId=C48 (construction of a dam); Salini Costruttori S.p.A. v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction (July 23, 2001), 6 ICSID Rep. 400 (2004) (civil construction contract).

institution's jurisdictional requirements by including appropriate provisions in the same written agreement that sets forth the SWF's obligations. This is most of what is required to ensure that a reliable dispute resolution mechanism will be available, but to ensure that any award rendered by an arbitral tribunal will also be enforceable, some additional measures are advisable.

3. Recognition and Enforcement of Arbitral Awards

The ICSID Convention requires each Contracting State, whether or not it is a party to the dispute, to recognize any award as binding and to enforce the award's pecuniary obligations (i.e., obligations to pay money) as if the award were a final judgment of the state's domestic courts.[54] Therefore, when an award is rendered, the prevailing party can enforce it in any Contracting State. This ability can be useful when the losing party does not voluntarily pay on the award and has assets located in a Contracting State. In this situation, the prevailing party can seek to execute the award against those assets in compliance with the state's applicable legal procedures.

But if the assets that the prevailing party seeks to execute belong to a state or state instrumentality such as an SWF, then the court may decline to order the execution because the assets are protected by the doctrine of sovereign immunity.[55] Indeed, the framers of the ICSID Convention expressly contemplated this possibility, noting that "[t]he doctrine of sovereign immunity may prevent the forced execution in a State of judgments obtained against foreign States or against the State in which execution is sought."[56] To make this clear, the ICSID Convention provides that nothing in the provision requiring Contracting States to recognize and execute awards should "be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution."[57] In fact, such a situation played out when a company controlled by French nationals, after winning an ICSID award against Liberia, sought to execute the award against assets of Liberia located within the United States.[58] The U.S. federal courts ultimately denied these requests, largely because the assets were protected by

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54. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 46, art. 54.

55. *See* BASSAN, *supra* note 21, at 93–96 (providing an overview of SWFs and their immunity from jurisdiction).

56. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 47, ¶ 43.

57. *Id.*

58. *See* Liberian E. Timber Corp. v. Government of Republic of Liberia, 650 F. Supp. 73 (S.D.N.Y. 1986).

sovereign immunity under the FSIA.[59]

In the case of an agreement between an SWF and a host state, such an outcome could be prevented if each party were to expressly "waive[] any right of sovereign immunity as to it and its property in respect of the enforcement and execution of any award rendered by an Arbitral Tribunal constituted pursuant to [the] agreement."[60] In most investments not involving SWFs, only the host state would be protected by sovereign immunity, so only the host state would ever make such a waiver. But when the investor and its property might also be protected, as in the case of an SWF, it makes sense for the waiver to be bilateral.[61] In this situation, when a host state seeks to execute an ICSID award against an SWF's assets in a Contracting State, the SWF could not claim that those assets are protected by sovereign immunity.

If properly implemented, these measures should ensure that host states and SWFs will have recourse to a reliable and effective dispute resolution mechanism, resulting in legally enforceable awards.

IV. PRACTICAL CONSIDERATIONS

A. Diversion of Investment

Some may be concerned that the approach proposed in this Article could discourage investment by SWFs in host states that insist that the SWFs make binding and enforceable obligations with respect to their activities. SWFs deterred by host states that make these requests might choose instead to invest in less demanding host states, to make only passive

59. *See* Liberian E. Timber Corp. v. Government of Republic of Liberia, 659 F. Supp. 606, 610 (D.D.C. 1987) ("The Court, however, declines to order that if any portion of a bank account is used for a commercial activity then the entire account loses its [sovereign] immunity.").

60. *ICSID Model Clauses: VII. Waiver of Immunity from Execution of the Award*, *supra* note 36.

61. Of course, this waiver would be useful to the host state only if the SWF signing the agreement has assets that are both located in Contracting States and substantial enough to satisfy payment of a potential award. This may not be the case, for instance, if the SWF is newly constituted solely for the investment corresponding to the agreement. In such a situation, the host state should seek to have the state to which the SWF belongs cosign the agreement, guarantee the obligations of the SWF under both the agreement and any arbitral award issued by an arbitral tribunal constituted pursuant to the agreement, and waive its rights of sovereign immunity as described above. One limitation of this approach is that the state's guarantees would not be enforceable through ICSID arbitration: they would be made by one state to another, and ICSID disputes must be between a state on one hand and a national of a different state on the other hand. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 46, art. 25(1). Therefore, the agreement would have to designate a separate forum, most likely the host state's national courts, with respect to those provisions, and this may not be useful if the guarantor state does not have substantial assets within the host state. Fortunately, SWFs by their nature typically do have substantial assets in Contracting States around the world, so the situation presented in this paragraph should arise only very rarely, if ever, and state guarantees should not typically be needed.

rather than direct investments in infrastructure (e.g., investing in an unlisted funds or purchasing a non-controlling stake in a local entity), or to divert funds to an asset class other than infrastructure. Eventually, such a trend could discourage states from adopting this Article's proposed approach or could even reduce the total amount of investment by SWFs in infrastructure.

The justifiability of this fear depends ultimately on the amount of leverage that each party has in the negotiation, which is difficult to generalize across different transactions. If a host state were to have a great deal of leverage prior to the commencement of an investment because, for instance, the state offered uniquely lucrative opportunities, then one would expect the SWF to be more likely to agree to certain obligations than it would be when dealing with a host state that presents essentially fungible opportunities.

As a result, it would be wise for host states to assess the degree of leverage that they possess in any negotiation with an SWF and to insist on an agreement of the sort proposed by this Article only when that degree is relatively high. In addition, the host state would be justified in requesting such an agreement whenever it has particularly serious concerns about the SWF's intentions, governance, or other characteristics. If a request in that situation causes the SWF to balk, then it might indicate the SWF's unwillingness to cooperate more generally, and its withdrawal might be in the host state's best interests. In this way, a request that the SWF accept reasonable obligations could allow the host state to test the SWF's level of commitment to a fair and mutually beneficial relationship.

Therefore, although this concern might limit the utility of the proposed approach in some situations, it could still be implemented to host states' benefit when they most need reassurance and security.

B. Limitations of ICSID

Another potential inadequacy of the proposed approach arises from the limitations of ICSID. Because ICSID cases have almost all been brought by investors against host states, arbitrators who normally serve on ICSID tribunals, including those on the ICSID Panel of Arbitrators, may not have the experience needed to determine all of the issues that may arise in the contractual disputes envisaged by this Article. They may know a great deal about expropriation of investors' assets by host states but know little of, for instance, how to calculate the damage to host states resulting from malfeasance by investors. Similarly, they may have expertise in interpreting bilateral investment treaties but difficulty with the kinds of private contractual arrangements proposed in this Article. As a result, the

parties may need to appoint arbitrators with more relevant experience, even if they have not served in many ICSID cases.[62] Eventually, the Contracting States may wish to choose new arbitrators to serve on the Panel.

Although ICSID's limitations may impede the adoption of the proposed approach at first, in the long term it should not prevent these arbitrations from taking place successfully. Any novel process requires certain changes, and initial inexperience with SWFs should pose no more difficulty for ICSID than did the Centre's initial establishment. Indeed, the institutional framework is already present and sufficient for the arbitrations contemplated by this Article, with no significant organizational or legal changes necessary. Accordingly, the process of identifying new arbitrators, while potentially tedious, should not bar the development of a promising new way to encourage investment, which is, after all, ICSID's ultimate goal.

C. Resource Limitations

ICSID arbitrations can be costly, and some developing countries may not have the resources necessary to pursue claims against SWFs who have breached their contractual obligations. It would be easy to overstate this problem, however, because many developing countries have already participated in ICSID arbitrations to completion.[63] To the extent that excessive costs pose an issue, one potential solution would be for the agreement between the parties to require the SWF to pay the host state's expenses in connection with an arbitration in which the host state prevails.

The feasibility of including such a requirement in the agreement would depend, once again, on each party's leverage in the negotiation. As a result, when (1) a host state expects that it will not be able to afford arbitration expenses, (2) an SWF refuses to agree to cover these expenses, and (3) the host state is particularly concerned that the SWF will breach its obligations, the host state should consider not allowing the investment. But again, if the host state's concern is legitimate, then avoiding this investment might be in the state's best interests.

CONCLUSION

These practical considerations are important to keep in mind, but rather than invalidating the approach proposed by this Article, they refine

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62. Parties in an ICSID arbitration may select arbitrators from outside of the ICSID Panel of Arbitrators. INT'L CTR. FOR SETTLEMENT OF INV. DISPUTES, *supra* note 46, art. 40(1).

63. Note the prevalence of developing countries among the parties in the list of concluded cases at ICSID. *See List of Concluded Cases*, *supra* note 43.

its scope and present important yet surmountable obstacles to its complete implementation. Overall, the regulation of SWFs through contractual obligations that are enforceable through international arbitration would constitute an improvement on today's non-binding, imprecise, insufficient, and unenforceable forms of self-regulation. If potential host states that would otherwise reject investments by SWFs chose instead to allow them to proceed with contractual protections in place, then these states would eventually attract more money for crucial development purposes such as infrastructure, as their economies so urgently need.