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Mark MCLAUGHLIN
Singapore Management University, mmclaughlin@smu.edu.sg

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Singapore Management University
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Defining a State-Owned Enterprise in International Investment Agreements

Mark McLaughlin

Abstract: The objective of this article is to establish a unified conceptual framework for state-owned enterprises in international investment law. I hope to furnish drafters and negotiators with the tools to define state-owned enterprises in accordance with their policy concerns. The central thesis is that there are five definitional criteria to be considered: 1) separate legal personality 2) extent and form of control 3) eligible governmental units 4) commercial nature of activity and 5) purpose of activity. While variations within each criterion can reflect the policy choices of contracting parties, failure to adequately delimit the boundaries of all five will confer discretion on arbitrators to do so.

Application of this framework to existing international investment agreements reveals that many bilateral investment treaties are insufficiently precise as to the definition of state-owned enterprises. However, the Trans Pacific Partnership does address all five of these criteria, and limits the scope of covered entities to those that are 'principally engaged in commercial activities' and have an 'orientation towards profit making'. China's strategic initiatives could necessitate a response that would further fragment the international investment regime. Furthermore, interpretive issues remain in relation to the scope of 'effective influence' and determining the purpose of investment activity.

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I. Introduction

State-owned enterprises (SOEs) have emerged as prominent actors in the globalised economy.[1] Their quantitative and qualitative evolution challenges many of the conceptual boundaries of international investment law.[2] A modest but growing body of literature has sought to address the resultant issues. Existing scholarship has focussed on matters of competitive neutrality,[3] corporate governance,[4] national security,[5] non-discrimination,[6] transparency,[7] state responsibility,[8] and dispute settlement.[9] However, there is a common observation in much of the literature: that no definition of a state-owned enterprise enjoys widespread support.

The central challenge of establishing policy coherence in relation to SOEs is that they bestride the great tectonic plates of international investment law: statehood and globalisation.

1 UNCTAD, *World Investment Report 2017: Investment and the Digital Economy* (New York ; Geneva: United Nations, 2017).; Raymond Vernon, 'The International Aspects of State-Owned Enterprises in State-Owned Multinationals Governments in Global Business', in *State-Owned Multinationals: Governments in Global Business* (Springer, 2017).; Skovgaard Poulsen and Lauge N, 'States as Foreign Investors: Diplomatic Disputes and Legal Fictions', 1 ICSID Review 31 (2016), at 12.; Przemyslaw Kowalski et al, 'State-Owned Enterprises: Trade Effects and Policy Implications', OECD Trade Policy Papers, No. 147, OECD Publishing, Paris (2012).

2 And, indeed, other areas such as trade and competition law. See Julien Chaisse, 'Untangling the Triangle: Issues for State-controlled Entities in Trade, Investment, and Competition Law' in *International Economic Law and Governance: Essays in Honour of Mitsuo Matsushita* (Oxford University Press, 2016) at 233.

3 OECD, *Competitive Neutrality Maintaining a Level Playing Field between Public and Private Business* (2012).; Hans Christiansen and Antonio Capobianco, *Competitive Neutrality and State-Owned Enterprises*, OECD Corporate Governance Working Papers 1 (2011).

4 *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 Edition, OECD Publishing, Paris (2015).

5 James E Mendenhall, 'Assessing Security Risks Posed by State-Owned Enterprises in the Context of International Investment Agreements', 1 ICSID Review 31 (2016), at 36-44.

6 Lu Wang, 'Non-Discrimination Treatment of State-Owned Enterprise Investors in International Investment Agreements?', 1 ICSID Review 31 (2016), at 45.

7 Anthony P Cannizzaro and Robert J Weiner, 'State Ownership and Transparency in Foreign Direct Investment: Loose-Lipped Leviathan?' (2017) Institute for International Economic Policy Working Paper Series at 61.

8 Nick Gallus, 'State Enterprises as Organs of the State and BIT Claims', 5 The Journal of World Investment and Trade 7 (2006), at 761.; AFM Maniruzzaman, 'Sovereign Immunity and the Enforcement of Arbitral Awards Against State Entities: Recent Trends in Practice' in American Arbitration Association Handbook on International Practice (New York: Juris Net, 2010).; David Gaukrodger, *Foreign State Immunity and Foreign Government Controlled Investors*, OECD Working Papers on International Investment 2010/02, OECD Publishing (2010).

9 Giulio Alvaro Cortesi, 'ICSID Jurisdiction with Regard to State-Owned Enterprises – Moving Toward an Approach Based on General International Law', 1 The Law & Practice of International Courts and Tribunals 16 (2017), at 108.; Paul Blyschak, 'State-Owned Enterprises and International Investment Treaties: When are State-Owned Entities and Their Investments Protected?', Journal of International Law & International Relations 6 (2010), at 1.; Mark Feldman, 'State-Owned Enterprises as Claimants in International Investment Arbitration', 1 ICSID Review 31 (2016), at 24.

The former is imbued with notions of sovereignty, the supremacy of the state, territorial integrity and domestic institutions; the latter with the free movement of people and capital, the softening of territorial boundaries, and cross-border governance structures that disaggregate into functionally distinct parts. Attempting to build a coherent governance regime is therefore the task of harmonizing divergent approaches to SOEs that result from these competing perspectives.

That task is hindered by the lack of a universal definition. It is obvious that an assessment of the form and function of any discrete regulatory system must begin with a shared logical premise of the entities to be regulated. Perhaps it is because of the absence of such a premise that international investment agreements (IIAs) often do not adequately address the unique characteristics of SOEs, and indeed most do not mention them at all.[10] A complete definition of SOEs is required in order that States are aware of the extent of their legal obligations in respect of SOE investment, and are making an informed policy choice when opting to include or exclude such investment from the scope of future treaties. States can disagree as to the legitimacy of certain SOE conduct and its attendant motivating factors, but this policy preference should be readily apparent in legal instruments. Otherwise, the role of SOEs in the global economy will be subject to the discretion of arbitrators.

This article seeks to provide negotiators and drafters with criteria to adequately define SOEs and assesses the suitability of the current network of IIAs. Part II provides context to the SOE phenomenon, exploring how the global economy has affected their character, and how they might affect global governance in turn. Part III is an interrogation of the theoretical underpinnings of SOEs, and a proposal of five definitional criteria: 1) separate legal personality 2) extent and form of control 3) eligible governmental units 4) commercial nature of activity and 5) purpose of activity. Part IV applies this conceptual framework to existing provisions on 'covered SOEs' in international investment agreements, in order to assess the viability of the current system. Part V looks ahead to the future prospects of global SOE governance and discusses the remaining interpretive issues.

II. The Interaction between SOEs and the Global Economy

[10] Jo En Low, 'State-controlled entities as "investors" under international investment agreements', Columbia FDI Perspectives (2012), at http://ccsi.columbia.edu/files/2014/01/FDI_80.pdf.; Yuri Shima, *The Policy Landscape for International Investment by Government-controlled Investors*, OECD Working Papers on International Investment 2015/01, OECD Publishing (2015).

It was in the context of the growth and internationalisation of private capital in the 1980s and 1990s that today's global framework for investment governance took root. The mitigation of legal barriers to trade and investment, as well as technological advances in communication and transportation, resulted in the exponential growth of international flows of capital.[11] The number of BITs rose from 165 in 1980 to 1,857 by the end of 1999 as States agreed to restrict their regulatory space and economic sovereignty in order to facilitate cross-border investment.[12] The International Centre for the Settlement of Investment Disputes (ICSID) emerged as the primary forum for disputes over foreign investment. Traditional diplomatic protection gave way to concrete standards of treatment in international agreements. As the realities of globalisation demanded an ever-more international regulatory response, the influence of the state was on the wane. Crucially, the international investment law framework established during this period was devised to regulate the vagaries of foreign private investment.

A renaissance of sovereign investment at the beginning of the 21st Century represents a further shifting of the sands in the role of the state in the global economy. Reports of an academic conference in October 2008 records a U.S. Professor as stating 'When we chose the topic for this Conference a year ago we thought the topic of [Sovereign Wealth Funds] was about *them* but now we discover it is also about *us*.'[13] Nations whose governments had traditionally been staunch advocates of private capital, such as the United States, undertook rescue operations of strategically important industries, acquiring direct stakes in the banking and automotive sectors.[14] By virtue of the "Go Global' policy, Chinese SOEs spread into the international economy to boost competitiveness and secure natural resources.[15] They present a particular conceptual difficulty for traditional theories that rely on the public-private

[11] World Bank, 'Foreign direct investment, net inflows (BoP, current US$) | Data', https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?end=2000&start=1984 (visited 8 May 2018).
[12] 'UNCTAD, Bilateral Investment Treaties 1959-1999' UNCTAD/ITE/IIA/2 (Geneva, 2000) at 15 http://unctad.org/en/Docs/poiteiiad2.en.pdf', (visited 8 May 2018).
[13] Cited in Maya Steinitz 'Foreign Direct Investment by State-Controlled Entities at a Crossroad of Economic History: Conference Report of the Rapporteur' in Karl P Sauvant, Lisa E Sachs and Wouter P F Schmit Jongbloed, *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press, USA, 2012) at 534.
[14] Rosa M Lastra and Geoffrey Wood, 'The Crisis of 2007–09: Nature, Causes, and Reactions', 3 Journal of International Economic Law 13 (2010), at 531.; Richard S Grossman and Christopher M Meissner, 'International aspects of the Great Depression and the crisis of 2007: similarities, differences, and lessons', 3 Oxford Review of Economic Policy 26 (2010), at 318.
[15] Huang Wenbin and Andreas Wilkes, 'Analysis of China's overseas investment policies', CIFOR Working Paper 79 at 44.; Canfei He, Xiuzhen Xie & Shengjun Zhu 'Going global: understanding China's outward foreign direct investment from motivational and institutional perspectives: Post-Communist Economies: Vol 27, No 4',

distinction, as there are a variety of methods of 'state capture' utilised by the Chinese Communist Party to exercise influence over ostensibly private companies.[16]

As states compete in the global marketplace for drivers of economic growth, domestic politics is increasingly interwoven with international politics; the private sphere becomes indistinguishable from the public; the line between participation and regulation is blurred.

However, global value chains and investment liberalization have exposed some SOEs to market forces. The twin pillars of democratization and privatization have heralded a new age of heightened accountability. Many SOEs have undertaken share issues through international stock exchanges or issued bonds, raising substantial capital in the process.[17] Indeed, China's political economy demands that SOEs professionalise and become permanent competitors in the international marketplace.[18] In order to satisfy the requirements of international capital, the internal governance of some SOEs has undergone a broader regime of professionalization; including the appointment of independent auditors, the inclusion of external directors on boards, the introduction of an incentive-driven pay structure, and the improvement of standards of transparency and disclosure.[19]

While exposure to the global economy has had a transformative effect on some SOEs, they may have a correspondingly radical effect on the global economy. Large SOEs are operating in India, Singapore, Indonesia, Vietnam, Japan, Korea, Russia, the United Arab Emirates, and Malaysia.[20] SOEs grew from 9.8% of the world's largest companies in 2005, to 22.8% in 2014.[21] Two thirds of these were Chinese SOEs. 86,000 foreign affiliates of SOEs existed in 2017, 38% of which were headquartered in the European Union.[22] Consequently, there are two significant trends related to state-owned enterprises: first, their increased presence in the global economy, and second, that the majority of SOEs have emerging economies as their home state.

16 Curtis J Milhaupt and Wentong Zheng, 'Beyond Ownership: State Capitalism and the Chinese Firm', 103 Georgetown Law Journal 663 (2015).
17 Mark Wu, 'The "China, Inc." Challenge to Global Trade Governance', Harvard International Law Journal 57 (2016), at 64.
18 Xu Yi-chong, *The Political Economy of State-owned Enterprises in China and India* (Palgrave Macmillan, 2012).
19 Francisco Flores-Macias, 'The Return of State-Owned Enterprises | Harvard International Review', http://hir.harvard.edu/article/?a=1854 (visited 3 May 2018).
20 Eduardo Pérez Motta, *Competition Policy and Trade in the Global Economy: Towards and Integrated Approach*, E15 Expert Group on Competition Policy and the Trade System, Policy Options Paper, 2016.
21 Grzegorz Kwiatkowski and Paweł Augustynowicz, *State-Owned Enterprises In The Global Economy – Analysis Based On Fortune Global 500 List* (2015) available at http://www.toknowpress.net/ISBN/978-961-6914-13-0/papers/ML15-353.pdf (visited 8 May 2018).
22 See UNCTAD, above n 1, World Investment Report 2017 at 32.

Global governance is necessarily an adaptive endeavour, and as developing economies grow in stature, so too will their influence in shaping transnational regulatory frameworks. If the current trend towards the accumulation of capital by states with large extractive industries continues, it follows that low-growth, developed economies will increasingly rely on these pools of capital to finance domestic infrastructure development.

The extent to which this manifests in international politics is yet to be seen, but the effect on the absolutist approach to private investment is already palpable. Free-market principles lie weakened and bruised by the 2008 financial crisis, and Western economies have shown a willingness to attract investment from foreign SOEs, endorsing an economic model that had been widely discredited by most governments in Western Europe and Northern America until recently. This apparent reversal has not been without its hesitancies.[23]

Indeed, it is precisely because SOEs exist at the ideological fault lines of competing economic models that they pose such an intriguing regulatory conundrum. At the national level, there can be internal agreement about the extent to which government intervention is required to mitigate the inherent competitive advantages of SOEs, namely: subsidization, preferential financing, regulatory favouritism, captive equity, preferential public procurement and sovereign immunity.[24] The cumulative effect of these competitive advantages is to loosen conventional business constraints for SOEs.[25]

Conversely, no such consensus exists at an international level. The problem is particularly acute in relation to the non-commercial policy objectives of SOEs.[26] The notion that foreign investment is infused with the politics of its home state has deep roots in the

[23] For example, the Chinese investment in a Nuclear Power at Hinkley Point in the United Kingdom. See 'State-Owned Enterprises as Global Competitors | READ online', https://read.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-as-global-competitors_9789264262096-en (visited 3 May 2018). Prime Minister Theresa May ordered a security review into the deal before approval, see Reuters 'UK's Theresa May to review security risks of Chinese-funded nuclear deal, 4 September 2016, https://uk.reuters.com/article/us-g20-china-britain-nuclear/uks-may-to-review-security-risks-of-chinese-funded-nuclear-deal-idUKKCN11A0GN.

[24] For a comprehensive treatment of the competition-related concerns related to foreign investment, see OECD, *State-Owned Enterprises as Global Competitors - A Challenge or an Opportunity?* (OECD Publishing, Paris, 2016.). at 27.

[25] It has also been suggested that political economy makes SOEs less susceptible to expropriation, by virtue of the resultant diplomatic complications, giving rise to a greater propensity for risk or lower drive for efficiency see Alvaro Cuervo-Cazurra et al, 'Governments as owners: State-owned multinational companies', 8 Journal of International Business Studies 45 (2014), at 919.

[26] See Mendenhall, above n 5.; Steven Globerman and Daniel Shapiro, 'Economic and strategic considerations surrounding Chinese FDI in the United States', 1 Asia Pacific Journal Management 26 (2009), at 163.; Karl P Sauvant, *The Rise of Transnational Corporations from Emerging Markets: Threat Or Opportunity?* (Edward Elgar Publishing, 2009).; Edward Montgomery Graham and David Matthew Marchick, *US National Security and Foreign Direct Investment* (Institute for International Economics, 2006).

origins of international investment law.[27] As SOEs internationalize, there is a concern that they pose a risk to critical infrastructure, could monopolize strategic resources, commit military or industrial espionage, and maintain lower standards of responsible business conduct.[28] Indeed, the fact that targets for acquisition by SOEs are typically valued at an above-market rate may suggest the existence of an 'SOE dividend' representing the additional non-commercial value of strategically important companies. [29]

In light of the starkly divergent approaches to state-led investment across the globe, the possibility of a harmonized regime of SOE governance seems remote. How can we hope to regulate for unauthorised market distortions if such distortions are explicitly endorsed in some jurisdictions? How can we guard against protectionism if states justify protectionist measures by citing nebulous national security concerns?[30]

In short, it may not be possible to do so. The policy divergences between states may prove too great, the vested interests too entrenched, for lawyers to seek to heal the fragmentation. Instead, we can seek to manage it, by furnishing drafters and negotiators with common definitional criteria within which to express their policy differences.

III. A Conceptual Framework for State-Owned Enterprises

A shared definition of state-owned enterprises is crucial to a rules-based system of global economic governance. Regulatory disciplines can only be developed if there is clarity as to the form and conduct of 'caught' entities. That it has proven elusive thus far is a reflection of the relative infancy of existing scholarship; recent literature has occurred within particular contexts, absent the need to consider the phenomenon of SOEs as a whole. I propose five

[27] The period of European expansionism saw the alignment of private investors interests with the interests of their home state; commercial and national actors developed a symbiotic relationship in which traditional functional distinctions vanished and imperialist and business objectives became one. See Kate Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (Cambridge University Press, 2013). at 33

[28] For a comprehensive treatment of the non-commercial policy objectives of SOEs, see See OECD, *State-Owned Enterprises as Global Competitors* above n 24. At 59.

[29] FNA Lehmann and A-T Tavares-Lehmann, '"State-to-State dispute settlement and the interpretation of investment treaties"', Study prepared for the Freedom of Investment Roundtable Unpublished OECD document cited in .cited in OECD, *State-Owned Enterprises as Global Competitors* above n 24. At 63.

[30] National Security concerns and a 'net benefit' test are at the core of the domestic legislation that has been introduced to address these concerns, most notably in the United States and Canada, see Paul Rose, 'US Regulation of Investment by State-Controlled Entities', 1 ICSID Review 31 (2016), at 77.; Kevin Ackhurst, Stephen Nattrass and Erin Brown, 'CETA, the Investment Canada Act and SOEs: A Brave New World for Free Trade', 1 ICSID Review 31 (2016), at 58.

definitional criteria within which states can adequately distinguish SOEs from both private investors and other forms of sovereign investment, and also express their particular policy preferences as to acceptable conduct.

The starting point is to examine the place of SOEs within theories of global economic governance.

A. SOEs on the Public/Private Continuum

A corollary of the tension between statehood and globalisation is the debate as to whether international investment law is a system of transnational public governance or private dispute settlement.[31] In either case, the underlying assumption is that it is both possible and useful to differentiate between the public and private sphere.[32] Modern international investment governance is therefore an exercise in resolving the confrontation between the private interests of transnational corporations and public interests of host states. Enterprises operate in the public or private sphere, and the appropriate regulatory response is defined by the side of the fence on which the enterprise is adjudged to fall. A governance framework for SOEs would therefore have as its foundation a determination as to their public or private character.

However, the distinction that forms the premise of this view is a false dichotomy. The international investment regime draws from sources of both public international law and private international law; it utilizes classic conceptions of public law and private law; and simultaneously acts upon both public and private actors.[33] Any attempt to construct a framework for the governance of SOEs on the basis that the public and private sphere are mutually exclusive is therefore likely to mischaracterize enterprises for which there is a functional overlap. This is borne out by recent developments.

The distinction between public and private law traditionally draws a dividing line between the law governing relations between governmental institutions and individual citizens on the one hand, and individual rights of property, contract, personal security and personal liberty on the other. However, the rapid growth of government participation within

[31] For a comprehensive account of this debate, see Julie A Maupin, 'Public and Private in International Investment Law: An Integrated Systems Approach', 2 Virginia Journal of International Law 54 (2014).
[32] For a discussion of the character of the public and private spheres in international arbitration, see Gus Van Harten, 'The Public—Private Distinction in the International Arbitration of Individual Claims against the State', 2 International & Comparative Law Quarterly 56 (2007), at 371.
[33] See Maupin, above n 31, Public and Private in International Investment Law. At 87

market-based economies presents a challenge to conceptions of public and private law rooted in the notion of the state as a mere regulator or 'referee' of disputes between private actors. For example, in the granting of a state monopoly, the scope of private rights is curtailed on the basis of public law principles. Furthermore, the existence of SOEs means that states can be both claimant and respondent in instances of international arbitration. ICISD jurisdiction does not extend to matters of disputes between states, but arbitral tribunals in *BUCG v Yemen* and *CSOB v Slovakia*, have that held that SOEs do indeed have standing before ICSID in certain circumstances.[34] The creation of SOEs in the domestic context is a deliberate intervention in the market for the provision of public services, the fulfilment of industrial policy, to protect fiscal revenues or to satisfy the demands of the domestic political economy.[35] Ascribing public character to state actors and private character to non-state actors therefore does not resolve the normative conflict, but rather obscures it.

The problematic nature of the public-private distinction is not a new idea international law, but it has proven to be particularly stubborn in relation to investment.[36] Too often is our starting point a question of classification as opposed to one of definition. If SOEs are to be classed as private actors participating in markets, then they would be regarded as any other private entity; if they are to be classed as public instrumentalities – an extension of state sovereignty – then they would be regulated using means that are more diplomatic than economic. This binary analytical framework is overly simplistic, leading to regulatory responses that are reactionary and incoherent. Rather than asking 'is this entity public or private?' and using the answer as the foundation of a governance structure, it is better to take an integrated approach; one that engages with the public and private effects of state enterprises as part of a holistic analysis. What is the character of actions taken by state owned enterprises? How do they interact with domestic and international regulatory frameworks? What is the effect of arbitral awards, governmental action and civil society on their governance regime? In truth, SOE conduct exists on a continuum, with some conduct more public than private and others more private than public. At the core of this holistic approach

[34] Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen, ICSID Case No. ARB/14/30; Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic, ICSID Case No. ARB/97/4. For further discussion of these cases, see Part IV below.
[35] An example of the furtherance of industrial policy by state investment is in the case of artificial intelligence, see Yujia He, 'How China is preparing for an AI-powered Future', Wilson Briefs, June 2017, available at https://www.wilsoncenter.org/sites/default/files/how_china_is_preparing_for_ai_powered_future.pdf. On matters of SOEs and the political economy, see Yi-chong, above n 18.
[36] Christine Chinkin, 'A critique of the public/private dimension', 2 European Journal of International Law 10 (1999), at 387.; Hilary Charlesworth, 'Worlds apart: Public/private distinctions in international law', in M. Thornton *Public and Private: Feminist Legal Debates* (Oxford University Press, 1995).

is the recognition that international investment law is necessarily dynamic; perpetually in a state of invention and reinvention. A more thorough analysis of SOEs is conducive to the creation of a bespoke regulatory regime that adequately addresses legitimate concerns.

Indeed, the application of this integrated approach to the modern landscape of international investment reveals an observable functional overlap between SOEs and private multinationals. Consider the recent discussions between Japan and the United Kingdom with regards to Brexit. Reuters reports that written guarantees were offered by Prime Minister Theresa May to Prime Minister Shinzo Abe in relation to car-makers Nissan, that the British car industry will remain 'competitive' even if they are unable to conclude a Japan-UK FTA after Brexit.[37] This assurance was communicated at a diplomatic level, in spite of the fact that Nissan is a privately-owned corporation. The minutiae of these guarantees are not yet known, but could encompass assurances as to future levels of taxation, health and safety regulation, labour laws or environmental standards. Are such concessions of a fundamentally different character than would apply to an SOE? Is the influence on the United Kingdom's domestic regulation less egregious by virtue of the fact that Nissan is privately-owned? It is submitted that the answer to these questions is no. The economic power wielded by transnational corporations confers a corresponding degree of political power, regardless of whether they are state-owned or privately-owned. Indeed, the confluence of state and private enterprise may well be the rational end-state of globalization; if economic growth is the driving force of the world order, then host politics is necessarily consumed, or at least heavily influenced, by economics.

Nevertheless, public and private functions do not collapse into each other entirely; to argue that two things are not mutually exclusive is not to say that they are identical. Indeed, the necessity of a discrete regulatory regime will only hold if state-ownership confers unique characteristics. Let us return to Japanese car-markers Nissan. How would a state-owned iteration of Nissan compare to the privately-owned one? Both would operate multiple jurisdictions, command considerable resources and influence the domestic regulatory framework of their host state. There are two fundamental differences.

Firstly, the SOE version of Nissan could influence the regulatory framework in their home state of Japan to a greater degree than the privately-owned company. The inherent ability to affect the regulation of the market in their home state encapsulates the twin pillars

[37] Reuters, 'UK secured Nissan investment with Brexit relief promise', 27 October 2016. https://uk.reuters.com/article/uk-britain-eu-nissan-support-idUKKCN12R1AK (visited 3 May 2018).

of SOEs: state control and investment activity. An international legal framework governing SOEs should be concerned with the interaction of these two elements; neither on its own adequately describes the phenomenon. Crucially, SOEs are state-controlled, but they are not the state, unlike other government-controlled investors such as state agencies, sovereign wealth funds and public pension funds.[38] The effect of this distinction should cast a long shadow over perspectives on SOE investment activity. If the state and SOE are legally independent, it is also possible that they are functionally independent. While SWFs are wholly controlled by the state, SOEs can be partially owned by private interests, or sub-national governments. This necessarily changes the interaction between elements of control and investment activity.

Secondly, the privately-owned version of Nissan is accountable to shareholders, whereas the SOE would be accountable to a government which is subject to the broader pressures of civil society. While executives of private enterprises have a fiduciary duty to act in a way conducive to maximizing financial returns for their shareholders, the investment decisions of SOEs may be taken for financial, diplomatic, strategic, military or national security reasons. This potential divergence of purpose occasionally provokes a backlash from governments and civil society.[39] The purposive element is therefore essential to the character of SOEs.

A universal definition of SOEs must therefore address the elements of control and investment activity, with the latter encompassing both its nature and purposes. Thus, they are distinguished from their private counterparts in a way that reflects their unique characteristics, avoiding a regression to the binary classifications of 'public' or 'private'. Existing definitions of SOEs in international organizations are of limited utility in this regard.

B. Definitions in the Practice of International Organisations

[38] Not all SWFs have separate legal personality, see Peter Kunzel et al, 'Sovereign Wealth Funds: Current Institutional and Operational Practices', 254 IMF Working Papers 08 (2008), at 12

[39] For instance, the fear of a foreign government exercising malign influence over critical infrastructure was cited by the U.S. Congress when overturning the presidential approval of the acquisition of six ports in the United States by Dubai Ports World, an SOE of the UAE. See further Brandt J C Pasco, 'United States National Security Reviews of Foreign Direct Investment: From Classified Programmes to Critical Infrastructure, This is What the Committee on Foreign Investment in the United States Cares About', 2 ICSID Review 29 (2014), at 350. The most recent demonstration of the pitfalls of economic dependency on an SOE was in March 2018, when Russian-controlled Gazprom decided not to restart gas supplies after an international arbitral tribunal awarded Ukraine's Naftogaz $2.5 billion dollars for a dispute over the price and supply of natural gas. See further Roman Olearchyk and Henry Foy, 'Ukraine's Naftogaz claims $2.5bn win over Russia's Gazprom' (1 March 2018), *Financial Times* https://www.ft.com/content/5ae3b27e-1d2f-11e8-956a-43db76e69936 (visited 3 May 2018).

Definitions of an SOE have been advanced by the World Bank and the Organisation for Economic Cooperation and Development (OECD).

The OECD has addressed the definition in the Guidelines on the Corporate Governance of State Owned Enterprises.[40] It provides that an SOE is: 'any corporate entity recognized by law as an enterprise…in which the state exercises ownership'.[41] Ownership is defined in terms of control, with full or majority voting rights or an equivalent degree of control. Examples of such equivalent control are significant minority ownership accompanied by articles of association that guarantee continued state control over the enterprise or its board of directors. Consideration of such 'golden share' arrangements should be assessed on a case-by-case basis. Minority shareholding confers control when the corporate or shareholding structures result in an 'effective controlling influence' by the state. It explicitly excludes companies in which the government holds an interest below ten percent. The Guidelines further provide that 'statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature'.[42] Economic activity is defined as one that involves offering goods or services for profit.

The asymmetrical application of an 'activity and purpose' test in this definition is curious. For statutory corporations to be SOEs, their activity and purpose must be largely economic in nature, but the same qualification is not applied to the corporate entity. The addition that the corporate entity must be recognized as an enterprise under national laws could act as an indirect application of the activity and purpose test, but this will necessarily depend on the provisions in the relevant domestic law. Given that many internationalized SOEs are corporate entities and not statutory corporations, the absence of this consideration is a significant narrowing of scope. The nature and purpose of the investment activity are therefore insufficiently addressed. However, the broad spectrum of scenarios 'caught' by the provisions on control addresses the issue of *de facto* SOEs, particularly the open-ended requirements of 'any other degree of control' and 'effective controlling influence'. This

[40] Many of the legal instruments of the OECD make no distinction on the basis of ownership. The OECD Declaration on International Investment and Multinational Enterprises and the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations are both ownership neutral. Indeed, the latter makes explicit reference to the parity of rights to provide cross-border services between government-owned enterprises and private enterprises.

[41] See OECD Guidelines on Corporate Governance 2015, above n 4, at 15.

[42] Ibid.

allows for a more thorough evaluation as to the character of governmental influence, unconstrained by form. In neither case is there an indication as to whether SOEs controlled by sub-national governments are included within the definition.

The World Bank defines SOEs as 'government owned or government controlled economic entities that generate the bulk of their revenues from selling goods and services'.[43] It also provides that control will be established where the government controls management through majority ownership of shares, or a significant minority shareholding where the distribution of the remaining shares leaves the government with effective control.[44] This definition therefore includes a consideration of the power to appoint members to the board. However, control is more narrowly defined that the OECD definition in that it is not inclusive of effective influence. The emphasis on the ownership stake is not suited to the modern international landscape in which influence can be exercised by other means, nor does it stipulate whether enterprises of sub-national governments are incorporated. It does adequately address the nature of investment activity, limiting it to 'commercial activities', defined as the sale of goods and services. There is some ambiguity over whether this definition encompasses an examination as to the purpose of the enterprise. 'Economic entity' or 'commercial activity' could suggest the requirement of a profit-making purpose, but this is not explicitly provided for. The matter as to whether an enterprise that conducts ostensibly commercial activity to advance a non-commercial policy objective is therefore not addressed.

Proposals by the OECD and World Bank both reflect different approaches to defining an SOE. However, within these definitions are policy choices which do not universally apply, and do not comprehensively address many of the central features of SOEs. In order to provide a comprehensive definition, there are five definitional criteria that must be addressed.

C. Five Definitional Criteria for SOEs

1. Separate Legal Personality

[43] World Bank, *Bureaucrats in Business: The Economics and Politics of Government Ownership* (World Bank Publications, 1995). at 26.
[44] Ibid.

The first is that SOEs have a legal personality that is separate from the state. This is important to distinguish SOEs from other forms of government-controlled investors.[45] The question as to whether SOEs are distinct from other types of state investment is fundamental to the task of designing a targeted regulatory regime to govern their activities.

In funding, function and form of investments, separate legal personality imbues the enterprise with unique characteristics.[46] While SWF assets are held by central government and funded by foreign exchange reserves and export revenues, SOE assets are held by companies of central or sub-central government, and are funded by public grants or profit-making activity. SWFs are mandated to pursue public welfare objectives such as market stabilization or saving for future generations, whereas the separate legal personality of SOEs allows for the pursuit of purely commercial interest. This manifests in that SOEs are far more likely to acquire a controlling interest in companies, invest on a short-term horizon and prefer industrial investments to financial ones.[47] Commercial interest is similarly bolstered by the added accountability of private investors even when the state has a controlling interest in the enterprise; a feature that is less potent if the state is itself the investor.

International legal instruments could provide for separate legal personality in various ways; the terms 'legal entity', 'juridical person', 'company', 'national' and 'economic entity' are all effective at communicating separate legal personality, even if this is not, on its own, sufficient to confer standing to SOEs under an international investment agreement.[48]

2. Extent and Form of Control

Secondly, there must be a stipulation as to the extent and form of control that a government must exercise over an entity in order that it may be considered an SOE. This criterion addresses the method by which the enterprise is controlled. With the vast array of economic models practised around the world, the degree and nature of state intervention in markets varies substantially. Developments in the global economy have also diversified the types of SOEs. Consensus on the precise relationship between government and enterprise that would

[45] The differences between SOEs and SWFs are often explored in the literature, see Larry Cata Backer, 'Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience', Transnational Law & Contemporary Problems 19 (2010), at 3.
[46] Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar Publishing, 2011). At 23.
[47] Ibid.
[48] On the standing of SOEs under BITs, see Mark Feldman, 'The Standing of State-Owned Entities Under Investment Treaties.', Yearbook on International Investment Law & Policy 2010-2011 (K Sauvant, ed) Oxford University Press 2012.; Blyschak, above n 9, State-Owned Enterprises and International Investment Treaties.

constitute 'control' is therefore elusive, and requires explicit provision in any legal instrument purporting to regulate SOEs.

One measure of control is expressed through the ownership of shares. Control is typically established either by outright ownership of the enterprise, ownership of a majority the shares, or by a specified minimum minority ownership, if the government is the largest shareholder. The power to appoint a majority of the board of directors similarly would confer governmental control. However, approaches to the determination of 'control' need not necessarily envisage every precise scenario under which an enterprise should be regarded as an SOE. States can allow for a broader examination, particularly if there are any so-called 'golden share' arrangements that grant the government veto powers over particular activities, or if there is evidence of extra-legal influence, such as a demonstrable 'revolving door' scenario between the management of the SOE and the incumbent government, or mechanisms to ensure compliance with state goals. It is important that this criterion remains sufficiently flexible to prevent circumvention in bad faith.

A vital question to be asked in the course of examining the control of an enterprise is whether it is functioning as an agent of the state.[49] In this respect, the ILC Articles on State Responsibility have been held to be relevant by investment tribunals in *Maffezini v Spain, EDF (Services) Ltd v Romania, and Bayinder v Pakistan*.[50] The official Commentary to Article 8 provides that some 'conduct is… attributable to the State because there exists a specific factual relationship between the... entity engaging in the conduct and the State'.[51] It further stipulates that Article 8 applies to those situations in which the conduct results from 'instructions', 'direction' or 'control' from the State.[52] An enterprise will therefore be acting as an agent where the conduct complained of forms an 'integral part' of the operation directed or controlled by the State.

However, it should be emphasised that 'the test under public international law for whether a State ''controls'' or ''directs'' the acts and omissions of a person or group of

[49] Articles 5 and 8 of the Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in Report of the International Law Commission on the Work of its Fifty-third Session, UN Doc A/56/10 (2001) (ILC Articles). A comprehensive discussion of the ILC Articles as they relate to SOEs was undertaken by the tribunal in *Emilio Agustin Maffezini v. The Kingdom of Spain* (Decision of the Tribunal on Objections to Jurisdiction, 25 January 2000), ICSID Case No. ARB/97/7 para 78.
[50] *Emilio Agustin Maffezini v. The Kingdom of Spain* (Decision of the Tribunal on Objections to Jurisdiction, 25 January 2000), ICSID Case No. ARB/97/7; *EDF (Services) Limited v. Romania* (Award, 8 October 2009), ICSID Case No. ARB/05/13; *Bayindir Insaat Turizm Ticaret ve Sanayi A.S. v. Islamic Republic of Pakistan* (Award, 27 August 2009), ICSID Case No. ARB/03/29
[51] ILC Draft Articles with Commentary above n 49 at 47.
[52] Ibid.

persons is set extremely high'.[53] Investment decisions will only be deemed to be at the direction or control of a State where there is unequivocal, specific and targeted factual bases to so conclude. Given the considerable lifespan of some foreign investments, it may also be necessary to demonstrate ongoing control in respect of the investment. Satisfying this requirement will involve an examination of the relationship nexus between the home state and the decision-making body of the enterprise, and how this has been utilised in respect of a particular investment. The existence of compliance or approval mechanisms in the home state that mandate the pursuit of declared state initiatives could be the manifestation of such agency.

Ultimately, the scope of 'control' in BITs is a policy decision; should a state prefer to limit coverage to expressions of share ownership, then they are of course free to do so. But failure to take a broader approach encompassing a consideration of effective influence may be unfit for the modern global economy. The difficulty in disentangling government and private enterprise in economies like China present a unique regulatory challenge.[54] It is not legitimate to engage in a kind of 'economic sinophobia' by blocking investments purely because they are Chinese, but consideration of the long arm of the state is an appropriate enquiry into the influence of the Chinese Communist Party on privately-owned enterprises..

3. Eligible Governmental Units

The third criteria that must be addressed to comprehensively define an SOE is whether it applies only to enterprises of central government, or also to municipal, county or local government, or any other political subdivision. It relates to the nature of the controlling entity, rather than the method of control. Different constitutional arrangements necessitate the inclusion of this provision in international legal instruments covering SOEs.[55]

Different levels of government can also affect the character of the investment. If an SOE is controlled at a municipal level, it may be subject to an entirely different set of pressures and priorities than at a national level. For instance, locally-controlled SOEs may be less likely to engage in activity for reasons that are of national strategic importance, and more likely to be concerned with the profit that will benefit their municipal area. It also might

[53] White Industries Australia Limited v Republic of India, UNCITRAL, Award (30 November 2011) para 5.1.25
[54] See Milhaupt and Zheng, above n 16.
[55] For example, the Constitution of the United States requires that its states consent before their SOEs are bound by international treaties.

speak to their susceptibility for corruption, if the municipal government is subject to less regulatory or media oversight.[56] Conversely, SOEs controlled at a national level may be more concerned with the furtherance of large-scale initiatives of global importance, particularly in relation to resource capacity and technological leadership.

4. Commercial Nature of Activity

Fourthly, the definition should address whether an entity must be engaged in commercial activity to be regarded as an SOE. To clarify, this definitional criterion addresses the nature of the activity, not its purpose. The requirement that SOE activity be of a commercial nature is crucial an international context. For example, some BITs in which the State itself is included as an 'investor' could lend credence to the argument that investments by SOEs should be protected despite their exercise of governmental authority.[57] Drafters should be cogniscant of the need to explicitly restrict BIT protections to investments made in a commercial capacity, if this is the policy being pursued. The issue is inextricably linked to the notion that SOEs have a separate legal personality from their home state.

It is necessary to expand on the activities that would be regarded as commercial and non-commercial. An activity will be of a non-commercial nature when it is under the exclusive competence of the sovereign, governmental units or state agencies. Typical instances of the exercise of exclusive competence are legislative activity, administrative action, and the development of public policy. In the context of international investment, the test applied to the ICSID convention is that of 'discharging an essentially governmental function'.[58] Examples would be to grant licenses, approve or block commercial transactions, impose quotas, fees, or expropriate companies.[59] Conversely, activity of a commercial nature will comprise the sale of goods or services to consumers. However, the extent of 'commercial nature' should extend not only to the contract of sale, but also the price and quantity of the good being supplied.

[56] Research by the OCED revealed that SOE officials are statistically more likely to accept bribes than officials in privately run enterprises, and 80% of the amounts involved in the study were received by SOE officials, see OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials, OECD Publishing, Paris, 2014.
[57] For example, BITs concluded with Kuwait and the UAE often include language such as 'institutions' 'authorities' and 'agencies' with the definition of an investor. See Part IV.B. below.
[58] For a comprehensive treatment of the application of the Broches test to SOEs, see Reza Mohtashami and Farouk El-Hosseny, 'State-Owned Enterprises as Claimants before ICSID: Is the Broches Test on the Ebb?', 2 BCDR International Arbitration Review 3 (2016), at 371.
[59] Ibid.

5. Purpose of Activity

The final criterion for defining an SOE is to address its policy objectives. This is perhaps the most controversial of the proposed definitional criteria, and one over which states are likely to have substantial disagreement. The difference in accountability between SOEs and their private counterparts is apparent; the latter is answerable to shareholders, while the former is answerable (at least in part) to government, and thus to broader considerations of the national interest. The potential for SOE conduct to be motivated by strategic considerations is therefore inherent to their nature.

The extent to which it is legitimate for a state to utilize commercial activity for strategic purposes strikes at the heart of the ideological divide between global powers. States that are accustomed to utilizing SOEs as a vehicle for the fulfilment of public policy objectives in a domestic context may carry that inclination across borders. Conversely, states that have a very limited role in their domestic economies – for whom public and private functions are quite distinct – are likely to reject to the notion that commercial means should be used for sovereign ends.

Just because SOEs can theoretically be motivated by non-commercial objectives, it does not then follow that an SOE necessarily does so. Some SOEs may indeed be operationally autonomous. It will be a difficult task to divine the motives of an SOE in an objective manner, especially where the transaction is both commercially justifiable and strategically beneficial.[60] Economies in the Global South might reasonably argue that many of the states now objecting to the use of foreign investment to promote the national interest have themselves endorsed this activity in the recent past.[61] Furthermore, if the enterprise is of mixed government-and-private ownership, then the source of accountability necessarily affects the pursuit of non-commercial objectives. Thus, this requirement is not without its own historical, evidentiary and interpretive issues.

Indeed, some arbitral tribunals have expressly rejected the relevance of purposes when addressing the issue of SOE access to the ICSID Convention.[62] The inclusion of such a

[60] For an account of the difficultly in tracing the origins of a transaction from SOE to its host government, see Minwoo Kim, 'Regulating the Visible Hands: Development of Rules on State-Owned Enterprises in Trade Agreements', 58 Harvard International Law Journal 225 (2017), at 233.
[61] See Miles, above n 27, The Origins of International Investment Law.
[62] Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen, ICSID Case No. ARB/14/30; Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic, ICSID Case No. ARB/97/4.

ground is therefore an expansion of the scope of an arbitrator's enquiry. However, the mixed scholarly reaction to the restrictive approach taken in these tribunals leaves open the possibility that a future tribunal may indeed consider the purpose of an investment. Consequently, the explicit stipulation of the inclusion or exclusion of non-commercial considerations from the scope of international legal instruments allows for a transparent and open discussion of these ideological differences by the Contracting parties, rather than delegating the issue to arbitrators after a dispute has arisen. The requirement that the entity must act on a profit-making basis is also inclusive of this criterion.

D. A Unified Definition of a State-Owned Enterprise

From the foregoing, it is possible to suggest a unified definition of SOEs. A state-owned enterprise is: 'an independent legal entity subject to control by governmental units that engages in commercial activity for profit-making or strategic purposes'.

This adequately addresses the unique features of SOEs, distinguishing them from other government-controlled investors, and expresses the lingering ambiguity as to their purpose. States may express their policy preference in relation to whether or not the definition of control extends to minority ownership or broader measures of influence, the scope of activity that will be considered commercial, the levels of government that will be included, and whether SOEs will be limited to a profit-making purpose or can act on the basis of other considerations.

Despite this, some criteria will remain more important than others. For example, if an SOE does not have separate legal personality, then this will be fatal in the context of those BITs that require an investor be a 'legal person'. Conversely, an SOE of a municipal government may be protected even where such protection is not explicitly stipulated. If an entity is exercising governmental authority, it will not be regarded as an SOE for those treaties which require the investment to be commercial in nature. Therefore, the relative weighting afforded to each of the criteria will depend on the wording of the specific treaty. Indeed, the inclusion of all five definitional criteria is relatively rare in the legal instruments of international investment law.

IV. 'Covered State-Owned Enterprises' in International Investment Agreements

The binary question of whether SOEs have standing under the legal instruments of international investment law is only of tangential relevance to this article, and nevertheless has been the subject of excellent analysis elsewhere.[63] Of more concern is the means by which state-owned enterprises become 'covered state-owned enterprises'; the emergence of definitional criteria for an SOE in international investment law; the adequacy of these methods of definition; and the potential for diverging approaches to cause fragmentation in global investment governance. However, these endeavours are inextricably linked, and share as their starting point an overview of the inclusion of SOEs in BITs, and FTAs.

Two empirical studies have been undertaken to ascertain the extent to which substantive treaty protections extend beyond private enterprise, reviewing 1,813 and 851 IIAs respectively.[64] As the gatekeeping provisions of BITs, the definitions of investor, investment, nationals or companies were surveyed for terms that support the inclusion of SOEs, such as 'state enterprises' 'governmentally owned', 'governmentally owned or controlled', 'public institutions', 'state corporations and agencies', 'governmental institutions', and 'public investment'.[65] The conclusions of these studies were largely aligned.

The first conclusion is that the vast majority of IIAs (84% and 81%) do not explicitly distinguish on the basis of ownership, but instead distinguish by reference to whether a legal person was established in accordance with the law of a contracting party. Secondly, there is a definite trend towards explicit inclusion of SOEs within the 'gateway' definitions of IIAs; the 16% of agreements inclusive of SOEs were of higher frequency in recent years. Third, explicit exclusion of SOEs from the scope of IIAs is exceptionally rare; less than 0.5% in both studies. [66]

A. Ownership-Neutral Provisions

[63] See Feldman, above n 48.; See Blyschak, above n 9, State-Owned Enterprises and International Investment Treaties.; See Julien Chaisse and Dini Sejko 'Investor-State Arbitration Distorted: When the Claimant is a State' in *Judging the State in International Trade and Investment Law Sovereignty Modern, the Law and the Economics* at 76.
[64] See Shima, above n 10., See Low, above n 10.
[65] Ibid.
[66] Article 1(d)(i) of Panama–United Kingdom BIT (1983) provides "all those juridical persons constituted in accordance with legislation in force in Panama…which have their domicile in the territory of the Republic of Panama, excluding State-owned enterprises."

The absence of explicit inclusion of SOEs within IIAs gives rise to a degree of legal uncertainty as to their place in international investment law. UNCTAD have suggested that the application of Article 31 of the Vienna Convention on the Law of Treaties (VCLT) should give rise to a presumption that investments by SOEs are covered by the scope of ownership-neutral terminology, in accordance with the ordinary meaning of terms like 'legal entity'.[67] This presumption is undermined by the ease with which explicit and implicit contradictions contained in other parts of the treaty could counteract it. Three examples of potential contradictions to the presumption have been advanced: preambles which include reference to 'private enterprise'; asymmetrical definitions of an investor within the same treaty; and subrogation clauses which are explicit in their inclusion of state-owned enterprises, allowing arbitrators to draw an inference from the absence of explicit inclusion of SOEs within gateway provisions.[68] Moreover, in *Inceysa Vallisoletana, S.L. v. Republic of El Salvador* it was held that a presumption in favour of jurisdiction is incompatible with the notion that the scope of a nation's consent to jurisdiction should be assessed on an individual basis.[69]

There is also a creeping tendency in some of the literature to hint that the subsequent inclusion of SOEs within recent BITs is evidence that SOEs also fall within the scope of older treaties that are absent such explicit inclusion. This is an interpretive leap that should be avoided. Such an approach was considered and rejected by *Aguas del Tunari, S.A. v. Republic of Bolivia* as being outside the rules of interpretation according to Article 31 of the VCLT.[70] International investment law is a discipline in which the contextual environment of each individual treaty weighs heavily on its final form. To strip treaties of their contemporaneous context and relative negotiating power would be to fundamentally misconstrue the intentions of the contracting parties. Their object and purpose may well warrant the inclusion of SOEs, but it is important not to overstate the certainty, given the lack of arbitral cases and occasional incongruence of some arbitral decisions.[71]

67 The Protection of National Security in IIAs: UNCTAD Series on International Investment Policies for Development (New York and Geneva: United Nations, 2009) at 43, available online: <http://www.unctad.org/en/docs/diaeia20085_en.pdf>

68 See Blyschak, above n 9, State-Owned Enterprises and International Investment Treaties. 23

69 *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26 , para. 176; See also *Noble Energy, Inc. and Machalapower Cia. Ltda. v. The Republic of Ecuador and Consejo Nacional de Electricidad* (Decision on Jurisdiction, 5 March 2008), ICSID Case No. ARB/05/12 at paras. 195-197

70 *Aguas del Tunari, S.A. v. Republic of Bolivia* Decision on Jurisdiction, 21 October 2005), ICSID Case No. ARB/02/3 at para. 291

71 For a review of cases filed by SOEs, see Chaisse and Sejko 'Investor-state Arbitration Distorted' above n 63 at 94.

However, the question of ownership-neutral language has been squarely addressed before arbitral tribunals.[72] In *CSOB v. Slovak Republic*, the tribunal had to examine whether a bank that was jointly owned by the Czech and Slovakian state was 'a national of another Contracting State' as is required to be afforded jurisdiction under the ICSID Convention.[73] The tribunal applied the two-pronged Broches test, in which a government-owned corporation falls within the scope of the ICSID convention if it is first, not acting as an agent of the government and second, not discharging an essentially governmental function.[74] The tribunal emphasized the importance of the commercial nature of SOE activity in allowing jurisdiction.[75] It was irrelevant if SOE conduct is "driven by" governmental policies, even if the State exercises control tantamount to the SOE being 'required' to act as directed.[76] More recently, the case of *BUCG v. Republic of Yemen* also addressed the question of whether SOEs could access ICSID, in this case a Chinese SOE.[77] In allowing jurisdiction, the tribunal affirmed the reasoning of the decision in CSOB by applying the Broches test, and in particular applying a test as to the nature of SOE activity, as distinct from its purpose.[78]

This interpretive approach has not been universally well-received.[79] It has been suggested that a 'bright-line' test, requiring an evaluation of the nature of an activity as divorced from its purpose, is to 'attempt the impossible'.[80] Fortunately, the thorny matter of determining which approach is correct can be side-stepped in this article.[81] The relevant aspect of these cases for our task is that many BITs are absent clear guidance as to the scope of covered SOE conduct, and thus it will be left to tribunals to make a determination on a case-by-case basis. If Yemen would like to exclude SOE activity that is 'driven by' their home governments, then they should provide for this explicitly in BITs. It is the uncertainty

72 In three other cases the tribunals stated that that the State-owned entity constitutes a "national" of a Contracting Party without closer examination, see Hrvatska Elektroprivreda d.d. v. Republic of Slovenia, ICSID Case No. ARB/05/24, CDC Group plc v. Republic of Seychelles, ICSID Case No. ARB/02/14, and *Telenor Mobile Communications A.S. v. The Republic of Hungary*, ICSID Case No. ARB/04/15. For a brief overview of these cases, see See Feldman, above n 48. At 624.

73 *Ceskoslovenska Obchodni Banka, A.S. v. The Slovak Republic*, Decision on Jurisdiction, 24 May 1999), ICSID Case No. ARB/97/4

74 Ibid. para 17, citing Aron Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (1972) 135 Hague Recueil des Cours 331 at 354-355.

75 Ibid. at para. 20.

76 Ibid.

77 *Beijing Urban Construction Group Co. Ltd. v. Republic of Yemen*, ICSID Case No. ARB/14/30

78 Ibid at para 10.

79 See Blyschak, above n 9, State-Owned Enterprises and International Investment Treaties at 45.

80 Ibid. 31; *United States of America v. The Public Service Alliance of Canada and others (Re Canada Labour Code)*, [1992] 2 S.C.R. 50 at para. 28

81 Further discussion of the Broches test in the context of SOEs can be found at See Mohtashami and El-Hosseny, above n 58, State-Owned Enterprises as Claimants before ICSID.

of the current provisions that are at issue; absent a comprehensive definition in the text of the treaty, the legal status of SOE investment will rely on contextual interpretations which can be highly unpredictable.

In light of the foregoing, it is necessary to view the textual variations of implicit inclusion of SOEs within the proposed conceptual framework. Legal personality, models of control and eligible governmental units will be referred to as the control-related criteria; nature of the investment and purpose of the investment will be referred to as the conduct-related criteria.

1. Control-Related Criteria in BITs

Separate legal personality is often included as a criterion for 'covered SOEs'. Gateway provisions refer to 'a company constituted or incorporated in accordance with the law of the home country'; the terms 'legal persons', 'national', 'economic entities' 'legal entities', and 'juridical persons' allow for the inclusion of entities that are owned by the state, but do not include the state itself. In other words, foreign investment directly by the sovereign (akin to many sovereign wealth funds) may not covered under bilateral investment treaties where SOEs are only included by implication. However, in the Germany-China BIT, the definition of an investor for Germany includes "juridical persons as well as any commercial or other company or association with or without legal personality", which could permit a broader range of sovereign investment.[82]

The position with regard to models of control is less homogenous. Mark Feldman identified that the definition of "investor" under an investment treaty normally will include one or more of: a place of incorporation requirement, a place of effective management (*siège social)* requirement, or a control requirement.[83] Language such as 'directly or indirectly controlled', 'owned or controlled' and 'controlled by natural persons' allow for the consideration of a broad range of circumstances which encompass anything from full ownership through to effective influence. Treaties which do not contain a 'control' requirement give considerable discretion to arbitrators as to entities that will be defined as SOEs and those that will not.

[82] This exemption from legal personality does not extend to the definition for China.
[83] See Feldman, above n 48. At 631.

The jurisprudence of tribunals is unclear as to what constitutes control when it has not been explicitly provided for. In the context of a private foreign investor, *Klockner v Cameroon* held that a majority shareholding constitutes control of an enterprise.[84] The control may be direct or indirect.[85] Furthermore, the status of minority shareholders before tribunals is particularly contentious, following the finding to the contrary in the *Barcelona Traction.* This was decided on the basis of customary international law and not a bilateral investment treaty.[86] The tribunal in *CMS v Argentina* distinguished the claimant rights of minority shareholders from traditional diplomatic protection, in asserting minority shareholders' standing.[87] Furthermore, establishing state control over a corporate enterprise in the context of attribution has proven to be a difficult test to satisfy, as provided by the tribunal in White Industries. Article 8 of the ILC Draft Articles on State Responsibility have been utilised as an interpretive tool in this regard.

The lack of clarity as to what constitutes 'control' is a corollary of the fact that these BITs do not explicitly consider SOEs. In a commercial context, control should be comparatively straightforward to establish; relative shareholding should be sufficient to confer certainty. In the context of SOEs, the situation is more complex. It is thus inevitable that if the inclusion of SOEs was not uppermost in the minds of the negotiating parties then the corresponding degree of detail as to the definition of 'control' would also be lacking.

The scope of covered enterprises owned by sub-central governmental units is highly context-dependent. The requirement often emerges from the constitutional arrangements of contracting parties. In the context of SOEs, the scope of BITs concluded by the United States are limited to federal government, as the relationship between federal and state government is governed by the Constitution and undertaking obligations with regard to the latter's enterprises would require their consent. However, in the case of ownership-neutral provisions, the inclusion or exclusion of enterprises from sub-central government does not directly arise. Consequently, this definitional criterion is left ambiguous.

The assorted methods by which 'investor' is defined in BITs gives rise to a range of definitions as to which SOEs are implicitly covered and which are not. SOEs are likely to require separate legal personality in order to be considered "investors" for treaties which do

84 Klöckner Industrie-Anlagen GmbH and others v. United Republic of Cameroon and Société Camerounaise des Engrais, ICSID Case No. ARB/81/2
85 Liberian Eastern Timber Corporation v. Republic of Liberia, ICSID Case No. ARB/83/2
86 Barcelona Traction, Light and Power Company, Ltd. (Belgium v. Spain) International Court of Justice, 1970 I.C.J. 3
87 CMS Gas Transmission Company v. The Republic of Argentina, ICSID Case No. ARB/01/8

not explicit include them. Models of control are only addressed if 'investor' is given a control-based definition, as opposed definitions based on 'place of incorporation' or 'siege social'. Control-based definitions can be sufficiently broad to include consideration of effective control, as proposed by the OCED, but often will receive no further clarification at all. Sub-central governmental units are often not addressed.

2. Conduct-related Criteria

Furthermore, other features of the definition of 'investor' could limit the scope of covered SOE conduct; namely the consideration of a legal entity's investment activity. 'Economic entities' and 'real economic activities' impose a requirement that the nature of a covered entity must be commercial in nature. There is no further clarification as to how an economic nature or activity is to be defined in relation to the definition of an investor. However, where the BITs use ownership-neutral language, the standing of SOEs could be limited by the criteria for investment. In the context of ICSID, the *Salini* case is instructive. Four criteria were proposed to for activity to be classed as an 'investment': (a) a contribution; (b) a certain duration of the economic operation; (c) the existence of a risk of sovereign intervention assumed by the investor; and (d) a contribution to the host State's economic development".[88] 'Economic development' potentially encompasses the benefit for the public interest, the transfer of 'know-how', enhanced GDP, and a positive impact on development.[89] The criterion of economic development has been rejected by some tribunals,[90] and a good faith requirement[91] and 'regularity of profit and return' requirement have been added by others.[92] The nature of SOE activity may therefore only fall within the definition of some BITs if they fulfil the definition of an investment in accordance with the BIT.

[88] *Salini Construttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001 at 52; see also *Joy Mining Mach. Ltd. v. Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction, 153 (Jul. 23, 2001) 19 ICSID Rev 486 (Aug. 6, 2004).
[89] 'Defining an ICSID Investment: Why Economic Development Should be the Core Element', Investment Treaty News, available at https://www.iisd.org/itn/2012/04/13/defining-an-icsid-investment-why-economic-development-should-be-the-core-element/ (visited 4 May 2018).
[90] *Quiborax v. Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction, 1 220 (Sept. 27, 2012); *Saba Fakes v. Republic of Turkey*, ICSID Case No. ARB/07/20, Award, T 110 (Jul. 14, 2010); *Victor Pey Casado and President Allende Found. v. Republic of Chile*, ICSID Case No. ARB/98/2, Award, 232 (May 8, 2008);
[91] *Phoenix Action, Ltd. V Czech Republic*, ICSID Case No. ARB/06/5 39 (Apr. 15, 2009)
[92] This criterion has been rejected by most tribunals, but see *SGS* v. *Pakistan*, Decision on Jurisdiction, 6 August 2003, para. 133 FN 113, citing *Fedax*; *Joy Mining* v. *Egypt*, Award, 6 August 2004, para. 53; *Helnan* v. *Egypt*, Decision on Jurisdiction, 17 October 2006, para. 59.

However, examination of the nature of an entity's activities should be distinguished from an examination of their purpose. The activities of an entity may well be commercial in nature - concluding sales contracts, hiring labourers, acquiring companies – but this does not speak to the reasons as to why these commercial acts were carried out. Consider the case of *HEP v. Slovenia*; a Croatian national electric company submitted a claim to ICSID in relation to a joint enterprise in a nuclear power plant.[93] In form, *HEP* was commercial in nature, as they were a shareholder in a limited liability company and participated in economic activities. However, it operated on a non-for-profit basis and was a significant source of electricity for Croatia, whose purchases were governed by a web of bilateral agreements. Attempting to disentangle the nature of the investment from its purpose in this instance is to willfully ignore a crucial aspect of the investor-host-state relationship.

One of the key concerns identified in relation to SOEs therefore passes unremarked in many treaties on investment. Consideration of a 'for-profit' element is found in some recent treaties whose language is ownership-neutral, however. Entities under the Finland-Namibia BIT can be investors 'irrespective of whether or not for profit'.[94] Similar language is found in the Argentina-Thailand BIT: 'whether or not for pecuniary profit', and the Germany-Philippines BIT contains 'irrespective of whether its activities are directed at profit'.[95] These treaties consider the non-commercial purposes of SOEs, and include non-profit activities within their scope. Conversely, the China-South Africa BIT excludes 'tangible or intangible property' that is 'not acquired in the expectation or used for the purpose of economic benefit or other business purposes', while the US-Rwanda BIT cites 'expectation of gain or profit' as one among several characteristics of an investment to be considered when determining whether the 'investment' requirement under the treaty has been met.

Those BITs which specifically provide for the inclusion of non-profit investment within their scope are of particular importance in relation to SOEs, and may prove to be a dividing line amongst the major powers of the global economy. The legitimacy of China pursuing national development or strategic goals through the vehicle of their SOEs is likely to be high on the agenda of the international political economy in the coming years, and BITs should have consideration of this modern phenomenon.

93 *Hrvatska Elektroprivreda d.d. v. Republic of Slovenia* (ICSID Case No. ARB/05/24).
94 China - Portugal BIT (2005), Finland - Namibia BIT (2002), China - Netherlands BIT (2001).
95 'Whether or not for pecuniary profit' is contained in the Japan - Russian Federation BIT (1998), Bahrain - Thailand BIT (2002), Japan - Mongolia BIT (2001).

From this analysis it is possible to draw some broad themes. Firstly, SOEs can generally be said to have standing under BITs, but a comprehensive examination of their provisions could be interpreted in such a way as to exclude SOEs. Secondly, the fact that SOEs are not explicitly provided for has a detrimental effect on the precision with which their definitional criteria are addressed. This is perhaps inevitable, but has significant consequences as to the necessary relationship between the home government and the enterprise that will give rise to protection under BITs. A more complete definition is required to enhance the predictability of the legal regime and its resultant outcomes. Many ownership-neutral provisions in BITs are therefore often unsuited to the modern era, and give arbitrators exceptionally broad discretion to determine the scope of covered SOEs. Conversely, some international investment treaties explicitly extend their scope to cover government-controlled entities.

B. Express Inclusion of SOEs

Express consideration of SOEs is a feature of more recent investment treaties.[96] Language inclusive of SOEs takes the form of 'governmentally owned or controlled' or where a contracting party has 'a substantial interest'.

The Convention establishing the Multilateral Investment Guarantee Agency provides that an eligible investor includes 'a juridical person, whether or not it is privately owned'.[97] This provision addresses the criteria of separate legal personality and model of control, but does not stipulate as to what level of government the juridical person would have to be owned by in order to fall within the scope of the convention. Furthermore, the focus on ownership excludes from the enquiry broader issues of control, such as appointments to the board and effective influence. There is also a requirement that the SOE must be operating on a 'commercial basis'. The term 'commercial basis' is not clarified in the convention, and thus would be subject to the same interpretive discretion as befalls the ICSID convention: whether or not this involves an examination of the nature of the SOE conduct or its purpose.

The 2012 US Model BIT and Canada Model FIPA both contain language explicitly inclusive of SOEs. 'Enterprises' are included the definition of an investor, which are further defined as 'any entity constituted or organized under applicable law, whether or not for

[96] See Low, above n 10.; See Shima, above n 10.
[97] Convention Establishing the Multilateral Investment Guarantee Agency 1985, available at https://www.miga.org/documents/commentary_convention_november_2010.pdf

profit, whether privately-owned or governmentally owned or controlled'.[98] A 'state enterprise' is defined as an 'enterprise owned, or controlled through ownership interests'. This is narrower than the proposed definition by the OECD to consider effective influence, and is not explicitly inclusive of entities where the government can appoint a majority of the board, though it could be argued that the latter is included by implication. The US Model BIT makes provision for the fact that the protections apply only to central government and the Canada Model FIPA includes sub-national entities in its protections.[99] An extensive definition of investment is expounded, laying out the nature of activity that would be covered under the treaties. As to the purposes, the situation is more ambiguous. In the definition, an 'investor' can operate on a non-profit basis. Definition of 'investment' restricts the coverage of real estate or other property to those 'acquired in the expectation or used for the purpose of economic benefit or other business purposes'.[100] The US Model BIT and Canada Model FIPA can therefore be said to address all of the definitional criteria I have identified in relation to SOEs. However, the conception of 'control' is insufficiently broad, missing some entities that should be caught by these provisions.

Similarly, the ASEAN Comprehensive Investment Agreement provides that 'investor' includes a 'juridical person', defined as a legal entity that is for profit or otherwise, and whether privately-owned or governmentally-owned or controlled.[101] Ownership is defined according to national laws, and control by the power to appoint directors or 'otherwise legally direct its actions'. The definition of control is therefore broader than envisaged in the US Model BIT. Whether it is so broad as to include consideration of effective influence will be a matter of interpretation. The phrase 'otherwise' suggests that it is non-exhaustive and so could include a fuller examination of the relationship between home government and investing enterprise.

In the Turkey-Bangladesh BIT, a 'company of a party' is inclusive of 'such Party or its agencies or instrumentalities having a substantial interest as determined by such Party".[102] This formulation is quite distinct from modern treaties. The criteria for control is one based on self-reporting, where the Contracting party is allowed to define for themselves what would be regarded as an SOE for the purposes of investment protection. The company is a juridical

98 Article 1 US Model BIT; Article 1 Canada Model FIPA
99 Ibid.
100 Ibid.
101 Article 4 ASEAN Comprehensive Investment Agreement
102 Article 1(1) Turkey-Bangladesh BIT

entity that is organized for pecuniary gain, privately or governmentally owned, or organized with limited or unlimited liability. The purpose of the SOE is limited by the requirement of 'pecuniary gain'.

Furthermore, some BITs explicitly provide for the inclusion of the government itself as an investor, as well as legally distinct state enterprises. The definition of investors from the United Arab Emirates in the UAE–China BIT explicitly includes the Federal Governments of the UAE, as well as the local governments and their financial institutions,[103] while the BIT between the Czech Republic and Kuwait, defines 'investor' to include the 'Government of that Contracting State', in addition to 'institutions, development funds, authorities, foundations, establishments and agencies'.[104] In the 2001 Belgium-Saudi Arabia BIT, the Saudi government and its financial institutions and authorities are identified as investors.[105] This is a particular feature of BITs where one of the contracting parties has a large sovereign wealth fund, such as the UAE, Kuwait and Saudi Arabia.

It is possible to draw some conclusions from the examination of the methods of explicit inclusion of SOEs with BITs. Firstly, when SOEs are specifically included, the definition is far more likely to touch upon all of the five criteria I have identified for SOEs. Secondly, clarification is given as to the scope of government control that will permit investment protection, but consideration of effective influence is still absent from many BITs. Thirdly, there is often a consideration as to whether or not an SOE must operate on a profit-making basis, but there is no consideration of the other purposes for SOE activity. Some of these deficiencies are addressed by the Comprehensive and Progressive Trans Pacific Partnership.

C. Innovation in the CPTPP: A Gold Standard?

The Trans-Pacific Partnership (TPP) is considered by many to be a watershed instrument in the regulation of SOEs in international economic law.[106] It represents the first integrated discipline with regard to SOEs, and was concluded by states with different economic models and varying levels of government involvement in the economy. Given the exceptionally

[103] Article 1(2) China-UAE BIT 1993
[104] Article 1(2) Czech Republic-Kuwait BIT
[105] Article 1(3) Belgium-Saudi Arabia BIT
[106] See Kim, above n 60. Ines Willemyns, 'Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?', 3 J Int Economic Law 19 (2016), at 657.

broad range of definitions between TPP members and in the broader international community, the stipulation of a common definition must be recognised as a significant leap forward in the harmonisation of SOE governance. Despite being largely designed by the United States, the SOE Chapter has been retained unaltered in the Comprehensive and Progressive Trans Pacific Partnership (CPTPP), which is proceeding despite the US withdrawal by the Trump administration.[107]

The section on 'State-Owned Enterprises and Designated Monopolies', applies 'with respect to the activities of state-owned enterprises that affect trade or investment'.[108] SOEs are defined in relation to two main criteria: governmental control and commercial activity. As to the former, a Party must either own more than 50 per cent of the share capital; control more than 50 per cent of the voting rights; or hold the power to appoint a majority of the board of directors. The scope of control envisioned in this agreement is superior to many of the BITs that preceded it, in as much as there is clarification as to the exact definition of control. However, it is absent a consideration of effective influence. Therefore, it does not cover *de facto* SOEs. It would have been improved by following the example set by the U.S.-Singapore FTA, which provides for a rebuttable presumption of effective control where the government owns more than 20% of its shares and is the largest shareholder.[109]

The enterprise must also be 'principally engaged in commercial activities', comprising three criteria: an orientation toward profit-making; the production of a good or service that will be sold to a consumer in the relevant market in quantities; and at a price determined by the enterprise.[110] The term 'engaged in commercial activities' would have been subject to the same interpretive ambiguity as the ICSID convention and the Broches test; whether to examine the nature of the activities or their purpose. However, the further clarification of '*principally* engaged', in conjunction with the requirement to have an orientation towards profit-making clearly invites consideration of purposes as well as nature. SOEs whose orientation is more strategic than profit-making are not covered enterprises for the purposes of the agreement. While the drawing of this line presents its own difficulties in a practical setting, it is a welcome clarification from the BITs that preceded it.

[107] 'Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) | New Zealand Ministry of Foreign Affairs and Trade', https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-concluded-but-not-in-force/cptpp/ (visited 4 May 2018).
[108] Ibid. Chapter 27
[109] Article 12.8.5. Free Trade Agreement, Singapore-U.S. United States Trade Representative, https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset-upload-file708 4036.pdf.
[110] Article 17.1 CPTPP

Annex 17-C provides that within five years of the date of entry into force of CPTPP, the Parties will conduct further negotiations on extending the application of the disciplines in this Chapter to the activities of state-owned enterprises that are owned or controlled by a sub-central level of government. The definition applied in the CPTPP therefore addresses all of the definitional criteria provided in the proposed conceptual framework. Furthermore, the disciplines shall not apply if, in any one of the three previous consecutive fiscal years, the annual revenue derived from the commercial activities of the state-owned enterprise or designated monopoly was less than 200 Special Drawing Rights.

The CPTPP is successful in defining a state-owned enterprise, and thereby providing the relevant grounds on which arbitral tribunals can base a determination of the scope of covered entities. The absence of effective influence when defining governmental control means that it should not be considered a gold standard, but a foundation upon which improvements can be built. Indeed, it has been suggested that this integrated approach to SOEs is a watershed in international investment and trade, which will influence the direction of future BITs and FTAs. In order to test this thesis, it is necessary to examine the draft texts of major IIAs recently concluded or currently in negotiation, and consider how China, as a major source of cross-border investment by SOEs, might respond.

V. Defining a State-Owned Enterprise: The Way Ahead

A. *SOEs in TTIP, TiSA and EU-Mercosur: Towards Consensus?*

The EU's textual proposal for SOEs in the Transatlantic Trade and Investment Partnership was made public on 7 January 2015.[111] The section on 'Possible Provisions on State Enterprises and Enterprises Granted Special or Exclusive Rights or Privileges' applies to the chapter on investment, and provides a definition of SOEs covered by the agreement. The control-related criterion is 'decisive influence', presumed when a Contracting Party holds: a majority of the enterprise's share capital, the majority of the voting rights, or can appoint more than half of the members of the board members. However, it also provides for a broader examination, encompassing 'government ownership of the enterprise, its financial

[111] Possible Provisions on State Enterprises and Enterprises Granted Special or Exclusive Rights or Privileges, available at http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153030.pdf

participation therein, by the rules or practices on the functioning of the enterprise, or by any other means relevant to establish such decisive influence'. Unlike the CPTPP, this definition is sufficiently broad to include consideration of *de facto* SOEs.

To be an SOE for the purposes of TTIP, the enterprise must also be 'involved in commercial activity'. Acting 'in accordance with commercial considerations' is further defined as 'consistent with customary business practices of a privately held enterprise operating according to market economy principles in the international trade', in relation to matters such as price, quality, availability, marketability, transportation when goods or services are supplied to or by an investment of an investor of the other Party. This definition as to the conduct of SOEs is different from the CPTPP in some notable respects. Firstly, 'involved in commercial activity' is a lower legislative hurdle than 'principally engaged in commercial activity'. This may allow for conduct undertaken for principally non-commercial considerations, but have commercial considerations as a secondary concern. Furthermore, there is no explicit mention of an orientation toward profit making. Covered SOE conduct would therefore turn on the interpretation applied to the term 'customary business practices' and 'market economy principles'. A viable interpretation of these terms could include a profit-making purpose within its scope. Therefore, while the TTIP does have some consideration of the purposes of the investment, the drafting could be clearer. Furthermore, the applicability of the SOE-related provisions to enterprises owned by sub-central governments is made explicit. Consequently, all of the proposed definitional criteria are addressed.

The influence of the CPTPP can be seen in the textual proposal of the Trade in Services Agreement (TiSA) between the European Union and the United States.[112] Control-related provisions refer to a 'juridical person' where a Contracting Party owns a majority of share capital; controls, through ownership interests, more the 50 percent of voting rights; or holds the appoint the majority of the board. Like the CPTPP, this definition lacks consideration of effective influence. The application of the TiSA SOE provisions only to central government enterprises is made explicit. Furthermore, the juridical person must be 'principally engaged in commercial activities', defined with the same tri-partite approach as in the CPTPP: first, an orientation towards profit-making; second, the production of a good or

[112] There is no official legal document. A leaked textual proposal of the Trade in Services Agreement (TiSA) between the European Union and the United States is available at https://wikileaks.org/tisa/document/20151006_Annex-on-State-Owned-Enterprises/20151006_Annex-on-State-Owned-Enterprises.pdf

supply of a service that will be sold to a consumer in the relevant market in quantities; third, at prices determined by the juridical person. Coverage of the SOE provisions are also limited to SOEs with revenue of less than 200 SDRs from its commercial activities in any one of the three preceding years. Consequently, the five definitional criteria are addressed, in addition to a limitation on their size.

The EU proposal for the text of the EU-Mercosur Agreement also closely follows the approach taken in the CPTPP.[113] An SOE is defined as an enterprise, including any subsidiary, in which a Party, directly or indirectly: owns more than 50% of sharing or voting rights; can appoint more than half of the board members; or exercises or has the possibility to exercise control over the enterprise. The term 'exercises or has the possibility to exercise control' is a particularly broad formulation, and is inclusive of effective influence. The SOE must also be 'engaged in a commercial activity', defined in the same way as the CPTPP. However, 'engaged' as with 'involved' in the TTIP, indicates a lower threshold than 'principally engaged'. Where the enterprise combines commercial and non-commercial activities, only the commercial activities of that enterprise are covered. The enterprises of sub-central governments are explicitly included, and it contains the same threshold of 200 million SDR as in the CPTPP.

While the approach of FTAs contains small differences as to the inclusion of effective influence and whether SOEs must be 'involved' or 'principally engaged' in commercial activity, there is some convergence upon the definitional criteria whereby SOEs can be comprehensively defined, at least among the Contracting parties to these conventions. This is a reflection of the increasingly suitability of the regime of international investment to manage SOEs as international actors. Crucial within many of these FTAs is that there is no requirement that contracting parties undertake sweeping privatisation; government-controlled investors are becoming a fixture of the global economy. International investment agreements now routinely provide for them explicitly. However, just because there has been a convergence with regard to EU and US-led FTAs, does not mean that the same policy choices, particularly in relation to the requirement that SOEs must be 'principally engaged in commercial activities', will be made by nations with high levels of government ownership in the economy.

[113] EU proposal on State-owned enterprises, enterprises granted special rights or privileges, and designated monopolies, available at http://trade.ec.europa.eu/doclib/docs/2016/november/tradoc_155072.pdf

B. Chinese SOEs and the Potential Fragmentation of Global SOE Governance

Chinese SOEs are the most prominent source of internationalized government investment, and are frequently cited as a threat to the national security of host states.[114] At the core of these suspicions is the concern that SOEs will pursue non-commercial policy objectives. Indeed, the TPP was devised as a tool to isolate China's brand of state-capitalism from the rest of the Asia-Pacific region.[115] The exclusivity of profit-making objectives in the definition of SOEs is a reflection of the desire of the United States to exclude non-commercial motivation from the scope of legitimate SOE investment activity. Consequently, the viability of a harmonized global approach to SOEs will therefore turn on whether China's SOEs are intent on pursuing non-commercial policy goals in the future.

The roots of the non-commercial policy objectives of SOEs are found in the accountability of management to the state. In the Chinese context, the state exercises substantial political influence over the executives of the largest SOEs.[116] A dedicated body exists for the selection, supervision and remuneration of managers in the form of the State-owned Assets Supervision and Administration Commission (SASAC). However, these functions are carried out in the shadow of the CCP; there is institutionalized party penetration of both corporate and regulatory roles. It is fairly common for SASAC to rotate senior corporate and political leaders among business groups.[117] The promotion-based performance incentives of SOE executives stem from financial performance and the furtherance of state goals, with the latter prevailing in SOE decision-making.[118] For instance, Chinese SOE Sinopec maintained artificially low oil prices in 2008 at the direction of the government, and funding was provided specifically for the Aluminium Company of China to acquire an Australian mining company, the CEO of which was promoted to a State Council position

[114] Patrick Griffin, 'CFIUS in the Age of Chinese Investment', 4 Fordham Law Review 85 (2017), at 1757.; Vivienne Bath, 'Foreign Investment, the National Interest and National Security - Foreign Direct Investment in Australia and China', Sydney Law Review 34 (2012), at 5.
[115] Ming Du, 'Explaining China's Tripartite Strategy Toward the Trans-Pacific Partnership Agreement', 2 Journal of International Economic Law 18 (2015), at 407.
[116] Curtis J Milhaupt and Li-Wen Lin, 'We Are the (National) Champions: : Understanding the Mechanisms of State Capitalism in China', Stanford Law Review 65 (2013), at 697.; See Milhaupt and Zheng, above n 16.
[117] See Milhaupt and Lin, above n 118. At 735.
[118] Ibid.

days after the acquisition was negotiated.[119] Therefore, the concern that the motivations of Chinese SOEs cannot be divorced from the policy goals of the CCP has ample justification.

However, the scale of investment output and intricacy of governance structures leave significant principal-agency gaps permitting the operational autonomy of some Chinese SOEs. The period of 'opening up' in China's economy corresponded with a formal separation between ownership and management.[120] Furthermore, the SASAC is mandated to supervise over 100 large-scale SOEs, many of which have subsidiaries of their own all over the world.[121] On a purely practical basis, the notion that the day to day management of such a sprawling network of interests could be centrally controlled is highly questionable. Indeed, a survey of Chinese SOEs in 2014 by the OECD identified motivating factors behind their internationalisation: better allocating resources globally; acquiring advanced technologies and management experience; and integrating the company's product line and catering for the Chinese domestic market.[122] This suggests motivating factors that are in line with what one might expect from a privately-owned equivalent. Some Chinese SOEs may therefore have a greater degree of autonomy than is sometimes suggested.

Host states remain suspicious about the purpose of investment by SOEs, in part because of the explicit linkage between state goals and SOE investment contained in China's policy initiatives. The 'Go Global' strategy represents the mobilization of national resources in order to finance overseas expansion of Chinese companies, and SOEs in particular.[123] The Ministry of Finance, National and Development and Reform Commission, China Development Bank and others provide direct capital contributions, outright subsidies, and access to loans at below market rates. When CNOOC sought to acquire a US-based petroleum exporter in 2005, $11 billion of the $18.5 billion offered was comprised of loans from other government-controlled companies at favourable rates.[124] The furtherance of state

[119] See further, Ming Du, 'China's State Capitalism and World Trade Law', 2 International & Comparative Law Quarterly 63 (2014), at 409.
[120] Geng Xiao, 'Reforming the governance structure of China's state-owned enterprises', (1998), at 8.; Chun Liao, *The Governance Structures of Chinese Firms: Innovation, Competitiveness, and Growth in a Dual Economy* (New York: Springer-Verlag, 2009).
[121] Wendy Leutert, *Challenges Ahead in China's Reform of State-Owned Enterprises*, Asia Policy, Number 21 (2016).
[122] Kowalski, P. and K. Perepechay (2015), "International Trade and Investment by State Enterprises", OECD Trade Policy Papers, No. 184, OECD Publishing, Paris
[123] See Wenbin and Wilkes, above n 15.; Canfei He, et al 'Going global: understanding China's outward foreign direct investment, above n 15.
[124] Erica S Downs and Peter C Evans, 'Untangling China's Quest for Oil through State-backed Financial Deals' (1 May 2006), *Brookings* https://www.brookings.edu/research/untangling-chinas-quest-for-oil-through-state-backed-financial-deals/ (visited 4 May 2018).

goals by commercial means is particularly apparent in the context of the Belt and Road Initiative (BRI) and 'Made in China 2025'. With respect to the former, the BRI Vision Document provides the 'cooperation priorities' of the BRI, one of which is 'facilities connectivity'.[125] It encompasses the development of transport infrastructure, port infrastructure, aviation infrastructure, and cross-border optical cables. These are admirable public policy goals that could promote much needed economic development through the creation of employment opportunities, sharing know-how and deepening regional integration. However, if it was implement by a Chinese SOE in a state along the Belt and Road solely for the fulfilment of public policy objectives, divorced from profit, then the investment would fall outside the scope of the governance structure envisioned by the CPTPP.

The CPTPP may therefore present a challenge to China's declared policy initiatives. China's response to reforming the international investment regime, particularly in relation to dispute settlement, has not been entirely clear-cut.[126] However, there are three ways in which China could respond to the most recent SOE developments. The first is to accept the 'new rule' that SOEs cannot operate for the furtherance of non-profit objectives, and therefore delegate absolute autonomy to the executives of SOEs. Practically, this would be achieved through reform of the corporate governance of SOEs, listing on stock exchanges and inviting partial investment by private stake holders. It would require increased transparency on the criteria for appointments to the board, and more thorough disclosure requirements as to rationale of investment decisions. Introducing measures to prevent the so-called 'revolving door' phenomenon, whereby individual executives alternate between the regulators and the regulated, would also focus the pursuit of commercial objectives. However, this would not allow for the government-directed investment along the Belt and Road nor the furtherance of the 'Made in China 2025' policy, and would entail a fundamental recasting of China's economic and strategic objectives. Of the three options, this is the least likely.

Secondly, China could establish a competing governance framework for state-owned enterprises through bilateral investment treaties or free trade agreements. Instead of a requirement that SOEs must be principally engaged in commercial activities and have an orientation towards profit-making, China could specifically allow for non-profit entities to fall within the scope of SOEs. Alternatively, China could borrow from the Investment

125 'Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road', http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html (visited 4 May 2018).
126 See Mark McLaughlin, 'Global Reform of Investor–State Arbitration: A Tentative Roadmap of China's Emergent Equilibrium' Chinese Journal of Comparative Law Vol 6 Issue 1 73-102

Canada Act in adopting a 'net benefit' test for SOEs its international investment agreements.[127] This would be inclusive of the state-directed public policy objectives of the BRI, aimed at fostering mutual benefit through cooperation. It would also be inclusive of SOE conduct designed to further China's strategic objectives, if such investment would also benefit the host state. States in which China has a considerable investment footprint may be receptive to such a suggestion, such as on the African continent, leading to the fragmentation of global SOE governance.[128]

The third option is for China to continue on its current trajectory, and argue that their SOEs already have an orientation toward profit-making, and are principally engaged in commercial activities. How receptive arbitral tribunals will be to this argument is as yet untested, as no case relating to an SOE (or indeed any case) has been brought under the formulation introduced by the CPTPP, and the SOE chapter is excluded from the provision for investor-state arbitration. In support, China would cite: the reduction of enterprises administered by central government; the increase in private capital; the record profits recorded by Chinese SOEs in 2017; and the recent edict by SASAC the all SOEs were mandated to make profits.[129] Conversely, it is clear that Chinese SOEs fulfil a key role in the implementation of state goals, not least from the government pronouncements and policy documents on the matter. Issues relating to the transfer of technology and acquisition of natural resources remain high on the agenda for SOEs.[130] Weighing this opposing evidence to determine an 'orientation toward profit-making' will be highly context-specific, and highlights the remaining interpretive issues of the formulation even when all five definitional criteria I proposed for SOEs are addressed.

C. Remaining Interpretive Issues

1. Defining 'Effective influence'

[127] See Ackhurst, Nattrass, and Brown, above n 30, CETA, the Investment Canada Act and SOEs.
[128] Cheung Yin-Wong et al, 'China's Outward Direct Investment in Africa', 2 Review of International Economics 20 (2012), at 201.
[129] 'China Orders State-Run Companies to Make Profits', *Bloomberg.com*, 24 January 2018, https://www.bloomberg.com/news/articles/2018-01-24/china-is-said-to-order-state-run-companies-to-be-profitable.
[130] Sourafel Girma and Yundan Gong, 'FDI, Linkages and the Efficiency of State-Owned Enterprises in China', 5 The Journal of Development Studies 44 (2008), at 728.

Within definitions of control, there is inconsistency as to whether to include a broader examination of 'effective' or 'decisive' influence. Effective influence is inherently vague and unstructured, and is designed as an anti-circumvention provision. Contained within its scope are ostensibly private enterprises over which the state can nevertheless direct investment decisions.

An example is China's institutional environment, in which the state wields influence outside the rigid structures of corporate governance, challenging the neat separation of enterprise on the basis of ownership. Divergent approaches at the national level are increasingly taking into this into account, with recent reforms in Canada, the United States and Australia invoking language such as 'influence', 'determinative impact on decision-making', and 'substantial interest'.[131] It is therefore not a great leap to imagine that consensus could be reached on an international definition that extends beyond share ownership. This is not to say that legal disciplines should have no cognizance of whether an enterprise is publically or privately owned in the Chinese context, only that it requires a more complete analysis. One interpretive tool is the phenomenon of 'state capture', which proposes that enterprises should be evaluated on the basis of: the political connections of the management; extent of financial support from government; chambers of commerce coordinating their activity; regulators conducting 'interviews' to compel or encourage compliance with government policies; and forced participation in restructuring.[132] This would exclude some SOEs and include some privately-owned enterprises. These concepts could be used to clarify the definition of 'effective influence'.

Traditional distinctions found the liberal economic order become blurred in the context of the China's model, which can have a deleterious effect on host states' response to Chinese investment. The challenge for the champions of private enterprise within the international investment regime is to devise a regulatory structure that is protective but not protectionist. While public response to Chinese investment can be reactionary, legal instruments need not mirror it. Investment should not be blocked purely on the basis that it flows from China, but on the tangible and demonstrable threat that individual acquisitions pose to specific national security interests. If a private or state-owned enterprise is indeed operating autonomously, then it should be subject to the same regulatory frameworks as their equivalents from other economies. Stakeholders should pay close attention to how the

131 For an overview of these regimes, see Robert Sroka, 'Friends with Net Benefits: The Investment Canada Act and State Owned Enterprises', 17 Asper Rev. Int'l Bus. & Trade L. 181 (2017) at 207.
132 See Milhaupt and Zheng, above n 16.

concept of 'effective influence' is fleshed out in the coming years, so it does not become a rebadged protectionist measure.

2. Determining 'Principally Engaged in Commercial Activity'

The difficulty in determining whether an enterprise is 'principally engaged in commercial activities' or has an 'orientation toward profit-making' is both conceptual and evidentiary. Can the purpose of conduct be neatly separated into profit and non-profit categories? Where does simply engaging in commercial activity become 'principally' engaging in such activity?

There are often multiple motivating factors that drive SOE investment, some commercial and some non-commercial. For instance, an Abu Dhabi SWF, the Mubadala Investment Corporation, committed to invest $92 million in a hospital in Kobe in order to acquire some of Japan's medical technologies.[133] Doctors would be seconded to the hospital to learn organ transplant techniques and the latest treatment for diabetes. Is this an example of a 'principally commercial' activity? If this conduct were repeated in multiple jurisdictions by an SOE, would the furtherance of public health policy through commercial means fall outwith the scope of the CPTPP?

At the core of the definitional challenges in relation to the purposes of SOEs is the infelicitous use of language as regards 'non-commercial' policy objectives. 'Non-profit', 'non-commercial' and 'extra-financial' are used almost interchangeably. However, these definitions would include long-term institutional investors that practice 'responsible investment' or 'ethical investment' which is motivated by religious or moral beliefs.[134] Perhaps a more accurate description of the bulk of concerns related to SOE investment decisions is the 'geopolitical' or 'strategic' motivation, therefore permitting investment in more benign areas of public policy, but each of these terms present their own definitional challenges.

Even if one accepts the existence of a solid line between SOEs that are 'principally commercial' and those that are not, its constituent parts make this determination exceptionally difficult. On a purely evidentiary basis, there would have to be full transparency of all the activities of an SOE in order to determine the extent to which it

133 Kathryn Gordon, Foreign Government-Controlled Investors and Recipient Country Investment Policies: A Scoping Paper, OECD Publishing, January 2009.
134 Andrew Rozanov, 'Definitional Challenges of Dealing with Sovereign Wealth Funds', 2 Asian Journal of International Law 1 (2011).

operates on a commercial basis.[135] For larger SOEs, this would be a colossal undertaking, potentially encompassing an examination of activity in multiple jurisdictions, as well as the motivating factors behind this activity. It is also somewhat of a moving target; at what point does an unprofitable entity become a non-profit entity?

Clearly, there remains significant interpretive issues with regard to the definition of SOEs, even after the clarification in the CPTPP. Both control and purposes are inherently 'moving targets' with shareholding and investment activity of a potentially different character one week from the next. While the inclusion of the five definitional criteria will be useful in defining SOEs in accordance with states' policy concerns, it is certainly not the final word on a universal definition. Interpretations will remain highly context-specific.

VI. Conclusion

The absence of a shared definition of a state-owned enterprise casts a long shadow in international investment law. Much needed policy debates about the role of the state in the global economy will be stifled if international legal instruments do not adequately delimit its boundaries. The frequency with which SOEs are not considered, particularly in older BITs, leaves a significant grey area as to the legitimacy of a considerable amount SOE activity around the world. SOEs should not be defined merely by the nature of their activity, but also by its purpose. Explicit consideration of SOEs should become a fixture of negotiations between contracting parties in BITs as well as FTAs.

Just as the trends in relation to 'definition of an investor' and 'fair and equitable treatment' are to provide a more detailed definition, so too should the provisions governing SOEs be precise so as to furnish arbitrators with more solid guidance as to the scope of covered entities. These provisions should have consideration of: separate legal personality, extent and form of control, eligible governmental units, commercial nature of activity, and purpose of activity.

The definition of SOEs provided in the CPTPP was a significant step forward in this regard, and may indeed set the precedent for future international investment agreements. However, the lack of consideration of 'effective influence' may exclude entities that should be caught by the provisions. Furthermore, limiting the definition of an SOE to one that 'principally engages in commercial activity' and has an 'orientation toward profit-making'

[135] See Cannizzaro and Weiner, above n 7.

ICSID Review, https://doi.org/10.1093/icsidreview/siz011

potentially sets the CPTPP on a collision course with China. If implementation of the Belt and Road Initiative continues via SOEs, then the question as to whether these entities should be regarded as SOEs under the CPTPP definition could trigger the fragmentation of global SOE governance.

From a broader perspective, the international investment regime is gradually evolving to accommodate the concerns of investment by SOEs. The extent to which an increase in SOE activity will cause a reversal of the traditional North/South roles in the global economy will be an important phenomenon in international economic governance in the decades ahead.