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INTERNATIONAL LAW AND PRACTICE

When the State Sovereign Immunity Rule Meets Sovereign Wealth Funds in the Post Financial Crisis Era: Is There Still a Black Hole in International Law?

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Abstract

This article examines the state sovereign immunity rule in the context of a rising number of sovereign wealth funds and their ever-increasing value of cross-border commercial activities in the aftermath of the latest global financial crisis. The concept of sovereignty and the rule of sovereignty remain in a state of flux while new actors such as sovereign wealth funds are participating in global commercial activities in a nontransparent and politically motivated manner. Accordingly, states may pursue strategic foreign policy objectives through these newer investment arms in an unconventional way, thereby being deeply involved in the political-economic arena and distorting the existing concepts of international law. This article posits that there is an international law black hole in which sovereign wealth funds have come to engage in commercial activities as well as exercise the public functions traditionally associated with states (acts *jure imperii*). The doctrine of restrictive immunity has come into question and the bulk of local court decisions have offered little clear guidance. Against this backdrop three interconnected perspectives are then discussed with reference to emerging economies like China: the immunity rule, the principle of sovereignty, and the balance of power in globalization.

Keywords

China; immunity rule; international law; sovereignty rule; sovereign wealth funds

1. INTRODUCTION

Sovereignty is an issue of international law that must be constantly examined. International law has long struggled with the problem of how makers of international law can also be bound by it.[1] International law rests on the traditional

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[1] E.g., S.V. Scott, *International Law in World Politics: An Introduction* (2010), 19–27; A. Anghie, 'Rethinking Sovereignty in International Law', (2009) 5 *Annual Review of Law and Social Science* 291.

notion of states which arose from the Westphalian system. As the nature of sovereignty and its relationship with law evolves, the foundation of sovereignty also changes. For example, the emergence of international human rights law has challenged the classical conceptualization of sovereignty, which asserts that a sovereign government has absolute legal authority within its territory over its citizens.[2] The recent intensification of globalization has further challenged international law which governs relations among sovereign states and private actors. The increasing popularity of investor-state arbitration, which allows privately constituted tribunals to examine claims initiated by commercial parties, has also distorted the power dynamics between sovereignty and private entities.

Some of the most important debates concerning the changing definition of sovereignty were reignited after the latest global financial crisis, which caused a dramatic increase in state economic intervention both by developed and developing nations. The return of 'state capitalism' has been accompanied by the remarkable comeback of the domination of public wealth, public investment and public enterprises.[3] State governments are interfering more deeply and comprehensively with private economic activities through nationalization of private industries and creation of state-owned investment entities.[4] A notable example in this movement towards nationalization was that, in 2010, the United Kingdom, a country which has traditionally embraced liberal economic principles, took up major shares of two global financial institutions – the Lloyds Banking Group and Royal Bank of Scotland – rescuing them from the edge of insolvency.

Among these, the recent rise of Sovereign Wealth Funds (SWFs), a transnational investment vehicle of states that are distinguishable from other state-controlled investment vehicles, deserves attention.[5] There seems to be no uniform definition of an SWF. The International Monetary Fund (IMF) made an attempt to distinguish SWFs by their functions and objectives, defining SWFs as 'special purpose investment funds or arrangements owned by the general government',[6] while the World Bank suggested them to be 'long term investment funds typical for both income and intergenerational wealth transfer'.[7] Although state-owned enterprises (SOEs) and SWFs both invest in economic markets abroad, SOEs generally seek controlling interests in investment targets by the way of acquisition of control of a private economic entity, whereas the investment purposes of SWFs seem to be more diverse.[8] For example, some authorities specify that the pool of money of an

[2] E.A. Posner, *The Perils of Global Legalism* (2009), Ch. 8.
[3] I. Bremmer, 'The Return of State Capitalism', (2008) 50(3) *Survival: Global Politics and Strategy* 55.
[4] T. McNamara, 'Foreign Sovereign Immunity during the New Nationalization Wave', (2010) 11(1) *Business Law International* 5–38.
[5] E.g., 'SOEs as Driving Force', in L.-C. Wolff (ed.), *China Outbound Investments: A Guide to Law and Practice* (2011), 4.
[6] International Working Group of Sovereign Wealth Funds (IWG), *Sovereign Wealth Funds Generally Accepted Principles and Practices 'Santiago Principles'* (2008); D. Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investors', (2010) *OECD Working Papers on International Investment*, available at www.oecd.org/corporate/mne/WP-2010_2.pdf.
[7] O.S. Mitchell, J. Piggott and C. Kumru, 'Managing Public Investment Funds: Best Practices and New Challenges', (2008) *Pension Research Council Working Paper PRC WP2008-07*, available at pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2015/09/MitchellPiggottKumru-WP-version-7.31.08.pdf.
[8] Ibid.

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SWF must be managed by a government sovereign entity such that it has foreign currency exposure, without outstanding liabilities, and must have a high risk tolerance, or a long investment horizon.[9]

Newly industrializing countries, flush with money from profitable economic globalization, have created funds for making investments in developed or developing countries with their surplus capital. These include Singapore, whose SWFs are based on substantial foreign reserves, Dubai, whose SWFs mainly derive from the region's oil revenues, and Uganda, which has attracted a large volume of donated international funds.[10] Among them all, the most dramatic increase in reserve size has come from China.[11] Today, the role and scale of SWFs in cross-border investment activities have become more visible. Through SWFs, sovereign nations have deepened their penetration into global financial markets and are increasingly able to mobilize their economic resources and co-ordinate activities to achieve economic and sovereign goals. According to an IMF estimate, overall assets held by SWFs were only about US$0.5 billion in the early 2000s, but have grown rapidly in the last 10–15 years. SWFs now manage US$7 trillion in assets.[12]

The growth of SWFs' geopolitical importance, investment size and total investments has brought them into the spotlight of law and policy, and this has complicated international law and domestic courts' interpretation of international legal principles. If sovereign investors are viewed as instrumentalities of the state, it is worrisome that states are extending their power into the territory of other states. Thus, defences based on both the sovereignty and immunity rules need to be rewritten or adjusted to reflect a solution for constraining any undue impact on sovereignty of the country in which investments are made. Under traditional international law principles, state-controlled investment actors are often intentionally precluded from utilizing legal tools that were designed for private plaintiffs to vindicate individual rights, in case they distort the power imbalance embedded in the international legal system. For instance, in a 2015 European Court of Human Rights (ECtHR) case, the tribunal dismissed a debt repayment claim by a Slovenian bank, which was nationalized and controlled by its state fund, against the government of Croatia. The tribunal reasoned that, according to Article 34 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention), a party could initiate an individual application only if it is a non-governmental organization. This clarification was thought to be consistent with ECtHR's previous interpretation of its own jurisdiction, which did not extend the protection of the European Convention to any government-controlled organization that is active on the market, on the ground that these entities do not have sufficient institutional and operational independence from the state.[13] On the other hand, the sovereign immunity doctrine emerged in the early nineteenth century

[9] S. Jen, 'Sovereign Wealth Funds: What They Are and What's Happening', (2007) 8 *World Economics* 1, at 1–2.
[10] For a description of different resources of SWF assets see B.J. Balin, 'Sovereign Wealth Funds: A Critical Analysis', (2009) *Johns Hopkins University School of Advanced International Studies*, available at papers.ssrn.com/sol3/papers.cfm?abstract_id=1477725.
[11] B. Alhashel, 'Sovereign Wealth Funds: A Literature Review', (2015) 78 *Journal of Economics and Business* 1–13.
[12] Fund Rankings (2016), *Sovereign Wealth Fund Institute*, available at www.swfinstitute.org/fund-rankings.
[13] *Ljubljanska Banka d.d. v. Croatia* (2015), application no. 29003/07.

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and is a rule of international customary law. Since it protects a state and its 'agents or instrumentalities' from being sued in a foreign state's court, it has met with some resistance by private plaintiffs due to their rights to court access since the mid-twentieth century.[14] Consequently, domestic courts played a leading role in developing the sovereign immunity doctrine before the doctrine was codified by a large number of countries including the United States, the United Kingdom, Australia and Canada.[15] Although before the 1950s developed countries actively embraced the absolute immunity principle, the rapid outflow of US capital into developing states following the end of the Second World War soon motivated them to reconsider the adoption of a restrictive immunity theory. The modern principle states that immunities should be confined to cases involving acts of a foreign state which are sovereign or governmental in nature, as opposed to acts that are commercial in nature or similar to those that are performed by private natural persons. Today, the restrictive theory predominates.

Although the distinction between the absolute and restrictive immunity rules may have worked well for SOEs, the rising status of SWFs posed some novel problems. As SWFs are usually 100 per cent controlled by a government, they are more likely to engage in strategic investments that are more 'politically motivated' than 'economically motivated', meaning that their acts could be deemed as more sovereign than commercial. With the 'more sovereign' nature of SWFs and lighter 'commercial purposes', the dual role of the state being both sovereign and corporate has made SWF's legal status more ambiguous. For example, with a strong state-controlled, industry-centered and export-oriented economy, Chinese SWFs are quite successful in mitigating trade deficits in commodities and other risks by taking direct equity positions in overseas industries, thus stabilizing supply and partaking in profits, and are becoming more frequent participants of global investment activities under the 'Go Globally' strategy and the more recent 'Belt and Road' initiative, both encouraging Chinese outbound investments. Having, for a long time, cautiously dealt with investment rules that were crafted by developed countries to protect the investment rights of their investors overseas, countries like China seem to be more keen on pushing the boundaries of how sovereignty-based defences could shield against liabilities.

Against this backdrop, the state sovereign immunity rule is still an unsettled area of international law. This article attempts to clear the confusion caused by an international 'black hole' when the state immunity rule has intersected with SWFs in the wake of the financial crisis, with special reference to cases related to China. Section 2 of this article provides background about the rising status of Chinese SWFs in terms of their participation in cross-border investment activities, and the differences between them and more traditional SOEs. Section 3 contains an in-depth analysis of the two recent cases related to China, *FG Hemisphere Associates LLC* v. *Democratic Republic of the Congo & Ors*,[16] and its ensuing *La Generale des Carrieres et des Mines*

[14] C. Whytock, 'Foreign State Immunity and the Right to Court Access', (2013) 93 *Boston University Law Review* 2035.
[15] Ibid., at 2043.
[16] *FG Hemisphere Associates LLC v. Democratic Republic of the Congo & Ors*, FACV 5, 6 & 7 of 2010 ('*Congo*').

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v. *F.G. Hemisphere Associates LLC* (Jersey),[17] both of which turn on domestic tribunals' further interpretations of the sovereignty immunity rule. Section 4 discusses the relationship of evolving international law definitions of sovereignty, immunity, and extraterritoriality, with regard to the emergence of new cross-border investment vehicles in the context of the capital importing states' changed regulatory interests in relation to their economic status in the world. Section 5 is the conclusion.

2. Status quo of Chinese sovereign funds

Following the 'Go Globally' strategy,[18] the Chinese government has employed a combination of investment strategies by encouraging its businesses to conduct overseas investment as a means to maximize state wealth and reputation, as well as investing abroad with the purpose of securing access to natural resources. Energy and metals are principal investment areas and account for nearly 70 per cent of outflow since 2005.[19] In spite of the fact that China has a long history of conducting overseas investment through SOEs, its first and only officially recognized SWF, China Investment Corporation (CIC), was not incorporated until 2007, with the purpose of managing some of the country's massive foreign exchange reserves. Together with the National Social Security Fund, the SAFE Investment Company (SIC) and the China-Africa Investment Fund, these four vehicles were considered to be China's most important SWFs co-ordinating resources and competing in the global investment and financial markets.[20] In 2014, the government of China officially launched the Silk Road Fund Co. Ltd., a US$40 billion investment vehicle to begin the expansion of its infrastructure investment in Eurasia. Apart from SWFs, the main form of state investment is through SOEs. There is very little functional difference between Chinese SWFs and SOEs. Both represent networks of public-private investment co-ordination in which wealth or profit maximization is blended with political objectives directed by the state even though some subtle differences exist between the two.

Chinese SOEs are sovereign in the sense that their ownership is vested directly and indirectly in the state. In China, SOEs usually do not enjoy immunity and unless an SOE is carrying out a function of the state, it is not likely to be considered as part of the state when it is sued in a Chinese court. Therefore, today, many Chinese SOEs are no longer corporate expressions of publicly controlled economic activities and function like privately held enterprises. While both state ownership and state oversight have been constantly reduced to separate government functions from business operations for SOEs, the same may not hold true for SWFs.

[17] *La Generale des Carrieres et des Mines v. F.G. Hemisphere Associates LLC (Jersey)*, [2012] UKPC 27 ('*La Generale*').
[18] For a general description of China's 'Go Globally' strategy, which consists of a series of national policy incentives that are used by the Chinese government to encourage its companies to invest abroad see I. Alon et al., 'Chinese State-Owned Enterprises Go Global', (2014) 35 *Journal of Business Strategy* 3.
[19] D. Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investors', (2010) *OECD Working Papers on International Investment*, available at www.oecd.org/corporate/mne/WP-2010_2.pdf.
[20] E. Cieślik, 'Investment Strategy of Sovereign Funds from Emerging Markets: The Case of China', (2014) 24 *Bulletin of Geography. Socio-Economic Series* 27, at 28.

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Generally speaking, investments by major Chinese SWFs can be classified into three brief periods. During the first stage between 2007 and 2009, investment by Chinese SWFs was primarily concentrated in the high-risk financial sectors by infusing a large amount of money in European and American reserve banks. For example, CIC has invested about US$10 billion in the American hedge funds Blackstone and Morgan Stanley since 2007.[21] As a result of the crisis brought about by sub-prime lending, a large portion of China's investments in foreign banks and financial institutions turned sour. Investments in Morgan Stanley, Fannie Mae and Freddie Mac greatly harmed these funds.[22] To recover economic losses and reshape investment strategies, Chinese SWFs appointed an advisory board of economic and investment experts to provide counsel on the international economic environment, corporate governance, development strategy, and investment policy, as well as upgrading and improving their corporate image and increasing their transparency.[23]

Learning from the mistakes of the initial period, during the second stage, roughly between 2009 and 2012, Chinese SWFs started to invest more heavily (through the acquisition of shares in existing companies) in developed countries and in more diversified areas including real estate, natural resources, and agriculture with longer term investment objectives in developing countries. The shift of investment strategy and focus caused widespread suspicion and protectionist fears in developed countries that SWFs from China and other emerging economies were trying to achieve commercial and, more importantly, political objectives for their national governments.

Since 2012, Chinese SWFs have become interested in high-tech fields and public sectors such as health care and education, as well as some combined portfolio investments. The objective of CIC, for instance, is to diversify China's foreign exchange holdings and seek maximum returns for its shareholder. This diversification strategy was undertaken to reduce investment risks. For example, in 2014 CIC invested US$1.6 billion in London Heathrow Airport, which made it one of the major controlling investors together with a number of other SWFs including Qatar Holding and GIC.[24] There has also been a switch to indirect investments made through subsidiaries and partnership companies of SWFs that provide financial assistance to Chinese overseas companies. Due to its own status as one of the Santiago Principles' original drafters, CIC has been seen to have implemented these principles in good faith.[25]

The efforts to expand sovereign investment by having SWFs co-ordinate a variety of market players with economic incentives and policy initiatives present a potentially substantial advancement in the integration of sovereign investing,

[21] I.N. Koch-Weser and O. Haacke, *China Investment Corporation: Recent Developments in Performance, Strategy, and Governance* (2014).

[22] Ibid.

[23] Ibid.

[24] S. Perez, 'Qatar Holding Buys 20% Stake in BAA for $1.4 Billion', *The Wall Street Journal*, 17 August 2012, available at www.wsj.com/articles/SB10000872396390444375104577595242977156080.

[25] C. Carr, '"National Interest" Concerns and Uncertain Investment Regime Are Impeding Important Investments by Sovereign Wealth Funds', (2013) 3 *Harvard Business Review Online* 67, available at www.hblr.org/wp-content/uploads/2013/03/Carr_National-Interest-Concerns.pdf.

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public policy, private markets, and even global economic governance. This integration suggests that it may be possible for a state to deploy a policy of politically motivated interventions in foreign markets and markets for control that is, simultaneously, financially motivated.

3. Easier or harder? The spotlight of the *FG Hemisphere Associates* cases

3.1. The decision

Interestingly, in its domestic legislation, China had not formally adopted any statute in the area of state immunity until 2005.[26] As a very brief statute with only four provisions, the law specifically addressing foreign central banks was reportedly prompted by requests from Hong Kong to maintain absolute immunity for foreign central bank assets in order to maintain itself as an international financial hub.[27] The law provides for absolute immunity from adjudication and execution of property of central banks in Mainland China, Hong Kong and Macau, and contains a reciprocity provision allowing for the provision of less immunity to countries that have allowed a lesser degree of immunity to Chinese central banks. However, this particular statute does not mention how the immunity rule should apply to other forms of state investment vehicles and was never openly interpreted by the judiciary.

Clues we have from China regarding the government's attitudes towards the legal status of SOEs and other state-controlled investment vehicles litigating in its courts come from Hong Kong case law. In June 2011, the Hong Kong Court of Final Appeal (CFA), Hong Kong's *de facto* supreme court, handed down its judgment in the *Congo* case. The CFA decided that, after Hong Kong's handover to the People's Republic of China, sovereign states enjoy absolute immunity in the courts of Hong Kong which cannot be waived in pre-dispute contractual documents. As Chinese courts rarely render rulings on public international law issues, this case is of great significance to understanding China's position on the sovereign immunity rule.

In *Congo*, the Democratic Republic of Congo (DRC) was sued in Hong Kong by a Delaware-incorporated 'vulture fund',[28] FG Hemisphere Associates (FG), which sought to enforce two arbitral awards granted against the DRC in arbitrations held in Paris and Zurich respectively. In satisfaction of DRC's liability under these awards, FG pursued 'mining entry fees' owed to DRC in the amount of US$9.25 billion payable by China Railway Group (Hong Kong) Limited, a Chinese SOE that had agreed to pay Gécamines, a Congolese State-owned mining company, US$350 million, for the development of more than 10 million tons of DRC's copper and cobalt reserves.

[26] Law of the People's Republic of China on Judicial Immunity from Measures and Constraints of the Property of Foreign Central Banks, Law on Judicial Measures Over Assets of National Bank (2005).

[27] Legislative Report on Enacting the First Law on Judicial Immunity of People's Republic of China, 2 March 2006, available at www.fmprc.gov.cn/web/wjb_673085/zzjg_673183/t238012.shtml.

[28] The IMF defines vulture funds as arbitrage-seeking investors who specialize in obtaining debt in the secondary markets at prices far below face value. B. Finlay, 'Taming the Vulture: Turning Distressed-Debt Investors Into Agents of Social Change', *Henry L. Stimson Center*, 2 July 2007, available at www.stimson.org/content/taming-vulture-turning-distressed-debt-investors-agents-social-change.

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FG acquired the rights to two arbitral awards totaling more than US$34 million in November 2004. These two awards were originally secured against the Congolese state by Energoinvest, a Yugoslavian state-owned company, which contracted to construct a hydroelectric facility and electric transmission lines in DRC in the 1980s, with the project financed by Energoinvest extending credit to DRC, after which the country defaulted on a US$30 million payment. This credit agreement contained an ICC arbitration clause, according to which Energoinvest pursued its claims in arbitration. DRC had signed terms of reference by which it agreed to arbitration under the 1998 ICC Rules of Arbitration. DRC neither attended the arbitration hearings nor challenged either award in any jurisdiction. In 2004, Energoinvest transferred the entire benefit of the principal and interest payable under two arbitral awards to FG, an American vulture fund whose main business is to invest in emerging markets including acquiring and recovering distressed debts, and particularly those of defaulting states. FG managed to recover US$3.3 million under the two awards through enforcement proceedings in Belgium, Bermuda and South Africa.

China Railway Group Ltd. (China Railway), a company listed in Hong Kong and Shanghai, along with another Chinese company, Sinohydro Corporation Ltd, entered into a co-operation agreement with Gécamines. Under the joint venture agreement among these parties, DRC would be paid US$221 million by the subsidiaries of China Railway as part of the entry fees for a mining project in DRC. The details of this project were released in an announcement by China Railway to the Stock Exchange in Hong Kong in April 2008. FG made an *ex parte* application to the High Court in Hong Kong and was granted, among other rulings, (i) leave to enforce the two awards against DRC in the same manner as judgments; (ii) interim injunctions restraining the China Railway subsidiaries from paying DRC US$104 million by way of entry fees. Both parts of the judgment were affirmed by the Court of Appeal. The critical question in this case was the nature and scope of state immunity, that is, whether DRC enjoys full sovereign immunity from FG's claims in Hong Kong, which is a part of China. If the common law notion of 'restrictive sovereign immunity' applies in Hong Kong, a traditional common law jurisdiction, DRC could be held liable for damages in a commercial dispute context.

Under the traditional theory of international customary law, one sovereign state does not adjudicate the conduct of a foreign state, and this extends to both criminal and civil liability. A sovereign state therefore enjoys absolute immunity from suit in the courts of another state unless the immunity is waived. The People's Republic of China in its judicial practices has never recognized a commercial exception, in spite of the fact that China signed the United Convention on Jurisdictional Immunities of States and Their Property in 2005. The Convention itself has not yet come into force, and has not been ratified nor accepted by the People's Congress of China, making it non-binding on China or any other state for the time being. Rather consistently in courts, China claims absolute immunity for itself and grants the same to other states. As a matter of fact and law, Chinese courts have no jurisdiction over, nor in practice have they ever entertained, any case in which a foreign state or government is sued as a defendant or for any claim involving the property of any foreign state or government. In the same vein, China has never accepted that any foreign

courts would have jurisdiction over cases in which the state or government of China is sued as a defendant, or in cases involving the property of the state or government of China.[29]

This position is apparently very different from the UK's immunity rule and practice that sovereign states only enjoy a 'restrictive immunity' which does not cover transactions of a purely commercial or private nature. A commercial exception to absolute immunity was codified in the United Kingdom's State Immunity Act 1978. The same was extended to Hong Kong by the State Immunity (Overseas Territories) Order in 1979. The post-1997 position was, however, unclear for three reasons. First, the UK's State Immunity Act no longer applies to Hong Kong. Second, continuing to apply the doctrine of restrictive immunity in Hong Kong would probably lead to doctrinal conflicts with China's practices on state immunity, giving rise to inconsistent immunity interpretations within the same sovereign territory. Third, no local legislation has been passed to fill the vacuum since the date of reversion. The argument made by FG was that DRC should not enjoy full sovereign immunity regarding its commercial dealings in Hong Kong, which has a common law heritage and so should apply the restrictive sovereign immunity principles inherited from the United Kingdom prior to 1997.

Three different lines of thought were discussed in the case. One possible theory is that the common law rule recognizing restrictive state immunity, as it had developed prior to the extension of the State Immunity Act to Hong Kong, revived and continued to apply after 1 July 1997 partly because there has been no local legislation to fill the vacuum since Hong Kong's handover to China. The appeal court, in a two-to-one majority decision, rejected the DRC's argument that Hong Kong courts did not have jurisdiction, given that the territory's autonomy does not extend to foreign affairs. Rather, the appeal court found that 'the doctrine of restrictive immunity currently continues to apply in Hong Kong'. The CFA rejected this ruling but held that the common law previously in force continues to apply in Hong Kong subject to such modifications, adaptations, limitations or exceptions as are necessary to bring its rules into conformity with Hong Kong's status as a Special Administrative Region of the PRC. The purpose and rationale of this approach is to avoid any inconsistency with the Basic Law, Hong Kong's *de facto* constitution. Otherwise, as the CFA rightly pointed out, 'damage is likely to be caused to a state's foreign relations' if courts in Hong Kong adopt an inconsistent position on state immunity.[30]

The second theory is that the Central People's Government of China is responsible for the foreign affairs of Hong Kong under Articles 13 and 19 of the Basic Law, and the Hong Kong courts cannot adjudicate on the question of sovereign immunity. The majority of the CFA followed this line of thinking and was of the opinion that the common law principle of state immunity should be modified in accordance with requirements of the Basic Law on the ground that the Basic Law is superimposed upon the common law. There are two bases for this conclusion.

[29] For a discussion of China's standing in response to being sued in a foreign court see W.H. Reeves, 'The Foreign Sovereign before United States Courts', (1970) 38 *Fordham Law Review* 455.

[30] *Democratic Republic of the Congo et al. v. FG Hemisphere Associates LLC*, FACV 5, 6 & 7/2010, 8 June 2011, paras. 321, 464.

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First, at common law, no region or municipality in any state can independently exercise sovereign rights and apply a state immunity doctrine which is at variance with the state immunity policy adopted by the state of which the region or municipality forms a part. It is well established that a state can only have one state immunity policy which covers its entire territory. As a Special Administrative Region of China, Hong Kong should adopt the state immunity rule of China. Second, according to Article 13 of the Basic Law, responsibility for foreign affairs is allocated to China's Central Government. Further, Article 19(3) of the Basic Law explicitly excludes foreign affairs from the sphere of autonomy of Hong Kong,[31] so that Hong Kong courts have no jurisdiction over 'acts of state such as defense and foreign affairs'.[32] As state immunity forms part of foreign affairs, the courts in Hong Kong are therefore bound to respect and act in conformity with the basic principle of absolute state immunity.[33]

In relation to the jurisdiction issue, the CFA took a different approach from the appeals court's provisional view that it had jurisdiction. The majority of the CFA concluded that the determination by the Central People's Government's policy of state immunity as a policy of absolute immunity is an 'act of state such as defense and foreign affairs' within the meaning of Article 19(3) of the Basic Law. The CFA was convinced that absolute immunity from prosecution fell under the 'defense and foreign affairs' exception and fell outside the limits of its judicial autonomy. As a result, the courts do not have jurisdiction over the determination of state immunity policy. Even at common law, in the opinion of the CFA, it is for the sovereign state to determine the principle of state immunity which it applies in its relations with other sovereign states, and which should be uniformly applied by all institutions of the state throughout its territory.

China's Central Government set forth its stance on the state immunity rule by issuing three letters through its administrative branches during the proceedings. The first of the three letters, which interpreted Articles 13 and 19 of the Basic Law, was issued by the Office of the Commissioner of the Ministry of Foreign Affairs (MFA) of the PRC in Hong Kong. The thrust of the letter was to reaffirm China's consistent practice of absolute immunity as a matter of principle, granting absolute immunity (including absolute immunity from jurisdiction and from execution) to other states and claiming the same for itself before foreign courts. The letter also confirmed that:

> The courts in China have no jurisdiction over, nor in practice have they ever entertained, any case in which a foreign state or government is sued as a defendant or any claim involving the property of any foreign state or government, irrespective of the nature or purpose of the relevant act of the foreign state or government and also irrespective of the nature, purpose or use of the relevant property of the foreign state or government.

[31] Arts. 13, 18(3), and 158(3) of the Basic Law of Hong Kong.
[32] Art. 19(3) of the Basic Law of Hong Kong.
[33] Procedurally, the courts of Hong Kong are bound to determine questions of fact concerning acts of state in accordance with a certificate issued by the Chief Executive based on a certifying document form the Central People's Government of China.

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In the second letter dated 21 May 2009, the Office of the Commissioner of the MFA in Hong Kong confirmed that the UN Convention on Jurisdictional Immunities of State and Their Property had not been ratified. The lower courts took the view that 'having signed the UN Convention, the PRC Government must be taken to have at least indicated its acceptance of the wisdom of the provisions therein'. While signing the UN Convention may be some evidence of a trend in customary international law, the safe view should be that 'the law [is] as it should be if it was to accord with good policy'. These letters can be viewed as the latest official statement made by China reiterating its 'principled' stance on state immunity and adhering to absolute sovereign immunity. The last time that China revealed its position was in the *Huguang (Bukuang) Railway Bonds* case,[34] for which the MFA sent an Aide Memoire to the US Government in 1983, clearly stating that as a sovereign state 'China incontestably enjoys judicial immunity' and 'The Chinese Government firmly rejects the practice of the United States imposing its domestic law on China to the detriment of China's sovereignty and national dignity'.[35]

China's stance on absolute immunity has also been reflected in its treaty practice. China has entered into treaties with other states which provide for the waiver of immunity.[36] In addition, it acceded to some multilateral conventions that contain 'restrictive' elements in the state immunity rule. Technically, China's extreme wariness about allowing exceptions to the absolute immunity rule, an anomaly to outsiders, is due to its arbitrary and varied approaches in distinguishing sovereign and non-sovereign practices.[37] Historically, China had long endured a regime of extra-territoriality imposed by the West, resulting in an array of 'unequal treaties' concluded under duress.[38] A more contemporary reason for China's enmity to restrictions on sovereign immunity is the existence of its vast number of SOEs, some of which are Global Fortune 500 companies which are aggressively investing overseas and involved in a large number of cross-border commercial transactions. In interpreting Articles 13 and 19 of the Basic Law, the Chinese government firmly re-emphasized its long-term position that China has never recognized a commercial exception to absolute immunity. The thrust of this case is that China explicitly asserted its position to apply the principle of absolute immunity in its relations with other sovereign states and, therefore, so did the courts of Hong Kong. Given the fact that the practice of Asian states, in particular China,[39] in the formative period of the doctrine or principles of state

[34] *Jackson v. PRC*, 550 F. Supp. 869 (ND Ala, 1982); 596 F. Supp. 381; 794 F.2d 1490 (11th Cir. 1986) and 801 F. 2d 404 (11th Cir. 1986).

[35] 'PRC: An Aide Memoire of the Ministry of Foreign Affairs', (1983) 22 ILM 81.

[36] J. Huang and J. Ma, 'Immunities of States and Their Property: The Practice of the People's Republic of China', (1989) *Hague Yearbook of International Law* 163, at 165–6.

[37] H. Wang, 'Sovereign Immunity: Chinese Views and Practices', (1987) 1 *Journal of Chinese Law* 23.

[38] D. Wang, *China's Unequal Treaties: Narrating National History* (2005), 2 (claiming that China and foreign countries had 500–1,000 treaties, agreements and conventions that contained unequal provisions from 1840 to 1943).

[39] China has had some early practices on privileges and immunities of diplomats and consuls since the Qing Dynasty but the judicial practices in this field of state immunities have been limited. J.A. Cohen and H. Chiu, *People's China and International Law: A Documentary Study* (1974), Vol. 2, Part VII.

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immunity did not exist,[40] this case will be a landmark case for understanding China's state immunity rule and practice.

The significance of *Congo* is two-fold. First, an arbitration clause or agreement is still effective and binding on the foreign state and may still be used. However, when a Chinese court (including a Hong Kong court) is approached for interim relief pending or in support of the arbitration in the enforcement stage, the foreign state may possess immunity from such proceedings. *Congo* presents an insurmountable problem to the case where the assets of the foreign state are located in Hong Kong or China, or where enforcement proceedings are brought in Hong Kong or China for any reason unless there is an explicit waiver of immunity. Second and more importantly, when the case involves China (including Hong Kong and Macau), the absolute state immunity doctrine is firmly applied unless there is an explicit waiver.

3.2. The enforcement aftermath

Failing to win enforcement against DRC through CFA, FG then attempted to enforce the two arbitration awards directly against Gécamines in a British Crown Dependency, in the *La Generale* case (Jersey) [2012]. The final decision was delivered by the UK Privy Council after two appeals.

In this case, FG asked the court to rule on the position of an SOE in cases of enforcement against state assets. To be more precise, FG alleged that Gécamines, a DRC SOE, is a state organ for the purpose of arbitral award enforcement. Although sovereign immunity is still potentially an issue, the main question discussed in this case was really in what circumstances an SOE should be considered as a state organ and/or a separate entity. Pursuant to Article 4 of The International Law Commission's Articles on State Responsibility for Internationally Wrongful Acts (2001), the conduct of any state organ shall be considered an act of that state under international law, whether the organ exercises legislative, executive or any other functions. The facts demonstrated a high degree of association between Gécamines and the DRC. Gécamines was formed and wholly owned by DRC. All its assets originated from the DRC in the form of mining concessions. In addition, DRC held considerable power and control over the entity. The board of directors, the chair of its management committee and the commissioners of its accounts, for instance, were appointed by (and could be removed by) the President of the DRC. Furthermore, the DRC had veto power over decisions to dispose of property, enter into contracts for loans and assets, and enter into major contracts for goods and services.

In the UK, since *Trendtex Trading Corporation* v. *Central Bank of Nigeria* ('*Trendtex*'),[41] the restrictive principle of immunity has been confirmed and a clear distinction has emerged in the context of immunity between, on the one hand, the state and 'a separate entity' (even one exercising sovereign activity) which is identified by the State Immunity Act of 1978 as 'any entity . . . distinct from the executive organs of the government of the state and capable of suing or being

[40] S. Sucharitkul, 'Jurisdictional Immunities in Contemporary International Law from Asian Perspectives', (2005) *Chinese Journal of International Law* 4, at 8.

[41] [1977] 1 QB 529, [1976] 3 All ER 437, [1976] 1 WLR 868.

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sued'. Usually, one first determines whether an SOE is a state organ by looking at the existence of a separate legal status, 'especially where a separate juridical entity is formed by the state for what on the face of it is commercial or industrial purposes', and 'the strong presumption is that its separate corporate status should be respected'.[42] However, this test is far from conclusive. Even with a separate legal personality, a state entity could still be considered part of the state and be held responsible for the state's overseas debts, if the entity performed the 'traditional function of a sovereign – to maintain law and order – to conduct foreign affairs – and to see to the defense of the country'.[43] In the post-financial crisis era, states that conduct large-scale overseas investment through SWFs should be cautioned against such activity because of the danger that the SWFs' actions may subject the state to liability.

A more functional test is developed in a series of cases since *Trendtex*, which consists of two parts. First, in order for a court to determine whether an SOE is a state organ, the court should look at the *degree of control* the state has over the SOE in management affairs, finances, and other aspects. The greater the degree of control, the more likely that the SOE would be considered a state organ. The second part of the test is a *functional independence* test, concerning the existence of independent and usually valid commercial purposes of the enterprises, while 'assisting, promoting and advancing development, prosperity and economic welfare and carrying out government policy are ... of the essence of many state owned entities promoting the needs of the state'.[44] In *La Generale*, the Royal Court reached the conclusion that Gécamines could be considered a state organ, but the Privy Council opined that lower courts (the Royal Court and the Court of Appeal) had applied the *Trendtex* test too leniently.

In reapplying the control test, the Privy Council started by examining Gécamines' constitution in an attempt to figure out the purpose of its incorporation and existence, i.e., why foreign citizens were added to the management team and why articles were passed to envisage the transfer of the company from controlling hands of the public authority to private stockholders. Due to the special management structure, both the management committee and the supervising authority's actions were required for some decisions to be effective. This shows that, although the governing state has some control, for many purposes the SOE is considered a separate entity that could act on its own. On the other hand, a review of the enterprise's commercial activities showed that a number of transactions involving the state and relating to its services to the state were separately negotiated with the state, which seems to demonstrate that the entity could operate independently from the state. To the Privy Council, Gécamines maintained rights of its own due to the fact that it was not a sham entity that was otherwise functionally inseparable from the government of DRC. Therefore, the Privy Council concluded that for a modern democratic state, allowing an SOE to exploit reserves of coal, oil and

[42] *La Generale des Carriereset des Mines v. F.G. Hemisphere Associates LLC* (*Jersey*), [2012] UKPC 27, 16.
[43] Ibid.
[44] M. Dixon, *Textbook on International Law* (2007), 181.

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minerals that are essential industries to the life of its citizens does not convert that company into an organ of that state. No further enforcement news has been heard since then.

As one of the most important FDI home countries among all emerging countries, China's FDI outflow has already caught up with its FDI inflow.[45] This strong outflow is heavily state driven. However, advantages that might have been conferred on state-controlled investment entities have increasingly faced rising skepticism and sparked dreadful responses overseas. On the surface and especially after *Congo*, China emphatically stated that it shall strictly adhere to the principle of absolute sovereign immunity in deciding the legal status of a foreign state-controlled investment entity participating in the lawsuit in China.[46] Besides, when listed as defendants in commercial lawsuits in foreign courts, China's SOEs have often vigorously argued for the application of absolute doctrine of sovereign immunity on the grounds that China must be immune from suit even when a claim arises out of purely commercial activities.[47] This has caused many to believe that resorting to arbitration against China and its SOEs would prove ineffective. If this assertion is used by China as a tactical instrument protecting China's SOEs, it is at least consistent with China's early investment treaty practices.

While earlier generations of Chinese BITs have indicated China's reluctance to allow its investors to participate in investment treaty arbitrations,[48] starting from its agreement with Barbados in 1998, China has ensured that its SOE-focused investment programme is protected by relying on more investor-friendly dispute settlement clauses.[49] In recent international investment agreements such as BITs and free trade agreements signed by China, Chinese SOEs are now included as a protected category either being 'public institutions', or 'governmentally owned or controlled' investors, which presumably follows the example of NAFTA and the 2012 US Model BIT.[50] This is contrary to the international trend,[51] because allowing SOEs to access more favourable protections afforded under these treaties seems to be less justifiable for private investors. Superficially, this does not seem to conform to the enactment purpose of the ICSID Convention, which seeks to stimulate a larger flow

[45] K.P. Sauvant and M.D. Nolan, 'China's Outward Foreign Direct Investment and International Investment Law', (2015) 18(4) *Journal of International Economic Law* 893, at 894.

[46] Ibid.

[47] See, for example, *Jackson v. People's Republic of China*, 794 F.2d 1490 (1986).

[48] W. Shen, 'The Good, The Bad or The Ugly? – A Critique of the Decision on Jurisdiction and Competence in Tza Yap Shum v. The Republic of Peru', (2011) 9(1) *Chinese Journal of International Law* 55; W. Shen, 'Confusion or Clarity in Perspective – Jurisprudential Review of Key Aspects in the Investor-State Arbitration Clause in the ASEAN-China Investment Treaty and the Jurisdictional Award of the First China-Related ICSID Case', (2010) 4(1) *World Arbitration and Mediation Review* 27; W. Shen, 'Is This a Great Leap Forward? – A Comparative Review of the Investor-State Arbitration Clause in the ASEAN-China Investment Treaty: From BIT Jurisprudential and Practical Perspectives', (2010) 27(4) *Journal of International Arbitration* 379.

[49] *Jackson v. People's Republic of China*, 794 F.2d 1490 (1986), at 916.

[50] Ibid.

[51] The latest example of this trend is the Trans-Pacific Partnership's inclusion of a chapter on SOEs and designated monopolies, which sets out disciplines aimed at ensuring a level playing field between SOEs and private entities: TPP, Ch. 17; I. Willemyns, 'Disciplines on State-owned Enterprises in TPP: Have Expectations Been Met?', (2016) *Leuven Centre for Global Governance Studies*, available at www.ghum.kuleuven.be/ggs/publications/working_papers/new_series/wp161-170/wp-168-willemyns-website.pdf.

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of private international investment.[52] In one landmark arbitration decision, *CSOB* v. *Slovak Republic*, the arbitration tribunal explicitly took the position that such protection should be extended only where the SOE is not 'performing state functions'.[53]

This position has been gradually modified through a number of efforts of the Chinese government to restructure its state-controlled investors. Before *Congo*, in an earlier Hong Kong Court of First Instance decision concerning whether the Chinese enterprise Guangdong Salvage Bureau (GZS) should be considered part of the PRC government, the court answered in the affirmative because GZS is under the total control of the Ministry of Communications, which in turn discharges a function of the state. In particular, the GZS can only perform operations commissioned by private clients with a reporting obligation. The GZS does not maintain its own assets and only has rights to possess and dispose of assets that are allocated to it. The GZS has no right to dispose of its assets and has no ability to assume civil liabilities. The government exercises full control over the GZS and therefore GZS should be considered part of the state.[54]

The ownership structure of the nationalized entity is considered to be the most important factor assessing the application of state immunity, which has also been upheld under the two-pronged test of *La Generale*. However, as Chinese SOEs and especially SWFs undergo large scale restructuring and reorganization, most of them are no longer under direct control of the state. For example, CIC has a three-tiered ownership structure: the board of directors, the board of supervisors and the executive committee.[55] CIC's board of directors is mandated and authorized to oversee its operation and overall performance based on objectives and broad policy set by the State Council while the board of supervisors monitors the board of directors. Further, the daily operations of CIC are delegated by the board of directors to an executive committee, which is also supervised by the board of supervisors and is operationally independent and makes individual investment and operational decisions.[56] The executive committee is accountable both to the board of directors and to the State Council. The State Council, through the State Administration of State-owned Assets Commission (SASAC) under the State Council, the state-owned assets authority supervising the management of strategically important SOEs in China, exercises the authority of appointment and dismissal of the governing board members of CIC.[57] In this way, CIC's organization formally separates state and fund operators so that CIC can be considered an independent entity that is incorporated entirely in conformity with PRC Company Law. Even the less transparent Chinese SWF SAFE Investment Corporation (SIC) is registered as a private company in Hong

[52] M. Feldman, 'The Standing of State-Owned Entities Under Investment Treaties', in K.P. Sauvant (ed.), *Yearbook on International Investment Law & Policy 2010-2011* (2012), Ch. 15.

[53] *CSOB v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, 24 May 1999, paras. 23–7.

[54] Even after *Congo*, the Hong Kong Court of First Instance rejected a claim of crown immunity by a Chinese SOE and upheld an order for execution against assets located in Hong Kong due to the lack of central government control; *TNB Fuel Services SDN BHD v. China National Coal Group Corporation* HKCFI 1016.

[55] H. Li, 'China Investment Corporation: A Perspective on Accountability', (2009) 43 *International Lawyer* 1495, at 1502–5.

[56] Ibid.

[57] Ibid.

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Kong, and is subject to Hong Kong's Companies Ordinance and its corresponding compliance and disclosure requirements. While no information is publicly available concerning funding sources of SIC, public registration and operation records suggest that it not inseparable from the state.[58] Therefore, structural and functional independence alone might no longer be conclusive in determining the degree of state control on Chinese SOEs and SWFs, as China's overseas investment has been mainly motivated by strategic state-related considerations, or so-called public policy concerns.[59] In this context, international law and domestic immunity rules seem to be inadequately prepared to pierce the sovereign veil of these entities by inquiring about any manipulative control the state might have over them, leaving a gap to be filled.

4. Dynamics of SWFs, power and sovereignty

The enormous increase in the number and assets of SWFs and other government-backed investment vehicles such as SOEs is of political and economic importance. More SWFs are in the process of transforming their previously conservative investment strategy focusing on national government bonds and US Treasury securities to more profit-oriented ones, seeking higher risk and higher yield investments in equities and corporate acquisitions.[60] The change in pattern does not necessarily create or trigger any legal issues but will have an impact on law and regulation. The popularity of, and competitive advantages enjoyed by, SWFs and other sovereign investment entities have changed the landscape of international economic law as state governments now act not only as regulators but also as market players, thus potentially distorting trade and investment.[61] The growing economic clout and global presence of SWFs from the South provides emerging countries with the opportunity to participate in the reform of the global financial system, and more broadly, international economic order, currently still dominated by the US-led Bretton Woods system. Relevant to China, along with the rising renminbi and some newly established renminbi-centric international financial institutions such as the BRICS New Development Bank,[62] Asian Infrastructure Investment Bank[63] and the Silk Road Fund,[64] there may emerge a multipolar, global neo-financial governance system in the future.

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[58] M. Faden, 'Improving Cross-Border Investment Regulation: A Case Study of China's Largest and Least Known Sovereign Wealth Fund', (2013) 7 *East Asia Law Review* 429, at 431–8.

[59] Sauvant and Nolan, *supra* note 45.

[60] Most of these equity and acquisition deals target at sovereign wealth funds and the portfolio of the government pension fund.

[61] I. Willemyns, 'Disciplines on State-Owned Enterprises in International Economics Law: Are We Moving in the Right Direction?', (2016) *Journal of International Economic Law* 1.

[62] W. Shen, 'Is Brics' New Development Bank New?', (2014) 29(10) *Butterworths Journal of International Banking and Finance Law* 655, at 655–6.

[63] W. Shen, 'Asian Infrastructure Investment Bank: Gap Filler or System Challenger?', (2015) 30(4) *Butterworths Journal of International Banking and Financial Law* 228, at 228–30.

[64] W. Shen, 'The 'One Belt, One Road' Initiative, The Renminbi Internationalisation Strategy and Neo-Global Financial Governance', in L.-C. Wolff and C. Xi (eds.), *Legal Dimensions of China's Belt and Road Initiative* (2016), Ch. 12.

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4.1. Immunity rule as part of domestic law

As reflected in recent case law of jurisdictions which historically embraced more liberal approaches to defining the commercial activity exception and were able to exercise more control over sovereign market players, courts also seem to have taken some steps back. For example, in the United States, the first country to codify the restrictive immunity principle, the 'commercial activity' exception has been given more conservative interpretations in recent cases. In the 2015 decision rendered by the Supreme Court of the United States *OBB Personenverkehr AG* v. *Sachs*, the Court decided in favour of the respondent by barring the suit.[65] The Court concluded that the single conduct of selling the Eurail Pass in the United States is 'commercial', but the claimed injury was 'based upon' a tort arising out of activities that occurred outside the American territory unconnected to the 'selling'.[66] Rather than confirming a narrow interpretation of the commercial exceptions, *OBB* has been seen mostly as a tort law exception as the Court refused to further interpret the meaning of 'commercial activity exception' based on an accident that occurred solely in Austria that rendered FSIA inapplicable. However, an opinion delivered two months later by the Second Court of Appeals provides more insights into this developing limitation. In *Atlantica Holdings* v. *Sovereign Wealth Fund Samruk-Kazyna JSC* ('*SK Fund*'), the Kazakhstan-owned SWF SK Fund was determined to have made misrepresentations in connection with its securities trading. The Court held that it could exercise jurisdiction by relying on the commercial exception based on FSIA 1605(a)(2), which permits the Court's jurisdiction over acts that occur outside the United States if they cause a 'direct effect' in the United States.[67] This 'direct effect' clause has become one of the most litigated FSIA clauses recently, as courts have grappled with what constitutes 'direct' and 'indirect' effects in determining the relationship between domestic events and commercial activities overseas.[68]

A territory-centered approach has been reflected in a line of recent cases including *Bolivarian Republic of Venezuela* v. *Helmerich & Payne International Drilling Co.*,[69] *De Csepel* v. *Republic of Hungary*,[70] and the most recent, *SK Fund*. In *SK Fund*, where financial losses were suffered from the SWF's commercial activities elsewhere due to misrepresentations the SWF made in its investor presentations, the court reasoned that those misrepresentations had a 'direct effect' in the United States. Thanks to the conflict of law principles, the court concluded that the US constituted a place of injury of such tort connected to the SWF's overseas commercial activities, directly impacting economic interests of American private market players including individuals.[71]

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[65] *OBB Personenverkehr AG v. Sachs*, 135 S. Ct. 1172 (2015).
[66] Ibid.
[67] 28 U.S.C. 1605 (a)(2).
[68] Crowell & Moring LLP, 'The Foreign Sovereign Immunities Act: 2013 Year in Review', (2015) 21 *Law & Business Review of the Americas* 241, 250–60.
[69] *Bolivarian Republic of Venezuela v. Helmerich & Payne International Drilling Co.*, 137 S. Ct. 1312 (2017).
[70] *De Csepel v. Republic of Hungary*, 714 F.3d 596 (D.C.Cir. 2013).
[71] *Atlantica Holdings v. Sovereign Wealth Fund Samruk-Kazyna JSC*, No. 14-197 (2d Cir. 2016).

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These recent decisions probably demonstrated that the US courts' attitudes towards the regulation of these sovereign market players are not always clear and consistent. Overall, it could be suggested that the courts have begun to offer more protection to these new actors based on sovereign principles, and require a much more stringent proof if exceptions under the FSIA are to be applied. At least two reasons could be offered to explain this. First, in the United States, where sovereign immunity has not been elevated to constitutional importance, courts seem to be willing to give more deference to attitudes of the other two branches of government, and their inconsistent interpretation of the rule reflects changing political needs and economic interests of the country, especially after the financial crisis where there was a wave of return to state capitalism.[72] In another aspect, the combination of sovereign rule and immunity rule essentially allows nations to exercise some extraterritorial judicial control – which does, however, have its boundaries. With rapid movement of goods and capital caused by increasing participation of sovereign market players which are supported by state wealth, sovereign nations are concerned with regulating the conduct of agents of other states only when these actions have directly harmed interests of its private market players, or have distorted the regular order of its domestic market. Without strong market regulatory needs, this protection of private interests at the expense of interfering with activities conducted by another state does not always warrant a strong extension of regulatory power, despite remaining uncertainties in interpreting the law.

Domestically, the SWFs' investment in the equities and capital markets has a threatening effect on fair competition in a market economy, due to SWFs' stronger capability to access and mobilize various resources; mostly financial resources and political connections. SWFs' political connection with their home state government may allow them to obtain a competitive advantage over other market players. A reverse trend against privatization swept over the globe in the late twentieth century, arguably as a byproduct of the rising SWFs.[73] Globally, SWFs are posing a threat to the sovereignty of the recipient nations since SWFs may make decisions on political, instead of economic, grounds.[74] Political considerations may include ways to 'obtain technology and expertise to benefit national strategic interests'[75] or 'to advance directly or indirectly the geopolitical goals of the controlling government'.[76]

Other possible strategic considerations include securing access to natural resources, improving competitive positions for domestic companies (through reducing the portfolio company's value), or aiding national development efforts and other

[72] P.M. Thoennes, 'Eo Nomine: The Divergence of State and Foreign Sovereign Immunity', (2015) 19 *Lewis & Clark Law Review* 543, at 575–8.

[73] L. Summers, 'Op-Ed, Sovereign Funds Shake the Logic of Capitalism', *Financial Times*, 30 July 2007.

[74] J. Politi, 'Sovereign Funds Face US Threat', *Financial Times*, 14 February 2008, at 8.

[75] Commission on the European Communities, *A Common European Approach to Sovereign Wealth Funds* (2008), 115 final, 27 February 2008, at 4.

[76] US Treasury Department, 'Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi', Press Release, 20 March 2008, available at www.treasury.gov/press-center/press-releases/Pages/hp881.aspx.

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policy objectives.[77] These objectives may differentiate SWFs from SOEs which are used to serve a 'commercial purpose', instead of exercising 'sovereign authority',[78] thereby justifying the adoption of the restrictive immunity rule. As the government's investment arm, the connection between the government and SWFs can easily allow the home state government to exert influence over the SWFs, thereby indirectly posing a threat to the host state.

While state governments are more surgically but aggressively penetrating private sectors, the involvement of SWFs in cross-border transactions also blurs the boundary between the markets and regulatory space. There is a natural tension between the interests of a foreign government and a home state government, aside from the conflict of interest between the foreign government as a shareholder and other regular shareholders in the portfolio companies. As a result of this tension, major economies have put regulatory protections in place to guard against (potential) threats to national interests that take the form of acquisitions of control.[79] The regulatory devices deployed by national regulators include, among others, increased disclosure requirements, market entry restrictions, veil-piercing and other corporate governance rules, most of which address concerns of information asymmetry and conflicts of interest. For instance, one of the six principles applied by Australia's Foreign Investment Review Board to SWF investment is to ensure that the SWF's 'operations are independent from the relevant foreign government'.[80]

4.2. Immunity as a rule of international law

There is a black hole in international law largely in connection with the sovereignty and immunity rules. In this black hole, as shown in *Congo*, vulture funds deny any sovereign prerogatives to their counterparts while maximizing the sovereign prerogatives of their home states (in the form of extraterritorial effect of law). What these vulture funds try to do is to deny host states any of the recognition or rights associated with sovereignty by stripping the protections of international law from host states. These vulture funds deliberately avoid bringing a case within the territorial sphere of the connected localities, whether the home state or host state (where the transaction is located), and instead seek a place where severe limitations on the host state's sovereignty allows them superior power. Sovereignty is therefore manipulated to defend and advance developed countries' interests. With a relative immunity rule, sovereignty then can be skillfully wielded to suit non-state-focused needs. When SWFs from emerging countries come into play, the sovereignty rule may be re-adjusted to de-emphasize the sovereign character of SWFs, which may entitle them to its immunity.

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[77] B.A. Templin, 'State Entrepreneurism', (2009) *Thomas Jefferson School of Law Working Paper Series*, available at www.papers.ssrn.com/sol3/papers.cfm?abstract_id=1428108.

[78] Dixon, *supra* note 44, at 195.

[79] C.D. Wallace, *The Multinational Enterprise and Legal Control: Host State Sovereignty in An Era of Economic Globalization* (2002). The most well-known regulatory scheme of this type is the US's inter-agency Committee on Foreign Investment in the US under the Exon-Florio regime, the purpose of which is to review all notices of pending foreign acquisitions of control over US companies by foreign investors and to block some deals if they pose a threat to national security.

[80] H. Sender and P. Smith, 'IMF Urges Action on Sovereign Wealth', *Financial Times*, 24 January 2008, at 4.

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The immunity rule is closely associated with the sovereignty rule. Sovereignty is often cited by the state governments to defend their cases in international tribunals.[81] Although sovereignty principles allow forum state courts the broadest jurisdiction on states' territories, this unlimited territorial jurisdiction is often then modified by state legislation. Argentina, in some pending investment arbitration cases before the ICSID, asserted two separate arguments that go to the heart of the sovereign prerogative of states to develop fundamental policies to address exceptional circumstances. Argentina's treaty law argument invokes the non-precluded measures provisions of Argentina's BITs that exempt certain actions taken by states in response to extraordinary circumstances from the substantive protections of the treaties. Argentina's customary international law argument asserted that the doctrine of necessity justifies the arbitrariness or wrongfulness of Argentina's actions in response to the circumstances of public emergency.[82] Technically, these two arguments touch upon the other arm of sovereignty, that is, the public or commercial nature of an activity engaged by a private entity and the subsequent immunity attached to such an activity. The 'nature of act' test is yet certain in its paramount significance even though it has often been cited in arguments. In any event, the immunity privilege extends only to sovereign activity, not commercial activity.

In *Beijing Urban Construction Group Co. Ltd.* v. *Republic of Yemen*,[83] a China-related investment arbitration case, the Republic of Yemen, as the respondent, claimed that the claimant, being an SOE, plays a government function and therefore should be regarded as the agent of the Chinese government, even though it has been involved in an ostensible commercial undertaking. The tribunal, based on the Broches principle and attribution rules, disagreed because an SOE 'should not be disqualified as a national of another Contracting State unless it is acting as an agent for the government or is discharging an essentially governmental function'.[84] This is consistent with the approaches taken by Hong Kong courts when determining whether to allow a Chinese SOE to claim immunity. In the recent *TNB Fuel Services SDN BHD* v. *China National Coal Group* case decided by the Hong Kong Court of First Instance, the Court did not allow the immunity principle to be invoked, even though the company was superficially controlled by the Chinese State Asset Supervision and Administration Commission (SASAC), as the company was taking independent activities on its own without acting on the state's behalf when the dispute occurred. Sovereignty and power are intimately connected. Sovereignty is reflexive in that 'it implies a search for the best allocation of power in each case, thus putting into question and potentially improving others' exercise of sovereignty as well as one's own'.[85] Understanding the politicization of the sovereignty principle opens the

[81] Apart from the immunity rule, the so-called odious debt doctrine has been also cited by a state government as an excuse not to pay sovereign debt. E.A. Posner and A.O. Sykes, *Economic Foundation of International Law* (2013), 159.

[82] W.W. Burke-White, 'The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System', (2008) 3 *Asian Journal of WTO & Health* 199, at 201; G. Van Harten, *Investment Treaty Arbitration and Public Law* (2007), 3.

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

[84] Ibid., Decision on Jurisdiction, 31 May 2017, paras. 80–1.

[85] S. Besson and J.L. Marti (eds), *Deliberative Democracy and Its Discontents* (2006), 196.

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way for a better understanding of international law and international relations and SOEs are gradually losing protections of the sovereignty umbrella as then activities they perform are increasingly more business-oriented, which is beyond state control.

On the other side of the spectrum, SWFs re-define the notions of public and private power.[86] The conventional distinction between public and private power cannot be the foundation for a legal matrix for SWFs. An SWF's participatory function should be set aside while its regulatory function triggers close attention. The status of SWFs alone cannot justify a waiver or imposition of immunity. When the state uses reserves and assets to protect their financial security, the practice can easily be characterized as an extension of government power. When business actions take place in other states, there is an influence or threat to the power-order on which the state system is based, as well as the hierarchy of power in which economic entities and national authorities are constructed within the national borders. SWFs pose dangers to the viability of the state system and sovereignty.

It is hard to generalize the objectives of SWFs, which vary from stabilizing the macroeconomic effects of sudden increases in export earnings, managing pension assets or a tranche of foreign exchange reserves, to restructuring sovereign wealth. Defining SWFs by reference to their objectives emphasizes their sovereign characters. The close ties between state sovereign objectives and the investment of its assets challenges the conventional understanding of the sovereign immunity effects of SWFs in host states.

If SWFs are understood to be extensions of sovereignty, there is a chance to apply an exception to the commercial activity exception or state-to-state exception. This exceptional rule restores sovereign immunity when the commercial activity in question is between two or more states.[87] In other words, the commercial activities exception does not apply to such transactions, disputes, contracts or proceedings that are between two or more states. The state-to-state exception reduces the scope of commercial activity exception by expanding the reach of international law. It looks like a regressive step but makes more sense when two states are involved in one commercial transaction. These two states' motives in transacting with another state and their options for dispute resolution are different from those of private parties. For instance, sovereigns lend money for different purposes than commercial banks. Other state-to-state transactions can involve food aid programs or other development initiatives. These transactions are hybrid transactions combining some commercial features with political purposes, most of which are related to domestic and foreign policy goals. This is an understudied wrinkle in sovereign immunity law.

Globalization marks an era of change. One change is that non-state actors will have an increased role, notwithstanding the states' continuous role of being the major pillar of the international system. Along with globalization, states have lost more control within their territory. They must turn to the extraterritorial exercise of public authority in an attempt to retain some level of control. The relocation

[86] F.L. Stewart, 'The Corporation, New Governance, and the Power of the Publicization Narrative', (2014) 21(2) *Indiana Journal of Global Legal Studies* 513–51.

[87] Section 33(3)(2) of UK State Immunity Act 1978.

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of public authority outside of the state further erodes the power and importance of the territorial state. International law is in the process of transforming into a world law or world internal law, which encompasses states, NGOs, companies, and individuals.[88] The transformation of sovereignty entails a broadening of the range of actors who play sovereignty concepts to include non-sovereign entities. The concept of sovereignty may need to re-emphasize the element of ultimate authority from territory to function.

The multiplicity of different actors in the spectrum of sovereignty clarifies the multifaceted nature of sovereignty. Where sovereignty historically was enjoyed solely by governments, today it is arguably becoming pooled between states, or even amongst other stakeholders.[89] This pooled sovereignty is 'states' legal authority over internal and external affairs, authorizing action through procedures not involving state vetoes'.[90] The re-imagination of both the sovereignty rule and immunity principle will reduce the sovereign element of sovereign investing.

5. Tentative conclusions

This article has analyzed the interplay between SWFs and the immunity rule through *Congo*, in which China unambiguously affirmed its stance of absolute immunity as well as its position on foreign affairs issues concerning Hong Kong. Several lessons can be learnt from recent case law discussed here. First of all, China is not willing to openly recognize the formal legal status of commercial exception in its courts, because admitting its existence is functionally equivalent to the country implicitly agreeing to the division line between the absolute and restrictive immunity rules. That being said, China is quite willing to allow its major trading partners to enjoy absolute immunity status in its courts based on reciprocity.

On the other hand, China is establishing more funds using state capital and encouraging their investments in jurisdictions with less intricate legal structures than China such as Sri Lanka, Pakistan, and Bangladesh.[91] The Chinese government has also adopted more transparent organizational structures for these investment vehicles. Recently established funds recruited top professional talent from economics, finance and legal disciplines and they invest prudently in accordance with generally accepted international principles even though the economic returns of these funds may be allocated in such ways that better serve state welfare. In the long run, the Chinese government will be silent on the questions of how 'sovereign' these funds are and where the blurry line can be drawn between the SWFs and SOEs. It follows that Chinese SWFs operating overseas might invoke immunity protection less frequently because they have been prepared to accept its more separate status from the state. It is predictable that SWFs will

[88] J. Delbrück, 'Prospect for a "World (Internal) Law?": Legal Developments in a Changing International System', (2002) 9(2) *Indiana Journal of Global Legal Studies* 400, at 402.
[89] W. Wallace, 'The Sharing of Sovereignty: The European Paradox', (1999) 47 *Political Studies* 503, at 506.
[90] R.O. Keohane, 'Ironies of Sovereignty: The European Union and the United States', (2002) 40 *Journal of Common Market Studies* 743, at 748.
[91] T. Kahandawaarachchi, 'Politics of Ports: China's Investment in Pakistan, Sri Lanka and Bangladesh', *University of Washington*, 2015, available at hdl.handle.net/1773/33536.

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gradually be deprived of their mysterious veils and become regular investors participating in global economic activities, deserving less preferential treatment. Once a rule of international customary law is established, state-backed investment vehicles will deserve less preferential treatment and, as a result, states need to apply different law and practices.

The state immunity rule, together with the extraterritoriality rule, arguably is advanced by developed countries to maximize their interests. Meanwhile, the sovereignty discourse is framed in a moral mode. Globalization is used to justify this loosening movement in the area of the immunity and extraterritoriality rules. The extraterritoriality rule works with the relative immunity rule. By contrast, the absolute immunity rule is often advocated and promoted by those developing countries with less extraterritorial effect of their domestic laws. Those countries rely on the absolute immunity rule to compensate for the extraterritorial effect and pressure posed by other countries' laws, especially the US, thereby protecting the rights and powers of outsiders.[92] The loosening of legal spatiality (or the decoupling of territory from sovereignty) can be attributable to the wave of globalization. It is more closely connected with the underlying change to political incentives and capabilities. The strict territoriality (or strict immunity) rule was favoured due to the collateral benefits to state governments but the relative territoriality rule has turned out to be more important along with the national state's growth of power and interest abroad.

It could be suggested that the 2008 financial crisis has increased state intervention in private spheres, increasing the importance of recognizing and regulating SOEs and that the growing popularity of SWFs is associated with the rise of countries like China. These developments have posed challenges to the current international legal framework, particularly rules of state immunity vis-à-vis SWFs. Worldwide, new legislation and case law indicates a general trend towards protecting state assets and making SWFs with independent status more separate from the state.

The key parameters for determining the relevance of the state immunity rule include the SWF's formal link with the national state, public origins of resources of the SWF administer, the purpose SWFs pursue, the public goals linked to the macroeconomic and financial interests of SWFs' national states, and the control imposed by the parent state on SWFs' activities and investment decisions.[93] An SWF may be granted instrumentality status by virtue of the control its state of incorporation is able to impose over its management and activities while the majority ownership is the benchmark of instrumentality status. As China is trying to reaffirm its leadership status in the world's economic order, the Chinese government is constantly separating itself from such enterprises that were originally considered as extensions of state power, thus narrowing the immunity

[92] N. Krisch, 'More Equal Than the Rest? Hierarchy, Equality and US Predominance in International Law', in M. Byers and G. Nolte (eds.), *United States Hegemony and the Foundations of International Law* (2003), 135, at 144.

[93] The US Supreme Court held that 'only direct ownership of a majority of shares by the foreign States satisfies the statutory requirement', excluding an entitlement to immunity for companies being only indirectly owned, *Dole Food Co. v. Patrickson* 538 US 468 [2003] 474.

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protection granted to Chinese SWFs. However, further interpretations from local courts as well as international investment arbitration tribunals are needed to test the firmness of such separation.

Generally speaking, the notion of sovereignty is one of the international law perspectives that are intrinsically linked with the basic structure and foundation of the world legal system.[94] However, territoriality has been slowly unbundled from sovereignty,[95] and has lost its predominant role in the sovereignty rule. As a result, the extraterritoriality rule is unilateralist and reflective of power and interests in the international system.[96]

There is a realist approach to separating sovereignty from the realism contention which would otherwise make the term impossible to define.[97] The contention holds two ideas about sovereignty: first, that sovereignty denotes constitutional independence, and second, that sovereignty means the capacity of a state to exercise force. The concept of sovereignty is advocated to be abandoned due to its inextricable link with the state and the statism of the international system. Should the penetration of business entities be seen as having an impact on the juridical notion of sovereignty? Do we need to transform the discourse on sovereignty to channel the autonomy into the global business law and community? There are problems which cannot be approached effectively in terms of a simplistic dichotomy between 'absolute' and 'restrictive' immunity.[98] Some states still support and implement in their judicial practice a rule of absolute immunity. This trend cannot be ignored, even though a minority of states, including China and Russia, are practicing this principle and these states establish and operate SWFs on a large scale. The complexity of the SWFs' legal issues depends to a large extent on the protectionist reaction of the recipient states which are concerned with the foreign investment decisions that are driven by political objectives, affecting strategic national security issues.

The other approach is to treat sovereignty as 'shared', 'pooled' or 'divided', meaning that the ultimate authority can be split, and sovereignty has been transferred into some spheres and where it can be dealt with differently. However, the idea of functionally limited sovereignty is oxymoronic and fails to provide a satisfactory account in either conceptual or in practical terms. The judicial tendency is to give greater weight to the public features of SWFs' operations, in particular the public origin of the invested assets, and the ultimate purposes SWFs are used to achieve. As to the future, we will hopefully know very soon.

[94] H. Xue, *Chinese Contemporary Perspectives on International Law: History, Culture and International Law* (2012), 68.

[95] K. Raustiala, 'The Evolution of Territoriality: International Relations and American Law', in M. Kahler and B.F. Walter (eds.), *Territoriality and Conflict in An Area of Globalization* (2006), 219, at 220.

[96] Ibid.

[97] J. Hoffman, *Sovereignty* (1998), 21.

[98] I. Brownlie, *Principles of Public International Law* (2003), 324.

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