CHINESE STATE-OWNED ENTERPRISES AND INTERNATIONAL INVESTMENT LAW

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ABSTRACT

Not only do Chinese SOEs play a key role in China's domestic economy, but they are also a major force in implementing the Government of China's ambitious Belt and Road Initiative, a global infrastructure development strategy adopted by the Chinese government to invest in nearly 150 countries and international organizations. The expansion of Chinese SOEs' global footprint has caused widespread concerns in host countries about their implications for national security, fair competition, transparency, and even the function of the free market at home. Since the multilateral trade and investment regimes that took shape in the post-war period did not anticipate many of the special features of Chinese SOEs, states have resorted to unilateral or bilateral measures to counteract Chinese SOEs' competitive advantages in international investment and subject them to heightened national security scrutiny.

The objective of this Article is to critically examine the alleged challenges that the expansion of Chinese SOEs' outbound foreign investment has posed to the liberal international investment order and to analyze whether the current international investment regime is resilient enough to accommodate the systemic friction between heterogeneous economic systems. It argues that international investment law is poorly designed to deal with Chinese SOEs because it is premised on some untenable assumptions, and these assumptions are not applicable to Chinese SOEs. The lack of effective international rules pushes nation states to become norm entrepreneurs in international investment law. However, the new SOE norms not only risk either overshooting or undershooting the Chinese SOE problem but also result in greater fragmentation of the international investment regime.

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I. INTRODUCTION

Despite three decades of extensive reform and privatization, state-owned, state-controlled, or otherwise state-influenced enterprises and sovereign wealth funds remain an important economic force in the global economy. They are serious competitors to private firms in global markets for market shares, resources, and ideas.[1] According to the Organization for Economic Cooperation and Development (OECD), 132 of the world's largest 500 enterprises measured by annual revenues were wholly or majority owned by sovereign governments in 2020, compared to 34 two decades ago.[2] In response to the COVID-19 crisis, governments have undertaken a vast array of measures to support the business sector. In some cases, rescue packages include the acquisition of equity stakes in companies in financial distress, increasing the number and presence of state-owned multinational enterprises to about 1,600 in the global economy in 2020.[3]

State-owned enterprises (SOEs) hold a prominent position in China's socialist market economy system.[4] Even as market-oriented

1. Przemyslaw Kowalski & Kateryna Perepechay, *International Trade and Investment by State Enterprises* 7 (OECD Trade Policy Papers No. 184, 2015), https://www.oecd-ilibrary.org/docserver/5jrtcr9x6c48-en.pdf?expires=1680206750&id=id&accname=guest&checksum=8D8EE7B80DCE0C5B433C049064C39D85.

2. Organization for Economic Co-Operation and Development [OECD], *Transparency and Disclosure Practices of State-owned Enterprises and Their Owners* 8 (2020), https://www.oecd.org/corporate/Transparency-Disclosure-Practices-SOEs.pdf.

3. United Nations Conference on Trade and Development, *World Investment Report 2021: Investing in Sustainable Economy*, U.N. Doc. A/Conf./21 https://unctad.org/system/files/official-document/wir2021_en.pdf.

4. There is no uniform definition of SOEs in part because of the ambiguity about the degree of state ownership or control needed to be called an SOE. The OECD defines it as "any corporate entity recogni[z]ed by national law as an enterprise, and in which the state exercises ownership[.]" *See* Organization for Economic Co-Operation and Development [OECD], *Guidelines on Corporate Governance of State-Owned Enterprises* 14 (2015), https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en. Ownership is understood to imply control, either by the state holding full or majority of voting shares or otherwise exercising an equivalent degree of control. *See id.* "Examples of an equivalent degree of control would include, for instance, cases where legal stipulations or corporate articles of association ensure continued state control over an enterprise or its board of directors in which

reforms have led to a rapid expansion of the private sector in China, SOEs continue to dominate the Chinese economy. There are more than 150,000 SOEs in China today, and they contributed anywhere between 23% and 28% of China's gross domestic product (GDP) and anywhere between 5% and 16% of employment in 2017.[5] More than one thousand SOEs are listed on China's stock markets, accounting for 44% of total market capitalization and 56% of revenues of publicly listed companies.[6] In 2021, 143 Chinese firms appeared on the list of Fortune Global 500, among which 82 were SOEs.[7] It has been widely accepted that SOEs are—and will be—a hallmark of China's socialist market economy model rather than a transitional phenomenon leading to liberal capitalism, as many critics of SOEs had expected.[8]

Not only do Chinese SOEs play a key role in China's domestic economy, but they are also a major force in implementing the Government of China (GOC)'s ambitious "Go Out" strategy[9] and, more recently, the Belt and Road Initiative (BRI), the Chinese paramount leader Xi Jinping's signature foreign policy undertaking.[10] In 2021, despite the impact of the COVID-19 pandemic, China's Outward Foreign Direct

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it holds a minority stake." *Id.* Entities in which the government holds equity stakes of less than ten percent that do not confer control are excluded. *See id.* at 15.

5. Chunlin Zhang, *How Much Do State-Owned Enterprises Contribute to China's GDP and Employment?*, 10 (World Bank, Working Paper, 2019).

6. Xianchu Zhang, *Integration of CCP Leadership with Corporate Governance: Leading Role or Dismemberment?*, 1 CHINA PERSPS. 55, 57 (2019) (noting that in 2017, "1,003 state-controlled listed companies accounted for 44% of the entire value of China's securities market"); *see also* Curtis J. Milhaupt, *The State as Owner–China's Experience*, 36(2) OXFORD REV. ECON. POL'Y 362, 362 (2020) ("listed companies with more than 20[%] state ownership account for 40[%] of total market capitalization and 56[%] of listed company revenues in China").

7. FORTUNE, *Global 500 2021*, (Aug. 2021), https://fortune.com/global500/2021/search/?fg500_country=China.

8. *See* Jude Blanchette, Commentary, *Confronting the Challenge of Chinese State Capitalism*, CSIS GLOBAL FORECAST 2021 (Jan. 22, 2021), https://www.csis.org/analysis/confronting-challenge-chinese-state-capitalism.

9. The essence of the "Go Out" policy, which was adopted in 1999, was to promote the international operations of capable Chinese firms through outbound FDI with a view to enhancing their international competitiveness. *See* WAYNE M. MORRISON, CONG. RSCH. SERV., RL33534, CHINA'S ECONOMIC RISE: HISTORY, TRENDS, CHALLENGES, AND IMPLICATIONS FOR THE UNITED STATES 17–18 (2019), https://crsreports.congress.gov/product/pdf/RL/RL33534.

10. As one of the most ambitious infrastructure projects ever conceived, the BRI includes a vast network of railways, energy pipelines, highways and streamlined border crossings both westward and southward, as well as invests in port development along the Indian Ocean, from Southeast Asia all the way to East Africa. *See* James McBride, Noah Berman & Andrew Chatzky, *China's Massive Belt and Road Initiative*, COUNCIL ON FOREIGN REL. (May 21, 2019), https://www.cfr.org/backgrounder/chinas-massive-belt-and-road-initiative.

Investment (OFDI) posted a year-on-year increase of 9.2%, reaching US$145.19 billion.[11] The United Nations Conference on Trade and Development (UNCTAD) ranked China fourth in the world in terms of OFDI.[12] The steady growth of China's OFDI is expected to continue as Chinese companies have increasingly realized that overseas investment is an effective strategy for them to upgrade, transform, and become more competitive.[13] Earlier statistics showed that at least 80% of all of China's OFDI was funded by SOEs.[14] With the growing strength of privately-owned enterprises (POEs) in China, however, a smaller proportion of China's increasing OFDI is coming from SOEs. Still, evidence shows that of the 650 Chinese investments in Europe from 2010 to 2020, roughly 40% have moderate to high involvement by state-owned or state-controlled companies.[15] In particular, the BRI projects are largely implemented by Chinese SOEs. As of October 2018, Chinese SOEs were accountable for about half of BRI projects by number and more than 70 percent by project value.[16]

The expansion of Chinese SOEs' global footprint has caused widespread concerns in host countries about their implications for national security, fair competition, reciprocity, transparency, corruption, and even the function of the free market at home.[17] Since the multilateral trade and investment regimes that took shape in the post-war period simply did not anticipate many of the special features of Chinese

11. 商务部召开例行新闻发布会 [The Minister of Commerce Holds Regular Press Conference] (Jan. 20, 2022), MINISTRY OF COM. OF PRC (Jan. 20, 2022), http://www.mofcom.gov.cn/xwfbh/20220120.shtml.

12. United Nations Conference on Trade and Development, *World Inv. Rep. 2022: Int'l. Tax reforms and sustainable Inv.* U.N. Doc. A/Conf./21, https://unctad.org/system/files/official-document/wir2022_en.pdf.

13. Don Weinland, *Chinese Firms are Quietly Pursuing a New Global Strategy*, ECONOMIST (Nov. 8, 2021).

14. Adrian Wooldridge, *The Visible Hand*, ECONOMIST (Jan. 21, 2012).

15. Daniel Michaels, *Behind China's Decade of European Deals, State Investors Evade Notice; Chinese Government Shareholders Wield Undetected Influence in Hundreds of Deals, New Research Finds*, WALL ST. J. (Sept. 30, 2020).

16. Rafiq Dossani et al., *Demystifying the Belt and Road Initiative* 13–15 (RAND, Working Paper No. 1338, 2020).

17. *See* Organization for Economic Co-operation and Development [OECD], *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* 52–53 (2016), https://read.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-as-global-competitors_9789264262096-en; *see also* CHINA'S INFLUENCE & AMERICAN INTERESTS: PROMOTING CONSTRUCTIVE VIGILANCE 123–38 (Larry Diamond & Orville Schell eds., Hoover Inst. Press, No. 702 2019).

SOEs,[18] many states have resorted to unilateral regulatory measures designed to counteract Chinese SOEs' competitive advantages in international investment[19] and subjected them to heightened national security scrutiny.[20] However, these unilateral measures have been criticized as arbitrary, discriminatory, and flying in the face of the rule of law in international economic relations.[21] On the international front, states have adopted new rules for regulating SOEs' behavior through bilateral and regional free trade agreements (FTAs) or bilateral investment treaties (BITs). Different from earlier FTAs, a separate and extensive SOE chapter features almost all new-generation mega-regional FTAs, such as the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the United States-Mexico-Canada Agreement (USMCA), the EU-Canada Comprehensive Economic and Trade Agreement (CETA)

18. Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARV. INT'L L. J. 261, 285 (2016) (explaining that difficulties arise because WTO rules were not written with China specifically in mind); PETROS C. MAVROIDIS & ANDRE SAPIR, *CHINA AND THE WTO: WHY MULTILATERALISM STILL MATTERS* 162–66 (Princeton Univ. Press 2021) (explaining that the GATT/WTO system was based on the liberal understanding that governments do not preempt the market mechanism). Similarly, the early negotiators of investment treaties did not anticipate the issues brought by China's integration into the global economy. *See* Wendy Leutert & Zachary Haver, *From Cautious Interaction to Mature Influence: China's Evolving Engagement with the International Investment Regime*, 93 PAC. AFFS. 59, 66–69 (2020) (explaining that China only began to engage with the international investment regime in the 1980s and active participation did not start until the 1990s); Jeffrey N. Gordon & Curtis J. Milhaupt, *China as a National Strategic Buyer: Toward a Multilateral Regime for Cross-Border M&A*, 2019 COLUM. BUS. L. REV. 192, 198 (2019) (arguing that "the cross-border M&A regime will require a new rules-of-the-game structure to take account of China's ascension").

19. For example, in the United States, the House passed the America Competes Act on February 4, 2022, and the Senate passed the United States Innovation and Competition Act in July 2021, both aiming at competing with China. *See* Patricia Zengerle & Michael Martina, *U.S. House Backs Sweeping China Competition Bill as Olympics Start*, REUTERS (Feb. 4, 2022), https://www.reuters.com/world/us/us-house-set-pass-sweeping-vote-china-competition-bill-2022-02-04/. Across the Atlantic, the European Commission proposed a new instrument in May 2021 under which the European Commission will have the power to investigate subsidies granted by foreign public authorities to facilitate acquisition of EU enterprises. *See* Press Release, European Commission, Commission Proposes New Regulation to Address Distortions Caused by Foreign Subsidies in the Single Market (May 5, 2021), https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1982.

20. *See generally* Ming Du, *The Regulation of Chinese State-Owned Enterprises in National Foreign Investment Laws: A Comparative Analysis*, 5 GLOBAL J. COMP. L. 118 (2016).

21. Isaac Lederman, *The Right Rights for the Right People? The Need for Judicial Protection of Foreign Investors*, 61 B.C. L. REV. 703, 703 (2020); E. Maddy Berg, *A Tale of Two Statutes: Using IEEPA's Accountability Safeguards to Inspire CFIUS Reform*, 118 COLUM. L. R. 1763, 1792–1800 (2018).

and the EU-China Comprehensive Investment Agreement (CAI).[22] Yet once again, questions were raised over whether these new mechanisms are adequate and effective in dealing with the challenges arising from Chinese SOEs' global expansion.[23]

The objective of this Article is to critically examine the challenges that the expansion of Chinese SOEs' OFDI has posed to the liberal international investment order and to analyze whether the current international investment regime is resilient enough to accommodate the systemic friction between heterogeneous economic systems.[24] This Article argues that international investment law is poorly designed to deal with Chinese SOEs because it is premised on some untenable assumptions. First, all business actors, be it an SOE or a POE, in international investment are motivated by private economic gain-seeking.[25] Second, commercial acts and governmental acts can be readily distinguished by national regulators or international tribunals.[26] This Article challenges these two assumptions. It argues that both assumptions break down when applied to Chinese SOEs. As Chinese SOEs operate in the interface of competing dimensions of the public and private,

22. Comprehensive and Progressive Agreement for Trans-Pacific Partnership ch. 18, Mar. 8, 2018, https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text [hereinafter CPTPP]; Agreement Between the United States of America, the United Mexican States, and Canada ch. 22, Nov. 30, 2018, https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between [hereinafter USMCA]; Comprehensive Economic and Trade Agreement, Can.-E.U. ch. 18, Oct. 30, 2016, https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/toc-tdm.aspx?lang=eng [hereinafter CETA]; Comprehensive Agreement on Investment, China-E.U. art. 3bis, Dec. 30, 2020, https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china/eu-china-agreement/eu-china-agreement-principle_en [hereinafter CAI].

23. Weihuan Zhou, *Rethinking the (CP)TPP as a Model for Regulation of Chinese State-Owned Enterprises*, 24 J. INT'L ECON. L. 572, 578–588 (2021) (questioning whether the SOE chapter of the CPTPP is an ideal model to regulate Chinese SOEs); *see generally* Jaemin Lee, *The "Indirect Support" Loophole in the New SOE Norms: An Intentional Choice or Inadvertent Mistake?*, 20 CHINESE J. INT'L L. 63 (2021) (arguing that the new SOE norms in the CPTPP and the USMCA include critical ambiguities and uncertainties which could potentially render full implementation of the norms elusive and complex).

24. For a critical analysis of how the global trading system deals with heterodox markets, see Andrew Lang, *Heterodox Markets and 'Market Distortions' in the Global Trading System*, 22 J. INT'L ECON. L. 677 (2019).

25. *See* Gordon & Milhaupt, *supra* note 18, at 197.

26. Christin Chinkin, *A Critique of the Public/Private Dimension*, 10(2) EUR. J. INT'L L. 387, 389 (1999); Gus Van Harten, *The Public-Private Distinction in the International Arbitration of Individual Claims Against the State*, 56(2) INT'L & COMP. CORP. L. Q. 371, 373–74 (2007); Anne Van Aaken, *Blurring Boundaries Between Sovereign Acts and Commercial Activities: A Functional View on Regulatory Immunity and Immunity from Execution* 18 (Univ. St. Gallen L. Sch., Working Paper No. 2013-17, 2013).

there are considerable conceptual and practical difficulties in ascertaining where the sovereign ends and the investor begins and whether the activities they perform are private or, rather, sovereign. But a key differentiator between liberal capitalism and state capitalism countries is the extent to which states may use commercial acts to pursue strategic, geopolitical objectives.[27] The lack of effective international rules on SOEs pushes states to become norm entrepreneurs and turn to innovative unilateral or bilateral measures of their own design. However, the new SOE norms not only tend to either overshoot or undershoot the Chinese SOE problem but also result in greater fragmentation of the international investment regime.

The Article proceeds as follows. Part II unpacks the black box of Chinese SOEs. It provides a political economy analysis of SOEs in China as well as an overview of China's SOE reforms in the past four decades, highlighting the close relationship between Chinese SOEs and the Chinese Party-state and the blurred boundary between SOEs and large successful POEs in China. Part III explains why Chinese SOEs have triggered unique regulatory concerns for host states in the cross-border investment context and how these concerns are currently addressed in international investment law. Moving from conceptual to concrete, Part IV and Part V examine two salient issues in international investment law involving Chinese SOEs: the standing of Chinese SOEs in international investment arbitration and the heightened national security review of Chinese SOEs' investments in some Western countries. Part IV explains that from both legal and policy perspectives, Chinese SOEs have standing as claimants in investor-state dispute settlement (ISDS). Part V shows that national security reviews can be discriminatory, arbitrary, and politicalized. A weaponized national security regime has a damaging impact on foreign investors' perception of the investment environment in a host country. It also runs the risk of breaching a host country's investment treaty obligations to foreign investors. The Chinese telecoms giant Huawei's recent investment treaty claim against the Government of Sweden before the International Centre for Settlement of Investment Disputes (ICSID) over its exclusion from the rollout of the 5G network amid national security concerns is only the tip of the iceberg.[28]

27. Bianca Nalbandian, *State Capitalists as Claimants in International Investor-State Arbitration*, 81 QUESTIONS OF INT'L L. ZOOM-OUT 5, 12–14 (2021).

28. Cosmo Sanderson, *Huawei Brings ICSID Claim Against Sweden over 5G Ban*, GLOB. ARB. REV. (Jan. 24, 2022), https://globalarbitrationreview.com/huawei-brings-icsid-claim-against-sweden-over-5g-ban.

Advancing from the status quo to future development, Part VI explores whether the new SOE rules in mega-regional FTAs, in particular the CPTPP, are fit to apply to Chinese SOEs. It argues that although the new SOE norms in the CPTPP are promising, it is far from clear that they will be effective in constraining Chinese SOEs. This Article concludes by reflecting on the challenges that Chinese SOEs pose to the liberal international investment order and urges the GOC to utilize external pressure as an incentive to push forward market-oriented SOE reforms.

II. Unpacking Chinese State-owned Enterprises

A. *The Political Economy of SOEs in China*

Empirical studies have overwhelmingly concluded that Chinese SOEs perform poorly compared to POEs both for financial performance and innovation.[29] Several reasons account for the relatively poor performance of SOEs. To begin with, the classical agency theory suggests that the separation of ownership and control in large firms gives rise to a misalignment of incentives between shareholders (owners) and managers (agents).[30] Managers may pursue a personal agenda for their own interests rather than work for the interest of the owners.[31] The agency problem is exacerbated in SOEs due to the weak monitoring of state assets caused by the high costs of monitoring, as well as the lack of incentives on the part of supervisory government officials who represent the state.[32] Indeed, Chinese SOEs have been notorious for facilitating corruption and enabling shareholders to be abused by powerful corporate insiders. They are currently a top target of the far-reaching anti-corruption campaign that Xi Jinping has launched since 2013.[33]

29. Ann Harrison et al., *Can a Tiger Change Its Stripes? Reform of Chinese State-Owned Enterprises in the Penumbra of the State* 4–6 (Nat'l Bureau Econ. Rsch., Working Paper No. 25475, 2019); Shang-Jin Wei et al., *From "Made in China" to "Innovated in China": Necessity, Prospect, and Challenges*, 31(1) J. Econ. Persps. 49, 51 (2017).

30. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 308 (1976).

31. *Id.* at 308–09.

32. Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 Geo. L.J. 665, 676–78 (2015); Nguyet Thi Minh Phi et al., *Performance Differential Between Private and State-Owned Enterprises: An Analysis of Profitability and Leverage* 2 (Asian Dev. Bank Inst., Working Paper No. 950, 2019).

33. Wendy Leutert & Sarah Eaton, *Deepening Not Departure: Xi Jinping's Governance of China's State-Owned Economy,* 248 China Q. 200, 215 (2021); Jamil Anderlini, *China Corruption Purge Snares*

Furthermore, during the process of China's economic development, SOEs are not only expected to be profit-oriented but also to fulfill various government policy objectives and specific government-directed tasks with public goods properties.[34] For example, Chinese SOEs have been playing an essential role in maintaining the employment of redundant workers, which contributed to social stability, developing national strategic industries, pioneering technological advances, leading sectoral and regional economic restructuring, maintaining macroeconomic stability by increasing investment when growth slows, and creating powerful national champions that secure strategic resources and spread Chinese economic influence abroad.[35] The existing literature overwhelmingly finds that policy burdens negatively impact Chinese SOEs' investment decisions and corporate performance.[36] The multitasking of Chinese SOEs has also made it difficult for the government to distinguish losses induced by strategic and policy burdens from those of poor managerial performance, which worsens information asymmetry and, in turn, increases agency cost, rent-seeking, moral hazard, managerial slacks, and corruption.[37]

Another cause of the inefficiency of state ownership is the so-called "soft budget constraint."[38] Although SOEs are vested with a moral and financial interest in maximizing their profits when they face financial distress, the government often provides subsidies, tax holidays, and low-interest loans to bail them out, and thus, SOEs could continue surviving even after chronic losses.[39] The roots of the soft budget constraint problem in transitional economies like China rest in the nonviability of some SOEs that the GOC decides to support for strategic purposes and the policy burdens that most SOEs still carry.[40] The soft budget

115 SOE "Tigers,", FIN. TIMES (May 18, 2015), https://www.ft.com/content/ad997d5c-fd3c-11e4-9e96-00144feabdc0.

34. Chong-En Bai et al., *The Multitask Theory of State Enterprise Reform: Empirical Evidence from China*, 96(2) AM. ECON. REV. 353, 354 (2006).

35. Barry Naughton, *State Enterprise Reform Today*, *in* CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT 1978–2018 375, 384 (Ross Garnaut et al. eds., 2018).

36. Justin Yifu Lin & Zhiyun Li, *Policy Burden, Privatization and Soft Budget Constraint*, 36 J. COMP. ECON. 90, 92–93 (2008); Ying Hao & Jing Lu, *The Impact of Government Intervention on Corporate Investment Allocations and Efficiency: Evidence from China*, 47 FIN. MGMT. 383, 415 (2018).

37. Jianhui Jian et al., *Do Policy Burdens Induce Excessive Managerial Perks? Evidence from China's State-Owned Enterprises*, 90 ECON. MODELLING 54, 56–57 (2020).

38. *See generally* János Kornai et al., *Understanding the Soft Budget Constraint*, 41 J. ECON. LITERATURE 1095 (2003) (explaining the "soft budget complaint").

39. *Id.* at 1096–98.

40. Justin Yifu Lin & Guofu Tan, *Policy Burdens, Accountability, and the Soft Budget Constraint*, 89 AM. ECON. REV. 426, 430 (1999).

constraint problem weakens the market disciplinary effects on SOE managers because the state is ultimately accountable for the losses of SOEs. As a result, SOEs are prone to losses and state assistance.

However, it is not always the case that SOEs perform poorly compared to POEs. The relationship between state ownership and the financial performance of firms varies greatly across national contexts. For example, Singapore's government-owned companies are comparable to the most profitable POEs in efficiency.[41] One recent International Monetary Fund research study suggests that SOEs perform as well as POEs in core sectors (mining, electricity, gas, water, and transport) when corruption is low.[42] Others found that the political ideology of the government (e.g., economic liberals or economic socialists), both independently and in conjunction with political institutions (state capacity and political constraint), affects the financial performance of SOEs.[43] It is also argued that China's SOEs have a positive impact on China's long-term economic growth by undertaking policy burdens because SOEs stabilize growth in economic downturns by carrying out massive investments; promote technical progress by investing in riskier areas of technology; and follow a high-road approach to compensation and benefits which is favorable for China to move toward a more sustainable growth model in the future. [44]

As will be examined closely in the next section, it is unrealistic today to uphold the simplistic and pessimistic view of Chinese SOEs as industrial dinosaurs fit only for dismemberment or bankruptcy after extensive reforms over the past four decades. Chinese SOEs have become competitive by leading on new technologies, finding niches, exploiting economies of scale, using cheaper labor, working harder, and making investments that pay off, other than relying on domestic monopolies and state supports.[45] Significantly, Chinese SOEs are no longer content to dominate China's domestic market. They have proactively engaged in global partnerships and acquisitions, aiming to become global

41. Fang Feng et al., *Do Government-Linked Companies Underperform?*, 28 J. BANKING & FIN. 2461, 2486–87 (2004).

42. Anja Baum et al., *Governance and State-Owned Enterprises: How Costly is Corruption?* 5 (IMF Working Paper, WP/19/253, 2019).

43. Ruth Aguilera et al., *State Ownership, Political Ideology, and Firm Performance around the World*, 56 J. WORLD BUS. 1, 2 (2021).

44. Hao Qi & David M. Kotz, *The Impact of State-Owned Enterprises on China's Economic Growth*, 52 REV. RADICAL POL. ECON. 96, 112–13 (2020).

45. *See* Zhong Nan & Zhuang Qiange, *Chinese Enterprises to Expand Global Presence*, CHINA DAILY (28 Feb. 28, 2023), https://www.chinadaily.com.cn/a/202302/28/WS63fd61b0a31057c47ebb13e7.html; *see generally* Xiaoqian Zhang et al., *Does mixed-ownership reform improve SOEs' innovation? Evidence from state ownership*, 61 CHINA ECON. REV. 1 (2020).

champions.[46] The argument is not that China's SOEs are as efficient as or even better than POEs. The point is simply that Chinese SOEs have drastically improved their performance and that they are serious competitors to private multinationals in global markets.

More importantly, even if China's SOEs are not as efficient as POEs, why are there still so many of them in China? One influential explanation is that SOEs continue to exist for political reasons.[47] In the Chinese context, as an authoritarian Party-state, the Chinese Communist Party (CCP) cannot base its political legitimacy on free democratic elections. To cling to power, the CCP has to ensure that it controls sufficient economic, political, and social resources.[48] Given the economic might of Chinese SOEs, they are, in essence, the economic foundation of the CCP's power base. As Xi Jinping unequivocally stated, "[SOEs] are an important material and political foundation of socialism with Chinese characteristics, and an important pillar and strength for our party to govern and rejuvenate the country."[49] Ideologically, through still upholding Marxist-Leninist and Maoist thought as guiding ideology, at least rhetorically, the primary goal of China's economic reforms is to build a socialist market economy with the state-owned sector as a leading sector.[50] The political connections that SOEs have with the CCP, the sole ruling party in China, and the strong ideological preference in favor of SOEs are the reasons why SOEs must be kept and improved rather than fully privatized.[51]

It is precisely within this complex institutional environment that Chinese SOEs have evolved and transformed over the past four decades. As we will subsequently see, the issue of giving autonomy to SOEs and making them truly independent market entities on the one hand and strengthening monitoring of SOEs and making more and more

46. Sidney Leng, *China's State-Owned Giants Given New Order: Create Global Industrial Champions*, SOUTH CHINA MORNING POST (Aug. 11, 2020), https://www.scmp.com/economy/global-economy/article/3096924/chinas-state-owned-giants-given-new-order-create-global.

47. Andrei Shleifer & Robert W. Vishny, *Politicians and Firms*, 109(4) Q. J. ECON. 995, 995–97 (1994).

48. Jiangyu Wang, *The Political Logic of Corporate Governance in China's State-Owned Enterprises*, 47 CORNELL INT'L L.J. 631, 660–61 (2014).

49. Xi Jinping, *Uphold the Party's Unwavering Leadership over State-Owned Enterprises*, PEOPLE'S DAILY (Oct. 12, 2016), http://cpc.people.com.cn/n1/2016/1012/c64094-28770427.html.

50. *See* XIANFA art. 7 (1982) (China).

51. *See* Paul Dragos Aligica & Vlad Tarko, *State Capitalism and the Rent-Seeking Conjecture*, 23 CONST. POL. ECON. 357, 375–76 (2012); Kemel Toktomushev, *China and Its Zombies: Traps of State-Owned Enterprises*, CHINA-US FOCUS (Nov. 27, 2020), https://www.chinausfocus.com/finance-economy/china-and-its-zombies-traps-of-state-owned-enterprises.

demands on SOEs, on the other hand, has been a recurrent issue in Chinese SOE reforms.

B. *An Overview of China's SOE Reforms*

SOEs have existed in China for many years, but their form, function, and implications for the global economy have changed dramatically over the past decade. To grasp the nature of Chinese SOEs, it is essential to understand China's economic and institutional transformation from a socialist planned economy to a socialist market economy with the state-owned sector as a leading sector. The reform of Chinese SOEs lies at the center of this grand economic transformation.[52] When SOE reform started in the early 1980s, SOE reforms were deemed to be necessary in order to reduce economic losses, increase economic growth, and raise living standards, from which the Chinese Communist Party (CCP) derives its governing legitimacy.[53] Fast forward to the twenty-first century, not only have Chinese SOEs survived in the ecology of business organizations, but they also evolved into major players in both the domestic and the global economy.[54] This section provides an overview of the past and present of the Chinese SOE reform from 1978 to 2022.

1. China's SOE Reforms Before 2012

After the CCP defeated the Nationalist Party and founded the People's Republic of China in 1949, the communist regime discarded the previous market economic order and, emulating the Soviet Union, created a socialist planned economy.[55] The new economic structure was, by and large, a replica of the Leninist model of a "state syndicate," in which state ownership was the sole basis of almost all economic activities.[56] In 1978, virtually all firms in China were SOEs; they accounted for 78% of industrial output and employed 76% of all industrial workers.[57] In the socialist planned economy era, SOEs were basically

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52. Kellee S. Tsai & Barry Naughton, *State Capitalism and the Chinese Economic Miracle*, *in* STATE CAPITALISM, INSTITUTIONAL ADAPTATION AND THE CHINESE MIRACLE 1, 1–3 (Cambridge Univ. Press 2015).

53. Hochul Lee, *A Dilemma of Success: The Reform Path of State-Owned Enterprises in China*, 46 ASIAN PERSP. 451, 452–53 (2022).

54. *See* Du, *supra* note 20, at 119–20.

55. *See* BARRY NAUGHTON, THE CHINESE ECONOMY: TRANSITIONS AND GROWTH 55 (MIT Press ed. 2007).

56. Youngjin Jung & Qian Hao, *The New Economic Constitution in China: A Third Way for Competition Regime?*, 24(1) NW. J. INT'L L. & BUS. 107, 110 (2003).

57. Loren Brandt, Thomas Rawski & John Sutton, *China's Industrial Development*, *in* CHINA'S GREAT ECONOMIC TRANSFORMATION 571 (Loren Brandt & Thomas G. Rawski eds., 2008).

production units rather than autonomous profit-seeking corporations.[58] National and local government planning commissions decided what each SOE was to produce, their allocation of materials, capital goods and workers, and how production was to be organized in order to achieve output targets.[59] The output was then sold to the government at predetermined prices.[60] The absence of autonomy and incentives were widely recognized as the central problems facing SOEs in the period prior to the SOE reform. Since the historic decision in 1978 to reform and open up the economy, the GOC has taken a gradual, experimental, and pragmatic approach—known as "crossing the river by touching the stone"—to bring about the reform of Chinese SOEs.[61] This approach is in sharp contrast to the alternative, "big bang" approach, which entails rapid large-scale privatization and was adopted by the former Soviet Bloc.[62]

China's SOE reforms had gone through three distinct phases before Xi Jinping came to power in 2012.[63] The first phase ran from the early 1980s until the early 1990s.[64] Due to strong ideological and political perceptions of the need for the state to control all critical means of production, state ownership of SOEs remained intact in the first phase.[65] Inspired by the success of the household responsibility system in the rural reforms in the early 1980s, reform measures in the first phase focused on increasing SOE autonomy and introducing a market mechanism to improve the performance of SOEs.[66] At first, while SOEs were still supplied with material inputs at planned prices and obliged to fulfill an output quota to be sold to the state at government-set prices, a dual-track system was introduced to allow SOEs to buy material inputs at market prices, produce beyond the quotas set by the government,

58. *See* BECKY CHIU & MERVYN K. LEWIS, REFORMING CHINA'S STATE-OWNED ENTERPRISES AND BANKS 61 (2006).

59. *See id.*

60. *See id.*

61. Chenggang Xu, *The Fundamental Institutions of China's Reforms and Develop*ment, 49 J. ECON. LITERATURE 1076, 1107 (2011); Justin Yifu Lin et al., *Competition, Policy Burdens, and State-Owned Enterprise Reform*, 88 AM. ECON. REV. 422, 424 (1998).

62. MINXIN PEI, CHINA'S TRAPPED TRANSITION: THE LIMITS OF DEVELOPMENTAL AUTOCRACY 22 (Harvard Univ. Press ed. 2006).

63. LIGANG SONG, STATE-OWNED ENTERPRISE REFORM IN CHINA: PAST, PRESENT AND PROSPECTS, IN CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT 1978–2018 345, 346 (Ross Garnaut et al. eds., 2018) ("examin[ing] the SOE reform process in four stages: 1978–92, 1992–2003, 2003–13, and 2013 to the present").

64. *See id.* at 349.

65. *Id.*

66. *Id.*

sell the excess at market prices, and keep the proceeds as corporate profits.[67] Later, a contract responsibility system was introduced in 1985 to create a formalized relationship between most small and medium-sized SOEs and the government. Under the contract responsibility system, SOE managers signed contracts with the government giving them the right to run day-to-day operations, greater emphasis was placed on SOEs' responsibilities for profits and losses, and more stable quotas on output and profits were instituted. Nevertheless, the firm remained a state asset. Profits were shared between the SOEs and the state in accordance with the terms of the contract.[68]

The contract responsibility system entailed the emergence of industrial product markets and competition among SOEs. There was evidence that SOEs made some productivity gains as a result of these firm-level reforms.[69] However, these reforms were soon viewed as inherently flawed.[70] For example, the dual track system allowed administrative interference and created incentives for arbitraging between planned and market prices.[71] It increased the pervasiveness of corruption for those SOEs that could buy at the typically lower planned price and sell at the market price.[72] The dual-track system was gradually eliminated over time as almost all product-market prices became competitively determined.[73] Likewise, the contract responsibility system did not solve the short-termism of management behavior: managers were rewarded for their successes but not punished for their failures.[74] This enabled managers to exploit their effective control over SOE assets for personal benefit at the expense of the state, damaging firms' long-term

67. Yongheng Deng et al., *Monetary and Fiscal Stimuli, Ownership Structure, and China's Housing Market* 9 (Nat'l Bureau of Econ. Rsch., Working Paper No. 16871, 2011), http://www.nber.org/papers/w16871.

68. Li Wei, *The Impact of Economic Reform on the Performance of Chinese State Enterprises, 1980–1989*, 105 J. POL. ECON. 1080, 1083 (1997).

69. *See generally* Mary M. Shirley & Lixin Colin Xu, *Empirical Effects of Performance Contracts: Evidence from China*, 17 J. L. ECON. & ORG. 168 (2001).

70. Stephen Green & Guy S. Liu, *China's Industrial Reform Strategy: Retreat and Retain*, *in* EXIT THE DRAGON? PRIVATIZATION AND STATE CONTROL IN CHINA 15, 17 (2005).

71. *See id.*

72. JINGLIAN WU, UNDERSTANDING AND INTERPRETING CHINESE ECONOMIC REFORM 70–71 (2005).

73. NICOLAS R. LARDY, MARKETS OVER MAO: THE RISE OF PRIVATE BUSINESS IN CHINA 13–14 (2014).

74. *See* Yingyi Qian, *Enterprise Reform in China: Agency Problems and Political Control*, 4 ECON. TRANSITION 427, 436–37 (1996).

development.[75] The lack of adequate monitoring after SOEs were given managerial autonomy further contributed to SOEs' poor performance.[76]

Moreover, the GOC encouraged the development of township and village enterprises (TVEs) and foreign-invested enterprises (FIEs) during this period.[77] Due to increasing competition from the private sector, SOEs stacked up huge losses.[78] From 1978 to 1993, the share of gross industrial output generated by SOEs declined sharply from 78% to 37.4%, even though virtually none closed during this period.[79] About 30% of SOEs were in the red in 1994, and their debt-to-equity ratio reached 211%.[80] In aggregate, "China's industrial SOEs no longer provided net revenues for the government, [and] absorbed fiscal and quasi-fiscal resources that were estimated to be as large as 5% of [the national GDP]."[81] The mounting losses put substantial pressure on government revenue, fiscal burdens, and banking stability and were key factors leading to further reforms.[82] Nevertheless, the main goal of dismantling the central planning system in the industrial sector as the first step of moving to a market mechanism was almost complete during the first phase of SOE reform.[83]

The second phase of China's SOE reforms commenced after the historic Southern tour of Deng Xiaoping in 1992.[84] This period was characterized by drastic ownership restructuring, with a focus on reducing the government's holdings of SOE assets through partial or full privatization.[85] The *Decision on Issues Regarding the Establishment of a Socialist Market Economic System* adopted at the Third Plenary Session of the Fourteenth Central Committee of the CCP required SOEs to be "modern enterprises" characterized by "clear property rights, well-defined

75. *See id.* at 434.

76. *See generally id.*

77. NAUGHTON, supra note 55, at 94, 274.

78. Shaomin Li & Shuhe Li, *The Road to Capitalism: Competition and Institutional Change in China*, 28 J. COMP. ECON. 269, 284, 290 (2000); Yuanzheng Cao et al., *From Federalism, Chinese Style to Privatization, Chinese Style*, 7(1) ECON. TRANSITION 103, 118–119 (1999).

79. Gary H. Jefferson, *State-Owned Enterprise: Reform, Performance, and Prospects*, *in* THE SAGE HANDBOOK OF CONTEMPORARY CHINA 121, 128 (Weiping Wu & Mark W. Frazier eds., 2018).

80. Xi Li et al., *A Model of China's State Capitalism* 8 (HKUST IEMS Working Paper No. 2015-12, 2015).

81. Fan Gang & Nicholas C. Hope, *The Role of State-Owned Enterprises in the Chinese Economy*, *in* US-CHINA ECONOMIC RELATIONS IN THE NEXT TEN YEARS, ch. 16, at 5 (2013).

82. Ross Garnaut et al., *Impact and Significance of State-Owned Enterprise Restructuring in China*, 55 CHINA J. 35, 37 (2006).

83. *See* NAUGHTON, *supra* note 55, at 92–93.

84. Xi Li et al., *supra* note 80, at 8.

85. *Id.* at 8–9.

power and responsibility, separation of enterprise from government, and scientific management."[86] In practice, corporatization was seen as a means of achieving the reform goals. The first general Chinese Company Law was enacted in order to provide for the incorporation of SOEs in 1994.[87] Thereafter, newly corporatized SOEs proliferated all over the country.[88] In 1999, the CCP outlined a clear roadmap to transform SOEs into competitive modern corporations.[89] First, a corporate governance structure providing checks and balances between the owner and the manager should be at the core of the enterprise system.[90] Second, whilst a minority of SOEs should remain state monopolies, the rest should actively develop into corporations with multiple equity holders, including non-state equity investment.[91] Third, well-performing SOEs were encouraged to list on domestic or overseas stock markets.[92]

Along with corporatization, central to SOE reforms in the 1990s was the policy of "grasp the big and let the small go" adopted in 1995, a reference to the policy of concentrating the government's resources and control on the larger SOEs in strategic and profitable sectors, while relaxing state control over smaller SOEs and retreating from labor-intensive competitive sectors.[93] The economic logic behind this policy was that the large firms performed much better than the smaller firms and had greater importance in the economy. Many small and medium-sized SOEs were assessed for reorganization, bankruptcy, debt write-offs, merger into partnerships, leasing, contractual operation, or sales.[94]

It is vital to understand that the corporatization of Chinese SOEs did not initially, and to this day does not, implicate the privatization of the

86. Decision on Issues Regarding the Establishment of a Socialist Market Economic System §1 (2) (promulgated by the Cent. Comm. of the Communist Party of China, Third Plenary Session, Nov. 14, 1993) (China).

87. *See* Le-Yin Zhang, *The Roles of Corporatization and Stock Market Listing in Reforming China's State Industry*, 32(12) WORLD DEV. 2031, 2034 (2004).

88. *See id.*

89. Zhonggong Zhongyang Guanyu Guoyou Qiye Gaige He Fazhan Ruogan Zhongda Wenti De Jueding (中共中央关于国有企业改革和发展若干重大问题的决定) [Decision on Several Important Issues Regarding Reform and Development of SOEs], §§ 5(3), 7(3) (promulgated by the Cent. Comm. of Communist Party of China, Fourth Plenary Session, Sept. 22, 1999) (China).

90. *Id.*

91. *Id.*

92. *Id.*

93. Mikael Mattlin, *Chinese Strategic State-Owned Enterprises and Ownership Control*, 4(6) BICCS ASIA PAPER 1, 8 (2010).

94. GREEN & LIU, *supra* note 70, at 1–2.

Chinese economy or its traditional SOEs, much less any withdrawal of the party-state from the corporatized SOEs. This is because even if the incumbent party-state no longer wholly owns 100% of equity interest in most newly corporatized SOEs, it retains a controlling equity interest in many of them.[95] Thus, the corporatization of SOEs leaves the control of the party-state over SOEs largely undisturbed.[96] Still, one research study shows that three-quarters of China's SOEs with 5.7 trillion RMB worth of assets were privatized between 1995 and 2005, making China's privatization by far the largest in human history.[97] China's "corporatization without privatization" SOE reform has the dual effects of reducing the government's cost burden from inefficient SOEs and creating opportunities for POEs to expand.[98] After this round of reform, the state sector shrank dramatically in absolute terms, and their productivity and profitability improved.[99] Nevertheless, Chinese SOEs still lagged behind POEs, and serious efficiency problems persisted. Between 1998 and 2003, about 35 to 39% of SOEs were in debt, about three to four times higher than the private sector.[100] SOEs accounted for virtually all of the state-owned banks' non-performing loans.[101] Further reforms were, therefore, still needed.

The third phase of SOE reforms started in 2003 and focused on restructuring large SOEs and improving their corporate governance.[102] Chinese company law and securities law were revised to achieve more congruence between Chinese law and practice and that of countries with more developed capital markets.[103] One key reform was the establishment of the State Assets Supervision and Administration Commission (SASAC), an ad-hoc, ministerial-level agency operating directly under

95. Nicholas Calcina Howson, *China's 'Corporatization without Privatization' and the Late Nineteenth Century Roots of a Stubborn Path Dependency*, 50 VAND. J. TRANSNAT'L. L. 961, 969–70 (2017).

96. *Id.*

97. Jie Gan et al., *Decentralized Privatization and Change of Control Rights in China*, 31(10) REV. FIN. STUD. 3854, 3859–60 (2018).

98. Garnaut et al., *supra* note 82, at 35–36.

99. Chang-Tai Hsieh & Zheng (Michael) Song, *Grasp the Large, Let Go of the Small: The Transformation of the State Sector in China* 24 (Nat'l Bureau of Econ. Rsch., Working Paper No. 21006, 2015).

100. Song, *supra* note 63, at 354.

101. *See id.*

102. Yongheng Deng et al., *supra* note 67, at 11.

103. *See generally* James V. Feinerman, *New Hope for Corporate Governance in China?*, 191 CHINA Q. 590 (2007).

the State Council, to oversee the management of the SOEs.[104] Prior to the creation of the SASAC, many commentators identified the absence of an ultimate principal as a key problem of Chinese SOEs.[105] Theoretically, the state, on behalf of all the Chinese people, formally owns SOE assets, but it is not readily apparent who represents the state. In reality, control rights and residual cash-flow rights were not clearly defined and invariably dispersed among multiple bureaus, each with different interests to pursue.[106] As a result, no single entity was ultimately responsible for an SOE's performance. The SASAC was primarily designed to fulfill the state's ownership function, combining the administrative functions previously carried out by various government agencies. The Law on State-Owned Assets of Enterprises in 2008 formally recognizes the SASAC as an "investor" and assigns the SASAC the legal rights and duties of a shareholder, holding SOE shares on behalf of the state.[107] As an investor, the SASAC "enjoys an owner's equity rights . . . but does not intervene directly in [SOEs' business] operations, so that the rights of ownership are separated from those of management."[108]

The establishment of the SASAC both centralized and decentralized China's state sector.[109] On the one hand, the principle of local control over local SOEs was clarified and institutionalized by clearly separating central SOEs from provincial and municipal SOEs (local SOEs).[110] Local SOEs are under the direct administration of local government through local SASAC offices.[111] On the other hand, the GOC has emphasized the control of large SOEs in strategic industries.[112] The logic behind the policy is "less is more[,]" i.e., by controlling the most powerful and profitable SOEs in strategic industries, the state can

104. State-owned Asset Supervision and Administration Commission of the Council [SASAC], *What We Do*, http://en.sasac.gov.cn/aboutus.html.

105. Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 499–500 (2003).

106. HONG SHENG & NING ZHAO, CHINA'S STATE-OWNED ENTERPRISES: NATURE, PERFORMANCE AND REFORM 268–69 (2012).

107. Qiye Guoyou Zichan Fa (企業國有資產法) [Law on State-Owned Assets of Enterprises] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009), ch. 2 (China).

108. Chiu & Lewis, *supra* note 57, at 122.

109. MIKAEL MATTLIN, THE CHINESE GOVERNMENT'S NEW APPROACH TO OWNERSHIP AND FINANCIAL CONTROL OF STRATEGIC STATE-OWNED ENTERPRISES 8 (Bank of Fin. Inst. for Economies Transition, Discussion Paper No. 10/2007, 2007).

110. *Id.*

111. *Id.*

112. *Id.*

maintain disproportionate control over profits, investments, and the national economy.[113] Accordingly, the SASAC serves as a unitary holding company for non-financial central SOEs. When the SASAC was established in 2003, 196 central SOEs were under its direct supervision.[114] Under the oversight of SASAC, that number was reduced to 98 by December 2022, as the smaller and less competitive firms were absorbed by the larger ones.[115] Although not large in number, the size and importance of central SOEs to the national economy in many respects surpass that of all the other SOEs combined. In 2021, central SOEs accounted for roughly 33% of total non-financial SOE assets, 55% of sales and 63% of total profits.[116] Out of 98 central SOEs, 49 were shortlisted for the Fortune Global 500 in 2021.[117] They also make the SASAC "the world's largest [controlling] shareholder."[118]

The SASAC also has a broad mandate that includes drafting regulations on the management of SOE assets, preserving and enhancing the value of state-owned assets, appointing and removing executives of SOEs under its supervision, and pushing forward further reforms of SOEs.[119] Although there have been doubts over whether the SASAC is always able to exercise its authority effectively,[120] the SASAC is a powerful state agency, and since its establishment, the SASAC has been pushing forward SOE reforms aggressively.[121] Under the SASAC's watch, China's state sector has become much more centralized and dominated by large SOEs. Despite the overall shrinking of the state sector, SASAC has been fairly successful in stabilizing large SOEs, drastically

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113. *Id.* at 45.

114. *Id.* at 44.

115. *List of Central SOEs*, SASAC (Dec. 31, 2022), http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html.

116. Ministry of Finance of the PRC, *Economic Performance of State-Owned and State-Controlled Enterprises in 2021* (Jan. 27, 2022), http://zcgls.mof.gov.cn/qiyeyunxingdongtai/202201/t20220126_3785083.htm; *see also* Guowuyuan Guanyu 2021 Niandu Guoyou Zichan Guanli Qingkuang De Zhonghe Baogao (国务院关于2021年度国有资产管理情况的综合报告) [Comprehensive Report on the Management of State-Owned Assets in 2021], State Council, http://www.sasac.gov.cn/n2588025/n2588119/c26496596/content.html.

117. *49 Central SOEs and 33 Local SOEs are Listed in the Fortune Global 500, State Council of the PRC*, SASAC (Aug. 2, 2021), http://www.gov.cn/xinwen/2021-08/02/content_5629061.htm.

118. JAMES MCGREGOR, NO ANCIENT WISDOM, NO FOLLOWERS: THE CHALLENGES OF CHINESE AUTHORITARIAN CAPITALISM 67 (Prospecta Press 2012).

119. *Main Functions and Responsibilities of SASAC*, SASAC (July 17, 2018) http://en.sasac.gov.cn/2018/07/17/c_7.htm.

120. CARL E. WALTER & FRASER J. T. HOWIE, RED CAPITALISM: THE FRAGILE FINANCIAL FOUNDATION OF CHINA'S EXTRAORDINARY RISE 189–91 (2012).

121. Song, *supra* note 63, at 356–58.

improving their profitability, and growing their assets.[122] As a result, the average size of SOEs by assets and sales increased significantly.[123] In particular, central SOEs have developed into a powerful and profitable economic force, representing the core of state capitalism in China.

2. SOE Reforms in the Xi Jinping Era (2013-Present)

The fourth and most recent phase of SOE reforms has started from the third plenum of the 18th CCP Congress held in November 2013 until now.[124] In this "Xi Jinping era," the Chinese central authorities laid out important directions for reforming SOE governance and operation structure, including 1) defining the functions of SOEs to determine levels of state ownership and control; 2) promoting mixed ownership with cross-holding between state-owned capital and private capital; 3) shifting from state-owned asset management to state-owned capital management; and 4) improving corporate governance of SOEs.[125] The core document guiding the overhaul of SOEs issued in 2015, *Guiding Opinions on Deepening the Reform of SOEs* (the "One"), is supplemented by a wide range of supporting policies (the "N"). The comprehensive and thorough Chinese SOE reform in the fourth phase of Chinese SOE reforms has been guided by the "One Plus N" policy framework.[126]

First, Chinese SOEs were classified as commercial SOEs and public service SOEs.[127] Commercial SOEs are further divided into SOEs in fully competitive sectors and SOEs in strategic sectors (i.e., key industries related to national security and national economic lifelines).[128] Commercial SOEs should stick to commercial operations and aim

122. Barry Naughton, *The Transformation of the State Sector: SASAC, the Market Economy, and the New National Champions*, *in* STATE CAPITALISM, INSTITUTIONAL ADAPTATION AND THE CHINESE MIRACLE 46, 49 (Barry Naughton & Kellee S. Tsai eds., Cambridge Univ. Press 2015).

123. *Id.*

124. Karen Jingrong Lin et al., *State-Owned Enterprises in China: A Review of 40 years of Research and Practice*, 13(1) CHINA J. ACCT. RES. 31, 39 (2020).

125. Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, Eighteenth Central Comm., Third Plenary Session (promulgated by the Cent. Comm of the Communist Party) (Nov. 12, 2013) (China).

126. Karen Jingrong Lin et al., *supra* note 124, at 38–39.

127. Notice of the SASAC, the Ministry of Finance, and the National Development and Reform Commission on Issuing the Guiding Opinions on Functional Definition and Classification of SOEs (promulgated by the SASAC, Dec. 7, 2015) (China) [hereinafter Notice of the SASAC].

128. *Id.*

to increase state-owned assets, while public service SOEs exist to improve people's quality of life and provide public goods and services. Accordingly, different levels of state ownership and control, growth strategies, regulations, and evaluations are outlined based on the classification of SOEs. For instance, commercial SOEs in fully competitive sectors will be evaluated according to financial performance metrics, including profitability and market competitiveness.[129] Commercial SOEs in strategic sectors, in contrast, will be evaluated not only in terms of their business performance indicators but also on their efforts to serve important national strategies, safeguard national security and the operation of the national economy, develop forward-looking strategic sectors, and complete specially assigned tasks.[130] Public service SOEs, primarily local utilities, will be evaluated by their cost control ability, quality of goods and services, and the stability and efficiency of their operations.[131] Political logic as opposed to market mechanism will, therefore, remain important in strategic and public service SOEs.[132] It was reported that the classification process has been completed for all central SOEs and almost completed for local SOEs by the first quarter of 2021.[133] Yet, there has been very little information released about how many firms fall into each category or which firms they are.

Second, the purpose of the mixed ownership reform (MOR) is to bring private-sector investment and management into SOEs to improve the efficiency and governance of the state sector.[134] It also encourages SOEs to take stakes in POEs.[135] Although the MOR has been one of the top priorities for SOE reforms since 2013,[136] the idea is actually not new. The corporatization in the 1990s created not only SOEs wholly owned by the state but also mixed-ownership firms, where the ownership and management of the firms were shared among state and private shareholders.[137] In fact, some of the best-known Chinese firms, such as

129. *Id.*

130. *Id.*

131. *See id.*

132. Song, *supra* note 63, at 362.

133. Liu Zhiqiang, *State-Owned Enterprises Will Deepen Reform by Functional Classification*, PEOPLE'S DAILY (Apr. 29, 2021, http://en.people.cn/n3/2023/0202/c90000-10202350.html.

134. Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State Owned Enterprises § 16 (promulgated by the CENT. COMM. & STATE COUNCIL, Aug. 24, 2015) (China).

135. Curtis J. Milhaupt & Wentong Zheng, *Why Mixed Ownership Reforms Cannot Fix China's State Sector*, PAULSON POL'Y INST. 1 (2016), https://www.paulsoninstitute.org/wp-content/uploads/2017/01/PPM_SOE-Ownership_Milhaupt-and-Zheng_English_R.pdf.

136. *Id.*

137. *Id.*

Haier and Lenovo, are mixed-ownership firms.[138] Mixed ownership had also become a significant ownership form among the subsidiary corporations of some of China's central SOEs even before the new round of SOE reforms.[139]

The MOR adopted policies tailored to specific sectors. Commercial SOEs in fully competitive sectors shall actively attract other state capital and non-state capital to diversify equity, and state capital may take only a minority position.[140] In contrast, state capital should maintain the position as the controlling or sole shareholder in strategic and public service SOEs and encourage non-state capital to become minority shareholders.[141] A significant example of the MOR was the share sale plan for China Unicom, China's second-largest telecom carrier.[142] It was announced in August 2017 that it would sell US$11.6 billion in shares worth 35% of its Shanghai-listed subsidiary to a group of fourteen private and state investors, including tech giants Alibaba, Baidu, Tencent, and JD.com.[143] The sale saw China Unicom's stake in the listed subsidiary drop from 63% to 37%,[144] but it was still the largest shareholder. The MOR also led to the expansion of the board of directors to 13 members, among which three are appointed by China Unicom, five by strategic investors, and five by independent directors.[145] Likewise, China's Zhuhai government sold in 2019 a 15% stake in Gree Electric, China's largest air conditioners maker.[146] After the sale, Gree Electric's ownership structure was changed from being state-controlled to privately controlled.[147] By the end of 2020, more than 70% of central SOEs and 54% of local SOEs had completed the MOR.[148]

138. *Id.* at 4.

139. *Id.*

140. *See* Notice of the SASAC, *supra* note 127.

141. *Id.*

142. Eric Ng, *China Unicom Gets Funding and Stake Boost from Parent in "Mixed Ownership Reform,"*, S. CHINA MORNING POST (Aug. 23, 2017), https://www.scmp.com/business/companies/article/2107875/china-unicom-gets-funding-and-stake-boost-parent-mixed-ownership.

143. *Id.*

144. *Id.*

145. CHINA UNICOM, SOCIAL RESPONSIBILITY REPORT OF 2018: BUILD THE "FIVE NEW" CHINA UNICOM 7 (2019).

146. Fan Feifei, *Gree Electric Steps on Reform Pedal*, CHINA DAILY (Dec. 4, 2019), https://www.chinadaily.com.cn/cndy/2019-12/04/content_37527500.htm.

147. *Id.*

148. *See The number of central enterprises with mixed ownership accounts for more than 70%*, SASAC (Jan. 21, 2021), http://english.scio.gov.cn/pressroom/node_8031542.htm.

Third, the role of the SASAC at the central and local levels will shift from "asset management" to "capital management." The SASAC was ordered not to interfere with the day-to-day management of SOEs at the firm level, and a wide range of powers were given back to SOEs to ensure their autonomy.[149] Specifically, two types of investment holding companies, state capital investment companies and state capital operation companies, were established under the auspices of the SASAC or directly under the government to serve as the state shareholder in SOEs.[150] State capital investment companies would mainly invest in sectors relating to national security or the commanding heights of the national economy.[151] Such investments would be in the form of controlling stakes and aim to improve the control and influence of state-owned capital.[152] By comparison, state capital operation companies would mainly aim to improve the efficiency of state-owned asset allocation.[153] Modeled on Singapore's Temasek, state capital operation companies are expected to serve as financial investors with the view to maximizing the value of state assets.[154] Both state capital investment and operation companies are authorized to perform the role of the shareholder and participate in the governance of the SOEs in which they invested through nominating directors and supervisors and voting in shareholders' meetings. However, they would not intervene in the daily operations of the SOEs.[155] The SASAC, in turn, will become the state shareholder in such state capital investment or operation companies. The rationale for creating such state capital companies is to further shield SOEs from the SASAC so as to stop the "tendency for [the] SASAC to become increasingly involved in the business operation of SOEs."[156]

149. Guowuyuan Guozi Wei Shouquan Fangquan Qingdan (国务院国资委授权放权清单) [*SASAC List on Power Authorization and Release*], *SASAC* (June 3, 2019), www.sasac.gov.cn/n2588030/n2588924/c11421043/content.html.

150. Guowuyuan Guanyu Tuijin Guoyou Ziben Touzi, Yunying Gongsi Gaige Shidan De Shishi Yijian (国务院关于推进国有资本投资，运营公司改革试点的实施意见) [Implementation Opinions on Advancing the Pilot Program of the Reform of State Capital Investment and Operation Companies] (promulgated by St. Council, July 14, 2018) (China) [hereinafter State Council Opinions].

151. *See id.*

152. *See id.*

153. *See id.*

154. Weijie Nicholas Ng, *Comparative Corporate Governance: Why Singapore's Temasek Model is Not Replicable in China*, 51 N.Y.U. J. INT'L L. & POL. 211, 213 (2018).

155. State Council Opinions, *supra* note 150.

156. Jiangyu Wang & Tan Cheng-Han, *Mixed Ownership Reform and Corporate Governance in China's State-Owned Enterprises*, 53(3) VAND. J. TRANSNAT'L. L. 1055, 1067–68 (2020).

Nineteen central SOEs were selected as state capital investment companies and only two central SOEs as state capital operation companies for a pilot reform by July 2022.[157] It was also reported that SASAC had decided not to expand the existing pilot program for state capital operation companies.[158] It is the latest sign that efforts to boost efficiency and profitability are taking a back seat to ensuring that central SOEs support government macroeconomic and industrial policies. While SASAC has been cautious in transforming central SOEs into state capital investment and operation companies, local SASACs have established more than 140 state capital investment and operation companies nationwide by November 2018.[159]

Fourth, another key point of the SOE reforms since 2013 is the call for ongoing government-directed mergers to make SOEs "stronger, better and bigger."[160] The consolidation of SOEs is motivated by both economic and political factors. Economically, it would improve SOEs' performance by eliminating unprofitable SOEs, cutting excess industrial capacity and overlapping investment, minimizing competition among SOEs, and increasing economies of scale.[161] Moreover, the consolidation would create more competitive national champions abroad with increased size and market share.[162] Politically, SOE consolidation would increase state control over the economy.[163]

However, the government-directed merger of SOEs is a double-edged sword. The creation of overly large SOEs is likely to strengthen their administrative monopoly status that leads to stronger pricing powers and less external pressure to improve quality and services. It

157. Zhou Lei, *From Managing Enterprises to Managing Capital: The Reform of State Capital Investment Companies Made Progress*, ECON. DAILY (July 8, 2022), http://www.xinhuanet.com/2022-07/08/c_1128813638.htm.

158. Gabriel Wildau, *China Rejects Singapore Model for State-Owned Enterprise Reform*, FIN. TIMES (July 20, 2017).

159. Kerry Liu, *China's State-Owned Enterprises Reform Since 2013*, 20 EUR. J. E. ASIAN STUD. 367, 378 (2021).

160. Frank Tang, *Xi Jinping Calls for China's State-Owned Enterprises to be 'Stronger and Bigger,' Despite US, EU Opposition*, S. CHINA MORNING POST (Nov. 3, 2020). https://www.scmp.com/economy/china-economy/article/3108288/xi-jinping-calls-chinas-state-owned-enterprises-be-stronger.

161. SEAN O'CONNOR, U.S.- CHINA ECON. SEC. REV. COMM'N, SOE MEGAMERGERS SIGNAL NEW DIRECTION IN CHINA'S ECONOMIC POLICY 3 (2018).

162. *Id.*

163. *Id.* at 6.

may also amplify the ills of SOEs—"inefficient operations, communication gaps, and weak oversight."[164] The lack of competition in the domestic market may also endanger the global competitiveness of SOEs in the long run.[165]

A significant example of SOE megamergers was the merger of China's two state-owned railway companies, China South Locomotive and Rolling Stock Corporation (CSR Corp) and China North Locomotive and Rolling Corporation Limited (CNR Corp), resulting in the creation of China Railway Rolling Stock Corporation (CRRC), now the world's largest train builder and second-largest industrial company. The merger was intended to end the price war between CSR Corp and CNR Corp in the overseas market and to increase the competitiveness of Chinese high-speed trains in the global market.[166] Other examples include a merger between Shenhua Group (China's largest coal miner) and Guodian Group (one of China's largest power generation companies) in August 2017. The new company, China Energy Investment Corp., has become the world's largest power company, with assets totaling $278 billion.[167] Likewise, the merger between Baosteel and its rival Wuhan Iron and Steel in 2016 created the world's second largest steelmaker with an annual production capacity of around 70 million tons.[168]

Finally, one unprecedented initiative in the new round of SOE reforms was to strengthen and institutionalize the role of the CCP in SOE governance. "To counterbalance the potential loss of [P]arty control over the state sector accompanying an increase in private-capital investment."[169] All Chinese SOEs, including those listed on stock markets, were mandated to incorporate the CCP's leadership role into

164. Wendy Leutert, *Challenges Ahead in China's Reform of State-owned Enterprises*, 21 ASIA POL. 83, 89–90 (2016).

165. Song, *supra* note 63, at 363.

166. Tom Mitchell, *China Railway Strategy Goes off Track*, FIN. TIMES (Dec. 23, 2014), https://www.ft.com/content/1b72fba0-875e-11e4-8c91-00144feabdc0.

167. Josephine Mason & Meng Meng, *China Set to Create World's Top Utility with Latest Government Merger*, REUTERS (Aug. 28, 2017), https://www.reuters.com/article/us-china-power-shenhua-guodian-idUSKCN1B80UG.

168. Peggy Sito, Celine Ge & Sidney Leng, *Baoshan, Wuhan to Merger to Create World's Second-largest Steel Producer*, S. CHINA MORNING POST (Sept. 22, 2016), https://www.scmp.com/business/companies/article/2021668/shanghai-baosteel-wuhan-given-green-light-form-chinas-biggest.

169. Lauren Yu-Hsin Lin & Curtis J. Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance*, 50 J. LEGAL STUD. 187, 193 (2021).

their articles of association.[170] The Constitution of the CCP was revised in October 2017, which specified that the party committee of SOEs "shall play a leadership role, set the right direction, keep in mind the big picture, ensure the implementation of [p]arty policies and principles, and discuss and decide on major issues" of SOEs.[171] The campaign to strengthen the party leadership in SOEs is further institutionalized in the Trial Regulation on the Work at Primary-Level Party Organization of SOEs issued by the CCP Central Committee in December 2019.[172] The board of directors must hear the opinions of the party committee before deciding on important issues.[173] The chairperson of the board of directors should ordinarily be the party secretary of an SOE.[174] A cross-appointment system was introduced to ensure that SOEs' party committee members are appointed to key positions and hold decision-making power.[175] The formalized role of the CCP in SOE governance has closed the gap between SOEs' corporate management and the CCP's strategic goals.[176]

To further implement SOE reforms discussed above, the SASAC has unveiled a "Three-year Action Plan for SOE Reforms (2020 to 2022)," setting out a clear roadmap as well as specific targets to meet.[177] Based on a series of performance indicators, Chinese SOEs have become stronger after the recent round of SOE reforms. They are now much less leveraged compared to the leverage level before 2016.[178] The shrinking trend of SOEs, both in numbers and the proportion of SOEs' assets in the industrial sector, has been reversed and stabilized.[179]

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170. Jennifer Hughes, *China's Communist Party Writes Itself into Company Law*, FIN. TIMES (Aug. 14, 2017), https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd.

171. XIANFA art. 33 (2017) (China).

172. *See* Zhongguo Gongchandang Guoyou Qiye Jiceng Zuzhi Gongzuo Tiaoli (中国共产党国有企业基层组织工作条例) [The Trial Regulations on the Work at Primary-Level Party Organization of SOEs], CCP Central Committee (Dec. 30, 2019) [hereinafter Trial Regulations].

173. *Id.* art. 15.

174. *Id.* art. 14.

175. *Id.* art. 14, 15.

176. Jude Blanchette, *From "China Inc." to "CCP Inc.": A New Paradigm for Chinese State Capitalism*, 66 CHINA LEADERSHIP MONITOR 7 (2020).

177. Frank Tang, *China Approves Plan to Boost Prominence of State Firms, Despite Complaints from Trade Partners*, S. CHINA MORNING POST (July 8, 2020), https://www.scmp.com/economy/china-economy/article/3092339/china-approves-plan-boost-prominence-state-firms-despite.

178. *See* Liu, *supra* note 159, at 387.

179. *Id.* at 387–88.

C. *Chinese SOEs and the Chinese Party-State*

Throughout most of the history of China's SOE reforms, the predominant concerns of Chinese policymakers were their low efficiency and low incentives for their managers. SOE reforms were therefore focused on improving their performance and profitability.[180] Precisely for this reason, China's SOE reforms were premised on the separation of the Party state's political functions from SOEs' business management. The government has been ordered to retreat from SOE governance, not interfere with the day-to-day management at the firm level, and make SOEs independent market entities.[181] However, when SOEs have become vastly more profitable, Chinese policymakers are expecting SOEs to be the spearhead of China's development objectives, pioneering technological advances, maintaining macroeconomic stability, and implementing major government strategies such as the BRI.[182] At the same time, while the GOC has been retreating from interfering in SOE management and more autonomy was granted to SOEs, the CCP has institutionalized its control of SOEs.[183] Xi Jinping openly asserted that party leadership and strengthening party building are the "root and soul" of Chinese SOEs and that SOE executives shall bear in mind that their role and responsibility is to work for the party.[184] The tenet of Chinese SOE reforms is succinctly described as the Party's leadership over SOEs is a major political principle; it must be steadfastly upheld. The establishment of a modern enterprise system is the direction of SOE reform; it also must be steadfastly upheld.[185]

To be sure, the overall SOE policy under Xi, in many aspects, exhibits a deepening of pre-existing trends rather than a decisive departure.[186] The core goal of molding SOEs to be both competitive in the market and observant of the Party line has remained consistent in the Xi Era. Still, the scale of institutionalizing, legalizing, and enhancing the Party's role in SOEs' corporate governance is unprecedented, which

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180. To be sure, the focus on profitability did not entirely exclude other objectives for SOEs. The point is that profitability and performance were central goals that overrode all other objectives when SOEs were in a critical condition.

181. *See* Yang Yao, *The Political Economy Causes of China's Economic Success*, *in* CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT 1978–2018 75, 84 (Ross Garnaut et al. eds., 2018).

182. Naughton, *supra* note 35, at 379.

183. Wang & Cheng-Han, *supra* note 156, at 1093–95.

184. Xinhua, *Xi Stresses CPC Leadership of State-Owned Enterprises*, CHINA DAILY (Oct. 12, 2016), https://www.chinadaily.com.cn/china/2016-10/12/content_27035822.htm.

185. *Id.*

186. Leutert & Eaton, *supra* note 33, at 217.

some termed as "party-state capitalism" or the "politicization of corporate governance."[187]

While strengthening the Party's leadership role may help limit opportunistic behavior and decrease mismanagement in the SOEs,[188] the fundamental challenge of this new approach is that there are important contradictions and tensions among the objectives. On the one hand, SOEs are facing increasing Party control and more political and developmental missions. On the other hand, they want to increase motivation, improve corporate governance, and promote financial flexibility.[189] This leads to the situation where "Not only must managers scramble to meet multiple inconsistent targets[,] they must also use the trade-off among targets to deflect demands for rigorous profit maximization."[190] In China's institutional context, the principle of party leadership would inevitably assign much greater weight to safeguarding the Party-state's interests rather than to the principle of corporate governance, such as maximizing shareholder value when facing conflicts.[191] To understand the behavioral logic of Chinese SOEs in both national and international markets, it is enlightening to look closely at how the Chinese Party-state exercises authority over Chinese SOEs.

One key tool for the CCP to ensure its control over SOEs is "personnel power," the authority to appoint, evaluate, rotate, and remove SOEs' top management.[192] The leaders of SOEs are appointed in accordance with a highly institutionalized cadre management system to ensure the principle of "absolute control of the (SOE) executives by the Party."[193] By directly managing SOE executives' careers, the Party shapes managerial incentives and, in turn, influences the corporate behavior of China's SOEs. In practice, the executives of Chinese SOEs face two sets of incentives in promoting their careers.[194] On the one hand, they want the SOEs they manage to be profitable because their

187. Margaret Pearson, Meg Rithmire & Kellee S. Tsai, *Party-State Capitalism in China* 6 (Harvard Bus. Sch., Working Paper No. 21-065, 2020); Tamar Groswald Ozery, *The Politicization of Corporate Governance: A Viable Alternative?*, 70 AM. J. COMP. L. 49 (2022).

188. Ozery, *supra* note 187, at 48.

189. Naughton, *supra* note 35, at 378.

190. *Id.*

191. Zhang, *supra* note 7, at 58–61.

192. *See* Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65(4) STAN. L. REV. 697, 737–43 (2013); RICHARD MCGREGOR, THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS 69 (2011).

193. Xi Jinping, *supra* note 49.

194. Ming Du, *China's State Capitalism and World Trade Law*, 63 INT'L & COMP. L.Q. 409, 419 (2014).

evaluation and promotion will be partly based on the financial performance of the firms they manage.[195] On the other hand, their career successes are ultimately determined by the CCP, which is more concerned with how well the SOE executives carry out the goals of the party-state.[196] These dual criteria normally align. Empirical evidence shows that better economic performance makes it less likely for a core central SOE leader to leave his executive post and more likely to transfer to another central SOE or government jobs.[197] However, different from their Western counterparts, who stand at the top of the corporate hierarchy and rely on the active labor market for executive career opportunities, top executives in Chinese SOEs have limited opportunities outside the state apparatus.[198] But they have ample upward potential in the political arena through being appointed to the senior party leader or government official positions, which would allow them to climb up the political ladder in the Party-state hierarchy, bringing them more prestige and a higher political status.[199] Consequently, when financial and state goals are in conflict, the incentives SOE executives face tend to push them to choose state interests over financial interests of the firm and other non-state shareholders.[200]

Another key mechanism for the CCP to exercise its authority over SOEs is by institutionalizing Party committees' leadership role in SOE corporate governance. Previously, there was an implicit division of labor between SOE Party committees and formal corporate governance institutions prescribed in Chinese Company Law, such as the shareholder meeting, the board of directors, and the supervisory board.[201] As the "political core" of SOEs, SOE Party committees focused mainly on political, social, and personnel matters, such as selecting and evaluating senior personnel, recruiting Party members, circulating political

195. *Id.*

196. *Id.*

197. Wendy Leutert & Samantha A. Vortherms, *Personnel Power: Governing State-Owned Enterprises*, 23 BUS. & POL. 419, 434–35 (2021).

198. *See id.* at 422–423 (finding that "[i]t is extremely rare for core central SOE leaders to cross over to the private sector" after their exit).

199. *See* Xiaping Cao et al., *Political Promotion, CEO Incentives, and the Relationship Between Pay and Performance*, 65(7) MGMT. SCI. 2947, 2949 (2019).

200. ANDREW SZAMOSSZEGI & COLE KYLE, U.S.- CHINA ECON. & SEC. REV. COMM'N, AN ANALYSIS OF STATE-OWNED ENTERPRISES AND STATE CAPITALISM IN CHINA 79 (2011); Yang Ruilong et al., *The Promotion Mechanism of 'Quasi-officials': Evidence from Chinese Central Enterprises*, 3 MGMT. WORLD 23–33 (2013).

201. *See* Wendy Leutert, *Firm Control: Governing the State-Owned Economy under Xi Jinping*, CHINA PERSPS. 27, 30–31 (2018).

propaganda materials, and organizing study sessions.[202] The board of directors led commercial decision-making with shareholder input and supervisory board oversight.[203] The objective was to expand the autonomy of SOE management for company decision-making and increase operational efficiency.[204] Later the principle of SOEs' Party committee having input on issues involving the "three majors and one large," i.e., major corporate decisions, major personnel appointment and dismissal, major projects, and large amounts of capital operation, was established in 2010.[205] Yet institutionalization and implementation of the principle were left to the discretion of individual SOEs.[206] By contrast, the new round of SOE reforms specifies that the Party committee in the SOEs serves a "leadership core" function as well as a "political core" function.[207] An SOE's Party committee has the authority to deliberate and discuss major issues concerning the reform, development, and stability of the firm, as well as major operational and managerial issues.[208] The board of directors shall first listen to the opinions of the Party committee before deciding on major issues.[209]

Other paths for the party to exert control over SOEs include bureaucratic design and disciplinary enforcement, such as anti-corruption campaigns.[210] The strengthening of the party's leadership role in SOEs entails several profound implications. To begin with, there is a risk that the oversight functions of conventional internal governance mechanisms, such as the board of directors, the supervisory board, and independent directors, are being supplanted by political incentive mechanisms and party committees that are deployed within the SOEs. For instance, official party documents have repeatedly stressed that as a critical step to improve the modern enterprise system, "it is vital to effectively enforce and safeguard the lawful exercise of the rights to make material decisions, select and appoint personnel [and] distribute

202. *Id.*

203. *Id.*

204. *Id.*

205. Guowuyuan Guanyu Jinyibu Tuijin Guoyou Qiye Guanche Luoshi Sanchong Yi Da Juece Zhidu De Yijian (国务院关于进一步推进国有企业贯彻落实"三重一大"决策制度的意见) [Opinions on Further Promoting the State-Owned Enterprises' Implementation of the Decision-making System for "Three Majors and One Large"] (promulgated by St. Council, July 15, 2010) (China) [hereinafter State Council "Three Majors and One Large"Opinions].

206. Leuert & Eaton, *supra* note 33, at 208 n.43 ("Party authorities . . . explicitly granted each firm and Party committee discretion").

207. Leutert, *supra* note 201, at 31.

208. Trial Regulations, supra note 172, at art. 15.

209. *Id.*

210. Leutert & Eaton, *supra* note 33, at 210, 215.

remunerations."[211] Now with both the board of directors and the party committee prescribed to be the decision-making bodies in the SOEs, the obvious challenge is how to divide the power between the two to ensure that the party committee's involvement in the decision-making process will not undermine the power of the board of directors to make independent decisions. Moreover, bolstering the party Committee's leadership role risks undermining the MOR of SOEs because it underscores the party state's willingness to subordinate commercial objectives to political imperatives.[212] It will further exacerbate POEs' concerns about how their interests as minority shareholders would be protected as their stake in SOEs is unlikely to grant them real power.[213] Finally, given that SOEs are the main players in implementing China's "go out" strategy, the move to strengthen party control of SOEs will exacerbate the rising perception that SOEs are simply the Chinese party-state's policy instruments to exercise governmental functions and implement government strategies.[214]

D. *The Porous Boundary of SOEs and Privately-Owned Enterprises in China*

The international trade and investment regimes frequently draw a stark distinction between SOEs and POEs. Since SOEs are controlled by the state, they are widely believed to be uniquely positioned to capture state-generated rents such as privileged market access, receipt of state subsidies, and *de facto* exemption from competition laws. POEs, by contrast, are often idealized as insulated from government intervention.[215] Consequently, extra trade and investment disciplines are considered necessary to ensure competitive neutrality between SOEs and POEs.[216] However, the formalistic distinction between SOEs and large successful POEs tends to break down in the institutional environment

211. Guowuyuan Guanyu Shenhua Guoyou Qiye Gaigede Zhidao Yijian (国务院关于深化国有企业改革的指导意见) [Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises] (promulgated by the Cen. Comm. Cmty. Party of China & St. Council, effective Aug. 24, 2015) (China).

212. Leutert & Vortherms, *supra* note 197, at 31–32.

213. Song, *supra* note 63, at 362.

214. *See* Gordon & Milhaupt, *supra* note 18, at 212–22.

215. *See* Asmund Rygh & Gabriel R. G. Benito, *Governmental goals and the international strategies of state-owned multinational enterprises: a conceptual discussion*, 26 J. MGMT. & GOVERNANCE 1155, 1159 (2022) ("[I]t is usually assumed that SOEs pursue non-financial goals besides or instead of the financial goals that are purportedly pursued by POEs in general.").

216. Yuri Shima, *The Policy Landscape for International Investment by Government-Controlled Investors: A Fact-Finding Survey* 15 (OECD, Working Paper No. 2015/01, 2015).

in China.[217] With a long tradition of state dominance in the economy, underdeveloped legal institutions, relatively inchoate conceptions of property rights, and omnipresent party leadership,[218] the party-state enjoys fairly extensive informal control rights over POEs, even in the absence of state ownership. Indeed, large POEs, similar to large SOEs, survive and prosper precisely because they have fostered connections to state power and have succeeded in obtaining state-generated rents.[219]

Empirical evidence has shown the value of political connections to Chinese POEs. For example, it was difficult for even large and profitable but less politically-connected firms to list shares on Chinese stock exchanges through initial public offerings.[220] These good firms were forced to go public through reverse mergers, an unconventional and much more costly route to access public financing.[221] Likewise, politically connected POEs were more likely to win commercial lawsuits in Chinese courts and obtain loans from state-owned banks.[222] It is also not unusual for large, successful POEs to receive state subsidies. For example, Huawei is legally an independent, privately held company.[223] Huawei's shares are held by its employees through an Employee Stock Ownership Plan.[224] Yet it was reported that Huawei had access to as much as $75 billion in tax breaks, financing, and cheap resources from the GOC as it grew to the world's largest telecommunications equipment company.[225] More revealingly, while the party-building amendments to corporate charters are mandatory for SOEs in the new round of SOE reform, the policy is not even directed at private firms.[226] Nevertheless, "almost 6[%] of listed POEs amended their charters to include some type of party-building provisions . . . from 2015 through 2018" as a means of signaling loyalty to the CCP.[227]

217. Pearson, Rithmire & Tsai, *supra* note 187, at 14–20.

218. Milhaupt & Zheng, *supra* note 32, at 671.

219. *Id.* at 668.

220. Charles M. C. Lee et al., *Going Public in China: Reverse Mergers Versus IPOs*, 58 J. CORP. FIN. 92, 93 (2019).

221. *Id.*

222. Haitian Lu, Hongbo Pan & Chenying Zhang, *Political Connectedness and Court Outcomes: Evidence from Chinese Corporate Lawsuits*, 58 J. L.& ECON. 829, 830 (2015); Hongbin Li et al., *Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms*, 87 J. DEV. ECON. 283, 284 (2008).

223. Huawei, Corporate Fact Sheet, https://www.huawei.com/en/facts/question-answer/who-owns-huawei.

224. *Id.*

225. Chuin-Wei Yap, *State Support Helped Fuel Huawei's Global Rise*, WALL ST. J. (Dec. 25, 2019).

226. *See* Lin & Milhaupt, *supra* note 192, at 189.

227. *Id.*

Consequently, as Milhaupt and Zheng observed, "[f]unctionally, SOEs and large POEs in China share many similarities in the areas commonly thought to distinguish state-owned firms from privately owned firms: market access, receipt of state subsidies, proximity to state power, and execution of the government's policy objectives."[228] To be sure, the claim is not that corporate ownership is completely irrelevant in China or that Chinese POEs are identical in all respects to SOEs but that the relationship between POEs and the GOC is complex, shifting, and variegated with respect to the level and quality of governmental intrusion, and that the boundary between SOEs and POEs is sometimes blurred in China's weak institutional setting.

III. The Challenges of Chinese SOEs to International Investment Law

The rise of Chinese SOEs' OFDI presents host countries with a vexing policy dilemma. On the one hand, the influx of foreign capital would bring much-needed new capital and job growth that would have positive economic and political ramifications to host countries.[229] On the other hand, due to their political ties with the GOC and concentration in strategic sectors, Chinese SOEs' OFDI can raise genuine concerns about fair competition, reciprocity, and national security from the perspective of host countries.[230] As discussed below, some concerns about Chinese SOEs' OFDI are overblown and not borne out by empirical evidence. It is, therefore, important to sort fact from fiction.

A. *Unfair Competition*

It is frequently claimed that SOEs may benefit from undue advantages which are unavailable to POEs. These advantages may include direct or indirect financial benefits, insulation from the full force of law enforcement in host countries because of sovereign immunity, and the existence of a protected source of revenue in the home market which allows for cross-subsidization and more risk-taking in overseas investments.[231] Indeed, much of the public criticism of Chinese SOEs alleges that foreign investors are placed on an unequal footing in both China's

228. Milhaupt & Zheng, *supra* note 32, at 668.

229. Organization for Economic Co-operation and Development [OECD], *Foreign Direct Investment for Development: Maximizing Benefits, Minimizing Costs* 9–18 (20020, https://www.oecd.org/investment/investmentfordevelopment/1959815.pdf.

230. *See* Ming Du, *When China's National Champions Go Global: Nothing to Fear but Fear itself?*, 48 (6) J. World Trade 1127, 1135–1150 (2014).

231. OECD, *supra* note 17, at 55–57.

domestic market as well as markets around the world when they compete with Chinese SOEs.[232]

The challenge is most severe in China's domestic market itself, as measures taken by the GOC to protect its SOEs have altered the competitive landscape for POEs and FIEs, particularly in high-tech and strategic industries.[233] The next frontier is the global market. As part of the scheme to support the "Go Out" strategy, the GOC has offered a range of financial and non-financial assistance to encourage the overseas expansion of Chinese SOEs.[234] The financial support takes a number of different forms, including access to loans below market rates, government special funds, direct capital contributions, and subsidies associated with the official aid programs.[235] The funds may come either from government ministries, such as the Ministry of Finance (MOF) and the National Development and Reform Commission (NDRC), or China's state-owned policy banks, such as China Development Bank (CDB) and China Export and Import Bank (Exim Bank), or even state-owned commercial banks.[236] For instance, China National Chemical Corporation (ChemChina), a central enterprise under the direct supervision of the SASAC, acquired Pirelli via its subsidiary China National Tyre and Rubber Company (CNRC) in 2015.[237] As CNRC did not have sufficient own funds to finance the acquisition, it benefited from financial support from the GOC and other state-owned financial institutions, including:

232. *See generally* Elizabeth J. Drake, *Chinese State-Owned and State-Controlled Enterprises: Policy Options for Addressing Chinese State-Owned Enterprises: Before the US-China Economic and Security Review Commission* (2012) (testimony of Elizabeth J. Drake, Partner, L. Off. of Stewart & Stewart); for an example of a Chinese SOE's reliance on subsidized loans, see Gary Hufbauer et al., *Investment Subsidies for Cross-border M&A: Trends and Policy Implications* 3–4 (United States Council Found./ Occasional Paper No. 2, 2008).

233. EUR. CHAMBER OF COMM. IN CHINA, CHINA MANUFACTURING 2025: PUTTING INDUSTRIAL POLICY AHEAD OF MARKET FORCES 16–20 (2017); ALICIA GARCÍA-HERRERO & GARY NG, CHINA'S STATE-OWNED ENTERPRISES AND COMPETITIVE NEUTRALITY 11–14 (Bruegel Pol'y Contribution, No. 05/21, 2021).

234. Victor Crochet & Vineet Hedge, *China's "Going Global" Policy: Transnational Production Subsidies under the WTO SCM Agreement*, 23 J. INT'L ECON. L. 841, 844–45 (2020).

235. Organization for Economic Co-operation and Development [OECD], CHINA: ENCOURAGING RESPONSIBLE BUSINESS CONDUCT, 90–91 (OECD Investment Policy Reviews, 2008).

236. HENRY SANDERSON & MICHAEL FORSYTHE, CHINA'S SUPERBANK: DEBT, OIL AND INFLUENCE, HOW CHINA DEVELOPMENT BANK IS REWRITING THE RULES OF FINANCE 25–27 (2013).

237. *Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on Foreign Subsidies Distorting the Internal Market* (Eur. Comm'n, Working Document SWD/2021/99, May 5, 2021).

- a EUR 800 million preferential loan from a bank consortium, including CDB, the EXIM Bank, and China Construction Bank. The loan agreement mentions as the purpose of the loan the acquisition of Pirelli;
- an RMB 17 million (approximately EUR 2.13 million) refund of the interest paid on the loan mentioned above. This refund was granted by the MOF for the acquisition of Pirelli's stock rights as part of the MOF's key projects of 2015 special funds for the development of foreign trade;
- a grant of RMB 500 million (around EUR 66 million) from the SASAC to promote global production capacity cooperation under the BRI;
- equity participation worth EUR 533 million via the Silk Road Fund (SRF), a government investment fund that is part of the BRI. The investment of SRF corresponded exactly to the amount that was needed by CNRC to gain absolute majority ownership in the Pirelli Group (65% versus 48.75% without SRF).[238]

Evidence shows that Chinese SOEs' overseas acquisitions have several unique features compared to Chinese private investors. First, Chinese SOEs tend to conduct larger deals and predominantly engage in full or majority acquisitions; second, Chinese private investors tend to invest in countries where the currency depreciates against the RMB, but the reverse holds for Chinese SOEs; third, Chinese SOEs tend to acquire less profitable and more indebted targets; fourth, SOEs tend to use a much higher proportion of cash and internal funds and far less debt and equity to finance their deals.[239] These findings suggest that Chinese SOEs may be less financially constrained than private investors because they have financial support from the Chinese state-owned banking system, which allows them to engage in large-scale transactions and pursue less cautious investment strategies. On the other hand, if Chinese SOEs benefit from preferential financing, one might expect them to offer higher prices than other competitors for target companies in cross-border M&A deals. However, there is no evidence that Chinese SOEs overall pay higher premiums than other investors for targets with comparable characteristics.[240] Therefore, the claim that the

238. *Id.*

239. *See generally* Clemens Fuest et al., *What Drives Chinese Overseas M&A Investment? Evidence from Micro Data*, 30 REV. INT'L. ECON. 306 (2022).

240. *Id.* at 330.

GOC's financial support enables Chinese SOEs to crowd out other investors in the global M&A market may be nuanced. "More micro-level and lending data would be needed in order to accurately assess to what extent [Chinese] SOEs really do put [their private competitors] at a competitive disadvantage on the financing front."[241]

Since there is no multilateral treaty on the regulation of cross-border M&A subsidies, some states have been exploring unilateral measures to address the potentially distortive effects of foreign subsidies on international investment. For example, the European Commission proposed a new instrument in May 2021 under which the Commission will have the power to investigate foreign subsidies granted by the public authorities of a non-EU country that confers a benefit to an undertaking engaging in economic activity in the EU.[242] In particular, a foreign subsidy directly facilitating the acquisition of EU undertakings is identified as most likely to distort the EU internal market. If the European Commission establishes that a foreign subsidy exists, it distorts the internal market, and the negative effects of the foreign subsidy outweigh the positive effects, the Commission will have the power to impose redressive measures or require commitments from foreign companies to prevent the distortion.[243]

B. *Reciprocity in Market Access*

There is no comprehensive multilateral agreement on foreign investment, and international investment flows are currently regulated by around 3,000 BITs and FTAs.[244] Since its first BIT with Sweden in 1982, China has signed 145 BITs (107 in force) and 24 treaties with investment provisions (19 in force) by December 2021,[245] second only to Germany in terms of the number of BITs concluded. However, very few Chinese BITs require China to permit market access to foreign investors.[246] In addition, China has assumed obligations with respect to FDI in services under Mode 3 in its schedule of concessions under the General Agreement on Trade in Services (GATS) within the WTO

241. OECD, *supra* note 17, at 59.

242. Press Release, European Commission, *supra* note 19.

243. *Id.*

244. Carolina Moehlecke & Rachel L. Wellhausen, *Political Risk and International Investment Law*, 25 ANN. REV. POL. SCI. 485, 486 (2022).

245. *International Investment Agreements Navigator*, UNCTAD, https://investmentpolicy.unctad.org/international-investment-agreements/countries/42/china.

246. *See* Jie Huang, *Challenges and Solutions for the China–US BIT Negotiations: Insights from the Recent Development of FTZs in China*, 18 J. INT'L ECON. L. 307, 323–25 (2015).

framework.[247] Mode 3 covers the supply of services in a foreign jurisdiction through commercial presence.[248] However, the assumption of market access commitments under Mode 3 is voluntary and subject to negotiation.[249] There is no general obligation imposed on China or any WTO Member to open the market to foreign FDI.[250] Nevertheless, China's commitments are asymmetric compared to other developed countries, and many lucrative services sectors in China remain closed to foreign investors.[251]

Against this backdrop, Chinese SOEs' OFDI spree has caused reciprocity concerns. Foreign investors are likely to face administrative, technical, and regulatory entry barriers to access the Chinese market, especially in key fields and industries that are dominated by Chinese SOEs and that the GOC regards as strategically important for China's political, economic, and social stability.[252] If the GOC would not approve similar investments made by foreign investors in China, critics have questioned why a host country should approve such investments launched by Chinese SOEs. For example, United States Senator Charles Schumer (D-NY) proposed that when any Chinese SOE sought to acquire an American company, an assessment as to whether there were reciprocal laws allowing for similar transactions in China should be performed.[253]

The GOC reformed its Foreign Investment Law in 2019 by providing pre-establishment national treatment, combined with a negative list of non-conforming measures, to foreign investors.[254] Foreign investment restrictions in many previously closed sectors are gradually liberalized.[255] Accordingly, China's Foreign Direct Investment Regulatory

247. *See* Aaditya Mattoo, *China's Accession to the WTO: The Services Dimension*, 6(2) J. INT'L ECON. L. 299, 301–04 (2003); *see also* GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS].

248. *See* GATS, supra note 247, at art 1.2 (C).

249. MAVROIDIS & SAPIR, *supra* note 18, at 92.

250. *Id.*

251. *See* NICHOLAS R. LARDY, THE STATE STRIKERS BACK: THE END OF ECONOMIC REFORM IN CHINA? 101 (2019).

252. *See* Adrian Blundell-Wignall, *How We Should Deal with China's State-Owned Behemoths*, FIN. REV. (May 11, 2021).

253. John Bussey, *Playing Hardball with Chinese Investors*, WALL ST. J. (Oct. 25, 2012), https://www.wsj.com/articles/SB10001424052970203937004578079090738883704.

254. [Foreign Investment Law of the People's Republic of China] (adopted at the Second Session of the 13th Nat'l People's Cong., Mar. 15, 2019, effective Jan. 1, 2020) art. 4, P.R.C LAWS.

255. Ouyang Shijia, *Negative List for Market Access to be Further Shortened*, CHINA DAILY (Oct. 11, 2021), http://global.chinadaily.com.cn/a/202110/11/WS61637544a310cdd39bc6df43.html.

Restrictiveness Index was reduced from 0.328 in 2017 to 0.214 in 2020.[256] Nevertheless, China's FDI regime is still considered highly restrictive compared to the OECD average index of 0.063 in 2020.[257]

Lifting market access barriers for EU investors in China was one of the EU's key negotiation objectives for the CAI.[258] China has made commitments in manufacturing sectors, including electric cars, chemicals, telecommunication equipment, and health equipment, and in service sectors, such as cloud services, financial services, private healthcare, environmental services, international maritime transport, and air transport-related services.[259] Similarly, in the U.S.-China "Phase One" deal, China pledged to "remove restrictions on investment, reduce burdensome regulation, and expeditiously review pending license applications of U.S. [firms] in domestic banking, credit rating, electronic payments, asset management, insurance, and securities industries."[260] More recently, Chinese President Xi Jinping pledged that China will become increasingly open to foreign investors, will further shorten the negative list for foreign investments, and will remove restrictions on telecommunication, healthcare, and other service industries, in an orderly fashion.[261]

C. *Non-Commercial Objectives*

One of the most acute concerns regarding Chinese SOEs is that their corporate and investment decisions may be driven by political and strategic objectives rather than commercial and market considerations.[262] Different from private investors, SOEs are not necessarily expected to maximize profits and long-term corporate value. State ownership would

256. Organization for Economic Co-operation and Development [OECD], *FDI Regulatory Restrictiveness Index* (2019), https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#.

257. *Id.*

258. EUR. COMM'N, IMPACT ASSESSMENT REPORT ON THE EU-CHINA INVESTMENT RELATIONS 3 (2013).

259. Gisela Grieger, *EU-China Comprehensive Agreement on Investment: Levelling the Playing Field with China*, European Parliamentary Rsch. Serv. Briefing 9 (Mar. 2021).

260. Virgil Bisio et al., *The U.S.-China "Phase One" Deal: A Backgrounder* 5 (U.S.-China Economic and Security Review Commission, Feb. 4, 2020).

261. Xi Jinping, President of the People's Republic of China, *Let the Breeze of Openness Bring Warmth to the World*, Keynote Speech at the Opening Ceremony of the Fourth China International Import Expo (Nov. 4, 2021).

262. *Risks, Rewards, and Results: U.S. Companies in China and Chinese Companies in the United States*: *Hearing Before the US-China Econ. & Sec. Rev. Comm'n* (2019) (statement of Elizabeth Drake, Partner at Schagrin Associates); for an example of how China links securing energy through state-owned firms with national security, see generally Jennifer Lind & Daryl G. Press, *Markets or Mercantilism? How China Secures its Energy Supplies*, 42(4) INT'L SEC. 170 (2018).

result in SOEs acting differently from POEs under some circumstances.[263] Thus, there are worries that China may weaponize Chinese SOEs' OFDI to effectively serve as "trojan horses," through which the GOC may secure access to foreign resources and technologies, acquire increasing power and influence, and expand its lead in the world economy.[264] That may jeopardize the host country's national security, energy security, economic security, and other vital interests.[265]

In response to these perceived risks, some countries have strengthened their domestic regulatory frameworks to review FDI by Chinese SOEs.[266] A number of high-profile overseas acquisitions launched by Chinese SOEs were forced to stall in the face of strong opposition from host countries. For example, the Canadian Government prohibited the $1.5 billion acquisition of Canadian construction company Aecon Group Inc., by China Communications Construction Company (CCCC) for national security reasons in 2018.[267] Even though Aecon itself supported the CCCC acquisition as a good strategy for it to compete with large global construction companies more effectively, the Canadian Government concluded that the combination of the CCCC's status as a Chinese SOE and Aecon's work on critical infrastructure made the acquisition a material risk to Canada's national security.[268] Similarly, in early 2021, the Australian government blocked a $300 million deal that would have seen the state-owned China State Construction Engineering Corporation acquire a major Australian construction company Probuild over national security concerns.[269]

263. OECD, *supra* note 17, at 27.

264. Robert Delaney, *China Using Tentacles to Erode US Security, Senator Warns, Urging Passage of Bill Boosting Scrutiny of Deals*, S. CHINA MORNING POST (Feb. 14, 2018), http://global.chinadaily.com.cn/a/202110/11/WS61637544a310cdd39bc6df43.html.

265. U.S.-CHINA ECON. & SEC. REV. COMM'N, 2017 ANNUAL REPORT TO CONGRESS 101–02 (2018).

266. For example, see AUSTRALIAN GOVERNMENT FOREIGN INVESTMENT BOARD, AUSTRALIA'S FOREIGN INVESTMENT POLICY 6, 10-11 (Jan. 14, 2022) for the approach of the Australian Government, https://firb.gov.au/sites/firb.gov.au/files/2022-01/Australias_Foreign_Investment_Policy-20220114.pdf.

267. Sandy Walker, *Canada Prohibits Chinese SOE Acquisition of Aecon on National Security Grounds*, DENTONS (May 25, 2018), https://www.dentons.com/en/insights/alerts/2018/may/25/canada-prohibits-chinese-soe-acquisition-of-aecon-on-national-security-grounds.

268. *Id.*

269. *See* Levi Parsons, *Furious China Accuses Australia of 'Weaponising National Security' by Blocking a $300 Million Takeover of a Major Building Company*, DAILY MAIL AUSTRALIA (Jan. 13, 2021, 7:23 PM EST), https://www.dailymail.co.uk/news/article-9139979/China-accuses-Australia-weaponising-national-security-blocking-300million-takeover.html.

There is no doubt that the official guidance of the GOC, such as the BRI, has a significant effect on Chinese SOEs' investment decisions. For example, evidence shows that Chinese investors were less likely to pursue targets in BRI countries before the GOC launched the BRI in 2013.[270] However, Chinese SOEs' investments in BRI countries have substantially increased since the announcement of BRI.[271] By contrast, the BRI fails to encourage Chinese POEs to invest in BRI countries.[272] These results suggest that "the BRI . . . [has] influence[d] the location choice of cross-border [investments] by Chinese SOEs."[273] However, following the GOC's official guidance is not necessarily an indicator of the purely strategic purpose of investments as Chinese SOEs may choose to adhere to official guidance for other purposes, such as minimizing the risks of their overseas investments or simply using their BRI projects to facilitate access to state support.[274] In other words, a strong commercial rationale may nevertheless be identified in following the official guidance in making the investments. This is particularly true when more and more Chinese OFDI is conducted by POEs and local SOEs without any monopoly status in China.[275]

It is important to emphasize that Chinese SOEs come in all sorts of sizes and shapes. Though by definition, all SOEs are controlled by the party-state, "significant variations exist in their distance from the political center, the percentage and density of state ownership, the competitiveness and political saliency of the sectors in which they mainly operate, as well as their organizational structure and management."[276] Those variations inevitably cause differences in Chinese SOEs' behaviors in cross-border investment.[277] For example, while central SOEs, given their national champion status and formal mandate to support

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270. Fuest et al., *supra* note 239, at 322.

271. *See id.*

272. *Id.* ("targets . . . become significantly more likely to be purchased by Chinese SOEs . . . [whereas] the policy does not change the investment pattern of Chinese private acquirers").

273. *Id.*

274. *See* Audrye Wong, *How Not to Win Allies and Influence Geopolitics: China's Self-Defeating Economic Statecraft*, 100 FOREIGN AFFS. 44, 46 (2021); *see also* Xiaohan Gong & Anatole Boute, *For Profit or Strategic Purpose? Chinese Outbound Energy Investments and the International Economic Regime*, 14(5) J. WORLD ENERGY L. & BUS. 345, 362 (2021).

275. Wei Li & Hans Hendrischke, *Chinese Outbound Investment in Australia: From State Control to Entrepreneurship*, 2020 CHINA Q. 701, 705–06 (2020).

276. Ji Li, *State-Owned Enterprises in the Current Regime of Investor-State Arbitration*, *in* THE ROLE OF THE STATE IN INVESTOR-STATE ARBITRATION 380, 385 (Shaheeza Lalani & Rodrigo Polanco Lazo eds., 2015).

277. *Id.*

macro-level industrial growth, are more likely to act as policy instruments of the state, the internationalization of local SOEs is mainly driven by commercial logic since they are restructured into more autonomous and market-oriented firms with greater flexibility.[278] Even for central SOEs, a more nuanced approach is required to analyze their motivations and behavioral patterns in their OFDI activities. On the one hand, there is evidence suggesting that the GOC has deployed FDI by central SOEs as an instrument to promote its policy directives, including implementing major development strategies such as the BRI, to isolate Taiwan and the Dalai Lama, to build a bloc of countries that support its diplomatic positions in the UN General Assembly, and to build support on the UN Security Council.[279] On the other hand, studies on Chinese SOEs' overseas oil and mining investments in Africa and Latin America show that they are essentially autonomous and market-driven and may adapt, modify and even subvert the GOC's directives and foreign policies.[280]

In summary, Chinese SOEs may pursue both commercial as well as public policy objectives, and the division between the two is not always clear-cut. It would be an oversimplification to conclude that all Chinese SOEs' foreign investments are dictated by the GOC or resulted from the GOC's policy strategies.[281] Whether, and to what extent, Chinese SOEs' OFDI are instruments of the GOC must be determined on a case-by-case basis.

D. *Human Rights*

SOEs can violate human rights in similar ways to POEs. As SOEs are becoming increasingly important players in some of the most troubling industry sectors associated with human rights abuses, such as metals and mining, construction, and fossil fuel energy, "[c]oncerns have . . .

278. Ming Hua Li et al., *Varieties of State Capitalism: Outward FDI Strategies of Central and Local State-Owned Enterprises from Emerging Economy Countries*, 45(8) J. INT'L BUS. STUD. 980, 995 (2014).

279. Randall W. Stone et al., *Chinese Power and the State-Owned Enterprise*, 76 INT'L ORG. 229, 243–46 (2022).

280. Lee Jones & Yizheng Zou, *Rethinking the Role of State-Owned Enterprises in China's Rise*, 22 NEW POL. ECON. 743, 755 (2017); Ruben Gonzalez-Vicente, *Mapping Chinese Mining Investment in Latin America: Politics or Market?*, 209 CHINA Q. 35, 56 (2012); Bates Gill & James Reily, *The Tenuous Hold of China Inc. in Africa*, 30 WASH. Q. 37, 44–48 (2007).

281. *See* Meg Rithmire, *Going Out or Opting Out? Capital, Political Vulnerability, and the State in China's Outward Investment* 11–21 (Harv. Bus. Sch., Working Paper No. 20-009, 2021) (identifying "three types of capital that differ in the logic of their international pursuits" instead of "imagining that all [SOEs] pursue the state's interest"); *see also* Wenjuan Nie, *China's State-Owned Enterprises: Instruments of Its Foreign Strategy?*, 31 J. CONTEMP. CHINA 383, 396–97 (2022).

been raised about the apparent lack of awareness of many [SOEs] of their responsibility to respect human rights[.]"[282] Allegations of human rights abuses by SOEs in their home countries as well as in their host countries abroad include labor-related abuses, environmental damage, land rights violations, and intimidation and defamation of human rights defenders.[283]

Lately, there has been an increased focus on the human rights implications of Chinese SOEs' OFDI in Asian, African, and Latin American countries with weaker governance and where Chinese investments are dominant.[284] For example, the Sino-Myanmar oil and gas pipelines, and in particular the Shwe gas pipeline, have led to intense local opposition in Myanmar.[285] The project is part of the GOC's broader resource strategy that seeks to secure the country's access to vital energy resources, and the Chinese SOE involved in the project is China National Petroleum Corporation (CNPC).[286] It was alleged that the project was associated with serious human rights violations, such as a lack of consultation with indigenous communities, the expropriation of land and forced relocation of affected communities without adequate compensation, arbitrary arrests and detention, and other forms of intimidation of individuals who spoke out against the project, and the use of forced labor.[287] However, CNPC denied these allegations.[288]

Principle 4 of the Guiding Principles on Business and Human Rights (UNGP), unanimously endorsed by the United Nations Human Rights Council (UNHRC) in 2011, provides that "[s]tates should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, . . . including, where

282. Rep. of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, ¶ 16, U.N. Doc. A/HRC/32/45 (May 4, 2016) [hereinafter Rep. on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises].

283. *See generally Working with SOEs*, HUMAN RIGHTS AND BUSINESS DILEMMAS FORUM (Dec. 9, 2021), https://hrbdf.org/dilemmas/working-soe/#.YbGe7dDP2Uk.

284. *See* BUS. & HUM. RTS. RES. CTR., *"Going Out" Responsibly: The Human Rights Impact of China's Global Investments* 18 (2021).

285. *See* Pichamon Yeophantong, *Civil Regulation and Chinese Resource Investment in Myanmar and Vietnam* 10 (Univ. Oxford Glob. Econ. Governance Programme, Working Paper No. 110, 2015).

286. *See id.* at 6–7.

287. *See id.* at 10.

288. CNPC, CLARIFICATION ON REPORTS REGARDING THE MYANMAR-CHINA OIL & GAS PIPELINE PROJECT (Aug. 2013), https://media.business-humanrights.org/media/documents/files/documents/cnpc-response-re-myanmar-pipeline-5-aug-2013-en.pdf.

appropriate, by requiring human rights due diligence."[289] What additional steps states should take in addressing human rights challenges was the focus of the Report of the Working Group on Human Rights and Transnational Corporations under the UNHRC in 2016.[290] The Report encouraged states to "lead by example" and adopt appropriate policies and processes to ensure that SOEs fully respect human rights.[291] Given the close relationship between the state and the enterprise, the state has the means for monitoring SOEs and ensuring their respect for human rights and leverage.[292]

The GOC and leading Chinese industry associations have issued a growing matrix of laws, regulations, and guidelines to promote responsible business conduct in China's overseas investments.[293] In particular, the SASAC has adopted regulations and guidelines on SOEs' OFDI.[294] For a long time, respect for human rights was embedded in corporate social responsibilities (CSR) in the GOC's policy documents and regulations. For example, the Third National Human Rights Action Plan of China (2016-2020) urged China's overseas enterprises to "abide by the laws of the [host countries] and fulfill their social responsibilities in the process of . . . making investment."[295] More recently, there has been a gradual shift in China's policy away from simply adhering to host country laws and regulations towards embracing international standards on human rights and environmental protection. China has committed to respecting human rights in foreign investment in its Third Universal Periodic Review before the UNHRC in 2019.[296] In the Fourth National

289. Office of the U.N. High Commissioner for Human Rights, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, at 6, UN Doc. HR/PUB/11/04 (2011).

290. *See generally* Rep. on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, *supra* note 282.

291. *Id.*

292. *Id.* ¶¶ 95–102.

293. *See* INCLUSIVE DEV. INT'L, SAFEGUARDING PEOPLE AND THE ENVIRONMENT IN CHINESE INVESTMENTS: A REFERENCE GUIDE FOR ADVOCATES 6–9 (2d ed. 2019).

294. For example, SASAC, INTERIM GUIDELINE ON CENTRAL ENTERPRISES' COMPLIANCE MANAGEMENT (2018).

295. INFO. OFFICE STATE COUNCIL PRC, NATIONAL HUMAN RIGHTS ACTION PLAN OF CHINA (2016-2020) (1st ed. 2016). On the differences between CSR and business and human rights, see Larry Catá Backer, *The Human Rights Obligations of State-Owned Enterprises: Emerging Conceptual Structures and Principles in National and International Law and Policy*, 50 VAND. J. TRANSNAT'L. L. 827, 843–44 (2017).

296. Press Release, Collective on Chinese Finance and Investment, Human Rights and the Environment (CICDHA), China Commits to the United Nations Human Rights Council to Respect Human Rights in its Foreign Investment (Mar. 19, 2019) (on file with the Business & Human Rights Resource Centre).

Human Rights Action of Plan (2021-2025) issued in September 2021, the GOC promises that it will "encourage Chinese businesses to abide by the UN Guiding Principles on Business and Human Rights in their foreign trade and investment, to conduct due diligence on human rights, and to fulfill their social responsibility to respect and promote human rights."[297] Critics have argued that China's current policy framework fails to provide a comprehensive plan to implement measures to protect human rights in relation to Chinese OFDI.[298] It remains to be seen what additional steps the GOC will take to ensure that human rights are fully respected in SOE's OFDI activities.

E. *Ideological Conflict*

A deep-rooted ideological concern is the inherent suspicion of some Western countries that foreign state capital is a threat to the free market at home. This is especially the case for countries where recently privatized corporate entities face competition or takeover by foreign SOEs. With doubts lingering around the commercial and financial autonomy of the foreign SOEs, this situation has led to concerns about the "renationalization" of privatized corporate entities through a foreign government.[299] For example, after the approval of CNOOC's acquisition of Nexen Inc. in December 2012, the Canadian government announced new policy guidance with respect to future proposed acquisitions by foreign SOEs. Later, the Economic Action Plan 2013 Act introduced several further steps in restricting investment by foreign SOEs in Canada.[300] In a statement that made clear the Canadian government's antipathy towards foreign SOEs, then-Prime Minister Stephen Harper stated in 2012:

> [A]ll investments are not equal . . . purchases of Canadian assets by foreign governments through state-owned enterprises are not the same as other transactions . . . To be blunt,

297. INFO. OFFICE STATE COUNCIL PRC, HUMAN RIGHTS ACTION PLAN OF CHINA (2021-2025) (2021).

298. BUS. & HUM. RTS. RES. CTR., *supra* note 284, at 11.

299. Organization for Economic Co-operation and Development [OECD], *SOEs Operating Abroad: An Application of the OECD Guidelines on Corporate Governance of State-Owned Enterprises to the Cross-border Operations of SOEs* 4–5 (2010).

300. Michael Woods et al., *Bill C-60: A More Restrictive Approach to Foreign State-owned Enterprises Investment in Canada*, MONDAQ (July 1, 2013), https://www.mondaq.com/canada/anti-trust competition-law/247764/bill-c-60-a-more-restrictive-approach-to-foreign-state-owned-enterprise-investment-in-canada.

> Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead.[301]

Similar views were expressed by the former Prime Minister of Australia, Tony Abbott, on his first visit to China as opposition leader in 2012:

> It would rarely be in Australia's interests to allow a foreign government or its agencies to control an Australian business . . . . That's because we do not support the nationalization of businesses by the Australian government, let alone a foreign one.[302]

IV. The Standing of Chinese SOEs in International Investment Arbitration

As the world's fourth-largest source of OFDI in 2021, it is no surprise that Chinese SOEs have increasingly utilized ISDS mechanisms contained in international investment agreements (IIAs), which promise them an enforceable remedy against infringing host states.[303] Nevertheless, in view of the close links between Chinese SOEs and the Chinese party-state, should Chinese SOEs be considered qualified "investors" and allowed access to ISDS against a host state? The status of Chinese SOEs is particularly complicated in the context of the ICSID Convention. As reflected in its preamble, the ICSID Convention was developed by the World Bank in significant part to encourage private international investment, as distinguished from sovereign/government investment. Article 25 (1) of the ICSID Convention provides that its jurisdiction is confined to dispute "between a Contracting State . . . and a

301. *Statement by the Prime Minister of Canada on Foreign Investment*, Gov't of Canada (Dec. 7, 2012), https://www.canada.ca/en/news/archive/2012/12/statement-prime-minister-canada-foreign-investment.html.

302. John Garnaut, *Abbott Talks Tough During China Visit*, Sydney Morning Herald (July 25, 2012). However, Abbott appears to have changed his views later. *See* Katharine Murphy, *Tony Abbott Says China's State-owned Enterprises Are Welcome in Australia*, Guardian (Apr. 11, 2014).

303. *See generally* Beijing Urban Constr. Grp. Co. (BUCG) v. Republic of Yemen, ICSID Case No. ARB/14/3, Decision on Jurisdiction (May 31, 2017) [hereinafter BUCG Decision on Jurisdiction]; China Heilongjiang Int'l Econ. & Tech. Coop. Corp et al. v. Mongolia, PCA Case No. 2010-20, Award (June 30, 2017) [hereinafter China Heilongjiang Award]; Ping An Life Ins. Co. & Ping An Ins. (Grp.) Co. v. Kingdom of Belgium, ICSID Case No. ARB/12/29, Award (Apr. 30, 2015); Wuxi T. Hertz Techs. & Jetion Solar v. Greece (UNCITRAL Arb., 2019).

national of another Contracting State."[304] In other words, the ICSID has no jurisdiction to arbitrate disputes between two states, nor does it have jurisdiction to arbitrate disputes between two private entities. Even if Chinese SOEs are covered in the definition of "investors" in Chinese IIAs, the question of whether Chinese SOEs have standing as "a national of another Contracting State" to bring ICSID proceedings must be independently answered.[305]

In determining whether an SOE has standing in ISDS, both ICSID and non-ICSID tribunals have consistently applied Articles 5 and 8 of the International Law Commission's Draft Articles on State Responsibility (the ILC Articles).[306] However, this body of jurisprudence has been subject to criticism both in academic writings[307] and in arbitral practice.[308] Moreover, only two arbitral tribunals have addressed the question of whether Chinese SOEs are qualified "investors" eligible to launch investment arbitration against host states to date.[309] Although both tribunals rejected the respondent state's claim that Chinese SOEs are not qualified investors, it remains uncertain to what extent the tribunals' conclusions in the two cases will be followed, as the tribunals' analyses are brief and case-specific.[310] This part

304. ICSID Convention art. 25(1), Apr. 10, 2006, ICSID/15 (providing: "The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre").

305. Paul Blyschak, *State Owned Enterprises and International Investment Treaties: When are State-Owned Entities and Their Investments Protected?*, 6 J. INT'L L. & INT'L REL. 1, 27 (2011).

306. *See generally* The International Law Commission, *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, at 39, 120, U.N. Doc. A/56/10 (2001) [hereinafter the ILC Draft Articles].

307. *See generally* CARLO DE STEFANO, ATTRIBUTION IN INTERNATIONAL LAW AND ARBITRATION 119-35 (2020); Mark Feldman, *State-Owned Enterprises as Claimants in International Investment Arbitration*, 31 ICSID REV. 24, 32-33 (2016).

308. Tulip Real Estate Inv. & Dev. Neth. B.V. v Republic of Turkey, ICSID Case No. ARB/11/28, Award, ¶ 289 (Mar. 10, 2014) [hereinafter Tulip Award] (disagreeing with the Decisions in *Mazzefini* and *Salini*); Tulip Real Estate Inv. & Dev. Neth. B.V. v Republic of Turk., ICSID Case No. ARB/11/28, Separate Opinion of Michael Evan Jaffe, ¶ 5 (Mar. 7, 2017) (concerning the questions of attribution under Art. 8 ILC Draft Articles).

309. *See generally* BUCG Decision on Jurisdiction, *supra* note 303; China Heilongjiang Award, *supra* note 303; Anran Zhang, *The Standing of Chinese State-Owned Enterprises in Investor-State Arbitration: The First Two Cases*, 17 CHINESE J. INT'L L. 1147, 1152 (2018).

310. In the BUCG Decision on Jurisdiction, the tribunal skipped over entirely the analysis of whether BUCG, as a state-owned entity, may be an agent of the GOC or exercises any governmental function. Instead, the tribunal only focused on the context-specific analysis of the

provides a detailed analysis of applying the ILC Articles to Chinese SOEs. It sets forth two arguments. First, it is highly unlikely that Chinese SOEs would be denied standing as qualified claimants in ISDS. Second, notwithstanding genuine concerns about SOEs in the global investment landscape, the denial of Chinese SOEs' standing before arbitral tribunals will not only be ineffective in addressing those concerns but also undermine the rule of law in international investment.

A. *Taking Stock: SOEs in ISDS*

The definition of "investor" in Chinese IIAs can provide substantial guidance on the question of whether Chinese SOEs have standing as claimants in ISDS. Empirical research of the definition of "investor" and the ISDS clauses in China's 851 IIAs reveals that with extremely limited exceptions, SOEs have equivalent standing to their private counterparts as "investors" in IIAs. Specifically, the definition of "investor" is normally not based on the nature of ownership but rather on whether a legal person is duly constituted in accordance with the law of a contracting party.[311] Similar to this global trend, many Chinese IIAs do not specifically address SOEs in the definition of "investor."[312] Moreover, a recent trend is that more and more Chinese IIAs expressly provide that any entity, including "government-owned or controlled enterprises" or public institutions, falls within the applicable definition of "investor."[313]

commercial function of the investment. *See* BUCG Decision on Jurisdiction, *supra* note 303, ¶¶ 35, 39, 42. Similarly, in the China Heilongjiang Award, the tribunal simply dismissed Mongolia's allegation that the claimants are instrumentalities of the Chinese government as unfounded. *See* China Heilongjiang Award, *supra* note 303, ¶ 418.

311. Jo En Low, *State-Controlled Entities as "Investors" Under International Investment Agreements*, 80 COLUM. FDI PERSP. 1, 1 (2012).

312. *See, e.g.*, Agreement Between the Government of the Republic of Turkey and the Government of the People's Republic of China Concerning the Reciprocal Promotion and Protection of Investments, China-Turk., art. 2, July 29, 2015; Agreement Between the Swiss Federal Council and the Government of the People's Republic of China on the Promotion and Reciprocal Protection of Investments, China-Switz., art. 1(2), Jan. 27, 2009.

313. *See, e.g.*, Regional Comprehensive Economic Partnership, art. 10(1)(f), Nov. 15, 2020 [hereinafter RCEP]; Free Trade Agreement Between the Government of Australia and the Government of the People's Republic of China, Austl.-China, art. 12(1), June 17, 2015 [hereinafter ChAFTA]; Agreement Between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments, Can.-China, art. 2(10)(a), Sept. 9, 2012 [hereinafter Canada-China BIT]; Agreement Between the Government of the United Mexican States and the Government of the People's Republic of China on the Promotion and Reciprocal Protection of Investments, China-Mex., art. 1(b), July 11, 2008 [hereinafter China-Mexico BIT].

Therefore, as a general matter, Chinese SOEs as claimants can bring claims under investment treaties in ISDS.

The same conclusion holds true in the ICSID context. SOEs have frequently acted as claimants and their standing to bring ICSID proceedings has never been declined.[314] When determining whether an SOE is "a national of another Contracting State," ICSID case law has consistently applied the famous Broches test, as it was first proposed by Aron Broches, the first secretary-general of the ICSID and the principal architect of the ICSID Convention. Broches observed in 1972 that the classical distinction between private and public investment, based on the source of the capital, was no longer meaningful since many SOEs were practically indistinguishable from completely privately-owned enterprises both in their legal characteristics and in their business activities.[315] He then concluded:

> . . . for purposes of the Convention a mixed economy company or government-owned corporation 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*.[316]

Specifically, the Broches test addresses two situations: conduct by an SOE acting under state control, i.e., acting as an agent, and conduct by an SOE exercising delegated governmental authority.[317] If an SOE were acting under state control as an agent or exercising governmental authority, then the SOE would not be able to utilize the ICSID. However, the Broches test does not prescribe *how* to determine whether an SOE was acting as an agent for the government or discharging an essentially governmental function.

The Broches test was first applied in *CSOB v. Slovakia* in 1999, in which Slovakia contended that CSOB, a state majority-owned bank, did not meet the requirement of a "national of another Contracting State"

314. Claudia Annacker, *Protection and Admission of Sovereign Investment Under Investment Treaties*, 10 CHINESE J. INT'L L. 531, 552-53 (2011); Masdar Solar & Wind Coopetertief U.A. v. Kingdom of Spain, ICSID Case No. ARB/14/1, Award, ¶166 (May 16, 2018) [hereinafter Masdar Award]. On the most recent investment disputes in which a state-owned entity acts as a claimant, see Qatar Nat'l Bank v. The Republic of South Sudan and Bank of South Sudan, ICSID Case No. ARB/20/40 (Oct. 6, 2020).

315. Aron Broches, *The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 136 COLLECTED COURSES HAGUE ACAD. INT'L L 331, 354–55 (1972).

316. *Id.* at 355.

317. Feldman, *supra* note 307, at 27.

under Article 25(1) of the ICSID Convention because CSOB served as a government agent or representative of the state which has been discharging essentially governmental functions throughout its existence.[318] The CSOB tribunal made several key findings which have had a profound influence on ensuing case law. First, the legislative history of the ISCID Convention indicated that the concept of "national" was not intended to be limited to POEs but to embrace also wholly or partially government-owned companies.[319] Thus, the Czech's majority ownership of and absolute control over CSOB alone would not disqualify it from filing a claim with ICSID.[320] Second, and most significantly, the tribunal applied a "nature" test, which looked at the nature of CSOB's acts at issue, rather than motive or purpose, in determining whether CSOB exercised any governmental functions.[321] Since the steps taken by CSOB to solidify its financial position in order to attract private capital for its restructured banking enterprise did not differ in their nature from measures a private bank might take to strengthen its financial position, the tribunal found that they were commercial in nature.[322] The fact that CSOB's activities were driven by state policies or serve state interests does not transform the otherwise commercial nature of these activities into governmental acts.[323]

The tribunal's sole focus on the nature of the CSOB's acts at issue was heavily criticized as a misapplication of the Broches test. It was suggested that further guidance on how to apply the Broches test should be drawn from the attribution rules in Articles 5 and 8 of the International Law Commission's Draft Articles on State Responsibility (ILC Articles).[324] Compared with *CSOB v Slovakia*, one particularly noteworthy aspect of the ILC Rules is the possibility to consider not only the nature of the SOE's acts but also other factors, including "ownership, control, the nature, purposes and objectives of the [SOE] whose actions are under scrutiny, and to the character of the actions taken," when determining whether the SOE's acts should be attributed to the

318. Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, ¶ 19 (May 24, 1999) [hereinafter CSOB Decision on Jurisdiction].

319. *Id.* ¶ 16.

320. *Id.* ¶ 18.

321. *Id.* ¶ 20.

322. *Id.*

323. *Id.* ¶¶ 21–25.

324. Feldman, *supra* note 307, at 32–33; Blyschak, *supra* note 305, at 35.

state.[325] After *CSOB v. Slovakia*, Articles 5 and 8 of the ILC Articles have been widely applied in investment arbitration, both to ascertain whether an SOE was a "national of another Contracting State"[326] and the analogous issue of whether the conduct of an SOE should be attributed to the Contracting State so that the proper respondent was the Contracting State.[327] As the arbitral tribunal observed in *Maffezini v. Spain*, there are sufficient similarities between the two scenarios, which would allow it to utilize jurisprudence developed for one definition in the context of the other.[328] However, as will be discussed below, it is unlikely that the application of the ILC Articles would change the outcome of *CSOB v. Slovakia* because the Broches test is the "mirror image" of Articles 5 and 8 of the ILC Articles.[329]

Article 5 of the ILC Articles prescribes that the conduct of an entity is attributable to the state if the entity is empowered by law to exercise elements of governmental authority and is acting in that capacity in the particular instance.[330] The key term "governmental authority" is not defined because what is regarded as "governmental" depends on the particular society, its history, and traditions.[331] For investment arbitration, this would entail activities such as "granting licenses, approve or block commercial transactions, impose quotas, fees or expropriate companies."[332] According to the ILC commentary, to apply Article 5, important elements to be considered include the content of the powers, the way such powers are conferred on an entity, the purposes for which they are to be exercised, and the extent to which the entity is

325. Emilio Agustín Maffezini v. Kingdom of Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, ¶ 76 (Jan. 25, 2000) [hereinafter Maffezini Decision on Objections to Jurisdiction].

326. BUCG Decision on Jurisdiction, *supra* note 303, ¶ 34; Masdar Award, *supra* note 314, ¶ 158.

327. Maffezini Decision on Objections to Jurisdiction, *supra* note 325, ¶ 78; EDF (Services) Ltd. (U.K) v. Romania, ICSID Case No. ARB/05/13, Award, ¶ 191 (Oct. 8, 2009) [hereinafter EDF Award]; Jan de Nul & Dredging Int'l N.V. v. Arab Republic of Egypt, ICSID Case No. ARB/04/13, Award, ¶ 156 (Nov. 6, 2008) [hereinafter Jan de Nul Award]; Toto Costruzioni Generali S.P.A v. Republic of Leb., ICSID Case No. ARB/07/12, Decision on Jurisdiction, ¶ 44 (Sept. 11, 2009); Gustav F W Hamester GmbH & Co KG (Germany) v. Republic of Ghana, ICSID Case No. ARB/07/24, Award, ¶ 171 (June. 18, 2010) [hereinafter Gustav Award]; Tulip Award, *supra* note 308, ¶ 281.

328. Maffezini Decision on Objections to Jurisdiction, *supra* note 325, ¶ 79.

329. BUCG Decision on Jurisdiction, *supra* note 303, ¶ 34.

330. The ILC Draft Articles, *supra* note 306, at 42.

331. *Id.* at 43.

332. Nalbandian, *supra* note 27, at 21 n.61.

Reza Mohtashami & Farouk El-Hosseny, *State-Owned Enterprises as Claimants before ICSID: Is the Broches Test on the Ebb?*, 3 BCDR INT'L ARB. REV. 371, 371, 381 (2016).

accountable to the government for their exercise.[333] By contrast, how the entity is classified in a given legal system, the existence of greater or lesser state participation in the entity's capital, and whether the entity is subject to executive control are not decisive criteria for attributing the entity's conduct to the state.[334]

Article 5 of the ILC Articles was first applied in *Maffezini v. Spain*.[335] The analytical framework outlined in *Maffezini v. Spain* was later refined in *Jan de Nul v. Egypt*. For an act by a non-state organ to be attributed to a state under Article 5 of the ILC Articles, two cumulative conditions must be fulfilled. First, the act must be performed by an entity empowered by the internal law of the state to exercise elements of governmental authority.[336] To make such a determination, the entity must be examined from both a structural and a functional point of view. If an entity is state-owned or controlled, directly or indirectly, by the state, it gives rise to the possibility that the entity may exercise elements of governmental authority.[337] However, the structural test by itself may not always be conclusive and it must be complemented by an additional functional test, which looks at the functions of or roles to be performed by the entity. [338] Second, the disputed act must be performed by the entity in the exercise of governmental authority.[339] Central to arbitral tribunals' differentiation of commercial acts from acts in the exercise of governmental authority was to inquire whether a private commercial entity may perform the same acts in normal business transactions.[340] Some tribunals also mentioned profit as a motive for the investment.[341] This two-step analytical framework under Article 5 has been followed by other investment arbitral tribunals ever since.[342]

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333. The ILC Draft Articles, *supra* note 306, at 43.

334. *Id.*

335. The award was rendered before the formal adoption of the ILC Draft Articles in 2001. However, the tribunal referred to Article 7 (now Article 5) of the ILC Draft Articles. *See id.*

336. EDF Award, *supra* note 327, ¶ 191.

337. Maffezini Decision on Objections to Jurisdiction, *supra* note 325, ¶ 77. By owning a majority of shares or other means of control, the state is at least structurally in a position to request an SOE to carry out governmental functions. Similarly, if the stated purpose of an entity is to carry out certain governmental functions, then a presumption that it is a 'state entity' is justified.

338. *Id.* ¶ 79.

339. Jan de Nul Award, *supra* note 327, ¶ 163; EDF Award, *supra* note 327, ¶ 191.

340. CSOB Decision on Jurisdiction, *supra* note 318, ¶ 25; Jan de Nul Award, *supra* note 327, ¶¶ 169–70; Gustav Award, *supra* note 327, ¶ 202.

341. *See* EDF Award, *supra* note 327, ¶ 197.

342. *See* Gustav Award, *supra* note 327, ¶¶ 190–93; Tulip Award, *supra* note 308, ¶ 292.

In *Jan de Nul v. Egypt,* the tribunal first found that Suez Canal Authority (SCA) was a public entity exercising elements of governmental authority because it was empowered to issue the decrees related to the navigation in the canal and to impose and collect charges for passing through the canal.[343] The tribunal then focused on the nature of the SCA's acts at issue, i.e., awarding a contract through a bidding process and the refusal to grant a time of extension, and concluded that these acts were not attributable to Egypt because any private contractors could have acted in a similar manner.[344] In *Tulip v. Turkey,* Emlak was an SOE possessing legal personality under Turkish law, separate and distinctive from the state. Even though it enjoyed certain preferential treatment from the Turkish government with regard to getting construction permits and buying land, the tribunal found that Emlak itself did not exercise elements of governmental authority with respect to any other entity or object.[345]

In summary, the CSOB tribunal focused only on the *nature* of the activities, which gave rise to the dispute when evaluating whether CSOB's activities were an exercise of governmental authority. However, it has now become an integral part of analysis for tribunals to examine the link between the entity under inquiry and the home state, including ownership structure, the chain of control, and the purpose of the entity (the structural test), in addition to the nature of its activities both in general and in the specific investment (the functional test).[346] This approach coincides with the ILC commentary, which suggests that multiple factors should be considered when deciding on attribution under Article 5.[347] Therefore, one may reasonably argue that arbitral tribunals now examine the nature of the specific act being complained of *in the context of* SOEs having a close connection with the home state and that this new approach is more nuanced than the tribunal's *sole* focus on the nature of the conduct in *CSOB v. Slovakia.* Nevertheless, like *CSOB v. Slovakia*, tribunals ultimately focus on whether the SOE exercised governmental authority in the specific investment in dispute.[348] In the final analysis, the outcome would likely be the same if this new approach were adopted in *CSOB v. Slovakia,* as the linchpin of both approaches is

343. Jan de Nul Award, *supra* note 327, ¶ 166.
344. *Id.* ¶ 170.
345. Tulip Award, *supra* note 308, ¶ 293.
346. Maffezini Decision on Objections to Jurisdiction, *supra* note 325, ¶¶ 76–79.
347. The ILC Draft Articles, *supra* note 306, at 43.
348. Jan de Nul Award, *supra* note 327, ¶ 170.

the nature of an SOE's activities in the specific investment. Non-ICSID tribunals have adopted largely the same approach as ICSID tribunals.[349]

Article 8 of the ILC Articles relates to the first limb of the Broches test, i.e., SOEs acting as an agent for the government. Different from Article 5, the conduct could be attributable to the state under Article 8 not because it is the result of the exercise of governmental power but because the person is "in fact acting on the instructions of, *or* under the direction or control of, that state in carrying out the conduct."[350] Nevertheless, the elements involved in the structural test under Article 5 may be relevant for the application of Article 8 because they may help inform whether the conduct is under the direct command or effective control of the state.[351] The ILC commentary on Article 8 explains that although corporate entities are owned by, and in that sense, subject to the control of the state, they are considered to be separate, and their conduct in carrying out their activities is *prima facie* not attributable to the state. In other words, majority ownership or shareholding by the state of a corporate entity is not sufficient for the purposes of attribution pursuant to Article 8.[352] However, where there is evidence that "the State was using its ownership interest in or control of a corporation specifically in order to achieve a particular result, the conduct in question [may be] attributed to the State."[353] Several investment tribunals confirmed that the degree of control which must be exercised by the state in order for the conduct of a person or entity to be attributable to the state is "effective control," [354] as the ICJ outlined in *Nicaragua v. United States of America.* [355] This is a very demanding standard as it

349. *E.g.*, OAO TATNEFT v. Ukraine, PCA Case No. 2008-8, Partial Award on Jurisdiction, ¶¶ 125–52 (Sept. 28, 2010) [hereinafter OAO Tatneft Partial Award on Jurisdiction]; Nykomb Synergetics Tech. Holding AB v. Republic of Latvia, Arbitral Award, at 29 (Arb. Inst. Stockholm Chamber Com. Dec. 16, 2003).

350. The ILC Draft Articles, *supra* note 306, at 47 (emphasis added).

351. Stefano, *supra* note 307, at 154; BUCG Decision on Jurisdiction, *supra* note 303, ¶¶ 37–41.

352. Tulip Award, *supra* note 308, ¶ 289; UAB E energija (Lithuania) v. Republic of Latvia, ICSID Case No. ARB/12/33, Award, ¶ 825 (Dec. 22, 2017).

353. The ILC Draft Articles, *supra* note 306, at 48 (footnote omitted).

354. Jan de Nul Award, *supra* note 327, ¶ 173; Tulip Real Estate & Dev. Neth. B.V. v. Republic of Turk., ICSID Case No. ARB/11/28, Decision on Annulment, ¶ 189 (Dec. 30, 2015) [hereinafter Tulip Decision on Annulment]; White Indus. Austl. v. Republic of India, Final Award, ¶ 5.1.25 (UNCITRAL Nov. 30, 2011).

355. Military and Paramilitary Activities in and Against Nicaragua (Nicar. v. U.S.), Judgment, 1986 I.C.J. 14, 181, ¶ 115 (June 27). In contrast, international criminal jurisprudence has asserted the "overall control" test for military or paramilitary groups. *See* Prosecutor v. Tadić, Case No. IT-94-1-I, Judgment, ¶ 117 (Int'l Crim. Trib. for the Former Yugoslavia July 15, 1999).

requires not only a general control of the state over the entity but also a specific control of the state over the particular act in question.

The finding that an entity performs certain acts under the direction and control of the state within the meaning of Article 8 is an issue of examining the evidence on record.[356] In *EDF v. Romania*, the evidence on record indicates that the Romanian Ministry of Transportation issued instructions and directions to two SOEs regarding these two companies' exercise of their shareholder rights. Further, the evidence indicates that the Romanian state was using its ownership interest in or control of the two SOEs to bring to an end their contractual arrangements with the foreign investor.[357] In the tribunal's view, such conduct fell within the meaning of the commentary to Article 8 of the ILC Articles and was attributable to Romania. In *Tulip v. Turkey*, the majority of Emlak's voting shares and the board at all relevant times were controlled by TOKI, a state organ responsible for Turkey's public housing and operations. Accordingly, the tribunal concluded that TOKI was capable of exerting a degree of control over Emlak to implement elements of a particular state purpose. However, the tribunal stressed that:

> . . . the relevant enquiry remains whether Emlak was being directed, instructed or controlled by TOKI with respect to the *specific activity* of administering the Contract with Tulip JV in the sense of sovereign direction, instruction or control rather than the ordinary control exercised by a majority shareholder acting in the company's perceived commercial best interests.[358]

Looking at the evidentiary record, the tribunal concluded that while Emlak was subject to TOKI's corporate and managerial control, Emlak's conduct with respect to the execution, maintenance, and termination of the contract was acting in what it perceived to be its commercial best interest. Due to an absence of proof that TOKI used its control of Emlak as a vehicle directed towards achieving a particular result in its sovereign interests, Emlak's conduct was not attributable to the state under Article 8 of the ILC Articles.[359]

356. *See* Masdar Award, *supra* note 314, ¶ 171; Gustav Award, *supra* note 327, ¶¶ 256–67.

357. EDF Award, *supra* note 327, ¶ 213; *see also* Bayindir Insaat Turizm Ticaret Ve Sanayi A.Ş.v. Islamic Republic of Pak., ICSID Case No. ARB/03/29, Award, ¶¶ 125–27 (Aug. 27, 2009).

358. Tulip Award, *supra* note 308, ¶ 309.

359. *Id.* ¶ 326.

B. *The ILC Articles and Chinese SOEs*

As discussed in Part II above, Chinese SOEs are not created equal. Significant variations exist in their organizational structure, management, industry, and relations with the state. In particular, whilst central SOEs are more likely to act as policy instruments of the Chinese party state, the internationalization of China's local SOEs is mainly driven by commercial logic. Also, not all central SOEs' OFDI have non-commercial objectives. In practice, to ascertain whether a Chinese SOE has standing as a claimant in ISDS must be determined on a case-by-case basis. Nevertheless, some general conclusions may be drawn by applying the ILC Articles to Chinese SOEs.

1. Do Chinese SOEs Exercise Elements of Governmental Authority?

First, for an investment by a Chinese SOE to be attributed to the GOC under Article 5 of the ILC Articles, it must be shown that (1) the Chinese SOE is empowered by the internal law of China to exercise elements of governmental authority, and that (2) the particular investment in question which gives rise to the dispute must be performed by the SOE in the exercise of the governmental authority.[360] Thus far, no investment tribunal has examined the issue of whether Chinese SOEs are empowered to exercise elements of governmental authority by the internal law of China.

However, this issue was extensively analyzed in WTO dispute settlement processes for the purpose of determining whether Chinese SOEs are "public bodies" in the context of the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). According to the WTO Appellate Body (AB), a "public body" is an entity that "possesses, exercises, or is vested with governmental authority."[361] To make such a determination, investigating authorities should evaluate the core features of the entity concerned and its relationship with the government, "having regard, in particular, to whether the entity exercises authority on behalf of [the] government."[362] The evidence that a government "exercises meaningful control over an entity and its conduct may serve, in certain circumstances, as evidence that the relevant entity possesses and exercises governmental authority."[363] The mere fact that a

360. *See* EDF Award, *supra* note 327, ¶¶ 191–93.

361. Appellate Body Report, *United States–Definitive Anti-Dumping and Countervailing Duties on Certain Products from China,* ¶ 317, WTO Doc. WT/DS379/AB/R (adopted Mar. 11, 2011) [hereinafter *US – Antidumping and Countervailing Duties*].

362. *Id.* ¶ 319.

363. *Id.* ¶ 318.

government is the majority shareholder of an entity is an important element of the analysis but insufficient in itself to establish the necessary possession of governmental authority.[364]

In assessing the role of the GOC in Chinese SOEs, the U.S. Department of Commerce (USDOC) identified the relevant governmental function as China's "governmental purpose of maintaining the predominant role of the state sector in the economy and upholding the socialist market economy."[365] Moreover, the USDOC found that the GOC exercises meaningful control over certain categories of SOEs in China and uses these SOEs as instrumentalities to effectuate the governmental function.[366] The USDOC grounded the findings on "manifold indicia," including "(i) the provision of direct and indirect benefits to SOEs; (ii) governmental incentives and demands for certain firm behavior in furtherance of certain policy goals; (iii) the GOC's maintenance of ownership levels as a means to maintain control over the state sector; (iv) the GOC's management of market competition and market outcomes through the instrumentality of enterprises in the state sector; (v) the supervision of the State-Owned Assets Supervision and Administration Commission over SIEs; (vi) the GOC's control over all company appointments in the state sector; and (vii) the presence of CCP groups and committees within enterprises."[367]

The AB ultimately upheld the USDOC's finding that Chinese SOEs in which the GOC has *a full or controlling ownership interest* are "public bodies" that "possess, exercise, or are vested with governmental authority."[368] By contrast, Chinese SOEs in which the GOC has "*significant ownership* that are also subject to certain government industrial plans" *may exercise* governmental authority "if indicia show that these enterprises 'are used as instruments by the [GOC] to uphold the socialist market economy.'"[369] Such a determination would be made on a case-by-case basis. Significantly, even POEs that have no formal government ownership may be found to be "public bodies" if it is found that the GOC "exercises meaningful control over such enterprises."[370] In an earlier

364. *Id.*

365. Appellate Body Report, *United States–Countervailing Duty Measures on Certain Products from China, Recourse to Article 21.5 of the DSU by China*, ¶ 5.56, WTO Doc. WT/DS437/AB/RW (adopted July 16, 2019) [hereinafter *US– Countervailing Measures, Recourse to Article 21.5*].

366. *Id.*

367. *Id.*

368. *Id.* ¶ 5.57(a).

369. *Id.* ¶ 5.57(b) (emphasis added).

370. *Id.* ¶ 5.57.

dispute, the AB also ruled that Chinese state-owned commercial banks are "public bodies," given the scope and extent of control exercised over them by the GOC.[371]

The AB's finding that Chinese SOEs, and even sometimes POEs, exercise governmental authority is not surprising, given the institutional environment in China. Still, one may wonder whether the legal criteria endorsed by the AB are not too crude. [372] For instance, the AB held that once there is some evidence that a Chinese SOE is vested with governmental authority, it will be labeled as a "public body."[373] An investigating authority is not required to inquire into whether an entity is exercising a government function when engaging in the specific conduct being complained of.[374] As described in Part II of this Article, central to the Chinese SOE reforms has been the establishment of a modern enterprise system characterized by "clear property rights, well-defined powers and responsibilities, separation between government and business, and scientific management."[375] Although the Party's political control over the Chinese economy and SOEs is real, it cannot be true that all Chinese SOEs' commercial activities are an exercise of the GOC's governmental authority. There is rich empirical evidence showing that Chinese SOEs are principally business entities and that they compete with POEs and FIEs in at least many non-strategic sectors.[376] This fact should at least be considered and balanced against the finding that the GOC maintains control over the SOEs.

It remains to be seen whether investment tribunals will transplant the WTO jurisprudence on the "public body" to the context of the ILC

371. *See US – Antidumping and Countervailing Duties*, *supra* note 361, ¶ 355.

372. *See* Douglas Nelson, *How Do You Solve a Problem Like Maria? US – Countervailing Measures (China) (21.5)*, 20 WORLD TRADE REV. 556, 558 (2021).

373. *US – Countervailing Measures, Recourse to Article 21.5*, *supra* note 365, ¶ 5.105.

374. *Id.*

375. Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State Owned Enterprises (promulgated by the Central Comm. & State Council, Aug. 24, 2015) (China).

376. *See generally* Barry Naughton, *The Transformation of the State Sector: SASAC, the Market Economy, and the New National Champions*, *in* STATE CAPITALISM, INSTITUTIONAL ADAPTATION, AND THE CHINESE MIRACLE (Barry Naughton & Kellee S. Tsai eds., 2015) (explaining that the Chinese state sector was subjected to successive waves of market oriented reforms and state-owned firms were forced to adapt to market competition or perish); Karen Yeung, *China's State-Owned Enterprises Under Pressure from Foreign Investors to Boost Transparency,* S. CHINA MORNING POST (Apr. 17, 2019, 8:00 PM), https://www.scmp.com/economy/china-economy/article/3006594/chinas-state-owned-firms-under-pressure-foreign-investors.

Article 5 analysis.[377] The crucial point is that to attribute a Chinese SOE's investment to the GOC under the ILC Article 5, it is not sufficient that Chinese SOEs are found to possess elements of governmental authority. It is also essential that this SOE exercises government authority in the particular investment project at issue.[378] This requirement is difficult to meet in practice. In the first place, an investment activity is essentially commercial in nature. Both SOEs and POEs make investments in normal business transactions and compete against other investors in the process. Having examined 1,279 cross-border acquisitions conducted by Chinese SOEs from 2002 to 2017, Fuest and others found that there is no evidence showing that Chinese SOEs have paid higher prices than other types of investors in acquiring companies with comparable characteristics, and "[t]his [finding] contradicts the view that government support enables Chinese companies to outbid other investors in the global M&A market."[379] The predominant commercial motivation of Chinese SOEs in their OFDI activities was also testified by multiple external parties, such as international investment banks, law firms, accounting firms, rating agencies, corporate partners, and financiers involved in the transactions.[380] Moreover, as a practical matter, how could a respondent state bear the burden of proof showing that a particular SOE investment is an exercise of governmental authority rather than a commercial act?

The arbitral tribunal's analysis in *BUCG v. Yemen* reflects this approach, i.e., it is essential to find an SOE exercising government authority in the particular investment project at issue in order to attribute the SOE's investment to the government. Although the tribunal accepted that Yemen's description of BUCG, a Chinese SOE, in the broad context of China's state-controlled economy was convincing, the tribunal found the description largely irrelevant because the issue was *not* the corporate framework of BUCG, but whether it discharged a Chinese governmental function "in the particular instance," namely, the construction of the Sana'a International Terminal project in Yemen.[381] The tribunal concluded that BUCG was not discharging a

377. Jürgen Kurtz, *The Use and Abuse of WTO Law in Investor–State Arbitration: Competition and Its Discontents*, 20 EUR. J. INT'L. L. 749, 771 (2009) (warning that WTO jurisprudence may be misused in the investment arbitration setting).

378. Jan de Nul Award, *supra* note 327, ¶ 163; EDF Award, *supra* note 327, ¶ 191.

379. Fuest et al., *supra* note 239, at 330.

380. Megan Bowman et al., *China: Investing in the World* Working Paper No. 13-5 CTR. FOR L., MKTS. & REGUL. 18 (2013), http://www.austlii.edu.au/au/journals/UNSWLRS/2013/70.pdf.

381. BUCG Decision on Jurisdiction, *supra* note 303, ¶ 42.

PRC governmental function in winning a contract through a competitive bidding process and building an airport terminal.[382]

2. Are Chinese SOEs Agents of the Government of China?

A challenge of Chinese SOEs' standing in ISDS may also be based on Article 8 of the ILC Articles.[383] If there is evidence showing that a Chinese SOE is under the effective control of the GOC and that the GOC exercised its ownership interest in or control of an SOE specifically in order to achieve a particular result, the investment would be attributed to the GOC.[384] Then the SOE in question will not have standing to bring an arbitration case against a host state.[385] Although disputing Chinese SOEs' standing through Article 8 of the ILC Articles is a potential route, it will be challenging for the respondent state to sustain this argument in practice for three reasons. To begin with, the ILC Commentary makes it clear that the attribution under Article 8 is highly demanding and exceptional.[386] It requires not only a general direction or control of the state over the SOE but also a specific control of the state over the particular investment in question. Even if the GOC has recently tightened the political control of SOEs, there is little evidence that the GOC has intervened in specific OFDI projects made by SOEs.[387] Indeed, one of the core objectives of the new round of SOE reforms is to redefine the role of the GOC not as the owner and regulator of SOEs but as a core investor.[388]

Secondly, whether a specific Chinese SOE's OFDI was performed under the direction and control of the GOC is ultimately an issue of examining the evidence on record.[389] As a legal matter, whether the state has exerted the required level of control to achieve a particular result is difficult to prove because, in most cases, the interests of the state and its SOEs are coincident. For example, in *Tulip v. Turkey*, in

382. *Id.*, ¶¶ 39–41.

383. *See generally* Abby Cohen Smutny, *State Responsibility and Attribution: When Is a State Responsible for the Acts of State Enterprises? Emilio Agustín Maffezini v. The Kingdom of Spain*, *in* INTERNATIONL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 17 (Todd Weiler ed., 2005).

384. Gustav Award, *supra* note 327, ¶ 198.

385. *Id.*

386. EDF Award, *supra* note 327, ¶ 200.

387. BUCG Decision on Jurisdiction, *supra* note 303, ¶ 40; China Heilongjiang Award, *supra* note 303, ¶ 418.

388. Hao Chen & Meg Righmire, *The Rise of the Investor State: State Capital in the Chinese Economy*, 55 STUD. COMP. INT'L DEV. 257, 258 (2020).

389. The ILC Draft Articles, *supra* note 306, at 48.

view of the Turkish government agency TOKI's dominant position in relation to the SOE Emlak, whether Emlak's decision to terminate the contract with Tulip JV was made by the Board of Emlak independently in the pursuit of Emlak's commercial interests or as a result of the exercise of sovereign power by TOKI was controversial.[390] Even if there was some limited evidence supporting the claimant's contention that the decision to terminate the investment contract was connected to TOKI, the tribunal ultimately concluded that business-related aspects predominated in Emlak's operations.[391] Similarly, the unique Chinese SOE governance structure, such as the role of party committee within SOEs and various informal channels through which the government influence may be exerted, do not necessarily mean that a Chinese SOE loses its essential commercial aim in a particular investment.

In *BUCG v. Yemen*, the evidentiary record discloses that BUCG participated in the airport project as a general contractor following an open tender in competition with other contractors. Its bid was selected on its commercial merits. Its contract was terminated, not for any reason associated with China's decisions or policies but because of alleged BUCG's failure to perform its commercial services on the airport site to a commercially acceptable standard.[392] Therefore the tribunal concluded that there was no evidence to establish that, in building an airport terminal in Yemen, BUCG was acting as an agent of the GOC. In the same vein, the arbitral tribunal summarily dismissed the Mongolian Government's claim in *Heilongjiang International Economic & Technical Cooperation Corp et al. v. Mongolia* because there was no evidence on the record to support the conclusion that the two Chinese SOE claimants acted as quasi-instrumentalities of the Chinese government.[393]

C. *A Policy Perspective*

The function of Articles 5 and 8 of the ILC Articles, as interpreted by investment tribunals, is grounded on two important assumptions. First, despite the state ownership and state control, SOEs are capable of engaging in economic transactions on a purely commercial basis as POEs.[394] Absent any express limitation, SOEs should be treated in the same way as POEs when they engage in commercial acts. Consequently,

390. Separate Opinion of Michael Evan Jaffe, *supra* note 308, ¶ 6.

391. Tulip Decision on Annulment, *supra* note 354 ¶ 219; *see also* OAO Tatneft Partial Award on Jurisdiction, *supra* note 349, ¶¶ 149–50.

392. BUCG Decision on Jurisdiction, *supra* note 303, ¶ 40.

393. China Heilongjiang Award, *supra* note 303, ¶ 418.

394. *See* BUCG Decision on Jurisdiction, *supra* note 303, ¶ 40.

the protection afforded by IIAs, including the ISDS clause, should be available to SOEs when they act in their commercial capacity. Second, even though SOEs must meet non-commercial objectives set out by their state shareholder that sometimes go beyond mere financial and economic returns,[395] it does not automatically lead to the conclusion that SOEs certainly and always do so. The arbitral tribunals are able to separate an SOE's independent business decisions from *de facto* political decisions to achieve a particular outcome.

However, the formalistic distinction between a commercial act (private) and a sovereign/governmental act (public) may be blurred in practice. [396] Concepts of the public and private are complex, shifting, and reflect political preferences with respect to the level and quality of governmental intrusion. There is no reliable or constant basis for the distinction. As the ILC Articles are based on a liberal conception of the state and market model, it is at least doubtful whether attribution rules in the ILC Articles are an "effective legal device to enhance the accountability of States for the acts of their instrumentalities, especially in the context of rather undefined experiences of State-driven economies."[397] Take Chinese SOEs as an example. Operating in the interface of competing dimensions of the public and private, it is difficult to ascertain where the sovereign ends and the investor begins.[398]

One technique for drawing the distinction is to examine the character of relevant acts of SOEs and ask whether a POE can also carry out those acts.[399] Thus, investment tribunals have relied on an assessment of the *nature* of SOE acts rather than their motive or purpose as a basis for defining the scope of commercial acts. This position is largely consistent with the distinction between *acta jure imperii* and *acta jure gestionis* in order to determine the scope of sovereign immunity.[400] However, as the international economic order is transitioning away from the

395. Malcolm G. Bird, *State-Owned Enterprises: Rising, Falling and Returning? A Brief Overview*, *in* THE ROUTLEDGE HANDBOOK OF STATE-OWNED ENTERPRISES 60, 61–63 (Luc Bernier et al. eds., 2020).

396. Chinkin, *supra* note 26, at 389.

397. STEFANO, *supra* note 307, at 58.

398. Nalbandian, *supra* note 27, at 13–14.

399. *See* CSOB Decision on Jurisdiction, *supra* note 318, ¶ 25; Jan de Nul Award, *supra* note 327, ¶¶ 169–70; Gustav Award, *supra* note 327, ¶ 202.

400. Rosalyn Higgins, *Certain Unresolved Aspects of the Law of State Immunity*, 29 NETH. INT'L L. REV. 265, 268–72 (1982); CHRISTOPH H. SCHREUER, STATE IMMUNITY: SOME RECENT DEVELOPMENTS 96–98 (1988).

neoliberal order towards a new geoeconomics order[401], "the extent to which states are entitled to use commercial channels to pursue strategic, geopolitical purposes lies at the very heart of the ideological drift between liberal capitalis[m] and state capitalis[m] countries."[402] It is precisely against this background that the standing of SOEs in ISDS has become a markedly controversial issue.

The legal analysis has shown that it is highly unlikely that Chinese SOEs would be denied standing as claimants in ISDS. It is important to stress that it may not be a guaranteed outcome in every dispute because attribution rules in the ILC Articles are highly flexible.[403] For example, the concept of governmental authority in Article 5 is "not only undefined but elusive when pursued."[404] The ILC commentary to Article 5 makes it clear that various elements and circumstances surrounding the entity and a given act or transaction, including the purpose of the act, may be taken into account in identifying the scope of governmental authority.[405] It was only developed in the case law that the purpose test is not decisive and that it has only a secondary role in comparison to the nature test. Furthermore, the WTO AB has already made the finding that Chinese SOEs in which the GOC has a full or controlling ownership interest "possess, exercise, or are vested with governmental authority."[406] If this ruling is transplanted to international investment law, then the remaining issue would be whether the Chinese SOE has exercised governmental authority in the particular investment in dispute. Even if the nature test has primary relevance for the purposes of attribution of SOEs conduct to the state, it was already proposed in the literature that the principle of competitive neutrality may be applied in the context-based analysis of the nature test. That is, if an SOE could not have made an investment on a rational basis, like any other private competitor in the market arena, without availing itself of its association with the state, then the investment may be attributed to the state.[407]

401. *See* Anthea Roberts et al., *Toward a Geoeconomic Order in International Trade and Investment*, 22 J. INT'L ECON. L. 655, 676 (2019).

402. Nalbandian, *supra* note 27, at 12.

403. James Crawford, *Revising the Draft Articles on State Responsibility*, 10 EUR. J. INT'L L. 435, 439–40 (1999).

404. David D. Caron, *The ILC Draft Articles on State Responsibility: The Paradoxical Relationship Between Form and Authority*, 96 AM. J. INT'L L. 857, 861 (2002).

405. The ILC Draft Articles, *supra* note 306, at 43.

406. *US – Countervailing Measures, Recourse to Article 21.5*, *supra* note 365, ¶ 5.56 (internal quotation marks omitted).

407. STEFANO, *supra* note 307, at 164.

With this caveat in mind, it remains highly unlikely that an investment tribunal would go to great lengths to reject the standing of a Chinese SOE in ISDS proceedings in the future for three reasons. First, SOEs are explicitly covered as qualified investors eligible to initiate ISDS proceedings in recently concluded Chinese IIAs.[408] When the intention of the IIA parties is clear, there are no good reasons for the host state to challenge the standing of Chinese SOEs in ISDS proceedings, nor are there strong reasons for an investment tribunal to go so far as to ignore the shared intention of the parties. Any limits on the access of SOEs to ICSID in such a scenario may diminish the institutional significance of ICSID.[409] It is also possible for SOEs to elect an arbitral institution other than ICSID and arbitral rules other than the ICSID convention.

Second, concerns about Chinese SOEs' OFDI are best addressed at the pre-entry stage of investment. Few IIAs grant foreign investors unconstrained rights with respect to cross-border acquisitions and investments. In any case, admission of foreign investment is subject to the laws and regulations of the host state.[410] Thus, host states are largely free to exclude investment from SOEs or attach conditions before admission is granted.[411] For example, the proliferation of national security screening mechanisms has allowed host states almost unlimited discretion to prohibit proposed investment or require foreign investors to undertake onerous commitments to alleviate any regulatory concerns that a host state might have.[412]

Third, once a Chinese SOE's OFDI project is granted market access, it is fully subject to the regulatory framework of the host state. Rigorous enforcement of the laws of the host state is likely to deal with most of the concerns caused by the SOEs' investment. For example, corporate laws impose robust fiduciary duties on the controlling shareholder, the

408. For example, Art. 9.10(a) of the China-Australia Free Trade Agreement defines a claimant in ISDS as an "investor" of a party. ChAFTA, *supra* note 313, art. 9.10. Art. 9.1(e) defines "investor" as a natural person or an enterprise of a party that seeks to make an investment. *Id.* art. 9.1(e). Article 9.1(b) states: "enterprise means any entity constituted or organised under applicable law, whether or not for profit, and *whether privately or governmentally owned or controlled*. . .." *Id.* art. 9.1(b) (emphasis added). *See, e.g.*, Canada-China BIT, *supra* note 313, art. 1 (10)(a); China-Mexico BIT, *supra* note 313, art. 1(b).

409. Low, *supra* note 311, at 3.

410. Annacker, *supra* note 314, at 563.

411. *Id.* at 562–63.

412. *See* Frédéric Wehrlé & Joachim Pohl, *Investment Policies Related to National Security: A Survey of Country Practices* 24–25 (OECD Working Papers on Int'l Inv., Paper No. 2016/02, 2016).

directors, and the senior management of the firm.[413] The point is whatever concerns a host state may have about Chinese SOEs, these concerns seem to be well addressed by national investment laws and regulations either at the pre-entry stage or on an ongoing basis.

By contrast, it is not clear what policy objectives a denial of Chinese SOEs' standing in ISDS proceedings would achieve. One thing is clear: it would deprive Chinese SOEs of an important, and sometimes the sole, remedy when a host state breaches its IIA obligations. Similar to other international economic governance regimes, such as the WTO and the EU,[414] international investment law does not impose any particular obligations on states with respect to property ownership. Since how capital should be formed is a fundamental choice of domestic policymaking, international law cannot, nor should it prescribe such basic choices if it is to remain effective.[415] Moreover, the advantages of ISDS in "delocalizing" investment disputes by affording foreign investors an alternative to domestic courts and in "depoliticizing" investment disputes by removing them from the realm of diplomatic protection have long been acknowledged.[416] It might be a convenient litigation strategy for the respondent state to persuade investment tribunals to refrain from exercising jurisdiction. For Chinese SOEs, however, disqualification from claiming under IIAs would likely leave their legitimate investments not effectively protected and, in turn, undermines the rule of law in international investment.

V. Weaponing National Security Review against Chinese SOEs

One of the most striking trends in investment policy over the past decade was that numerous countries have introduced new or reinforced existing national security screening mechanisms for foreign investment.[417] Recent examples include the U.K.'s new National

413. *See* Paul Rose, *Sovereigns as Shareholders*, 87 N.C.L. REV. 83, 104 (2008).

414. *See* Treaty on the Functioning of the European Union, art. 345, Mar. 25, 1957; Petros C. Mavroidis & Thomas Cottier, *State Trading in the Twenty-First Century: An Overview*, *in* STATE TRADING IN THE TWENTY-FIRST CENTURY 3, 3 (Thomas Cottier & Petros C. Mavroidis eds., 1998).

415. Bin Gu & Chengjin Xu, *Treatment Standards of State-Owned Enterprises as Public Entities: A Clash or Convergence Across International Economic Laws?*, 50 H.K.L.J. 1025, 1053–54 (2020).

416. Sergio Puig, *Emergence & Dynamism in International Organizations: ICSID, Investor-State Arbitration & International Investment Law*, 44 GEO. J. INT'L L. 531, 550–52 (2013).

417. For example, from January 2011 to September 2019, at least 13 countries introduced new regulatory frameworks. In addition, at least 45 significant amendments to existing screening systems were recorded in 15 jurisdictions in this period. *See* U.N. Conference on Trade and Development, *National Security-Related Screening Mechanisms for Foreign Investment: An Analysis of Recent Policy Developments*, at 4, INV. POLICY MONITOR (SPECIAL ISSUE) (Dec. 2019).

Security and Investment Act 2021, the EU's new investment screening framework, and the enhanced investment screening requirements that are embodied in the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) in the United States.[418] The Covid-19 crisis has accelerated this trend in response to new concerns about foreign investment in light of the pandemic.[419] China has frequently accused other states of abusing national security review of investment from China. For instance, China's Ministry of Commerce has identified the abuse of national security review as a major regulatory hurdle for Chinese investors in the U.S.[420] Commenting on Australia's decision to block a Chinese SOE's acquisition of a major Australian construction company in 2021, the Chinese Embassy in Canberra accused Australia of "weaponizing" national security.[421] This section will first explain the reasons for the proliferation of national security reviews in national investment laws before highlighting how certain features of national security reviews in major Western countries impact Chinese investors, in particular SOE investors, and how Chinese investors respond to the increasingly weaponized national security reviews.

A. *Explaining the Proliferation of National Security Review*

A number of factors account for the proliferation of national security review mechanisms in national foreign investment laws. To begin with, whereas the concept of national security was traditionally framed in terms of an armed attack, civil war, terrorist activity, rioting, or other nexus to warfare, the range of issues may be credibly described as national security has expanded exponentially in the 21st century world of complex supply chains and "weaponized interdependence."[422] Diffuse threats such as economic emergencies, infectious disease, cybersecurity, transnational crime, corruption, human rights violations, environmental degradation, and climate change are perceived as national security matters even if there is no military dimension.[423] As

418. *See generally* CHENG BIAN, NATIONAL SECURITY REVIEW OF FOREIGN INVESTMENT: A COMPARATIVE LEGAL ANALYSIS OF CHINA, THE UNITED STATES AND THE EUROPEAN UNION (2020).

419. Harlan Grant Cohen, *Nations and Markets*, 23 J. INT'L ECON. L. 793, 796–97 (2020).

420. *Regular Press Conference of the Ministry of Commerce (July 25, 2019)*, Ministry of Com., China (July 29, 2019), http://english.mofcom.gov.cn/article/newsrelease/press/201908/20190802889887.shtml.

421. Parsons, *supra* note 269.

422. Henry Farrell & Abraham L. Newman, *Weaponized Interdependence: How Global Economic Networks Shape State Coercion*, 44 INT'L SEC. 42, 45 (2019).

423. J. Benton Heath, *The New National Security Challenge to the Economic Order*, 129 YALE L.J. 1020, 1034–36 (2020).

the range of security threats expands, so does the range of industries that may be considered security sensitive. The sensitive sectors are no longer limited to military and defense industries and can encompass, among others, telecommunications, transportation, energy, water and food supply, education, health services, and the media.[424] For example, the national security review of foreign investment in Canada may take into account not only factors related to traditional militarized security, such as the potential effects on Canada's national defense capabilities and sensitive technologies, but also new national security concerns, such as the supply of critical goods and services, sensitive personal data, organized crime, and corrupt foreign officials.[425]

Furthermore, technology is a key enabler for economic, political, and military power and a crucial factor for the international competitiveness of countries.[426] The mastery of cutting-edge technologies and know-how is vital to economic growth, national security, and social stability.[427] Some technological areas, such as artificial intelligence, high-performance computing, biomaterials, and the emerging 5G network, appear to offer the potential for transformative change. Advances in these areas are likely to shape societies, economies and create new forms of power and influence in the international system. States in possession of such assets may have a strong interest in ensuring that they remain in domestic hands.[428] It is, therefore, unsurprising that the FIRRMA expands the scope of "covered transactions" that fall within the national security review to include critical *technologies*, critical *infrastructure,* and security-sensitive personal *data* of U.S. citizens (TID U.S. business).[429] Notably, there is no equity acquiring threshold that would except a "covered transaction" in a TID U.S. business, meaning that a foreign person acquiring even 1% interest in a TID U.S. business would

424. Wehrlé & Pohl, *supra* note 412, at 22.

425. *Guidelines on the National Security Review of Investments*, GOV'T CANADA (Mar. 24, 2021), https://ised-isde.canada.ca/site/investment-canada-act/en/investment-canada-act/guidelines/guidelines-national-security-review-investments.

426. *See* Martijn Rasser & Megan Lamberth, *Taking the Helm: A National Technology Strategy to Meet the China Challenge*, CTR. FOR NEW AM. SEC. 9–11 (2021).

427. *See* James Manyika et al., *Disruptive Technologies: Advances That Will Transform Life, Business, and the Global Economy*, MCKINSEY GLOB. INST. 19 (2013).

428. NAT'L INTEL. COUNCIL, GLOBAL TRENDS 2040: A MORE CONTESTED WORLD 56–57 (2021); Matthew Daniels & Ben Chang, *National Power after AI*, CTR. FOR SEC. & EMERGING TECHS. 12–18 (July 2021).

429. Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), Pub. L. No. 115-232, § 1703(a)(4).

be considered a "covered transaction" if certain rights are granted to foreign investors.[430]

Next, strengthening national security mechanisms is, in part, also a reaction to the increasing investment activities of SOEs and sovereign wealth funds.[431] As discussed in Part III above, one of the most acute concerns regarding sovereign investment is that their corporate and investment decisions may be driven by political and strategic objectives rather than commercial and market considerations.[432] Different from private investors, sovereign investment is not necessarily expected to maximize profits and long-term corporate value. That may jeopardize the national security, energy security, economic security, technological edge, or other vital interests of a host country.[433]

Lastly, the upgrading of investment screening mechanisms in some Western countries represents a direct reaction to the rising investment from China in strategic industries as well as to the transformation of the geopolitical background. China's unique state capitalism model has generated a heated debate regarding the merits of state-led development and the crisis of Western liberal capitalism. For the first time since 1850, the global capitalist system is experiencing "the rapid rise of a continent-sized capitalist power that espouses ideas, institutions, [interests, and values] fundamentally different from those of Anglo-American capitalism."[434] Therefore, China's state-led economic model itself was identified as a key challenge to the liberal international economic order and, in particular, the economic and national security interests of the U.S.[435] The U.S. National Defense Authorization Act for 2019 declared that "long-term strategic competition with China is a [national security] priority" that must be addressed through a combination of military, political, and economic means.[436]

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430. *See id.*

431. Milan Babic, *State Capital in a Geoeconomic World: Mapping State-Led Foreign Investment in the Global Political Economy*, 30 REV. INT'L. POL. ECON. 201, 206 (2021).

432. *See* Jennifer Lind & Daryl G. Press, *Markets or Mercantilism? How China Secures its Energy Supplies*, 42 INT'L SEC. 170, 204 (2018).

433. *Welcoming Foreign Direct Investment While Protecting Essential Interests*, at 5, COM (2017) 494 final (Sept. 13, 2017).

434. Christopher A. McNally, *Sino-Capitalism: China's Reemergence and the International Political Economy*, 64 WORLD POL. 741, 765 (2012).

435. U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION, 2018 REPORT TO CONGRESS OF THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION: EXECUTIVE SUMMARY AND RECOMMENDATIONS 1 (2018).

436. John S. McCain National Defense Authorization Act for Fiscal Year 2019, Pub. L. No. 115-232, § 1261(a), 132 Stat. 1636, 2060 (2018).

B. *Heightened Scrutiny of Chinese SOEs' Investment*

In most cases, SOEs are treated in the same manner as POEs under domestic regulatory frameworks. However, some states, such as the United States, Australia, and Canada, have applied special review procedures to address national security concerns stemming from investment by SOEs.[437] These reviews are either cross-sectoral or sector-specific, and a foreign SOE's investment may be partially or totally prohibited after the review.[438] The enhanced scrutiny of investments from SOEs is based on the conventional wisdom that SOEs inherently present greater national security risks to host countries than other investments. However, there is no empirical evidence supporting such a claim.[439]

In the United States, the foreign investment review process conducted by the Committee on Foreign Investment (CFIUS) is comprised of three formal steps: a declaration or written notice; a national security review; and a national security investigation.[440] Although the process of notifying a transaction to CFIUS remains largely voluntary, a declaration is mandatory for transactions involving a foreign person in which a foreign government has a "substantial interest," defined as a 25% ownership interest between a foreign person and U.S. business and 49% ownership interest or greater between a foreign government and foreign person.[441] Moreover, if a national security review indicates that the foreign person is controlled by a foreign government, CFIUS is required to conduct a national security investigation and take any necessary actions.[442] In other words, any government-controlled entity investing in the U.S. must undergo a national security investigation.

In Canada, two types of review of foreign investment made by non-Canadian investors are provided by the Investment Canada Act (ICA): national security reviews and net benefit reviews.[443] All investments by SOEs, including even private investors assessed as being closely tied to

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437. *See* Du, *supra* note 20, at 126–32.

438. Shima, *supra* note 216, at 7–9.

439. Dep't for Bus., Energy & Indus. Strategy, National Security and Investment Act 2021: Statement for the Purposes of Section 3 ¶ 26 (2021) ("The Secretary of State does not regard state-owned entities, sovereign wealth funds or other entities affiliated with foreign states, as being inherently more likely to pose a national security risk.").

440. JAMES K. JACKSON, CONG. RSCH. SERV., RL33388, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) 12 (2020).

441. Foreign Investment Risk Review Modernization Act of 2018, Pub. L. No. 115-232, § 1706 (IV)(bb), 132 Stat. 2174, 2185 [hereinafter FIRRMA]; 31 C.F.R. § 800.244(a)–(b) (2020).

442. *See* 50 U.S.C. app. § 2170(b)(1)(B); *see also* JACKSON, *supra* note 440, at 22–23.

443. Huy Do et al., *The Foreign Investment Regulation Review: Canada*, THE L. REVS. (Oct. 21, 2022), https://thelawreviews.co.uk/title/the-foreign-investment-regulation-review/canada.

or subject to direction from a foreign government, are subject to enhanced national security scrutiny under the ICA, regardless of the value or size of the investment.[444] Net benefit review under the ICA occurs when an investment exceeds a certain financial threshold. The 2023 threshold for private sector investment is C$1.287 billion in enterprise value.[445] In comparison, the financial threshold applicable to foreign SOEs' investment is significantly lower: C$512 million in book value of assets.[446] Pursuant to the SOE guidelines, the Minister may consider the governance and commercial orientation of foreign SOEs in determining whether an acquisition by an SOE is of net benefit to Canada. In practice, that means that SOEs seeking to complete investments subject to the ICA must satisfy the Minister that they are free from political influence and that they will adhere to Canadian laws, implement standards and practices that promote sound corporate governance and transparency, adopt free market principles, and make positive contributions to the productivity and industrial efficiency of the Canadian business.[447]

The Australian government is empowered to examine proposed foreign investments and to decide if they are contrary to Australia's national interest. While prior approval is necessary only if investment exceeds certain thresholds in the case of private foreign investors, the Foreign Investment Review Board (FIRB) would launch an investigation whenever an SOE acquires a direct interest (usually 10% or more) in an Australian entity or business, regardless of the value.[448] As part of its national interest assessment, the FIRB normally considers various factors, including national security, competition, impact on the community and the economy, the character of the investor, and other government policies such as taxation.[449] Moreover, where foreign SOE investors are involved, the FIRB would also consider additional factors, including "[whether] the investment is commercial in nature or if the

444. The Minister of Innovation, Sci. & Indus., Guidelines on the National Security Review of Investments ¶ 7 (2021).

445. *See Thresholds for Review*, GOV'T CANADA, https://ised-isde.canada.ca/site/investment-canada-act/en/investment-canada-act/thresholds.

446. *See id.*

447. *Statement Regarding Investment by Foreign State-Owned Enterprises*, GOV'T CANADA (2012).

448. *See* AUSTRALIAN GOVERNMENT FOREIGN INVESTMENT BOARD, *supra* note 266, at 6.

449. Certain investments that do not meet thresholds to be reviewed under the national interest test, to which national security assessment is one factor to be considered, may still be screened under a separate national security test if the investment relates to a 'national security business' or 'national security land'. *See National Security Guidance*, FOREIGN INV. REV. BD. 3 (2021) (Austl).

investor may be pursuing broader political or strategic objectives that may be contrary to Australia's national interest."[450]

C. *A Critique of Weaponized National Security Review: The United States as an Example*

1. The Expansive Concept of National Security

Like other states, one key feature of U.S. national security screening of foreign investment is that the very concept of national security itself is undefined. It was purposefully left ambiguous, in theory giving regulators flexibility to deal with future and yet unforeseen threats.[451] In lieu of defining national security, the Foreign Investment and National Security Act of 2007 (FINASA) set forth a non-exhaustive list of eleven factors that CIFUS may consider when assessing the national security risks of a proposed investment.[452] The FIRRMA further provides a "sense of Congress" concerning six additional factors that CFIUS should consider.[453]

The listed factors have raised interpretation issues, including overly broad and vague elements such as "critical infrastructure" and "critical technology."[454] Further, "[i]t is not clear how these factors are assessed, which factors are more important and why," how to weigh and balance the relevant factors, "and how to draw a conclusion if different factors point to different inferences."[455] As a result, CFIUS retains almost unlimited discretion to prohibit a proposed investment or requires a foreign investor to undertake onerous commitments to alleviate any national security concerns that CFIUS might have.

The expansive concept of national security is a serious threat to international economic governance. If national security is conceptualized as a "fusion of economic, ideological and technological supremacy[,]"[456] how can one draw the line between the protection of legitimate security concerns and impermissible protectionism? Without proper control of

450. *See* AUSTRALIAN GOVERNMENT FOREIGN INVESTMENT BOARD, *supra* note 266, at 10.

451. *See* Deborah M. Mostaghel, *Dubai Ports World Under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?*, 70 ALB. L. REV. 583, 592–93 (2007).

452. *See* Defense Production Act of 1950 § 721(f); 50 U.S.C. § 4565, *amended by* Foreign Investment and National Security Act of 2007.

453. *See* FIRRMA § 1702(c)(1)–(6).

454. *See Dave Clemente, Cyber Security and Global Interdependence: What is Critical?,* 16–17 (2013).

455. Du, *supra* note 20, at 137.

456. Joel Slawotsky, *The Fusion of Ideology, Technology and Economic Power: Implications of the Emerging New United States National Security Conceptualization*, 20 CHINESE J. INT'L L. 3, 60–61 (2021).

its potential abuse, an expansive conceptualization of national security may move "the norm from economically oriented efficiency and interdependence to security-oriented self-reliance and self-sufficiency."[457]

2. Unpredictable, Discriminatory, and Politicized National Security Review

The decision-making process in the U.S. national security review is frequently criticized as unpredictable, untransparent, discriminatory, politicized, and prone to abuse.[458] Firstly, national security reviews may be discriminatory. In *Ralls Corp. v. CFIUS*, a Chinese-owned company Ralls sought to acquire a wind-farm project near a U.S. Navy weapons systems training facility in north-central Oregon.[459] CFIUS issued orders mandating interim mitigation measures, and President Obama followed up with an executive order formally blocking the deal.[460] However, the fact that dozens, if not hundreds, of other foreign-owned and foreign-made wind turbines also operated within the vicinity of the U.S. Navy installation was conveniently ignored.[461] The FIRRMA has further legalized the discriminatory practice by allowing CFIUS to discriminate among foreign investors in reviewing investment transactions by labeling some countries as "a country of special concern"—a country that "has a demonstrated or declared strategic goal of acquiring a type of critical technology or critical infrastructure that would affect United States leadership in areas related to national security[.]"[462] Given that the FIRRMA's special momentum stemmed from concerns about increasing Chinese investment in American businesses, Chinese investors are most likely the targets of the discriminatory treatment. In fact, the FIRRMA requires the Secretary of Commerce to submit to Congress and CFIUS a detailed report on foreign direct investment

457. Anthea Roberts et al., *Geoeconomics: The U.S. Strategy of Technological Protection and Economic Security*, LAWFARE (Dec. 11, 2018, 7:00 AM), https://www.lawfareblog.com/geoeconomics-us-strategy-technological-protection-and-economic-security.

458. *See* Berg, *supra* note 21, at 1792–1800; Cheng Bian, *Foreign Direct Investment Screening and National Security: Reducing Regulatory Hurdles to Investors Through Induced Reciprocity*, 22 J. WORLD INV. & TRADE 561, 565–66 (2021).

459. *Ralls Corp. v. CFIUS*, 758 F.3d 296, 304 (D.C. Cir. 2014).

460. The interim mitigation measures prevent Ralls from building the wind farms during the pendency of CFIUS review and ordering the removal of all items from the project sites, including concrete foundations. *Ralls Corp.*, 758 F.3d at 305–06.

461. *See id.* at 305.

462. *See* FIRRMA, § 1702(c)(1).

transactions made by Chinese investors in the U.S. every two years after the enactment of the FIRRMA until 2026.[463]

Secondly, confidentiality marks a key feature of the CFIUS. The CFIUS process shields the inner workings of its members from public knowledge and even from the foreign investors affected by the review.[464] Information submitted to CFIUS is confidential and, with limited exceptions, not subject to information disclosure requirements.[465] The lack of transparency creates hidden barriers for foreign investors in practice. Combined with CFIUS's broad power, the national security review process has become so unpredictable that some commentators called it a "lottery" for foreign investors.[466]

Thirdly, the CFIUS review process is vulnerable to politicization.[467] As a profoundly contested political issue, a national security review of high-profile M&A transactions can easily fall prey to congressional outcry, media sensationalism, and public hysteria. The evidence shows that "almost all major deals [involving Chinese SOE acquirers] were subject to politicization by the media, members of Congress, the security community, domestic industry incumbents, and groups generally critical of China."[468] Consequently, rather than addressing real national security concerns, political interference based on political gamesmanship, emotion, and even xenophobia create huge uncertainties for Chinese investors.[469]

The botched attempt by CNOOC, a Chinese SOE, to acquire Unocal in 2005 was a typical example. The congressional reaction was so vehement that CNOOC withdrew its bid before CFIUS completed its

463. *See id.* §1719(b).

464. In Ralls, for example, the court found that the U.S. Government did not provide Ralls with advance notice, access to the unclassified evidence supporting the decision, and an opportunity to rebut that evidence. *See Ralls Corp.*, 758 F.3d at 320.

465. *See* FIRRMA, § 721(c)(1)–(2). On the other hand, assessing the proper standard of transparency in relation to national security review requires taking into account the sensitivity of the information at issue.

466. Xingxing Li, *National Security Review in Foreign Investments: A Comparative and Critical Assessment on China and U.S. Laws and Practices*, 13 BERKLEY BUS. L.J. 255, 272 (2015).

467. EDWARD M. GRAHAM & DAVID M. MARCHICK, US NATIONAL SECURITY & FOREIGN DIRECT INVESTMENT 123 (2006).

468. DANIEL H. ROSEN & THILO HANEMANN, AN AMERICAN OPEN DOOR? MAXIMIZING THE BENEFITS OF CHINESE FOREIGN DIRECT INVESTMENT 62 (2011).

469. *See* Yiheng Feng, "*We Wouldn't Transfer Title to the Devil": Consequences of the Congressional Politicization of Foreign Direct Investment on National Security Grounds*, 42 N.Y.U. J. INT'L L. & POL. 253, 280–83 (2009); *see also* Li Zhou, The Danger of Anti-China Rhetoric, VOX (Aug. 5, 2021), https://www.vox.com/22558949/china-violence-asian-americans.

review.[470] With the benefit of hindsight, it is now clear that the U.S. had overreacted. The main concern that CNOOC might divert Unocal's energy supplies exclusively to meet China's needs was not strongly supported. By 2005, Unocal was no longer a major player in the energy industry.[471] In 2004, the year before the transaction, Unocal produced about 1% of the U.S. natural gas consumption.[472] It possessed no refineries in the United States, and its most valuable assets were located primarily overseas,[473] which was the primary reason why CNOOC found it so attractive in the first place. To assuage the national security concerns, CNOOC announced its willingness to divest itself of Unocal's American holdings.[474] Even if CNOOC rerouted all Unocal's U.S. production to China, which was economically penalizing for CNOOC and its controller, it would not harm the U.S. interest because "US buyers [could easily] replace Unocal's minuscule production . . . with extra imports" from the international market.[475]

Likewise, 50 members of the U.S. Congress representing the Congressional Steel Caucus urged CFIUS to scrutinize a joint venture between U.S.-based Steel Development Co. and China's fourth-largest steelmaker and state-owned Anshan Iron & Steel Group in July 2010.[476] In its letter to Secretary Timothy Geithner, the Congressional Steel Caucus stated that the investment could give the Chinese "access to new steel production techniques and information regarding American national security infrastructure projects."[477] Anshan announced that it had decided, given the opposition from the members of Congress, to put its investment on hold, notwithstanding the absence of any decision

470. *See* Joshua W. Casselman, *China's Latest 'Threat' to the United States: The Failed CNOOC-UNOCAL Merger and its Implications for Exon-Florio and CFIUS*, 17 IND. INT'L & COMPAR. L. REV. 155, 164 (2007).

471. DICK K. NANTO ET AL., CONG. RSCH. SERV., RL33093, CHINA AND THE CNOOC BID FOR UNOCAL: ISSUES FOR CONGRESS 9 (2005) ("[w]hen [Unocal] was placed on the market in 2005, most observers no longer categorized it as a major oil company.").

472. *Id.* at 10.

473. *See* CNOOC Limited Proposes Merger with Unocal Offering USD $67 Per Unocal Share in Cash, CNOOC LTD. (June 23, 2005), https://www.cnooltd.com/art/2005/6/23/art_8431_1130421.html.

474. *See id.*

475. *See* THEODORE H. MORAN, FOREIGN ACQUISITIONS AND NATIONAL SECURITY: WHAT ARE GENUINE THREATS? WHAT ARE IMPLAUSIBLE WORRIES? 5 (2009) (paper presented at OECD Global Forum on International Investment).

476. Doug Palmer, *US Lawmakers Urge Probe of Chinese Steel Investment*, REUTERS (July 2, 2010), https://www.reuters.com/article/usa-china-trade-idUSN0224177620100702.

477. *Id.*

by the CFIUS.[478] However, it is unlikely that Anshan's investment would create any national security concerns. To begin with, the "new steel production technologies" referred to in the letter were developed in Italy.[479] It was not the property of the United States and could be bought on the open market. [480] Moreover, Anshan would only take a 20% minority equity in the joint venture.[481] Finally, the joint venture was expected to generate less than 0.3% of total U.S. rebar production.[482] A Forbes reporter called the national security concerns about Anshan's investment "idiocy" and "utter nonsense."[483]

Finally, to challenge a national security decision in the U.S. domestic courts is usually fruitless because judicial review on such decisions is limited. In particular, a presidential decision to suspend or prohibit deals is not subject to judicial review. In *Ralls Corp. v. CFIUS*, Ralls sued both the CFIUS order and the presidential veto.[484] The Court of Appeals for the D.C. Circuit confirmed that Ralls could not challenge the merits of the President's decision.[485] However, the Court held that the presidential veto deprived Ralls of constitutionally protected property interests without procedural due process because the government did not provide Ralls with advance notice, access to the unclassified evidence supporting the decision, and an opportunity to rebut that evidence.[486] The D.C. Circuit's decision represents a major change because it was the first court decision providing some remedy to foreign investors injured by the CFIUS or the President.[487]

Nevertheless, the thrust of the *Ralls* ruling proves to be of little use to prospective investors. If anything, *Ralls* confirms that foreign investors face severe hurdles in challenging a CFIUS decision, even more for a presidential blocking order. To start with, as CFIUS screens foreign investment, it works with classified or privileged information. It is not

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478. Mark Feldman, *China's Outbound Foreign Direct Investment: The U.S. Experience*, 13 INT'L J. PUB. POL. 304, 315 (2017).

479. *US Steel Sector Falls Out over Anshan-SDC Joint Venture*, FASTMARKETS METAL BULL. (Dec. 29, 2010), https://www.metalbulletin.com/Article/2740763/REVISITED-US-steel-sector-falls-out-over-Anshan-SDC-jv.html.

480. *Id.*

481. Stan Abrams, *The Curious Case of Anshan Steel and the Space-Age Rebar Technology*, FORBES (July 7, 2010), https://www.forbes.com/sites/china/2010/07/07/the-curious-case-of-anshan-steel-and-the-space-age-rebar-technology/.

482. *Id.*

483. *Id.*

484. *See Ralls Corp.*, 758 F.3d at 306.

485. *See id.* at 312–14.

486. *See id.* at 319–20.

487. Lederman, *supra* note 21, at 720.

possible for CFIUS to share sensitive information with foreign entities that could pose a national security risk.[488] Furthermore, although foreign investors may challenge procedures of a CFIUS review, i.e., whether investors were afforded procedural due process, courts will not question the outcome of a CFIUS review.[489] Lastly, even if in the highly unlikely scenario that a court rules that CFIUS exceeded its authority in recommending the transaction be prohibited, once CFIUS refers the matter to the President, the presidential order blocking the deal is non-appealable.[490] In fact, *Ralls* remains the only foreign investor who has ever gone to court to challenge a CFIUS review.[491]

D. *Challenging National Security Decisions Before International Investment Tribunals*

To respond to the allegedly unfair and arbitrary national security reviews, Chinese investors have resorted to a range of formal and informal mitigating and remedial measures, including lobbying, media campaign, diplomatic assistance, and support from business associations.[492] Most importantly, states regulate foreign investment within a legal boundary. Chinese investors may contest national security decisions both in domestic courts of host countries as well as before international investment tribunals.

The extent to which national security decisions are subject to administrative or judicial review differs across countries, as does the extent of possible remedies. For the purpose of this Article, it is sufficient to say the following. First, although many argued that national security decisions should be non-justiciable,[493] most countries allow foreign investors to contest security-related decisions through either judicial appeal

488. *See* Chang Liu, *Ralls v. CFIUS: The Long Time Coming Judicial Protection of Foreign Investors' Constitutional Rights Against Government's National Security Review*, 15 J. INT'L BUS. & L. 361, 375 (2016).

489. *See Ralls Corp. v. CFIUS*, 758 F.3d at 311 ("courts are barred from reviewing final 'actions' the President takes '*to suspend or prohibit*' any covered transaction") (quotation marks and emphasis in original); Shannon Tiezzi, *Chinese Company Wins Court Case Against Obama*, THE DIPLOMAT (July 17, 2014).

490. *See* JACKSON, *supra* note 440, at 23.

491. JI LI, THE CLASH OF CAPITALISMS? CHINESE COMPANIES IN THE UNITED STATES 183 (Cambridge Univ. Press 2018).

492. Ji Li, *In Pursuit of Fairness: How Chinese Multinational Companies React to U.S. Government Bias*, 62 HARV. INT'L L. J. 375, 380 (2021).

493. *See* Adam Tomkins, *National Security and the Role of the Court: A Changed Landscape?*, 126 L. Q.R. 543, 543–44 (2010).

or administrative reconsideration, or both.[494] Second, national security concerns are primarily relevant in connection with the establishment of new investments. However, prospective foreign investors rarely use domestic appeals processes because

> disagreements between the authorities and [prospective foreign] investors are mostly settled in the course of the [national security] review process itself. Insofar as authorities signal to investors that their investment is unlikely to obtain approval, investors face strong incentives to either submit a revised proposal aimed at accommodating the regulatory concerns or withdraw from the process.[495]

Third, national security concerns may also affect established investments. Compared to prospective investors, established investors are more likely to seek a judicial remedy in domestic courts because they are more likely to suffer heavy financial losses and other adverse effects due to the national security decision. For example, Chinese company TikTok filed a lawsuit challenging the legality of President Trump's executive order banning its use in the U.S. market.[496] Similarly, Chinese telecoms giant Huawei filed lawsuits challenging the ban on their products in the U.S. and Sweden courts.[497] Finally, even if domestic courts may have jurisdiction to review national security decisions, they have shown considerable deference to the decisions of the relevant government agencies.[498] It is unlikely for domestic courts to determine the case on its merits. Rather, domestic courts may only review the procedural grounds leading to the national security decision, and a victory for the plaintiff foreign investor will lead to a renewed review rather than a reversal of the previous decision.[499]

494. Wehrlé & Pohl, *supra* note 412, at 40–42.

495. Kathryn Gordon, *Accountability for Security-Related Investment Policies*, OECD 6 (2008).

496. Brian Fung, *TikTok Sues Trump Administration over Looming US Ban*, CNN (Aug. 24, 2020, 1:48 PM), https://edition.cnn.com/2020/08/24/tech/tiktok-legal-challenge/index.html.

497. *See* Demetri Sevastopulo, *Huawei Challenges its Designation as a Threat to US Security*, FIN. TIMES (Feb. 9, 2021), https://www.ft.com/content/b7c2294d-9207-4fae-8fed-d63a80c99618; Finbarr Bermingham, *Huawei 5G Ban is Upheld by Swedish Court in Further Blow to Chinese Telecoms Giant's European Plans*, S. CHINA MORNING POST (June 23, 2021), https://www.scmp.com/news/china/article/3138369/huawei-5g-ban-upheld-swedish-court-further-blow-chinese-telecoms-giants.

498. *See* Craig Forcese, *Through a Glass Darkly: The Role and Review of National Security Concepts in Canadian Law*, 43 ALTA. L. REV. 963, 999 (2006); Dominic McGoldrick, *The Boundaries of Justiciability*, 59 INT'L & COMP. L.Q. 981, 1011–14 (2010).

499. *See* Gordon, *supra* note 495.

Where domestic remedies prove to be inadequate, foreign investors may also seek remedies through ISDS mechanisms embodied in international investment agreements (IIAs), which may impose obligations on host states for the establishment, protection, promotion, and regulation of foreign investment.[500] Depending on the circumstances of each case, national security decisions may lead to a breach of the obligations of host states under IIAs to accord foreign investors national treatment (NT), most-favored-nation (MFN) treatment, and fair and equitable treatment (FET) at the pre-establishment phase.[501] Moreover, if national security measures are taken at the post-establishment stage, they may contravene provisions in IIAs on expropriation, non-discrimination, FET, full protection and security, the freedom of capital transfers, and the umbrella clause.[502] For instance, in *Global Telecom Holding S.A.E v. Canada*, the claimant alleged that Canada had breached the FET obligation in the Canada-Egypt BIT by subjecting it to an arbitrary, unreasonable, baseless, and non-transparent national security review.[503]

However, IIAs normally allow host states to adopt measures for the protection of certain public policy concerns, including "essential security interests," that may otherwise constitute a violation of treaty obligations.[504] The national security exception may either be listed as one of

500. Ioannis Glinavos, *Which Way Huawei? ISDS Options for Chinese Investors*, *in* HANDBOOK OF INTERNATIONAL INVESTMENT LAW AND POLICY 2451, 2468–71 (Julien Chaisse et al. eds., 2021); Lizzie Knight & Tania Voon, *The Evolution of National Security at the Interface Between Domestic and International Investment Law and Policy: The Role of China*, 21 J. WORLD INV. & TRADE 104, 131 (2020).

501. *See* Mark McLaughlin, *State-Owned Enterprises and Threats to National Security Under Investment Treaties*, 19 CHINESE J. INT'L L. 283, at 302–16 (2020). Whether there is a violation of the relevant BIT must be considered on the case-by-case basis. Some BITs do not apply to the pre-establishment phase of an investment. Moreover, even if a BIT grants establishment rights, the parties may still use a negative list or a positive list to exclude certain sectors or activities from the pre-establishment obligations. Under both circumstances, market entry restrictions based on national security grounds, including discriminatory treatment to foreign SOEs, do not violate the BIT. *See* Lu Wang, *Non-Discrimination Treatment of State-Owned Enterprises Investors in International Investment Agreements?*, 31 ICSID REV. 45, 48–49 (2016).

502. U.N. Conference on Trade and Dev., The Protection of National Security in IIAs, at 31, U.N. Sales No. E.09.II.D.12 (2009) [hereinafter UNCTAD, National Security in IIAs].

503. *See* Glob. Telecom Holding S.A.E v. Can., ICSID Case No. ARB/16/16, Award, ¶¶ 573–82 (Mar. 27, 2020) [hereinafter Global Telecom Holding Award].

504. Katia Yannaca-Small, *Essential Security Interests Under International Investment Law*, *in* INTERNATIONAL INVESTMENT PERSPECTIVES 2007: FREEDOM OF INVESTMENT IN A CHANGING WORLD 92, 105 (OECD 2007). Most IIAs that include a security exception use the term "essential security interests" or "national security" to describe a situation where the exception may be invoked. Several tribunals considered that, by including the expression 'essential', the term 'essential

the non-conforming measures that a contracting party wishes to maintain or be prescribed as an independent exception clause in IIAs. For example, Article 10.15 of the Regional Comprehensive Economic Partnership Agreement (RCEP), to which China is a signatory, provides that

> Nothing in [the investment] Chapter shall be construed to: . . . (b) preclude a Party from applying measures that *it considers necessary* for: (i) the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security; or (ii) *the protection of its own essential security interests.*[505]

Unless otherwise prescribed in the relevant IIA, a successful invocation of the national security exception clause would exempt a host state from liability for compensation.[506] In this section, I will first provide an overview of how national security exception clauses were interpreted by investment arbitral tribunals. Then I will inquire why, despite the fact that Chinese investors have been victims of arbitrary national security decisions, they have rarely challenged such decisions through ISDS mechanisms provided in Chinese IIAs.

1. The National Security Exception before Investment Tribunals

International arbitral tribunals have dealt with complaints against national security decisions in a number of investment disputes.[507] It is well known that substantial textual variations exist among IIAs and that *ad hoc* arbitral tribunals sometimes render inconsistent interpretations of even the same investment treaty standard and facts.[508] Still, there are several key trends in arbitral results that can be identified in relation to

security interests' is narrower than the more general term security interest. It may generally be understood to refer to those interests relating to the quintessential functions of the state, namely, the protection of its territory and its population from external threats, and maintenance of law and public order internally.

505. RCEP, *supra* note 313, art. 10.15 (emphasis added).

506. CMS Gas Transmission Co. v. Republic of Arg., ICSID Case No. ARB/01/8, Annulment, ¶ 146 (Sept. 25, 2007) [hereinafter CMS Annulment]; LG&E Energy Corp, LG&E Capital Corp., LG&E Int'l Inc. v. Republic of Arg., ICSID Case No. ARB/02/1, Decision on Liability, ¶ 264 (Oct. 3, 2006) [hereinafter LG&E Liability].

507. "At least 16 national security-related investment cases have been examined by international arbitration tribunals. . . . Most of these cases (10) involved claims filed by [foreign investors] against Argentina." U.N. Conference on Trade & Dev., WORLD INVESTMENT REPORT 2016: INVESTOR NATIONALITY: POLICY CHALLENGES, at 97, U.N. Sales No. E.16.II.D.4 (2016).

508. *See* Julian Arato et al., *Parsing and Managing Inconsistency in Investor-State Dispute Settlement*, 21 J. WORLD INV. & TRADE 336, 338 (2020).

the national security clauses in IIAs.[509] First, the scope of "essential security interests" is flexible but not unlimited. In several ISDS cases brought against the Government of Argentina by foreign investors concerning measures undertaken during the financial crisis in the 2000s, all arbitral tribunals concurred in the view that a severe economic crisis could constitute an "essential security interest."[510] However, tribunals disagreed on whether Argentina's economic crisis was severe enough to qualify as a national security issue. For the tribunals in the *CMS*, *Enron*, and *Sempra* cases, only an economic crisis imperiling a state's very existence and independence, such as "total economic and social collapse," would be of sufficient scale to fulfill the requirement.[511] They denied that such a dire situation existed in Argentina.[512] By contrast, the *LG&E* and the *Continental Casualty* tribunals agreed that the devastating economic, political, and social conditions in Argentina triggered the protections afforded under the national security exception clause.[513]

More recently, in *Devas v. India* and *Deutsche Telekom v. India*, a pair of investors claimed that India's annulment of a contract for a satellite telecommunications spectrum on national security grounds violated their treaty rights. The Indian government stated that the spectrum was reacquired for national needs, including the needs of defense, para-military forces, and other public utility services, as well as for societal needs.[514] Although the genuineness of India's national security claim was open to question,[515] both tribunals stated that they should grant a wide

509. *See* Prabhash Ranjan, *Essential Security Interests in International Investment Law: A Tale of Two ISDS Claims Against India*, *in* HANDBOOK OF INTERNATIONAL INVESTMENT LAW AND POLICY 579, 581 (Julien Chaisse et al. eds., 2021).

510. UNCTAD, National Security in IIAs, *supra* note 502, at 8–9.

511. CMS Gas Transmission Co. v. Republic of Arg., ICSID Case No. ARB/01/8, Award, ¶ 355 (May 12, 2005) [hereinafter CMS Award].

512. *Id.*; Sempra Energy Int'l v. Argentine Republic, ICSID Case No. ARB/02/16, Award, ¶ 348 (Sept. 28, 2007) [hereinafter Sempra Award]; Enron Corp. & Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, Award, ¶¶ 306–07 (May 22, 2007) [hereinafter Enron Award].

513. LG&E Liability, *supra* note 506, ¶ 238; Cont'l Cas. Co. v. Argentine Republic, ICSID Case No. ARB/03/9, Award, ¶ 180 (Sept. 5, 2008) [hereinafter Cont'l Cas. Award].

514. CC/Devas (Mauritius) Ltd., Devas Emp. Mauritius Private Ltd., & Telecom Devas Mauritius Ltd. v. Republic of India, PCA Case No. 2013-09, Award on Jurisdiction and Merits, ¶ 364 (July 25, 2016) [hereinafter Devas Award on Jurisdiction and Award].

515. The tribunal in *Deutsche Telekom v. India* found that four years after the annulment of contract, the Indian Government was still debating how to use the appropriated satellite spectrum. There was only a possibility but no guarantee that the spectrum would be allocated for military use. Deutsche Telekom AG v. Republic of India, PCA Case No. 2014-10, Interim Award, ¶¶ 286–87 (Dec. 13, 2017) [hereinafter Deutsche Interim Award]; *see also* Devas Award on Jurisdiction and Award, *supra* note 514, ¶ 96 (David Haigh dissenting).

margin of deference to India in the determination of essential security interests. As the tribunal in *Devas v. India* stated:

> An arbitral tribunal may not sit in judgment on national security matters as on any other factual dispute arising between an investor and a State. National security issues relate to the existential core of a State. An investor who wishes to challenge a State decision in that respect faces a heavy burden of proof, such as bad faith, absence of authority, or application to measures that do not relate to essential security interests.[516]

Consequently, even if there was no imminent military or security threat, the Government of India's declaration that the satellite spectrum was reacquired for military use was sufficient for the tribunals to hold that the measure was for the protection of India's essential security interests.[517]

On the other hand, the scope of essential security interests is not unlimited. The tribunal in *Deutsche Telekom v. India* stressed that the term "essential security interests" cannot be "stretched beyond its natural meaning."[518] In both *Devas v. India* and *Deutsche Telekom v. India*, the tribunals made a clear differentiation between military needs and public or societal interests. Although they showed significant deference to India's asserted military needs, both tribunals held that public utility services and social needs for which the satellite spectrum was to be used —such as train tracking, emergency communication and disaster warnings, crop forecasting, rural communications, telemedicine, and tele-education, did not constitute "essential security interests."[519] The effort to put some control on the nebulous concept of national security was also apparent in other international fora. For example, an ECHR decision refused to accept the contention that drug trafficking was a matter of national security.[520] More recently, Russia and India blocked a United Nations Security Council draft resolution that, for the first time,

516. Devas Award on Jurisdiction and Award, *supra* note 514, ¶ 245; Deutsche Interim Award, *supra* note 515, ¶ 235.

517. Deutsche Interim Award, *supra* note 515, ¶ 281; Devas Award on Jurisdiction and Award, *supra* note 514, ¶ 335.

518. Deutsche Interim Award, *supra* note 515, ¶ 236.

519. *Id.* ¶¶ 281–84; Devas Award on Jurisdiction and Award, *supra* note 514, ¶ 354.

520. *See* C.G. & Others v. Bulgaria, App. No. 1365/07, ¶ 43 (July 24, 2008), https://hudoc.echr.coe.int/eng?i=001-86093.

would have defined climate change as a security threat to world peace.[521]

Article XXI security exception of GATT 1994 has been incorporated into many IIAs.[522] In *Russia–Traffic in Transit*, a WTO Panel ruled that it is generally left to "every [WTO] Member to define what it considers to be its essential security interests" because such a determination will "depend on the particular situation and perceptions of the state in question, and can be expected to vary with changing circumstances."[523] However, the discretion of a WTO Member is limited by its obligation to interpret and apply the essential security interests exception in good faith.[524] For the Panel, the obligation of good faith requires that Members not use the security exception as a means to circumvent their WTO obligations. The Panel concluded that the invoking Member should articulate the essential security interests it seeks to protect.[525] This obligation, for the panel, is "crystallized in demanding that the measures at issue meet *a minimum requirement of plausibility* in relation to the proffered essential security interests, i.e., they are not implausible as measures protective of these interests."[526] On the surface, the investment tribunals' approach to interpreting "essential security interests" is less deferential compared with that of the WTO panels. For instance, the tribunals in *Devas v. India* and *Deutsche Telekom v. India* seem to suggest that the line between security interests and public or societal interests can be clearly drawn. But it is at least disputable why some public or social needs, such as disaster response, cannot be considered national security interests.[527]

To conclude, national security is not static but an evolving concept that may encompass not just military threats but also political and economic dimensions. Investment arbitral tribunals have jurisdiction to

521. Rick Gladstone, *Russia Blocks U.N. Move to Treat Climate as Security Threat*, N.Y. TIMES (Dec. 13, 2021), https://www.nytimes.com/2021/12/13/world/americas/un-climate-change-russia.html.

522. For instance, Article 16.3 of the China-Australia Free Trade Agreement (2015). ChAFTA, *supra* note 313, art. 16.3. Article XXI of GATT 1994 provides: "Nothing in this Agreement shall be construed . . . (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests. . . ." General Agreement on Tariffs and Trade 1994 art. 21, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 190 [hereinafter GATT 1994].

523. Panel Report, *Russia–Measures Concerning Traffic in Transit*, ¶ 7.131, WTO Doc. WT/DS512/R (adopted Apr. 5, 2019) [hereinafter *Russia – Traffic in Transit*].

524. *Id.* ¶ 7.132.

525. *Id.* ¶¶ 7.133–7.134.

526. *Id.* ¶ 7.138 (emphasis added).

527. Heath, *supra* note 423, at 1045.

review host states' invocation of national security exceptions, and they grant a wide margin of deference to host states with regard to the determination of an essential security interest. Nevertheless, such deference cannot be unlimited. The legitimacy of essential security interests claimed by host states should be determined case-by-case in each dispute.

Second, national security exception clauses in IIAs normally contain a nexus requirement. The measure in dispute must have some relation to the national security objective varying from "necessary" to "directed at."[528] The significance of the nexus requirement is in establishing the degree of connection between the adopted measure and the national security objective that the measure seeks to achieve. A nexus requirement of "necessary" to protect security interest is stricter compared with "directed to."[529] Earlier investment arbitral tribunals conflated the "necessary" requirement in the security exception clause in IIAs with the customary international law defense of necessity provided in Article 25 of the ILC Articles, which requires that, for a measure to be "necessary," it must be the "only way" for the state to safeguard an essential interest against a grave and imminent peril.[530] More recently, however, arbitral tribunals clarified that the treaty defense of necessity provided in IIAs is different from the customary international law defense of necessity.[531] To assess the necessity of the measures to protect a state's essential security interests, the tribunal in *Deutsche Telekom v India* laid down a two-prong test: first, "whether the measure was principally targeted to protect the essential security interests at stake"; and second, whether the measure was "objectively required in order to achieve that protection, taking into account whether the state had reasonable alternatives, less in conflict or more compliant with its international obligations."[532] The tribunal found that the Government of India's

528. Deutsche Interim Award, *supra* note 515, ¶ 288.

529. *Id.*

530. CMS Award, *supra* note 511, ¶ 323; Sempra Award, *supra* note 512, ¶¶ 350–51; Enron Award, *supra* note 512, ¶¶ 309–10.

531. Deutsche Interim Award, *supra* note 515, ¶ 228; CMS Annulment, *supra* note 506, ¶ 129; Sempra Energy Int'l v. Argentine Republic, ICSID Case No. ARB/02/16, Decision on the Argentine Republic's Application for Annulment of the Award, ¶ 198 (June 29, 2010); LG&E Liability, *supra* note 506, ¶ 245; Cont'l Cas. Award, *supra* note 513, ¶ 167; Dimitrios Katsikis, '*Necessity' Due to Covid-19 as a Defence to International Investment Claims*, 36 ICSID REV. 46, 60–63 (2021).

532. Deutsche Interim Award, *supra* note 515, ¶ 239.

annulment of the contract was not "necessary" because the two conditions were not met.[533]

Third, all investment arbitral tribunals held that absent specific wording in the applicable IIAs that grants complete discretion to a host state to decide how to protect its security interests, national security exception clauses are not self-judging.[534] The typical formulation of a self-judging security exception clause allows a host state to adopt such measures that it considers necessary for protecting its essential security interests.[535] Under a self-judging clause, once it has been determined that the threat in question falls under the security exception, it is the exclusive prerogative of host country authorities to determine how to react to this threat. However, a self-judging national security exception in IIAs does not provide a complete shield from judicial scrutiny as states remain subject to the general obligation to carry out their treaty commitments in good faith, as required by Article 26 of the Vienna Convention on the Law of Treaties.[536] This view is nevertheless contested as critics argued that there is no explicit textual warrant for a good faith view of security measures, that the good faith test in international law is ambiguous, and that investment tribunals may impose significant constraints on sovereign states to take security measures.[537]

Until now, there has not been a specific case dealing with self-judging national security clauses in IIAs. Nevertheless, the WTO panel in *Russia-Transit Measures* held that the obligation of good faith applies not only to the respondent's articulation of its essential security interests but also to the nexus requirement.[538] As discussed above, this is a highly deferential standard of review as it only requires a minimum requirement of plausibility in relation to the proffered essential security

533. *Id.* ¶¶ 286–90. The tribunal found that the annulment of contract was not "principally targeted" at achieving the security objective because there was no clarity as regards the usage of the spectrum even years after the contract had been annulled. Moreover, reasonable and least restrictive alternative measures were clearly available to India.

534. CMS Award, *supra* note 511, ¶¶ 371–73; Devas Award on Jurisdiction and Award, *supra* note 514, ¶ 219.

535. UNCTAD, National Security in IIAs, *supra* note 502, at 39.

536. William W. Burke-White & Andreas von Staden, *Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties*, 48 VA. J. INT'L L. 307, 370 (2008); Stephan Schill & Robyn Briese, *"If the State Considers": Self-Judging Clauses in International Dispute Settlement*, 13 MAX PLANCK Y.B. U.N. L. 61, 120 (2009).

537. *See* Ji Ma, *International Investment and National Security Review*, 52 VAND. J. TRANSNAT'L L. 899, 933–37 (2021); Jose E. Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, *in* THE YEARBOOK OF INTERNATIONAL INVESTMENT LAW AND POLICY 379, 425–26 (Karl P. Sauvant ed., 2009).

538. *Russia – Traffic in Transit*, *supra* note 523, ¶ 7.138.

interests. Specifically, a panel must determine "whether the measures are so remote from, or unrelated to, the . . . emergency that it is implausible that [the respondent state] implemented the measures for the protection of its essential security interests."[539] Following this legal standard, the Panel concluded in *Saudi Arabia–IPRs* that the non-application of criminal procedures and penalties to an intellectual property pirate company did not have any plausible relationship to Saudi Arabia's protection of its essential security interests.[540]

For non-self-judging national security exception clauses, arbitral tribunals are entitled to make their own assessment as to whether such a measure can be justified on national security grounds, which includes an evaluation of whether there is a threat to national security and whether the host state's measures are a necessary response to the threat.[541] Still, a non-self-judging security provision does not give arbitration tribunals the authority to completely ignore the assessment of the host state invoking the exception nor to dictate which measures a host state should take. As the tribunal in *Deutsche Telekom v India* explains:

> Whether a measure is 'necessary' . . . is subject to review by the Tribunal, as the clause is not self-judging. . . . In that review, the Tribunal will undoubtedly recognize a margin of deference to the host state's determination of necessity, given the state's proximity to the situation, expertise and competence. Thus, the Tribunal would not review *de novo* the state's determination. . . . On the other hand, the deference owed to the state cannot be unlimited, as otherwise unreasonable invocations of [the exception clause] would render the substantive protections contained in the treaty wholly nugatory.[542]

The arbitral tribunal in *Global Telecom Holding S.A.E v. Canada* also took a deferential approach to analyze whether Canada's national security review constituted a violation of the FET. The tribunal did not even assess the genuineness or rationality of Canada's security concerns and considered only how the national security review *process* was

539. *Id.* ¶ 7.139.

540. Panel Report, *Saudi Arabia–Measures Concerning the Protection of Intellectual Property Rights*, ¶ 7.293, WTO Doc. WT/DS567/R (adopted June 16, 2020).

541. UNCTAD, National Security in IIAs, *supra* note 502, at 41.

542. Deutsche Interim Award, *supra* note 515, ¶ 238.

conducted.[543] Moreover, the tribunal considered that due process should be deemed satisfied

> where the subject of the investigation is afforded a fair opportunity to make its case in relation to readily identifiable issues, and that opportunity is afforded reasonably ahead of an administrative decision being made based on objectively verifiable factors and after an appropriate time period which is not unnecessarily rushed.[544]

Applying this standard, the tribunal found that Canada did not breach the FET obligation.[545]

2. Why Have Not Chinese Investors Challenged Arbitrary National Security Reviews?

Since its first BIT with Sweden in 1982, China has signed 145 BITs (107 in force) and 24 treaties with investment provisions (19 in force) by December 2021.[546] The new generation Chinese IIAs include most of the standard investment protections, along with full advance consent to ISDS.[547] However, no Chinese investor has formally challenged the abusive national security reviews before investment arbitral tribunals until December 31, 2021, when the Chinese telecoms giant Huawei filed an investment treaty claim against Sweden over its exclusion from the rollout of 5G network due to national security concerns.[548]

A number of reasons may explain the reluctance of Chinese investors to challenge national security decisions before international arbitral tribunals. Firstly, early Chinese IIAs are limited in the scope of protection provided to foreign investors. For instance, they only apply to the period *after* an investment was made and do not address the pre-establishment period.[549] Therefore, a host state may screen China's foreign

543. Global Telecom Holding Award, *supra* note 503, ¶ 607.

544. *Id.* ¶ 608.

545. *Id.* ¶ 616.

546. UNCTAD Investment Policy Hub, *supra* note 245.

547. *See* Yuwen Li & Bian Cheng, *China's Stance on Investor-State Dispute Settlement: Evolution, Challenges, and Reform Options*, 67 NETH. INT'L L. REV. 503, 514–23 (2020).

548. *See Huawei Tech. Co. v. Kingdom of Swed.*, ICSID Case No. ARB/22/2, Procedural Order No. 1 (July 27, 2022).

549. *See* Agreement Between the Federal Republic of Germany and the People's Republic of China on the Encouragement and Reciprocal Protection of Investments, China-Ger., art. 2(1), art. 2(3), Dec. 1, 2003, 2362 U.N.T.S. 253 [hereinafter China-Germany BIT]; *see also* Agreement on Encouragement and Reciprocal Protection of Investments Between the Government of the

investment without much concern about its treaty obligations. In addition, due to the skepticism of international dispute resolution as biased towards Western investors and the fact that China was a capital-importing country with scarce overseas foreign investment at the time, China took a conservative attitude towards ISDS until the late 1990s.[550] Early Chinese IIAs provide either no ISDS provisions at all or a narrowly constructed ISDS clause that only admits disputes "involving the amount of compensation for expropriation" to arbitration.[551] Some tribunals, such as the tribunal in *China Heilongjiang International Economic & Technical Cooperative Corp. v. Mongolia*, adopted an extremely narrow construction of the ISDS provision that the only arbitrable matter was the amount of compensation for expropriation. The tribunal, therefore, lacked jurisdiction with regard to whether an expropriation had actually occurred.[552] Even if a liberal interpretation is adopted, the scope of the ISDS clause remains narrow, as the only arbitrable matter under the IIA would be expropriation and its compensation.

Second, national security decisions are often carved out as non-conforming measures, sheltered by self-judging national security exception clauses, or simply prescribed as non-justiciable in some Chinese IIAs. For example, national security decisions taken under the auspices of the ICA are not subject to any dispute settlement provisions in the Canada-China BIT.[553] On August 9, 2021, the Canadian government

People's Republic of China and the Government of the Kingdom of the Netherlands, China-Neth., art. 2, art. 3(2), Nov. 26, 2001, 2369 U.N.T.S. 219.

550. *See* Manjiao Chi & Xi Wang, *The Evolution of ISA Clauses in Chinese IIAs and Its Practical Implications: The Admissibility of Disputes for Investor-State Arbitration*, 16 J. WORLD INV. & TRADE 869, 874 (2015).

551. Stephan W. Schill, *Tearing Down the Great Wall: The New Generation Investment Treaties of the People's Republic of China*, 15 CARDOZO J. INT'L & COMP. L. 73, 90–91 (2007); *see, e.g.*, Agreement Between the Government of the People's Republic of China and the Government of the Republic of Singapore on the Promotion and Protection of Investments, China-Sing., art. 13(3), Nov. 11, 1985, 1443 U.N.T.S. 279; *see also* Agreement Between Japan and the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investment, China-Japan, art. 2(2), Aug. 27, 1988, 1555 U.N.T.S. 197.

552. China Heilongjiang Award, *supra* note 303, ¶¶ 435–54. By contrast, the tribunals in *Tza Yap Shum v. Peru* and *Sanum v. Laos* adopted a different interpretation when faced with the same question. They found that a limitation of the ISDS clause solely over the amount of compensation for expropriation would deprive the clause of its *effect utile*. *See* Tza Yap Shum v. Republic of Peru, ICSID Case No. ARB/07/6, Award, ¶¶ 147–52 (July 7, 2011); *see also* Sanum Invs. Ltd. v. Lao People's Democratic Republic, PCA Case No. 2013-13, Award on Jurisdiction, ¶¶ 322–42 (Dec. 13, 2013).

553. "A decision by Canada following a review under the *Investment Canada Act*, an Act respecting investment in Canada, with respect to whether or not to: (a) initially approve an investment that is subject to review; or (b) permit an investment that is subject to national security

ordered the telecom company China Mobile International (CMI), a wholly owned subsidiary of the central Chinese SOE China Mobile, to either divest itself entirely of or wind up the Canadian business based on a national security review in pursuance of the ICA.[554] The national security concern of the CMI was stated as follows:

> As the Investor is a state-owned enterprise ultimately controlled by the Chinese state, this investment could result in the Canadian business being leveraged by the [I]nvestor's ultimate controller for non-commercial purposes, such as the compromise of critical infrastructure and foreign interference, to the detriment of Canada's national security.[555]

The CMI filed a legal challenge to the order before the Federal Court but lost the battle.[556] The CMI Canada thereafter ceased operations on January 5, 2022.[557] Because the decision was made under the ICA, it is not possible for the CMI to invoke the ISDS clause in the Canada-China BIT.

Likewise, in the China-Australia FTA (ChAFTA), Australia reserves the right to adopt or maintain any measure when it considers necessary for the protection of essential security interests with respect to proposals by foreign persons and foreign government investors to invest in Australia. Australia's treaty obligations with respect to market access, NT, and MFN treatment do not apply to such decisions.[558] Moreover, the ChAFTA incorporates WTO Article XXI national security exception.[559] The same is true with the new mega-regional FTAs that China

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review; shall not be subject to the dispute settlement provisions under Article 15 and Part C of this Agreement." Canada-China BIT, *supra* note 313, annex D.34.

554. Alexandra Posadzki & Steven Chase, *Ottawa Says China Mobile Must Divest Telecom Business*, THE GLOBE & MAIL (Sept. 14, 2021), https://www.theglobeandmail.com/business/article-ottawa-says-china-mobile-must-divest-telecom-business/.

555. Application for Judicial Review under Section 18.1 of the Federal Court Act (Canada) at ¶ 27, China Mobile Commc'ns Grp. Co. & Can. Attorney Gen., [2021] F.C. 1277 (Can.), Court File No. T-1377-21.

556. *See* Jim Bronskill, *Chinese Telecom Firm Loses Court Battle Against Order to Divest Canadian Subsidiary*, NAT'L POST (Dec. 7, 2021), https://nationalpost.com/news/canada/chinese-controlled-firm-loses-court-bid-to-pause-ottawas-divestment-order.

557. Shailaja Pai, *China Mobile Leaving Canada*, DEVELOPING TELECOMS (Dec. 29, 2021), https://developingtelecoms.com/telecom-business/operator-news/12595-china-mobile-leaving-canada.html.

558. ChAFTA, *supra* note 313, art. 16.3.

559. Art. 16.3 of the ChAFTA provides: "Article XXI of GATT 1994 and Article XIV bis of GATS are incorporated into and made part of this Agreement, mutatis mutandis." ChAFTA, *supra* note 313, art. 16.3.

has recently concluded, such as the RCEP, or aspires to join, such as the CPTPP.[560] The fact that China has signed up for the restrictive, self-judging national security exception clause is also a reflection of China's own approach to the national security review of inbound foreign investment.[561]

Third, Chinese culture also plays an important role in shaping Chinese investors' ambivalence about ISDS.[562] China's deeply rooted Confucian philosophy emphasizes harmony and conflict avoidance and sees that the optimal resolution of disputes should be achieved not by the exercise of legal power but by moral persuasion.[563] As a cultural predisposition, Chinese investors usually prefer informal and non-adversarial methods to resolve their disputes with host states.[564] Lastly, unfamiliarity with ISDS and the problems with the ISDS system, such as the lack of stability and predictability in arbitral awards, lengthy and costly arbitral proceedings, and no opportunity for appeal, would also likely make Chinese investors less willing to make use of the system.[565]

Chinese investors are more likely to resort to ISDS when certain conditions are present. First, the applicable IIA does not contain a national security exception clause or only contains a non-self-judging national security exception clause. That would give the arbitral tribunal much more leeway to assess the genuineness and necessity of the host states' national security claim.[566] Second, the national security decision of a

560. RCEP, *supra* note 313, art. 10.2(3); CPTPP, *supra* note 22, art. 29.2.

561. *See* Zhong Hua Ren Min Gong He Guo Wai Shang Tou Zi Fa (中华人民共和国外商投资法) [Foreign Investment Law of the People's Republic of China] (promulgated by the Thirteenth National People's Congress, 15 March 2019, effective 1 January 2020) (US-China Bus. Council trans.). Art. 35 of the Foreign Investment Law of China stipulates that the decision of security review shall be final, which means that the decision may not be administratively reconsidered or challenged in court in China. *Id.*

562. *See* Danny McFadden, *The Growing Importance of Regional Mediation Centres in Asia*, *in* MEDIATION IN INTERNATIONAL COMMERCIAL AND INVESTMENT DISPUTES 160, 160–63 (Catharina Titi & Katia Fach Gómez eds., 2019).

563. Hanqin Xue, Cultural Element in International Law, Melland Schill Lecture at University of Manchester 13 (May 5, 2016) (on file with University of Manchester Library), https://www.library.manchester.ac.uk/media/services/library/usingthelibrary/serviceweprovide/digitisation/Judge-Xue-speaker-notes.pdf.

564. Guiguo Wang, *Chinese Mechanisms for Resolving Investor-State Disputes*, 1 JINDAL J. INT'L AFF. 204, 222–23 (2011); Dae Un Hong & Ju Yoen Lee, *Why Are There So Few Investor-State Arbitrations in China? A Comparison with Other East Asian Economies*, 1 CHINA & WTO REV. 35, 44 (2018).

565. *See* U.N. Comm. on Int'l Trade L., *Possible Reform of Investor-State Dispute Settlement: Submission from the Government of China*, U.N. Doc. A/CN.9/WG.III/WP.177 (July 19, 2019).

566. For example, the current China-Czech Republic BIT does not have a security exception clause. *See* Agreement Between the Czech Republic and the People's Republic of China on the Promotion and Protection of Investments, China-Czech, Dec. 8, 2005, https://edit.wti.org/app.

host state manifestly lacks merits. There is little evidence that the investment presents a national security threat. Third, the foreign investor would suffer heavy financial loss or other adverse effects due to the national security decision. That is particularly true for established investments because sunk costs would be high if investors were banned from lucrative businesses or even forced to divest. The potential for substantial financial remedy through ISDS would make a legal challenge appealing.

That explains why Huawei formally challenged the Government of Sweden's decision to exclude Huawei equipment and services from the 5G network before the ICSID. To begin with, Huawei has significant investments in Sweden, employing more than 600 people and Huawei Sweden generated revenues of approximately SEK 5 billion (about 530 million USD) in 2019.[567] Because of the decision of the Swedish authorities, Huawei claims that its immediate revenue loss is estimated at SEK 5.2 billion for the 2021–2025 period alone.[568] As the national security decision will be effective for a period of 25 years, the total estimated revenue losses would be substantially larger. [569] Furthermore, Huawei contends that as the most audited and inspected company in the technology industry, it has never had a major cyber security incident, nor has anyone ever produced evidence of any security problems with Huawei equipment.[570] Relatedly, Huawei has long complained that host countries did not consider the steps that Huawei had taken to guard against state interference and exploitation of its technology and equipment.[571] Finally, the China-Sweden BIT, originally signed in 1982

php/document/show/82ab83bc-0cdc-436e-8dc8-30be68475150. The China-Germany BIT (2005) has only a loosely drafted security exception. Ad Art. 3 of the Protocol provides: "Measures that have to be taken for reasons of public security and order... shall not be deemed 'treatment less favorable' within the meaning of Article 3 [National treatment and MFN]." Clearly, whether "measures have to be taken" to protect public security and order need to be independently assessed by the arbitral tribunal. China-Germany BIT, *supra* note 549, ad. art. 3. In addition, even if a national security decision does not violate national treatment and MFN, it may still violate the FET provided in Art. 3.1 of the BIT. *Id.*, art. 3(1).

567. Huawei, *Written Notification of Dispute Pursuant to Article 6 bis of the Agreement on the Mutual Protection of Investments entered into between the Kingdom of Sweden and the People's Republic of China on 29 March 1982, as amended on 27 September 2004,* (Dec. 31, 2020), https://jusmundi.com/en/document/pdf/other/en-huawei-technologies-co-ltd-v-kingdom-of-sweden-notice-of-intent-tuesday-5th-january-2021.

568. *Id.*

569. *Id.*

570. *Is Safety the Real Reason to Ban Huawei*, HUAWEI (Feb. 14, 2019), https://huawei.eu/story/safety-real-reason-ban-huawei.

571. Jarrod Hepburn & Luke Eric Peterson, *Analysis: As Huawei Invokes Investment Treaty Protections in Relation to 5G Network Security Controversy, What Scope is There for Claims under Chinese*

and then amended in 2004, does not contain a national security exception clause.[572] Based on the same reasons, Huawei warned the Czech Republic of potential international arbitration in early 2019 in relation to assertions by the Czech cybersecurity agency that Huawei's technologies and equipment pose a national security threat.[573]

VI. LOOKING TO THE FUTURE: NEW SOE RULES IN MEGA-REGIONAL FTAS

There is a lack of international investment disciplines on SOEs. Conventional IIAs normally do not have special rules for SOEs and treat them in the same way as private investors.[574] Some international trade rules for SOEs in the GATT/WTO system do exist, but they are limited in scope and are generally perceived as inadequate.[575] Outside of formal international treaties, the OECD, the World Bank, UNCTAD, and G20 have created voluntary and nonbinding guidelines on the corporate governance of SOEs and policy reactions of host states to SOEs' investments.[576] However, they do not necessarily resolve the challenges posed by SOEs. For one thing, as international soft law, these policy guidelines are toothless. For another, whereas the guidelines enunciate numerous laudable objectives, they contain comparatively little guidance on the practices that are necessary to achieve them.[577]

Treaties with Czech Republic, Canada, Australia and New Zealand?, INV. ARB. REP. (Feb. 11, 2019), https://www.iareporter.com/articles/analysis-as-huawei-invokes-investment-treaty-protections-in-relation-to-5g-network-security-controversy-what-scope-is-there-for-claims-under-chinese-treaties-with-czech-republic-canada-australia-a/.

572. *See* Agreement on Mutual Protection of Investments Between the Government of the Kingdom of Sweden and the Government of the People's Republic of China, China-Swed., Sept. 27, 2004, https://edit.wti.org/document/show/pdf/a6d6d6eb-5198-4dab-a881-fbd8c8c4c69b .

573. Marc Santora, *Huawei Threatens Lawsuit Against Czech Republic After Security Warning*, N.Y. TIMES (Feb. 8, 2019), https://www.nytimes.com/2019/02/08/business/huawei-lawsuit-czech-republic.html.

574. Low, *supra* note 311, at 1–2.

575. Andrea Mastromatteo, *WTO and SOEs: Article XVII and Related Provisions of the GATT 1994*, 16 WORLD TRADE REV. 601, 617–18 (2017).

576. *See* OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2015), http://dx.doi.org/10.1787/9789264244160-en; OECD, GUIDELINES FOR RECIPIENT COUNTRY INVESTMENT POLICIES RELATING TO NATIONAL SECURITY (May 25, 2009); WBG, CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A TOOL KIT (2014); G20, GUIDING PRINCIPLES FOR GLOBAL INVESTMENT POLICYMAKING (2016); U.N. Conference on Trade & Dev., *Investment Policy Framework for Sustainable Development*, U.N. Doc. UNCTAD/DIAE/PCP/2015/5 (2015).

577. Curtis J. Milhaupt & Mariana Pargendler, *Governance Challenges of Listed State-Owned Enterprises Around the World: National Experiences and A Framework for Reform*, 50 CORNELL INT'L L.J. 473, 533–35 (2017).

In parallel with the rise of SOEs as an important force in global trade and investment, the negotiation of FTAs offers a new avenue to adopt innovative SOE disciplines.[578] A typical example is the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) concluded in 2018. Largely built upon the SOE disciplines contained in some FTAs that the U.S. had signed before, the TPP included a stand-alone chapter that applies "with respect to the activities of state-owned enterprises . . . that affect trade or investment."[579] The inclusion of the SOE chapter in the CPTPP represents the most ambitious attempt of the international community to regulate SOEs in the international economy up to date.[580]

After much deliberation, China formally submitted a request to accede to the CPTPP in September 2021.[581] The outcome of China's CPTPP accession bid is far from assured, given all the spotlight on China's unique state capitalism model and the ongoing diplomatic tension with some of the key existing CPTPP Members.[582] Nevertheless, China's application to join the CPTPP clearly indicates that China is prepared to embrace the CPTPP SOE rules. Moreover, the SOE chapter in the CPTPP has since emerged as the template for SOE regulation in more recent FTAs.[583] This includes the CAI, in which China has agreed, for the first time, to incorporate special SOE rules.[584] It is, therefore, helpful to critically analyze the SOE rules in the CPTPP and

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578. *See* Kevin Lefebvre et al., *Containing Chinese State-Owned Enterprises? The Role of Deep Trade Agreements* 1 (WBG Policy Research Working Paper, Paper No. 9637, 2021).

579. CPTPP, *supra* note 22, art. 17.2.1.

580. *See* Julien Sylvestre Fleury & Jean-Michel Marcoux, *The US Shaping of State-Owned Enterprise Disciplines in the Trans-Pacific Partnership*, 19 J. INT'L ECON. L. 445, 446 (2016).

581. Eleanor Olcott, *China Seeks to Join Transpacific Trade Pact*, FIN. TIMES (Sept. 16, 2021), https://www.ft.com/content/df94b345-8fb9-473f-8e58-0cb230c0a1fa.

582. Mireya Solís, *China Moves to Join the CPTPP, But Don't Expect a Fast Pass*, BROOKINGS INST. (Sept. 23, 2021), https://www.brookings.edu/blog/order-from-chaos/2021/09/23/china-moves-to-join-the-cptpp-but-dont-expect-a-fast-pass/.

583. *See, e.g.*, USMCA, *supra* note 22, ch. 22; *see* Free Trade Agreement Between the European Union and the Socialist Republic of Viet Nam, European Union-Viet., ch. 11, Mar. 30, 2020, 2020 O.J. (L 186) 63; Agreement Between the European Union and Japan for an Economic Partnership, European Union-Japan, ch. 13, Apr. 18, 2018, https://eur-lex.europa.eu/resource.html?uri=cellar:cf1c4c42-4321-11e8-a9f4-01aa75ed71a1.0001.02/DOC_2&format=PDF#page=349. The TPP SOE chapter also served as a useful blueprint for the negotiating parties of the now stalled Transatlantic Trade and Investment Partnership (TTIP) and Trade in Services Agreement ("TiSA"). RACHEL F. FEFER, CONG. RSCH. SERV., TRADE IN SERVICES AGREEMENT (TISA) NEGOTIATIONS: OVERVIEW AND ISSUES FOR CONGRESS, 8–9 (2017).

584. CAI, supra note 22, section II, art. 3bis.; *see also* Uri Dadush & André Sapir, *Is the European Union's Investment Agreement with China Underrated?* 7 (Bruegel Policy Contribution, Working Paper No. 09/21, 2021).

interrogate how effective they may be in addressing the challenges posed by Chinese SOEs.

The SOE chapter of the CPTPP has a number of novel features, including a bright line definition of SOEs, cumulative obligations of non-discriminatory treatment and commercial considerations, prohibition of non-commercial assistance to SOE service providers, and better enforcement mechanisms.[585] Fundamentally, the CPTPP seeks to "achieve a more level playing field—regulatory and competitive neutrality—for both [SOEs and POEs]."[586] Nevertheless, as will be argued below, it is far from clear whether the CPTPP would provide an ideal model for the regulation of Chinese SOEs.[587]

A. *Is the Definition of SOE too Narrow?*

One of the main issues regarding the disciplines on SOEs in international law is the lack of a clear and consistent definition of what SOEs are. Article XVII of the GATT defines state trading enterprises (STEs) as "Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports."[588] Although there might be some overlaps between the notion of an STE and that of an SOE, the two are not synonymous. On the one hand, a private enterprise without state ownership can be an STE. On the other hand, SOEs cover a wider remit than STEs because the latter is limited to SOEs with special rights or privileges.[589] As the WTO concedes, the definition of STEs is far from being clear, and the absence of a clear definition renders Article XVII ineffective.[590] The scope of Article VIII GATS is even narrower because

585. Jan Yves Remy & Iain Sandford, *Rules for State-Owned Enterprises in Chapter 17 of the Trans–Pacific Partnership Agreement: Balancing Market-Oriented Disciplines and Policy Flexibility for States*, *in* THE COMPREHENSIVE AND PROGRESSIVE TRANS-PACIFIC PARTNERSHIP: ANALYSIS AND COMMENTARY 510, 511–12 (Jorge A. Huerta-Goldman & David A. Gantz eds., 2022).

586. Mitsuo Matsushita & C. L. Lim, *Taming Leviathan as Merchant: Lingering Questions About the Practical Application of Trans-Pacific Partnership's State-Owned Enterprises Rules*, 19 WORLD TRADE REV. 402, 405 (2020).

587. *See* Zhou, *supra* note 23, 578–88; Minwoo Kim, *Regulating the Visible Hands: Development of Rules on State-Owned Enterprises in Trade Agreements*, 58 HARV. INT'L L.J. 225, 254–60 (2017).

588. GATT 1994, Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994 ¶ 1.

589. Mastromatteo, *supra* note 575, at 606.

590. *Technical Information on State Trade Enterprises*, WTO, https://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm.

it only applies to monopoly suppliers and exclusive service suppliers.[591] Similarly, there is controversy over whether SOEs are "public bodies" and, therefore, can be a subsidy provider in the SCM Agreement.[592] The purpose of such a determination is "intended to prevent states from circumventing their obligations simply by acting through an alter ego."[593] The WTO AB required that a "public body" must be an entity that "possesses, exercises or is vested with governmental authority."[594] The idea that an SOE should be delegated with governmental authority has been assimilated by the definition of SOEs in many FTAs.[595]

The CPTPP represents a paradigm shift away from the pre-existing definitions and, for the first time, adopts a clear-cut rule based exclusively on quantifiable proxies to determine what an SOE is.[596] Article 17.1 of the CPTPP expressly defines an SOE in relation to two main criteria: governmental control and commercial activity. It provides that an SOE is "an enterprise that is principally engaged in commercial activities in which a [CPTPP] party: (a) directly owns more than 50[%] of the share capital; (b) controls, through ownership interests, the exercise of more than 50[%] of the voting rights; or (c) holds the power to appoint a majority of members of the board of directors or any other equivalent management body."[597] Moreover, "commercial activities" are defined as "activities which an enterprise undertakes with an orientation toward profit-making and which result in the production of a good or supply of a service that will be sold to a consumer in the relevant market in quantities and at prices determined by the enterprise."[598] Thus entities engaged mainly in non-profit activities or public services are excluded. The limitation of the definition to those SOEs that are engaged in commercial activities reflects the competition-related concerns underlying SOE regulations. The CPTPP does not seek to regulate SOEs when they engage in non-commercial activities that do not risk distorting competition. It also recognizes that SOEs, in

591. GATS, *supra* note 247, art. 8.

592. Kim, *supra* note 587, at 238.

593. *Id.* at 254.

594. *US – Antidumping and Countervailing Duties*, *supra* note 361, ¶ 317.

595. *See e.g.*, Free Trade Agreement Between the United States of America and the Republic of Korea, S. Kor.-U.S., art. 16.3(1)(a), June 30, 2007, https://ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file193_12715.pdf; United States-Australia Free Trade Agreement, Austl.-U.S., art. 14.4(1)(a), May 18, 2004, https://ustr.gov/archive/assets/Trade_Agreements/Bilateral/Australia_FTA/Final_Text/asset_upload_file918_5159.pdf.

596. Kim, *supra* note 587, at 243–44.

597. CPTPP, *supra* note 22, art. 17.1.

598. *Id.*

providing public services, achieve policy objectives that private participation cannot fulfill.[599] According to the SOE definition in the CPTPP, it is irrelevant whether an entity enjoys special privileges, monopoly status, or exercises governmental authority or not. The government ownership or control of a commercial entity, by itself, is sufficient to identify an SOE.

Although a clear-cut definition eliminates uncertainties about what an SOE is, rigid rules may also weaken SOE regulations. The quantitative thresholds defining ownership/control in the CPTPP fail to consider various techniques that could be used to ensure indirect governmental control, even if the government no longer owns more than 50% of the shares or holds power to appoint a majority of the board of directors.[600] For example, how might interlocking directorates and indirect ownership structures impact the determination of an SOE?[601] What if the government holds less than the majority of the shares but still constitutes the largest block of voting rights?[602] That is particularly an issue for Chinese SOEs. Despite the MOR reform, after which the reformed firms may no longer meet the definition of SOEs in the CPTPP, it is entirely possible that the GOC still holds sway over at least some of the new firms in China's unique institutional context. An example is Yunan Baiyao, one of the most famous listed pharmaceutical companies in China. After two rounds of MOR, Yunnan SASAC now owns 25% of Yunnan Baiyao's shares.[603] However, it remains one of the two largest shareholders of Yunan Baiyao. Indeed, the bottom line of Yunan Baiyao's MOR was that no single private investor could own more voting rights than Yunan SASAC.[604] Moreover, it is not clear whether the party committee still plays the role of "leadership core" in mixed ownership companies in which the state capital controls less

599. Remy & Sandford, *supra* note 585, at 526–27. Some scholars argue that the CPTPP's non-regulation of non-profit SOEs "risks ignoring the impact which nonprofit entities can have on the market, as well as their ability to abuse a dominant position." *See* Matsushita & Lim, *supra* note 586, at 415–16.

600. Leonardo Borlini, *When the Leviathan Goes to the Market: A Critical Evaluation of the Rules Governing State-Owned Enterprises in Trade Agreements*, 33 LEIDEN J. INT'L L. 313, 327 (2020).

601. *See* Mitsuo Matsushita, *State-Owned Enterprises in the TPP Agreement*, *in* PARADIGM SHIFT IN INTERNATIONAL ECONOMIC LAW RULE-MAKING: TPP AS A NEW MODEL FOR TRADE AGREEMENTS? 187, 200–02 (Julien Chaisse et al. eds., 2017).

602. *See* Ben Hancock, *Reach of TPP's SOE Disciplines Limited by Definition, Scope, Exceptions*, 33 INSIDE U.S. TRADE 23 (2015).

603. David Blair & Yingqing Li, *Traditional Pharma Firm Furthers Reform Efforts*, CHINA DAILY (Feb. 22, 2019, 11:45 AM), https://www.chinadailyhk.com/articles/41/5/161/1550807394437.html.

604. *Id.*

than 51% of the voting rights.[605] Although the definition of SOEs in the CPTPP may be stretched to encapsulate *de facto* control, "thereby requiring inquiry into inter-locking and indirect ownership structures as well as other forms of indirect 'control' such as through building shareholder coalitions,"[606] the concern remains that the SOE definition in the CPTPP may not be able to capture the scenarios where the state may be able to exert strong influence without reaching the quantitative thresholds.[607] After all, it seems fairly easy for SOEs to reorganize their ownership or voting structure to circumvent the rule.[608]

By comparison, under the U.S.-Singapore FTA, an SOE is an enterprise in which the Government of Singapore has "effective influence."[609] Importantly, effective influence may exist when the government owns less than 50% of the voting rights of an entity as long as it can determine the outcome of the strategic, financial, or operating decisions or plans of an entity or otherwise exercise substantial influence over the management or operation of an entity.[610] There exists a rebuttable presumption of effective influence when the government ownership exceeds 20% and constitutes the largest block of voting rights of the entity.[611] The SOE definition in the U.S.-Singapore FTA was followed by the USMCA and the CAI.[612] Specifically, the CAI widens the SOE definition in the CPTPP, adding that SOEs also include those

605. Zhong Yang Qi Ye Hun He Suo You Zhi Gai Ge Cao Zuo Zhi Yin (中央企业混合所有制改革操作指引) [Operating Guidelines for the Mixed Ownership Reform of Central Enterprises] (promulgated by State-Owned Assets Supervision and Administration Commission, Oct. 31, 2019, effective Oct. 31, 2019) Lawinfochina, CLI.4.337155, https://rb.gy/6gqvpf.

Part 3.1.1 provides: "Party building of mixed ownership enterprises. Establishing Party's organization and carrying out Party's work shall be the prerequisite of the mixed ownership reform of central enterprises. According to the characteristics of different types of mixed ownership enterprises, the setting methods, responsibilities, positioning and management models of Party's organizations shall be specified. . . ." The notice seems to suggest that party committee may play different roles in different types of mixed ownership enterprises. Although the SASAC notice only refers to central SOEs, it is reasonable to assume that the guidelines are likely to be followed by local SOEs as well. *Id.*

606. Matsushita & Lim, *supra* note 586, at 413.

607. Kim, *supra* note 587, at 257–58.

608. *Id.*; Ines Willemyns, *Disciplines on State-Owned Enterprises in International Economic Law: Are We Moving in the Right Direction?*, 19 J. INT'L ECON. L. 657, 666 (2016).

609. United States-Singapore Free Trade Agreement, Sing.-U.S., art 12.8.1, May 4, 2003, https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf.

610. *Id.*, art 12.8.5.

611. *Id.*

612. *See* USMCA, *supra* note 22, arts. 22.1, 22.1 n.8; CAI, *supra* note 457, Section II, art. 3bis(1). The CAI does not use the term SOEs but "covered entities" instead.

entities in which the government holds power to control the decisions through minority ownership as well as enterprises in which the government "has the power to legally direct the actions or otherwise exercise an equivalent level of control in accordance with its laws and regulations."[613] This definition is likely to broaden the SOE definition significantly and may even include some ostensible POEs in China.

B. *Non-Discriminatory Treatment and Commercial Considerations*

The GATT recognizes that, by acting as a trader, a government may influence the direction of international trade through its purchase and sales decisions. Thus, Article XVII:1 imposes on STEs the core obligation to undertake purchases and sales on a non-discriminatory basis and solely in accordance with commercial considerations involving either imports or exports.[614] However, the application of Article XVII:1 is flawed in at least three important aspects. First, it is unclear whether the non-discriminatory treatment in Article XVII:1 extends beyond a requirement of MFN treatment and includes an NT obligation.[615] The negotiating history suggests that Article XVII:1 was not intended to include an NT obligation. The GATT/WTO panels declined to take a position on this issue.[616] Second, in *Canada—Wheat Exports*, the AB found that the "commercial considerations" requirement does not impose a distinctive obligation on STEs and that it suffices for STEs to act in a non-discriminatory manner to comply with the provision.[617] Third, the AB clarified that the obligation to act solely in accordance with commercial considerations does not impose comprehensive competition-law-type obligations on STEs. It does not require STEs to refrain from using their exclusive or special privileges simply because such use might disadvantage competing commercial actors. The only constraint imposed on the use of exclusive or special privileges is that they should be used to make sales that are driven exclusively by commercial considerations.[618] While some question whether the AB's interpretation of the requirement that STEs act in accordance with

613. CAI, *supra* note 22, section II, art. 3bis(1).

614. GATT 1994, art. 17(1).

615. Mastromatteo, *supra* note 575, at 608–09.

616. Panel Report, *Canada–Measures Relating to Exports of Wheat and Treatment of Imported Grain*, ¶¶ 6.48–6.50, WTO Doc. WT/DS276/R (adopted Apr. 6, 2004) [hereinafter *Canada – Wheat Exports*]; Report of the Panel, *Canada–Administration of the Foreign Investment Review Act*, ¶ 5.16, L/5504 (Feb. 7, 1984), GATT B.I.S.D. (30th Supp.) at 140 (1984).

617. Appellate Body Report, *Canada–Measures Relating to Exports of Wheat and Treatment of Imported Grain*, ¶ 89, WTO Doc. WT/DS276/AB/R (adopted Aug. 30, 2004).

618. *Id.* ¶¶ 145–49.

commercial considerations is correct as economic logic would not support the AB's view, the AB's interpretation has been firmly established in the GATT/WTO jurisprudence.[619]

Article 17.4 of the CPTPP requires the SOEs of a CPTPP party to act on a commercial basis and not to discriminate in their purchases and sales of goods and services against suppliers, buyers, and investors of other CPTPP parties.[620] Although the obligations of non-discrimination and commercial considerations in the CPTPP are plainly rooted in the GATT STE rules discussed above, there are several important changes.[621] First, Article 17.4 dissolves any uncertainty with respect to the NT principle. The non-discriminatory treatment of SOEs now explicitly incorporates both NT and MFN treatment.[622] Second, NT and MFN obligations are not restricted to trading activities in goods but extend to trade in services and investors from other parties. In a similar vein, the obligations cover not only imports and exports but also SOEs' activities in the markets of their home states.[623] Third, acting in accordance with commercial considerations is no longer considered an illustration of non-discrimination treatment but an independent obligation. An SOE must cumulatively satisfy both requirements of non-discriminatory treatment and commercial considerations. Commercial considerations are defined as the same factors, such as price, quality, availability, marketability, and other factors, that a privately owned enterprise in the same business or industry would normally consider in commercial decisions.[624]

Compared to the GATT rules on STEs, the circumscribing word "solely" was absent from Article 17.4 of the CPTPP. In the WTO Panel's view, the requirement that STEs act solely in accordance with commercial considerations must imply that they should seek to purchase or sell on terms that are economically advantageous for themselves. An STE would not be acting solely in accordance with commercial considerations if it were to make "purchases or sales on the basis of such considerations as the nationality of potential buyers or sellers, the policies pursued by their governments, or the national (economic or political) interest of the Member maintaining the STE." [625] Therefore, there are concerns that the absence of the word "solely" in the commercial

619. Mavroidis & Sapir, *supra* note 18, at 74–80.
620. CPTPP, *supra* note 22, art. 17.4.
621. Borlini, *supra* note 600, at 329.
622. CPTPP, *supra* note 22, arts. 17.4.1.b(i), 17.4.1.c(i).
623. *Id.*, arts. 17.4.1.b(ii), 17.4.1.c(ii).
624. *Id.*, art. 17.1.
625. *Canada – Wheat Exports*, *supra* note 616, ¶ 6.88.

considerations requirement would "allow states to circumvent it by arguing that commercial considerations do not need to be solely market-driven."[626] Whether Article 17.4 allows for such flexibility is uncertain and will have to be clarified later.

Another difficulty with the obligation to act on a commercial basis is that there is no easy economic test to determine whether a firm's behavior is commercially sound. Central to determine whether an SOE has fulfilled this obligation is to inquire whether a POE may perform the same acts in normal business transactions, but actions such as selling at very low prices to hook customers can be practiced by commercially motivated firms and those with ulterior motives alike.[627] Further interpretative guidance would be helpful to clarify how to determine whether SOEs are not acting in accordance with commercial considerations.

C. *Non-Commercial Assistance*

It has long been argued that general principles of non-discriminatory treatment and commercial considerations would not solve all of the issues and that there is a need for specific disciplines that address specific concerns with SOEs.[628] One example is that many of the inherent advantages of SOEs boil down to direct and indirect subsidization by the government. In this regard, Article 17.6 prohibits the provision of non-commercial assistance (NCA) by the government (or SOEs) to SOEs if such assistance causes "adverse effects" to the trade and investment interests of another party or "injury" to a domestic industry of another party.[629] Article 17.1 defines NCA as "assistance to a [SOE] by virtue of that [SOE's] government ownership and control," including "direct transfers of funds or potential direct transfer of funds or liabilities" as well as the provision of "goods or services other than general infrastructure on terms more favorable than those commercially available to [an] enterprise."[630]

In essence, Article 17.6 of the CPTPP extends and adapts WTO subsidy regulation to SOEs. The definition of NCA is reminiscent of that of "financial contributions" under Article 1 of the SCM Agreement.

626. Fleury & Marcoux, *supra* note 580, at 456.

627. Philip I. Levy, *The Treatment of Chinese SOEs in China's WTO Protocol of Accession*, 16 WORLD TRADE REV. 635, 641–42 (2017).

628. Willemyns, *supra* note 608, at 669.

629. The NCA rules apply not only to assistance from government to an SOE, but also to the provision of NCA by an SOE to another SOE. *See* CPTPP, *supra* note 22, arts. 17.6.1, 17.6.2.

630. *Id.*, art. 17.1.

Similarly, the term "by virtue of that [SOE's] government ownership or control" in the NCA definition, which means that access to NCA favors SOEs as a distinct class, is, in effect, the specificity requirement in Article 2 of the SCM Agreement.[631] Lastly, the requirements of "adverse effect" or "injury" also resemble Articles 6 and 15 of the SCM Agreement, although the CPTPP defines these two terms more narrowly, arguably making investigations of the violation easier.[632] Of particular significance of the NCA rules in the CPTPP is that they not only apply to the production and sale of goods by SOEs but also to assistance given to SOEs in respect of the supply of services *outside* the providing party's own territory. Therefore, a CPTPP Member is prohibited from causing adverse effects on the interests of another Member by providing NCA to SOEs through supplying services.[633] However, the NCA rules do not apply to a service supplied by an SOE within the territory of the subsidizing party.[634] Given the enormous challenges faced by Member states to negotiate subsidy disciplines for services trade at the WTO, "the inclusion of provisions on [NCA] pertaining to services provided by SOEs constitutes a considerable breakthrough as far as service subsidies are concerned."[635]

Despite the fairly lengthy provisions, the CPTPP does not generally inhibit NCA. Instead, the new rules aim at controlling certain negative effects that may arise from the NCA.[636] One may wonder to what extent the main concerns with the SCM Agreement, such as the high evidentiary burden in proving the existence of a subsidy in China, the failure of the notification process, and the ineffectiveness of remedies in disciplining subsidies, are addressed in the CTPPP.[637] By contrast, the Japan-United States-European Union Trilateral Initiative proposed to expand the list of subsidies prohibited outright while reversing the

631. Yoshinori Abe & Takemasa Sekine, *Non-Commercial Assistance Rules in the TPP: A Comparative Analysis with the SCM Agreement*, *in* THE COMPREHENSIVE AND PROGRESSIVE TRANS-PACIFIC PARTNERSHIP: ANALYSIS AND COMMENTARY 542, 546 (Jorge A. Huerta-Goldman & David A. Gantz eds., 2021).

632. Borlini, *supra* note 600, at 330.

633. CPTPP, *supra* note 22, arts. 17.4.1.b(i), 17.4.1.c(i). Note that the injury limb does not apply to the services sector.

634. *Id.*, art. 17.6.4.

635. Fleury & Marcoux, *supra* note 580, at 459–60.

636. Borlini, *supra* note 600, at 330.

637. *See* Chad P. Bown & Jennifer A. Hillman, *WTO'ing a Resolution to the China Subsidy Problem*, 22 J. INT'L ECON. L. 557, 567–572 (2019).

burden of proof of the negative impacts of the subsidies in some cases.[638] The USMCA contains an unconditional prohibition to three forms of NCA provided to an SOE primarily engaged in the production of goods other than electricity.[639]

D. *Will Extensive Carve-outs Hollow Out the SOE Rules?*

The CPTPP rules on SOEs are subject to general exemptions, as well as a wide range of specific limitations in the form of reservations and individual exceptions, in recognition of the need for governments to pursue policy objectives through SOEs. First, Article 17.2 enumerates several areas that are not included within the regulatory scope of the SOE regulations in the CPTPP: regulatory and supervisory measures from a central bank or a monetary authority; regulatory or supervisory measures over financial services suppliers; measures adopted for the purpose of a failing or failed financial institution; sovereign wealth fund; independent pension fund; government procurement; the provision of goods and services by an SOE to carry out a party's governmental functions; and the establishment or the maintaining of an SOE.[640] Second, Article 17.9 allows each party to list certain SOEs' activities to which SOE disciplines shall not apply. States can list in their schedule Annex IV non-conforming activities of SOEs.[641] Those schedules list the obligations concerned (non-discriminatory treatment and commercial considerations, as well as non-commercial assistance), the entity to which the obligations do not apply, and the scope of non-conforming activities. Third, Annex 17-D is used by states to list disciplines that do not apply to SOEs that a sub-central government owns or controls.[642] Finally, Article 17.13 allows more flexibility for SOEs by excluding smaller SOEs from the obligations, i.e., those that do not generate annual revenue above a threshold amount calculated in Annex 17-A; the adoption of temporary measures in response to a national or global

638. *Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and European Union* (Jan. 14, 2020), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/joint-statement-trilateral-meeting-trade-ministers-japan-united-states-and-european-union. For a critique of the new proposed rules in trilateral dialogue, *see* Robert Howse, *Making the WTO (Not So) Great Again: The Case Against Responding to the Trump Trade Agenda Through Reform of WTO Rules on Subsidies and State Enterprises*, 23 J. INT'L ECON. L. 371, 382–84 (2020).

639. USMCA, *supra* note 22, art. 22.6.1.

640. CPTPP, *supra* note 22, art. 17.2.

641. *Id.*, art. 17.9.1.

642. *Id.*, art. 17.9.2.

economic emergency; as well as the supply of financial services by a state-owned enterprise pursuant to a government mandate.[643]

While some exemptions discussed above are quite sensible,[644] other exemptions are more controversial, such as a sweeping exemption for SOEs that a sub-central level government owns or controls, state-owned domestic service providers, and sovereign wealth funds (SWFs).[645] Combined with reservations and specific exceptions contained in the annexes and side agreements, which go quite far and include a wide range of enterprises, there are more pages devoted to exceptions than there are to the general rules themselves.[646] Apparently, this complex legal framework resulted from political compromises as different states have different views on SOEs, and some CPTPP parties continue to rely heavily on SOEs. Still, looking at the extensive carve-outs, the question arises whether the totality of all exemptions and exceptions in the CPTPP renders the substantial provisions rather useless.[647]

The challenges are even more acute when applying these exemptions to Chinese SOEs. For example, the exemption of sub-central SOEs considerably limits the scope of the application of SOE rules. But sub-central SOEs are equally capable of severely distorting international investment. After extensive restructuring and reorganization of the state sector in China, there are only 98 central SOEs under the direct supervision of the SASAC.[648] At the same time, there are hundreds of thousands of sub-central SOEs flourishing in China, accounting for almost half of the total annual revenue of all Chinese SOEs and a quarter of all Chinese enterprises listed on the Fortune Global 500 in 2021.[649] Given that Chinese sub-central SOEs are important players in a wide range of industries, their exemption leaves important lacunae in the SOE rules. In this respect, it is noted that the CAI applies to Chinese SOEs at all levels of government, including sub-central

643. *Id.*, art. 17.13(1), (2), (5).

644. For example, the exemptions of smaller SOEs, government procurement and services supplied in the exercise of governmental authority. *Id.*, art. 17.13.

645. Borlini, *supra* note 600, at 328.

646. *Id.*

647. Willemyns, *supra* note 608, at 675.

648. *Directory Names*, State-Owned Assets Supervision & Admin. Comm'n of the State Council, http://en.sasac.gov.cn/directorynames.html (last visited Apr. 22, 2023).

649. 去年国企利润增长超三成 国有经济运行稳中有进 [Last year, the profits of state-owned enterprises increased by more than 30%, and the state-owned economy operated steadily and made progress], Ministry of Fin. of the People's Republic of China (Jan. 28, 2022), http://www.gov.cn/shuju/2022-01/28/content_5670891.htm (last visited Feb. 4, 2023).

SOEs.[650] Another example of the exception is SWFs. China is actively exploring the potential transformation of SOEs into SWFs, and it is not too far-fetched to imagine the SWFs of the next generation functioning as today's SOEs.[651] China is restructuring the mode of state interference rather than eliminating SOEs. Lastly, some CPTPP parties, such as Mexico and Vietnam, have successfully negotiated extensive exceptions for certain SOEs in specific sectors or activities.[652] There is no reason why China will not push hard for an extensive list of carve-outs in the accession negotiations.

E. *The Investment Law Implications of the New Rules for Chinese SOEs*

The CPTPP applies to the behavior of SOEs which affects trade or investment between the CPTPP parties.[653] It is, therefore, useful to summarize how the CPTPP rules may affect SOEs' investment activities. It is important to highlight that even though the CPTPP rules have relevance to Chinese SOEs' investment, they do not address many concerns about Chinese SOEs.

First, the NCA rules in the CPTPP apply to assistance given to SOEs in respect of their supply of services outside the providing party's own territory. Specifically, a CPTPP party is prohibited from causing adverse effects on the interests of another party by providing NCA to the SOEs' supply of a service through FDI.[654] Therefore, the subsidization of SOEs' overseas investment by the Chinese government is captured by the CPTPP rules. On the other hand, when Chinese SOEs are investors abroad, their investments will enjoy broader rights in the other CPTPP party's market.[655] For instance, SOE investors enjoy NT and MFN treatment for both purchases and sales of goods and services in other CPTPP parties' territories.[656] Chinese SOEs' investment is also protected under the NCA rules against market displacement or impediment of like products, as well as price undercutting, price suppression, price depression, or lost sales in the goods sector.[657]

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650. CAI, *supra* note 22, section II, art. 3bis(1).

651. *See* Yingyao Wang, *The Rise of the "Shareholding State": Financialization of Economic Management in China*, 13 SOCIO-ECON. REV. 603, 615 (2015).

652. Sean Miner, *Commitments on State-Owned Enterprises*, *in* ASSESSING THE TRANS-PACIFIC PARTNERSHIP: VOLUME 2: INNOVATIONS IN TRADING RULES 91, 97–98 (Jeffrey J. Schott & Cathleen Cimino-Isaacs eds., 2016).

653. CPTPP, *supra* note 22, art.17.2.1.

654. *Id.*, art.17.6.1(c).

655. Matsushita & Lim, *supra* note 586, at 420.

656. CPTPP, *supra* note 22, art. 17.4.1(b)–(c).

657. *Id.*, art. 17.7.1 (a), (c).

Second, Article 17.5.1 requires states to provide their domestic courts with jurisdiction over civil claims against other CPTPP parties' SOEs based on their commercial activities carried on in its territory unless the party does not provide jurisdiction over similar claims against enterprises that are not foreign SOEs.[658] The GOC's long-held view is that Chinese SOEs, as independent enterprise entities, assume independent legal liabilities and that they could not claim state immunity before foreign courts except in "extremely extraordinary circumstances."[659] Still, some Chinese SOEs have adopted the controversial sovereignty immunity defense in U.S. courts, sometimes backed by China's Ministry of Foreign Affairs.[660] According to Article 17.5.1, Chinese SOEs will be precluded from claiming foreign sovereign or state immunity in CPTPP Members' courts for their commercial activities, in particular in common law jurisdictions.[661]

Lastly, Article 17.5.2 stipulates that "any administrative body that a [CPTPP] party establishes or maintains that regulates a [SOE should] exercise its regulatory discretion in an impartial manner with respect to enterprises that it regulates, including enterprises that are not [SOEs]."[662] Similarly, each CPTPP party shall ensure that its competition law applies to all commercial activities, including SOEs, in its territory unless explicitly exempted.[663] These provisions aim at curbing regulatory favoritism and require the evenhanded application of laws and regulations between SOEs and other commercial entities.

F. *Will China Be Able to Implement SOE Obligations?*

When it comes to the substantive obligations for SOEs, such as the requirements of non-discrimination, commercial considerations, and transparency, the SOE rules in the CPTPP draw heavily from the existing rules under the GATT/WTO system, including the obligations embodied in China's Protocol of Accession to the WTO. Although the SOE rules in the CPTPP have added precision and expanded the scope of SOE obligations, in at least some aspects, the CPTPP rules may be

658. *Id.*, art. 17.5.1.

659. Guan Feng, *Do State-Owned Enterprises Enjoy Sovereign Immunity*, KING & WOOD MALLESONS: CHINA L. INSIGHT (Sept. 27, 2018), https://www.chinalawinsight.com/2018/09/articles/dispute-resolution/do-state-owned-enterprises-enjoy-sovereign-immunity/.

660. Matthew Miller & Michael Martina, *Chinese State Entities Argue They Have "Sovereign Immunity" in US Courts*, REUTERS (May 16, 2016, 11:13 AM), https://www.reuters.com/article/us-china-usa-companies-lawsuits-idUSKCN0Y2131.

661. Matsushita & Lim, *supra* note 586, at 418.

662. CPTPP, *supra* note 22, art. 17.5.2.

663. *Id.*, art. 16.1.2.

even less stringent than the obligations in China's Protocol of Accession to the WTO.[664] To the extent that the existing SOE rules have not been successful in bringing about China's compliance with the WTO rules,[665] the effect of the SOE rules in the CPTPP may also be limited. There is no guarantee that the SOE rules in the CPTPP are able to constrain China's state capitalism effectively. In short, the current SOE rules may serve as a starting point for future negotiations of appropriate SOE rules in the 21st century.

Take the transparency obligation in the CPTPP as an example. As SOEs compete in the global marketplace, transparency and disclosure have gained great importance. Transparency allows host states to be clear about how SOEs are controlled and supported by their home states and to monitor the implementation of state obligations in international trade and investment agreements.[666] However, research shows that state ownership has a negative effect on the transparency of multinational enterprises.[667] The lack of transparency for SOEs has contributed to growing levels of anxiety over their national security and competitive neutrality implications. The OECD calls for states to be transparent about the objectives, operations, and performance of SOEs when they operate abroad.[668]

Chinese SOEs are particularly criticized for their lack of transparency compared to their private counterparts.[669] Moreover, it is widely acknowledged that neither the notification mechanisms under the SCM Agreement nor the WTO trade policy review mechanism have been successful in forcing China to provide enough information on SOEs.[670] The perception that Chinese SOEs lack transparency is disconcerting because, given the ideological, security and competition concerns about Chinese SOEs in host states, it is essential for Chinese SOEs

664. Zhou, *supra* note 23, 581–586.

665. U.S. Trade Rep., 2021 REPORT TO CONGRESS ON CHINA'S WTO COMPLIANCE 2 (Feb. 2022).

666. *See* OECD, *supra* note 2, at 8.

667. *See* Anthony P. Cannizzaro & Robert J. Weiner, *State Ownership and Transparency in Foreign Direct Investment*, 49 J. INT'L BUS. STUDIES 172, 174–75 (2018).

668. *See* OECD, *Transparency Checklist for SOEs Operating Abroad: A Draft Reporting template*, DAF/INV/WD(2016)15 (Oct. 19, 2016).

669. Yipeng Liu & Michael Woywode, *Light-Touch Integration of Chinese Cross-Border M&A: The Influences of Culture and Absorptive Capacity*, 55 THUNDERBIRD INT'L BUS. Rev. 469, 479 (2013).

670. The poor implementation of transparency requirements on SOEs is due to the absence of any specific obligations applying to SOEs, no agreed definition of SOEs that ought to be subject to discipline and no shared understanding of how SOEs do or do not offend the non-discrimination norms of the WTO. *See* Robert Wolfe, *Sunshine over Shanghai: Can the WTO Illuminate the Murky World of Chinese SOEs?*, 16 WORLD TRADE REV. 713, 720–24 (2017).

to work extra hard to attain local legitimacy and therefore be more transparent about their financing, structures, and objectives.[671]

Article 17.10 of the CPTPP contains extensive transparency requirements for SOEs that each party should provide.[672] The requirements combine the proactive disclosure of SOE information by the home state with a request mechanism for other parties to obtain information.[673] Article 17.10.1 requires each party to provide to the other parties or otherwise make publicly available on an official website a list of its SOEs and to update this list annually.[674] In addition, a party shall provide the following information regarding a specific SOE upon receiving a written request from another party: percentage of shares and votes under government ownership; special shares, votes, or other rights; government officials serving as officers or on the board of the SOE; the SOE's annual revenue and total assets, exemptions, and immunities accorded to the SOE under national law as well as any other publicly available information.[675] Moreover, the request mechanism allows other parties to obtain information regarding the NCA provided by a state to its SOEs. The response must be sufficiently specific to enable the requesting party to evaluate the effects of the NCA on trade and investment between the parties. The disclosed information could include the legal basis and policy objective of the measure, the amount of the assistance, its duration, as well as statistical data permitting an assessment of the effects of the NCA on trade and investment.[676]

Wolfe questioned the effectiveness of the transparency requirements provided in the CPTPP. First, the record of WTO Members' notification of industrial subsidies with respect to SOEs is consistently poor, and the same disincentives exist when providing information in response to information requests.[677] Second, the transparency provisions are not accompanied by strong institutional support. The mandate of the Committee on State-Owned Enterprises and Designated

671. Klaus E. Meyer et al., *Overcoming Distrust: How State-Owned Enterprises Adapt Their Foreign Entries to Institutional Pressures Abroad*, 45 J. INT'L BUS. STUD. 1005, 1024 (2014).

672. See Fleury & Marcoux, *supra* note 580, at 462.

673. *Id.* at 462–63.

674. *Id.*

675. CPTPP, *supra* note 22, art. 17.10.3.

676. *Id.*, arts. 17.10.4, 17.10.5.

677. Robert Wolfe, *Letting the Sunshine in at the WTO: How Transparency Brings the Trading System to Life* 18–19 (WTO Staff Working Paper, Paper No. ERSD-2013-03, 2013). These disincentives include bureaucratic incapacity, worries about providing adverse information for a potential legal dispute, the difficulty for a party's trade authority to notify actions taken by other ministries or other levels of government or by SOEs, and ambiguity about what requires notification etc. *Id.*

Monopolies does not include regular receipt, discussion, and dissemination of SOE information. The information provided in response to an information request can be kept confidential if the party supplying the information requests it.[678] As a result, the requested information cannot benefit all affected parties. Lastly, given the number of Chinese SOEs, it may be unrealistic to expect China to create an online list of every SOE. [679] It might be even more unrealistic for any CPTPP party to expect China to provide sufficiently specific written evidence that would enable a requesting party to evaluate the impact of Chinese SOEs on international trade and investment. On the other hand, the CPTPP has set in place a more powerful mechanism to enforce transparency obligations through dispute settlement. The answering party has an obligation to cooperate with the requesting party in the information-gathering process concerning SOEs. A panel is entitled to draw adverse inferences from instances of non-cooperation by a disputing party in the information-gathering process. In addition, the panel shall not request additional information to complete the record where the information would support a party's position, and the absence of that information is the result of that party's non-cooperation in the information-gathering process.[680] Consequently, a requesting party no longer needs to rely on the grace and good faith of the responding party to seek information about SOEs. A stronger enforcement mechanism may provide additional incentives for China to comply with the daunting obligations.

VII. Conclusion

As "mighty leviathans of the Chinese planned economy," Chinese SOEs were long depicted as "muscle-bound goons" or the "relics of a failed economic experiment," characterized as "possessing a lack of managerial flair, little concern for profit, low employee motivation and mobility, [and] a tendency to maximize corporate size."[681] After extensive reforms over the past four decades, it is no longer true to uphold the simplistic and pessimistic view of Chinese SOEs as industrial dinosaurs fit only for dismemberment or bankruptcy. Chinese SOEs have vastly improved their financial performance in the past decade. Modern corporate governance systems have been established in

678. CPTPP, *supra* note 22, arts. 17.10.9, 17.12.

679. Wolfe, *supra* note 670, at 725–26.

680. CPTPP, *supra* note 22, Annex 17-B.

681. John Hassard et al., *China's State-Owned Enterprises: Economic Reform and Organizational Restructuring*, 23 J. ORG. CHANGE MGMT. 500, 501 (2010).

Chinese SOEs, some of which can rival the best multinational corporations in the world.[682] Significantly, Chinese SOEs are no longer content to dominate China's domestic market. They have proactively engaged in global partnerships and acquisitions, aiming to become global champions.[683]

The rise of Chinese SOEs as active global players presents host countries with a vexing policy dilemma. The positive economic and political ramifications of FDI are widely acknowledged, but due to their strong political ties with the GOC and concentration in strategic sectors, Chinese SOEs may raise some unique challenges to host states. This Article provides a detailed analysis of such challenges and critically analyses how such challenges are addressed in the current international investment regime. Specifically, this Article argues that from both legal and policy perspectives, Chinese SOEs should have standing as claimants in ISDS; that a weaponized discriminatory, arbitrary, and politicalized national security regime runs the risk of breaching a host country's investment treaty obligations to foreign investors; and that the new SOE rules in the CPTPP may not be effective in regulating Chinese SOEs.

As Howson argued, Chinese companies investing abroad represent a new phase of China's changing relationship with international economic norms.[684] Both the Chinese government and the Chinese SOEs are forced for the first time to play by internationally accepted rules not only during the entire investment phase but also with respect to internal corporate governance.[685] In this sense, Chinese SOEs' cross-border investments have started a socialization process bringing value to both China and the global economy. It is hoped that the recent spotlight on Chinese SOEs may serve as an external incentive for the GOC to push forward market-oriented SOE reforms. These reforms will not only reduce suspicion and misunderstanding when Chinese SOEs "go out" but also help them become truly competitive global champions.

682. Li-Wen Lin, *A Network Anatomy of Chinese State-Owned Enterprises*, 16 WORLD TRADE REV. 583, 593 (2017).

683. Leng, *supra* note 46.

684. Nicolas C. Howson, *China's Acquisitions Abroad - Global Ambitions, Domestic Effects*, 48 L. QUAD. NOTES 73, 74 (2006).

685. *See id.*