

Incipient activism of Sovereign Wealth Funds and the need to update United States securities laws

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ABSTRACT

Sovereign Wealth Funds (SWFs) lie at the cutting edge of a tectonic transformation in global business and international law embodying the sweeping changes in the global order. Illustrating the new financial and legal paradigm, SWFs demonstrate the blurring of lines between public actor states and private market actors. Ostensibly entrusted with the advancement of the public good of their respective citizenry, SWFs traditionally invested their vast pools of capital in apolitical, non-controversial, conservative government debt. Starting around 2006–2007, SWFs initiated an aggressive campaign of diversification and commenced allocating their immense investment capital into equity markets, real estate, energy projects, farming and private equity. This significant change led to SWF investment becoming inextricably linked to strategic industries in recipient nations. Simultaneously, apprehension developed in capital recipient nations with respect to potential non-financial motivation of SWF investment and the interrelated national security implications. In response, SWFs emphasized that they were not interested in exercising control over companies or countries, voluntarily limited their stakes, and expressed intent to embrace a passive shareholder approach. Since plowing into various investment markets, SWFs have generally acted cautiously and refrained from activist conduct which substantially obviated concerns over undue foreign control in host states. However, SWFs have recently undertaken a more activist investment approach comparable to other large investors. While the SWF activism is profits-centric, the behavioral shift reintroduces anxieties with respect to foreign government influence over political decision-making in host nations as well as undue dominance over strategic industry and infrastructure. Moreover, given their titanic financial strength, even profits based investment raises concerns over SWF dominance and influence over financial markets, portfolio companies and economic sectors.

In the United States, securities laws mandate disclosure and regulatory approval for certain transactions. Such laws afford regulators an opportunity to review investment activity and provide an alert to ascertain whether the investor is in compliance with rules and regulations. In light of the budding activism, it is timely to examine whether securities laws need to be updated. What are the ramifications of SWFs working with other SWFs with respect to acting in concert and group action? Are SWF investors sufficiently different as to justify heightened regulation? This article will examine current US regulatory policy, identify potential shortcomings in light of the developing investment climate, and concludes with suggested reforms.

Keywords: activist investors, institutional activism, securities laws

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control over companies, voluntarily limited their stakes, and expressed intent to embrace a passive shareholder approach.⁹ Since plowing into various investment markets, SWFs have indeed generally acted cautiously and refrained from activist conduct, which substantially obviated concerns over undue foreign control.¹⁰

However, SWFs have recently steered towards a more activist investment approach¹¹ similar to other major investors.¹² This new activism – which includes partnering with other large investors – both private and public – renews concerns with respect to foreign government influence over political decision-making in host nations as well as undue dominance over strategic industry and infrastructure.¹³

Illustrating these anxieties over nefarious investment motivations, the United States has increasingly become more active in scrutinizing business transactions either rejecting deals or insisting on post-deal divestment.¹⁴ In the United States, the Committee on Foreign Investment (CFIUS) is an important mechanism utilized to prevent undue foreign influence over key American industries.¹⁵ For example, the United States aggressively assessed the national security implications of China's Lenovo's intent to acquire the server business of IBM before ultimately approving the transaction.¹⁶

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instruments to higher risk/reward equity investments. This shift in strategy has stoked fears in the United States and Europe that these funds—which find home primarily in the Middle East and Asia—will use their economic clout to pursue political goals. This type of rhetoric has led some to call for increased regulation of SWFs.”).

⁹See, e.g., Heidi N. Moore, *Wall Street Banks: Will Sovereign Wealth Funds Speak Up?* WALL ST. J. (Jan. 8, 2009, 5:36 PM), <http://blogs.wsj.com/deals/2009/01/08/wall-street-banks-will-sovereign-wealth-funds-speak-up/> (noting that SWFs were passive).

¹⁰See Ashby Monk, *Recasting the Sovereign Wealth Fund Debate: Trust Legitimacy and Governance*, SOC. SCI. RESEARCH NETWORK at 2 (Nov. 27, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134862 (“The Kuwait Investment Authority stated their SWF have ‘been passive in all [its] investments [. . .] [It] has not played an active role or been an activist with [any] of [its] shares.’”). See WHARTON LEADERSHIP CTR. & JOSEPH H. LAUDER INST. MGMT. INT’L STUDIES, *THE BRAVE NEW WORLD OF SOVEREIGN WEALTH FUNDS* (2010), available at http://d1c25a6gwz7q5e.cloudfront.net/papers/download/052810_Lauder_Sovereign_Wealth_Fund_report_2010.pdf (same).

¹¹Richard Levick, *Game-Changer: Qatar Plays Historic Role in Glencore’s Bid for Xstrata*, FORBES (Sept. 12, 2012, 7:23 AM), <http://www.forbes.com/sites/richardlevick/2012/09/12/game-changer-qatar-plays-historic-role-in-glencores-bid-for-xstrata/> (describing Qatar’s involvement in the Glencore Xstrata merger as “a watershed moment when a SWF acts like an activist shareholder”); See Nili, *supra* note 2 (“[W]e see more and more that some SWFs do exercise their voting rights . . .”).

¹²Large funds have become activist investors in the United States. See Randall Smith, *Some Big Public Pension Funds Are Behaving Like Activist Investors*, http://dealbook.nytimes.com/2013/11/28/some-big-public-pension-funds-are-behaving-like-activist-investors/?_r=0 November 28, 2013 (noting that large pension funds are becoming increasingly active and that “several big United States public funds [] have played roles in shareholder uprisings in recent years.”). Large fund activism has proponents. See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013), available at <http://columbialawreview.org/wp-content/uploads/2013/05/Gilson-Gordon.pdf> (“The role for activist shareholders is to potentiate institutional voice; specialists in monitoring combine through the capital markets with specialists in low-cost diversification to provide a form of market-based stewardship.”).

¹³See Joel Slawotsky, *Sovereign Wealth Funds as Emerging Financial Superpowers: How U.S. Regulators Should Respond*, 40 GEO. J. INT’L L. 1239, 1255 (2009) (“SWFs also have the potential to succeed at forms of activism in which private activist investors have had only mixed results. Professor Fleischer notes the possibility that the US Government’s decision to save Fannie Mae and Freddie Mac in the way that it did, diluting shareholder equity while leaving debt holders relatively unscathed, might have been partially related to the fact that China was both companies’ largest debt holder.”). See also Nili, *supra* note 2 (“[W]e see more and more that some SWFs do exercise their voting rights. So, a move towards shareholder rights and influence may exacerbate national security concerns in situations where SWFs have gained a significant equity stake in a corporation.”).

¹⁴See Anthony Lin, *U.S. Court Throws Out Chinese CFIUS Challenge*, AMERICAN LAWYER, Oct. 11, 2013, <http://www.americanlawyer.com/id=1202623198261/U.S.-Court-Throws-Out-Chinese-CFIUS-Challenge?slreturn=20140319153553> (CFIUS rejection of a Chinese corporate transaction based upon security concerns and President Obama’s issuance of an executive order blocking the transaction. Ralls filed suit, lost but obtained a reversal on appeal.) See also *Divestment Of Procon Investment In Lincoln Mining Required As A Result Of US Regulatory Review*, LINCOLN MINING CORP., June 18, 2013, http://www.lincolnmining.com/news/index.php?&content_id=255 (CFIUS requirement that Chinese investors divest their controlling interest investment in Lincoln).

¹⁵U.S. DEP’T TREASURY, THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) (2012), <http://www.treasury.gov/resource-center/international/Pages/Committee-on-Foreign-Investment-in-US.aspx>. See also JAMES K. JACKSON, CONG. RESEARCH SERV., THE COMMITTEE ON FOREIGN INVESTMENT IN THE UNITED STATES (CFIUS) (Mar. 6, 2014), available at <http://www.fas.org/sgp/crs/natsec/RL33388.pdf>.

¹⁶See Brian Wingfield & Edmond Lococo, *A Lenovo Bid for IBM Unit Seen Sparking Security Review*, BLOOMBERG (Jan. 22, 2014, 11:13 PM), <http://www.bloomberg.com/news/2014-01-22/u-s-security-review-seen-should-lenovo-bid-for-ibm-unit.html> (“Growing Chinese investment in the U.S. has prompted national-security concerns. Proposed transactions by Chinese companies accounted for about 20 percent of the 114 reviews by an inter-agency government panel in 2012, supplanting the U.K. as the most-scrutinized nation.”). The deal was, in fact, approved. See Alex Barinka & David McLaughlin, *IBM Obtains U.S. Approval for Sale of Server Business to Lenovo*, BLOOMBERG (Aug. 15, 2014, 5:37 PM),

However, the current CFIUS regime was found to be problematic by the D.C. Court of Appeals in *Ralls v. Obama*,¹⁷ thus furthering the importance of securities regulations given the potential of a reduction in CFIUS's power.¹⁸ While not designed to screen foreign investment as CFIUS is, securities laws in the United States laws can serve as another crucial regulatory mechanism – a complement to CFIUS – to detect improper foreign investment. CFIUS is admittedly limited, (and in light of the D.C. Circuit ruling, may potentially become less powerful), and US securities laws can fill an important function.¹⁹ Securities laws mandate disclosure and regulatory filings for certain transactions, providing an alert to ascertain whether the investor is in compliance with rules and regulations.²⁰ For example, pursuant to US securities law, each owner of a five percent stake in a company's shares must report the holding.²¹ If more than one investor owns more than a five percent share, the law treats the individual holdings severally. Thus, multiple SWFs could potentially individually own less than the five percent percentage trigger, and yet collectively own more than five percent percentage of shares. Such a position would allow them to pressure management, or engage in other activist behavior without filing the required disclosure statements.²²

However, while severally-owned, under securities laws, if the several holders are acting “as a group,” the investors are treated as members of the group and the law aggregates the several holdings.²³ Under what circumstances are investors considered a “group”? Pursuant to the Second Circuit's *CSX Corporation v. Children's Investment Fund Management* ruling, there must be a tangible agreement to form a group.²⁴ Under *CSX*, “group action” exists when members “act as a . . . group for the purpose of acquiring [or some other activity with respect to the] securities of an issuer.”²⁵

In light of budding activism, it is timely to examine the issue of aggregating SWF holdings.²⁶ What are the ramifications of SWFs working with other SWFs or other large funds with respect to acting in concert and group action? SWFs, being advised by large law firms, will likely avoid conduct that would directly constitute group activity.²⁷ Are SWF investors sufficiently different as to justify heightened regulation?²⁸ After all, “[f]oreign government investors are different from other institutional investors (i.e., mutual,

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<http://www.bloomberg.com/news/2014-08-15/ibm-gets-u-s-approval-for-sale-of-server-business-to-lenovo.html> (“While CFIUS placed some conditions on the deal, they don't significantly affect the business, and terms of the transaction didn't change as result, a person with knowledge of the matter said, without specifying the conditions. The sale drew scrutiny because of disputes between China and the U.S., the world's two largest economies, over cyberintrusions. By completing the deal, IBM can jettison a less profitable business to focus on growing areas, such as cloud computing and data analytics, while giving Lenovo a bigger piece of the global computing-hardware market.”).

¹⁷See *Ralls Corp. v. Comm. on Foreign Investment in the United States*, 758 F.3d 296 (D.C. Cir. 2014) (reversing the district court decision and unanimously holding that President Obama's order unwinding a Chinese-controlled acquisition had deprived the buyer of a constitutionally protected property interest without due process).

¹⁸The possibility of an overhaul or at least a weakening of CFIUS's power to screen investors with nefarious intentions is a reasonable possibility in light of the decision.

¹⁹See *Executive Summary*, U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION, http://origin.www.uscc.gov/sites/default/files/annual_reports/Executive%20Summary%202013.pdf (last visited May 21, 2014), at page 3 (“The United States has a limited screening process for determining the potential national security threat from a specific foreign investment.”).

²⁰See *infra* Section III.

²¹See Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (2000).

²²This is not to suggest that engaging in activist investing should be illegal for SWFs. However, due to the exceptional nature of SWFs and the anxieties concerning foreign influence over American industry and national security, this proposes lowering the reporting trigger for SWFs. Doing so would protect the rights of SWFs while assuaging apprehension about SWF motivations.

²³See *Roth v. Jennings*, 489 F.3d 499, 507–08 (2d Cir. 2007) (disclosure requirements mandating that membership in a “group” wherein in the aggregate the “group” owns 5 percent of a publicly traded company's shares, “if two or more entities agree to act together for any of the listed purposes, a ‘group’ is ‘thereby’ formed.”).

²⁴See *CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP*, 654 F.3d 276, 278 (2d Cir. 2011) (rejecting the district court's ruling that circumstantial evidence consisting of two investors' multiple meetings established the formation of a group).

²⁵*Id.* at 284.

²⁶See Nili, *supra* note 2, (“This partly explains why investor activism and corporate governance are still ripe and, only very recently, an emerging trend within the SWF framework.”).

²⁷SWFs are represented by large law firms such as White & Case (see *Sovereign Wealth Funds*, WHITE & CASE, <http://www.whitecase.com/sovereign/#.UqhQEfQW3CY> (last visited Apr. 19, 2014); Jones Day (see *Sovereign Investors*, JONES DAY, <http://www.jonesday.com/sovereigninvestors/> (last visited Apr. 19, 2014); and Skadden (see *Mergers and Acquisitions*, SKADDEN, <http://www.skadden.com/practices/mergers-and-acquisitions> (last visited Apr. 19, 2014)).

²⁸Scholars have also raised the possibility that restrictions against sovereign wealth fund investments in capital recipient nations may violate investment treaties. See Locknie Hsu, *SWFs, recent US legislative changes, and treaty obligations sovereign wealth funds, recent US legislative changes, and treaty obligations*, 43 J. WORLD TRADE 451, 451–77 (2009).

pension, and hedge funds), because they are not only large, but also foreign and politically connected.”²⁹ The immense assets of SWFs provide these funds with astonishing firepower so that ordinary rules of investing may be substantially less relevant and significantly immense leverage is available vis-à-vis obtaining influence over companies and industries.

This article examines current US regulatory policy, identifies potential shortcomings in light of the developing investment climate, and concludes by offering suggested reforms. The first section describes SWFs and provides a factual background detailing their developing financial prowess. It discusses how SWFs once relegated their capital to passive, low risk investments which raised little or no apprehension regarding foreign influence over host nation economic or security interests. However, with an ever-increasing active investment approach including buying equity shares, real estate and energy assets, concerns have increased regarding potential non-financial motivational investment. The section will also discuss various proposals aimed at balancing concerns while at the same time encouraging SWF investment in host nations. The second section details the phenomenon of activist investing both in general terms as well as SWF specific activism. Activist investing, (once the province of “cowboy” investors,) has gone mainstream with large “respectable” funds now engaging in this practice. SWFs, as a type of large fund, can be expected to exercise a more activist investing style. The third section discusses several US securities laws in the context of SWF investment. The fourth section discusses proposals to modify the existing securities regulatory framework. While the securities laws were designed to prevent unfair takeovers and informational advantage and were not intended to screen inappropriate foreign ownership, the securities laws in particular can serve as an additional tool to address anxieties. Given the colossal economic power of SWFs, the recommended amendments should serve to detect and discourage improper conduct. The proposed updates offer the specter of addressing legitimate concerns over SWF purchases of corporate stakes while simultaneously encouraging the free movement of capital necessary for a prosperous economy.

I. SOVEREIGN WEALTH FUNDS: EXCEPTIONAL CHARACTERISTICS AND NATIONAL INTEREST CONCERNS IN RECIPIENT NATIONS OVER SWF INVESTMENT MOTIVATION

SWFs are large pools of capital owned by sovereigns.³⁰ The source of capital is generally derived from international trade, usually exports of energy products such as crude oil and natural gas or some other product.³¹ The earnings are placed into SWFs where they are invested for various purposes.³² SWFs are unique investors since they are considered part of governments or central banks.³³ This section will describe the exceptional qualities of SWFs, host nation anxieties regarding non-SWF impingement on national interests, and attempts to bridge the gap between recipient nation apprehension with regard to those domestic security concerns and the crucial need for foreign investment capital.

A. The unique nature of SWFs

A revolutionary transformation is changing the established global international law and economic dynamic.³⁴ SWFs are at the forefront of the new global international law and financial structure, embodying the “visible manifestations of these tectonic changes in the organization of the global order.”³⁵ Indeed, “[t]he old understanding of international law as something created solely by and for sovereigns is defunct.”³⁶ In contrast with the past when states were the archetype actor in international law, privatization and globalization have served to undermine the differences

²⁹See Elvira Sojli & Wing Wah Tham, *The Impact of Foreign Government Investments on Corporate Performance: Evidence from the U.S.*, SOC. SCI. RESEARCH NETWORK at 2 (June 2, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1540555.

³⁰See Epstein & Rose, *supra* note 8, at 114 n. 9 (describing various sovereign wealth fund definitions).

³¹See Slawotsky, *supra* note 13, at 1239 (noting that SWFs derive their funds from foreign exchange derived profits on exports).

³²Slawotsky, *supra* note 13, at 1239 (noting different types of SWFs designed for various purposes).

³³See Joel Slawotsky, *Sovereign Wealth Funds and Jurisdiction Under the FSIA*, 11 U. PA. J. BUS. L. 967, 974 (2009) (noting that the purpose and character of a sovereign wealth fund’s investments, along with its corporate governance, may impact its ability to claim sovereign immunity).

³⁴See Rafael Domingo, *Gaius, Vattel, and the New Global Law Paradigm*, 22 EUR. J. INT’L L. 627, 629 (2011) (analyzing the changes in international law).

³⁵Backer, *supra* note 2, at 1273.

³⁶See Paul B. Stephan, *Privatizing International Law*, 97 VA. L. REV. 1573, 1574–75 (2011).

between state and private actors.³⁷ Exemplifying the new international law paradigm, SWFs embody the obscuring of the traditional demarcation between state and private actor roles and of the convergence of public and private law.³⁸

At their core, SWFs are creations of states.³⁹ As such, they benefit from their status as government actors and enjoy tax-exempt status in the United States.⁴⁰ However, the role of SWFs as private market participants has legal implications, such as removal of foreign sovereign immunity.⁴¹ It is this dual nature of SWFs which exemplifies the blurring of the historical distinctions between public and private actors.⁴² Moreover, it is this blending of state and private statuses that gives rise to concerns over potential non-financial motivational investment. As stated by Larry Backer:

It is clear that SWFs represent a multifaceted nexus point for the convergence of public and private law. On the one hand, SWFs encompass attempts by states to participate in global markets like private individuals. On the other hand, SWFs may govern by other means. SWFs potentially allow states to convert private markets into public arenas through which they might project political and regulatory power abroad.⁴³

SWFs provide an avenue for states to advance their particular international law agenda.⁴⁴ The Norwegian SWF has been particularly apt at projecting its sponsor state's international law agenda.⁴⁵ Various companies can be excluded from the list of SWF investment options as well as being subjected to divestment based upon the recommendation of the Norwegian SWF's Ethics Council, which reviews companies based upon compliance with international law-based human rights and ethics.⁴⁶ The use of international law as a benchmark for investment decisions represents an example of a state utilizing the private sector to promote its foreign policy.⁴⁷ Moreover, it represents an inherent difference from private corporations who generally (if at all) do not make business decisions based upon compliance with human rights or foreign policy. It is this ability, and willingness, to advance a governmental agenda, rather than pursuing the pure profit

³⁷See Slawotsky, *supra* note 1, at 2 (discussing the blurring of historical distinctions).

³⁸See Joel Slawotsky, *The Global Corporation as International Law Actor*, 52 VA. J. INT'L L. 79, 85 (2012) ("The world is experiencing a unification of public and private actors in which private corporations are involved with traditionally state obligations and the state is a player in private financial markets . . . This coalition of interests underscores the blurring of the distinction between states and corporations.")

³⁹See Itai Trilnick, *Israeli Cabinet Approves Plans for Sovereign Wealth Fund*, HAARETZ (Apr. 15, 2013, 9:07 AM), <http://www.haaretz.com/business/israeli-cabinet-approves-plans-for-sovereign-wealth-fund.premium-1.515583> ("Legislation to establish a sovereign wealth fund, in which the state's income from Israeli natural gas will be stashed, was approved by the government yesterday, after the plan's proponents managed to overcome vehement opposition.")

⁴⁰See, e.g., Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440 (2009).

⁴¹See Slawotsky, *supra* note 33, at 974.

⁴²See Slawotsky, *supra* note 38, at 79; Backer, *supra* note 1, at 10–11.

⁴³Backer, *supra* note 1, at 59. International investment treaties present a further illustration that the lines of differentiation between public and private are already clouded.

[S]ince most investment treaties and domestic investment statutes do not exclude state-owned companies or sovereign wealth funds from their broad definitions of investors and investments, it is entirely possible to have state actors on both sides of the dispute Conversely, it is also possible to have non-state actors in interest on both sides of the dispute. This can happen where a state delegates a governmental function to a non-state company, and then the company does something that violates the state's investment treaty or statutory obligations toward a foreign investor. Here the international law principles on attribution come into play to transform the non-state company into a state actor, thereby rendering the state liable for the company's actions under international law. *All of these scenarios seem to undermine the utility of the strict state/non-state distinction between public and private in international investment disputes.*

Julie Maupin, *Public and Private in International Investment Law: An Integrated Systems Approach*, 54 VA. J. INT'L L. 367, 403–04 (2014) (emphasis added).

⁴⁴See Backer, *supra* note 2, at 1280.

⁴⁵On this level, SWFs unquestionably wield the capacity to influence global politics. It is important to note that while the Norwegian SWF has in fact acted in an activist fashion for some time, this has been with regard to ethics-based socially responsible investing. As will be discussed *infra* notes 176–186 and accompanying text, the Norwegian SWF activism appears to be gravitating away from a narrow social based context to a more generally based style of profit-focused activism.

⁴⁶See, e.g., Ethics Council decisions *infra* 176–186.

⁴⁷See Backer, *supra* note 2, at 1280 ("[T]he Norwegian Global SWF acts in a sovereign capacity. It deliberately seeks to project Norwegian policy preferences on a host of private actors otherwise beyond its reach. It seeks to use its investment strategies as a doorway to negotiate changes in foreign law.")

motive, that underscores the concerns over motivation.⁴⁸ The next section will describe the contextual anxieties over foreign corporate investment and government motivations both generally and specifically in the United States.

B. National interest concerns and foreign direct investment

Foreign direct investment (“FDI”) has generally been viewed with great enthusiasm.⁴⁹ However, global economic and strategic challenges have led to increasing scrutiny of cross-border transactions.⁵⁰ Governments have become more vocal in protecting local economic sectors and helping domestic corporations in an attempt to prevent unemployment and recession.⁵¹ For example, Australia rejected a takeover bid by a US company on national interest grounds. American agricultural giant Archer Daniels Midland sought to acquire an Australian grain corporation; however, citing grounds of national interest, the Australian Treasury Secretary opposed the transaction. “Treasurer Joe Hockey said he was rejecting the proposal on national interest grounds after Australia’s Foreign Investment Review Board failed to reach a consensus recommendation.”⁵²

In the United States, CFIUS⁵³ is an important mechanism⁵⁴ used to detect and prevent foreign entities transacting business with American companies that may damage national security.⁵⁵ CFIUS balances the need for FDI with national security considerations evaluating business proposals via a mechanism whereby an array of government agency representatives review a transaction and decide whether to recommend approval, rejection or recommendation with modifications.⁵⁶

Recent years have witnessed an increased level of CFIUS scrutiny.⁵⁷ The Ralls matter provides an illustration into the heightened apprehensions over foreign influence. In March 2012, Ralls, a corporation owned by Chinese nationals, acquired interests in a wind farm project from Terna, an American corporation. The proposed wind farm was adjacent to a restricted American military zone. On September 28, 2012, President Obama delivered a Presidential Order banning the acquisition and ownership in any form of the wind farm project by the Chinese connected parties, based upon “credible evidence” indicating that the parties, “through exercising control of the [companies,] might take action that threatens to impair the national security of the United States.”⁵⁸ The order also directed Ralls to divest of its interests in the project within ninety days and take down physical structures from the site within fourteen days.⁵⁹

⁴⁸Although exceptions may exist, private market participants are interested in profits as opposed to geo-political interests.

⁴⁹See Daniele Gallo, *The Role of Law, The Rule of Law and the Rise of Sovereign Wealth Funds: The Need For A Greater External And Internal Activism Of The European Union*, http://eprints.luiss.it/1295/1/WPG_01-14_Gallo.pdf (last visited May 21, 2014) at page 4 (“As to the positive features characterizing SWFs as investors in the global economy, there is no doubt that they contribute to both global growth and stability by maintaining an open flow of resources for long-term investments.”).

⁵⁰*Id.* at 8 (noting an increasing protectionist stance by recipient nations).

⁵¹See Nick Edwards & Kang Xize, *China wealth fund eyes Asia “as Western protectionism rises”*, REUTERS (Nov. 10, 2012, 10:35 PM), <http://www.reuters.com/article/2012/11/11/us-china-congress-cic-idUSBRE8AAO1120121111> (noting a rise in protectionist rhetoric in Western nations); see Katrin Bennhold, *Urging Europe to Stay European*, N.Y. TIMES, Oct. 22, 2008, http://www.nytimes.com/2008/10/22/business/worldbusiness/22funds.html?_r=0 (“With shares of some prominent companies trading at beaten-down prices, President Nicolas Sarkozy of France suggested on Tuesday that European leaders set up sovereign wealth funds to buy stakes in crucial industries to shield them from foreign raiders.”).

⁵²See Lincoln Feast & Colin Packham, *Australia surprises with rejection of \$2.55 billion GrainCorp takeover by ADM*, YAHOO! FINANCE, Nov. 28, 2013, <http://finance.yahoo.com/news/australia-surprises-rejection-2-55-225920266.html> (“The deal had been seen as the first test of the conservative government’s vow that Australia was ‘open for business’ after the victory of Tony Abbott’s Liberal Party in elections in September.”).

⁵³Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (2007).

⁵⁴The current CFIUS regime was found to be problematic by the D.C. Court of Appeals in *Ralls v. Obama*, 758 F.3d 296 (D.C. Cir. 2014), thus raising the possibility the CFIUS regime will be amended or judicially curtailed.

⁵⁵See Mark E. Plotkin, *Foreign Direct Investment by Sovereign Wealth Funds: Using the Market and the Committee on Foreign Investment in the United States Together to Make the United States More Secure*, 118 YALE L.J. POCKET PART 88 (2008) (discussing the application of CFIUS to cross-border investments by SWFs).

⁵⁶*Id.*

⁵⁷COMM. ON FOREIGN INV. IN U.S., ANNUAL REPORT TO CONGRESS (2011), available at <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2011%20CFIUS%20Annual%20Report%20FINAL%20PUBLIC.pdf>.

⁵⁸See Order Regarding Acquisition of Four U.S. Wind Farm Project Companies by Ralls Corporation, 77 Fed. Reg. 60, 281 (Oct. 3, 2012), available at <http://www.whitehouse.gov/the-press-office/2012/09/28/order-signed-president-regarding-acquisition-four-us-wind-farm-project-c>.

⁵⁹President Obama’s Order barred the parties from admittance to the project sites; from selling or conveying any items produced by Terna to any third party for use on the project sites and from selling or conveying the project

Other than the reference to “credible evidence,” the Presidential Order was devoid of any explanation. Ralls filed suit challenging CFIUS’ and the President’s authority to block and unwind the transaction alleging President Obama’s Order constituted violations of the Exon-Florio Amendment (as well as the Administrative Procedures Act (APA)), and unconstitutionally deprived Ralls of property without due process of law.⁶⁰ The District Court of Columbia dismissed the suit as moot.⁶¹

Ralls appealed and in an unprecedented order, the D.C. Circuit ruled that the constitutional rights of Ralls were indeed violated.⁶² If the appeals court ruling remains, the clear import is that the present CFIUS review process may potentially be altered either legislatively or judicially. At a minimum, the Ralls saga demonstrates the scrutiny imposed on foreign deals, particularly when defense and technology are involved.

In another example of heightened scrutiny, CFIUS closely examined the proposed transaction between Chinese Lenovo and IBM to acquire IBM’s server business. CFIUS closely examined the transaction as the US government was keenly interested. While the transaction was ultimately approved,⁶³ the scrutiny demonstrates the heightened national security concerns enveloping review of foreign owners of strategic US businesses.

Lenovo Group Ltd. (LNVGY) must convince government officials that buying a server unit from International Business Machines Corp. (IBM) won’t give China back-door access to U.S. secrets and infrastructure. The wrinkle is that the Pentagon, the FBI and the nation’s biggest telecommunications companies buy the IBM servers, according to people familiar with the matter and an analysis by Bloomberg Industries.⁶⁴

In another illustration, a privately owned company from the United Arab Emirates’ plan to invest in a port “has resurrected an unfinished debate over foreign ownership of critical US infrastructure.”⁶⁵ Even if the acquire is not itself “strategic,” proximity to a vital national interest will also generate concern.⁶⁶ Undoubtedly, foreign government-owned vehicles – such as SWFs – which want to acquire United States business interests will garner close examination.

The next subsection will examine concerns over foreign investment in the context of SWF transactions. These concerns stem from the exceptional nature of SWFs: while they are private market actors, SWFs are state-owned and funded. This duality presents the potential of investments that are not purely financially motivated and may instead include, primarily or secondarily, ulterior aims such as the acquisition of military secrets, technological prowess or the advancement of strategic goals not in the interests of the recipient host nation.

Footnote continued

companies to any other entity until all the structures were removed and CFIUS was advised and had the opportunity to oppose any proposed recipient party.

⁶⁰See Complaint, *Ralls Corp. v. Barack H. Obama*, No. 1-12-cv-01513 (D.D.C. Sept. 12, 2012). Subsequent to the issuance of the Presidential Order, Ralls amended its complaint to include claims against the President. See Amended Complaint, *Ralls Corp. v. Barack H. Obama*, No. 1-12-cv-01513 (D.D.C. Oct. 1, 2012).

⁶¹See *Ralls Corp. v. Committee on Foreign Investment in the United States*, 926 F.Supp.2d 71 (D.D.C. 2013).

⁶²See *Ralls Corp. v. Committee on Foreign Investment in the United States*, 758 F.3d 296 (D.C. Cir. 2014).

⁶³See Barinka & McLaughlin, *supra* note 16, (noting CFIUS approved the transaction).

⁶⁴See David McLaughlin & Alex Barinka, *Lenovo-IBM Deal Probed by U.S. Over Servers at Pentagon*, BLOOMBERG (Apr. 4, 2014, 5:29 PM), <http://www.bloomberg.com/news/2014-04-04/lenovo-ibm-deal-probed-by-u-s-over-servers-at-pentagon.html>.

⁶⁵See David Baumann, *Middle Eastern Investment in Florida Port Rekindles Security Infrastructure Debate*, FORBES (Aug. 20, 2014, 12:04 PM), <http://www.forbes.com/sites/mergermarket/2014/08/20/foreign-investment-in-florida-port-rekindles-security-infrastructure-debate/> (“In a July 29 letter to Treasury Secretary Jack Lew—whose department administers the CFIUS process—Hunter said this is the first time a ‘Middle Eastern company will fully operate a US cargo terminal’ and called on CFIUS to determine whether it presents any risk to national security.”).

⁶⁶Raymond Barrett & David Baumann, *US Regulators To Examine Whether Smithfield Foods Sale Is Kosher*, FORBES (May 29, 2013, 4:29 PM), <http://www.forbes.com/sites/mergermarket/2013/05/29/us-regulators-to-examine-whether-smithfield-foods-sale-is-kosher/> (“As key US regulators review the deal, they’re likely to take a look at how close Smithfield’s facilities are to military bases and other sensitive government locales.”). While the transaction was approved, (see Shruti Date Singh & Bradley Olson, *Smithfield Receives U.S. Approval for Biggest Chinese Takeover*, BLOOMBERG (Sept. 6, 2013, 6:37 PM), <http://www.bloomberg.com/news/2013-09-06/smithfield-receives-u-s-regulator-approval-for-shuanghui-deal.html>), the fact that a senate hearing was convened underscores the sensitivity in the United States over such transactions. Simon Montlake, *U.S. Senate Hearing On Smithfield Foods Poses Challenge To CFIUS*, FORBES (July 9, 2013, 11:49 PM), <http://www.forbes.com/sites/simonmontlake/2013/07/09/u-s-senate-hearing-on-smithfield-foods-poses-challenge-to-cifus/> (discussing Senate hearing).

C. National security concerns in the context of SWF investments

SWFs, as hybrid actors consisting of both private market as well as government actor elements, are under particularly strict scrutiny. The opacity of SWFs has been a key focus of Western critics, who fear politically-driven investment decisions. Controversies and mistrust arise from conflicting purposes of state capitalism and market capitalism.⁶⁷ Such tension can be heightened by the lack of transparency making it difficult to assess the SWFs' activities and their impact on global capital markets. The lack of a transparent and verifiable decision-making process, governance and investment strategy has triggered considerable concerns among host countries.⁶⁸

While SWFs have existed for decades,⁶⁹ two primary factors have elevated their power and profile in recent years: One, SWF assets, which are derived primarily from exports, have reached staggering levels due to high energy prices and global trade imbalances.⁷⁰ Wielding approximately \$6 trillion in assets, SWFs possess astounding wealth.⁷¹ These assets are expected to continue rapidly growing and are estimated to rise above \$8 trillion by 2016.⁷² Indeed, SWF assets are currently nearly triple the assets of hedge funds, which in 2012 were about \$2 trillion.⁷³ Two, although SWFs had historically invested in conservative debt instruments such as United States Treasury bonds,⁷⁴ commencing around 2006–2007, SWFs began venturing into global stock markets.⁷⁵ SWFs have continued diversifying their investments into a wide array of businesses.⁷⁶ SWF investments now affect a broad range of blue-chip companies across the globe.⁷⁷ Therefore, potential SWF influence over global capital markets and portfolio companies is becoming more prominent.

Parallel with SWFs' expansion into global equities and other forms of assets, concerns arose in recipient nations with respect to sovereign investment as potential national security threats.⁷⁸ Many Western nations perceived that SWFs were acting as agents for their sovereign masters and therefore had agendas in addition to the profit motivation.⁷⁹ Investments by SWFs clearly raise

⁶⁷See Doug Bandow, *State capitalism versus free markets*, WASHINGTON TIMES, June 28, 2010, <http://www.washingtontimes.com/news/2010/jun/28/state-capitalism-versus-free-markets/?page=all> (reviewing IAN BREMMER, *THE END OF THE FREE MARKET: WHO WINS THE WAR BETWEEN STATES AND CORPORATIONS?* (2010)) (discussing the economic and political differences between the two models).

⁶⁸Qingxiu Bu, *China's Sovereign Wealth Funds: Problem or Panacea?* 11 J. WORLD INV. & TRADE 849 (2010) (noting concern over China's CIC).

⁶⁹See Lippincott, *supra* note 4, at 654 ("Since their inception in the 1950s, Sovereign Wealth Funds (SWFs) have dramatically expanded with the purpose of investing government revenue and maximizing returns for states with surplus funds.")

⁷⁰See Slawotsky, *supra* note 13, at 1239 ("[O]il exporting nations and Asian exporters have accumulated a staggering amount of assets due to high oil prices, globalization, and large global imbalances.")

⁷¹*Fund Rankings*, SWF INSTITUTE (last visited Apr. 23, 2014), <http://www.swfinstitute.org/fund-rankings/>.

⁷²Klaus Wille, *Sovereign Funds' Assets to Gain 60% by 2016, UBS's Castelli Says*, BLOOMBERG (Mar. 12, 2013, 8:33 PM), <http://www.bloomberg.com/news/2013-03-13/sovereign-funds-assets-to-gain-60-by-2016-ubs-s-castelli-says.html> ("Sovereign wealth funds will increase their assets by 60 percent over the next three years, bolstered by rising income from commodities and exports, according to UBS AG.")

⁷³Juliet Chung, *Hedge-Fund Assets Rise To Record Level*, WALL ST. J. (Apr. 19, 2012, 4:07 PM), <http://online.wsj.com/news/articles/SB10001424052702304331204577354043852093400> ("Total hedge-fund assets surged to \$2.13 trillion at the end of the first quarter.")

⁷⁴See Slawotsky, *supra* note 13, at 1246 ("Traditionally, SWFs have had a low tolerance for risk, opting to invest in government-guaranteed debt.")

⁷⁵*Id.* at 1246-47 (noting that SWFs acquired slices of trophy assets in the banking, technology and energy sectors).

⁷⁶See Slawotsky, *supra* note 1, at 22 (noting examples of SWFs acquiring stakes in stock exchanges, water providers, financial service institutions).

⁷⁷See e.g., Morgan Stanley, Schedule 13G (Dec. 31, 2010), available at <http://www.sec.gov/Archives/edgar/data/895421/000095012311013366/c12390sc13gza.htm> (China's SWF owns 10% of Morgan Stanley); Julia Werdigier, *Qatar Takes Profit on a Stake in Barclays*, N.Y. TIMES, Oct. 20, 2009, http://www.nytimes.com/2009/10/21/business/global/21barclays.html?_r=0 (Qatar owns almost 6% of Barclays); *Qatar stakes in Siemens, Shell reflect drive to step up development*, REUTERS (May 23, 2012, 10:00 AM), <http://www.reuters.com/article/2012/05/23/shell-qatar-idUSL5E8GE9P920120523> (buying shares in Siemens and Shell Oil); Tom Bill & Brenda Goh, *Norway SWF close to buying \$1.7 billion UK mall stake – source*, REUTERS (Aug. 9, 2012, 5:57 PM), <http://uk.reuters.com/article/2012/08/09/uk-norges-meadowhall-idUKBRE8780XY20120809> (buying stake in mall); Kate Kelly, *Morgan Stanley, Qatari Fund May Do Commodities Deal*, CNBC (July 20, 2012, 11:29 AM), <http://www.cnbc.com/id/48241872> (buying investment bank's commodity unit); *Abu Dhabi AMD stake raises concerns*, TAIPEI TIMES, Nov. 18, 2007, <http://www.taipetimes.com/News/biz/archives/2007/11/18/2003388418> (Abu Dhabi ownership stake Advanced Micro devices).

⁷⁸See Epstein & Rose, *supra* note 8, at 111 (noting heightened concerns in Western nations).

⁷⁹See Bu, *supra* note 68 (noting concerns that SWF investments – particularly from undemocratic states – were making investment decisions based at least in part on geo-political motivations).

delicate issues with regard to market behavior, political and economic motivations, and the protection of important national interests.⁸⁰ The potential non-profits centric agenda exists since SWFs are government-owned entities.⁸¹ Questions abound with respect to the motivations of SWFs; specifically “relating to their impact on the stability of the international financial system and whether or not such investments are commercially or strategically motivated.”⁸² Due to the wide-ranging interests of their state backers, SWFs, could impinge upon the sovereign interests of recipient nations’ economic and international policies. Financial “[m]arkets may become another front in the political engagement among states.”⁸³

Legendary financier Felix Rohytan noted that: “[SWFs] are making investments that they probably think are O.K. but not spectacular [T]here has to be a political objective over and above the rate of return You don’t need to appoint two directors to a board to have influence when you own 10 percent of the company.”⁸⁴

Foreign governments have indeed acted for non-financial reasons:

. . . to extract know-how . . . to increase competition and efficiency in the local market . . . to obtain certification for the domestic market . . . and to exploit insider information. We find evidence of technological transfer and increased competitiveness for China and Singapore. There is supporting evidence for a certification effect in the case of United Arab Emirates (UAE).⁸⁵

Larry Backer has highlighted the intertwining of private market actors and state power in the form of SWFs and the reality that governments can utilize their SWFs to achieve non-financial goals. In the context of the Norwegian SWF’s ethics-based investment approach, he describes how a state projects power and conducts international foreign policy through an SWF.⁸⁶ The Norwegian SWF thus provides an example of how a state actor can utilize a private market vehicle to project policy and shape international law. The Norwegian SWF purposely attempts to influence the policies of other nations through the private marketplace by using “its investment strategies as a doorway to negotiate changes in foreign law, especially with respect to corporate social responsibility.”⁸⁷ This is evidenced by its actions of divestment.⁸⁸

The potential for foreign state-owned SWFs to engage in behavior tinged with, or perhaps primarily motivated by, a political agenda can increase when nations experience economic or political tension. During times of increasing nationalism or geo-political strife, governmental economic decisions may be more frequently based upon political considerations as opposed to pure market considerations. In an example of mixing politics and business, Russian president Vladimir Putin offered Ukraine cheap gas in return for the Ukraine joining an economic federation with Russia.⁸⁹ Indeed, during the Cold War, the Soviet Union was willing to lose money in its transactions with Cuba in order to advance the interests of its Cuban ally.

⁸⁰See Amy Keller, *Sovereign Wealth Funds: Trustworthy Investors or Vehicles of Strategic Ambition? An Assessment of the Benefits, Risks and Possible Regulation of Sovereign Wealth Funds*, 7 GEO. J. L. & PUB. POL’Y 333 (2009); Lippincott, *supra* note 4, at 651-52 (noting the concerns that foreign nations may hold undue influence over recipient nations).

⁸¹See Gallo, *supra* note 49, at 5 (citing the examples of Singaporean and Chinese governmental influence over their SWF investments).

⁸²Jeremy Leong, *Domestic Constraints on Sovereign Wealth Fund Investment Activity*, THE SOVEREIGN WEALTH FUND INITIATIVE (2012), <http://fletcher.tufts.edu/SWFI/~ /media/Fletcher/Microsites/swfi/pdfs/2012/LeongFinal.pdf>.

⁸³See Backer, *supra* note 2, at 1274.

⁸⁴Alex R. Sorkin, *What Money Can Buy: Influence*, N.Y. TIMES, Jan. 22, 2008, at C1, available at http://www.nytimes.com/2008/01/22/business/22sorkin.html?_r=1&scp=1&sq=%22what%20money%20can%20buy%25&rst=cse.

⁸⁵Sojli & Tham, *supra* note 29, at 4.

⁸⁶Backer, *supra* note 2, (analyzing the Norwegian SWF and how Norway engages in foreign policy through its private actor SWF).

⁸⁷Backer, *supra* note 2, at 1278.

⁸⁸See *infra* examples of divestment. *But see* EARTH RIGHTS INT’L, BROKEN ETHICS: THE NORWEGIAN GOVERNMENT’S INVESTMENTS IN OIL AND GAS COMPANIES OPERATING IN BURMA (MYANMAR) (2010), [hereinafter BROKEN ETHICS], available at <http://www.earthrights.org/sites/default/files/documents/Broken-Ethics.pdf> (criticizing the alleged hypocrisy of the Norwegian SWF because the fund maintains investments in companies which have partnered with human rights abusers and corrupt local politicians).

⁸⁹See Irina Reznik & Henry Meyer, *Russia Offers Ukraine Cheaper Gas to Join Moscow-Led Group*, BLOOMBERG (Dec. 2, 2013, 8:29 AM), <http://www.bloomberg.com/news/2013-12-01/russia-lures-ukraine-with-cheaper-gas-to-join-moscow-led-pact.html> (“Russia will offer cheaper natural gas to Ukraine if the government in Kiev opts to join a Moscow-led economic bloc after halting free-trade talks with the European Union, according to First Deputy Prime Minister Igor Shuvalov.”).

The Soviet Union sold crude oil to Cuba at below market prices and purchased sugar from Cuba at above market prices.⁹⁰

In another example, in reaction to Belarus' failure to repay its debt to the Russian government, Russian gas supplier Gazprom threatened in 2007 to stop supplying the former Soviet Republic with half of its natural gas requirements.⁹¹ Previously, in response to the Czech Republic's granting of permission to the US to install an anti-missile system in its territory, "mysterious technical problems" resulted in reduced energy supplies from Russia.⁹² While those particular disputes have been resolved, they illustrate the potential of mixing business and politics. In contrast to governments, private actors would not be interested in extracting political concessions or obtaining strategic leverage at the cost of lost profits.

A stellar illustration of the principle that government controlled private market actors are potential conduits of government policy occurred in 2014 with regard to the disagreement between Russia and the Ukraine.⁹³ While Russian government controlled Gazprom initially claimed the Ukraine owed it \$2 billion – in the context of a geo-political dispute - that bill increased ten-fold in a couple of months:

What Gazprom executives now say Ukraine owes them comes to more than \$22 billion. In early March, Gazprom put the bill at less than \$2 billion. How Gazprom now calculates its charges explains a lot about the way the company is used by the Kremlin for political purposes. Behind the payment demands was a warning that Gazprom would cut off gas supplies to Ukraine, which it has done at least twice before, in 2006 and 2009, over political and financial disputes. And behind that warning is one to European countries that largely depend on Russian gas supplies moving through Ukraine.⁹⁴

State actors might also use their capital-rich SWFs through "soft-power" to obtain favorable treatment from foreign governments. Victor Fleischer notes the possibility that the US Government's decision to save Fannie Mae and Freddie Mac by diluting shareholder equity while leaving debtholders relatively unscathed might have been partially related to the fact that China was the largest debtholder for both companies.⁹⁵ In another example, China may have lent money to Costa Rica to persuade the country to sever ties with Taiwan:

A similar story took place in Costa Rica, which severed diplomatic ties with Taiwan in favor of the PRC in 2007. China financed Costa Rica's National Stadium and patrol cars for Costa Rica's police force, as well as providing US\$900 million in credit for the expansion and remodeling of an oil refinery. On Xi Jinping's recent visit, China pledged a further US\$400 million loan for road construction and public transportation vehicles. Bilateral trade between Costa Rica and China reached US\$6.17 billion in 2012.⁹⁶

⁹⁰See *Timeline: Post-Revolution Cuba*, PBS, <http://www.pbs.org/wgbh/amex/castro/timeline/index.html> (last visited Apr. 24, 2014) ("The Soviets agreed [in 1963] to purchase sugar at inflated prices while selling Cuba oil at deflated prices. Also Cuba will receive free of charge all military equipment it requests.").

⁹¹See *Threat of Gas Supply Cuts Lifted After Belarus Pays Part of Debt to Gazprom*, KYIVPOST (Aug. 3, 2007, 11:37 AM), <http://www.kyivpost.com/content/world/threat-of-gas-supply-cuts-lifted-after-belarus-pay-27110.html>.

⁹²Davis Prosser's *Outlook: The Wind is Blowing the Wrong Way on Fuel Prices and a Cold Front is Coming*, INDEPENDENT, Aug. 30, 2008, at 50, available at <http://www.independent.co.uk/news/business/comment/david-prossers-outlook-the-wind-is-blowing-the-wrong-way-on-fuel-prices-and-a-cold-front-is-coming-913397.html> (noting "[a] dispute with Ukraine two years ago led Russia to suspend gas exports to its neighbour, hitting supplies to the West which depend on a major pipeline passing through the country. And this summer, shortly after the Czech Republic agreed the US could install an anti-missile shield in the country, mysterious technical problems reduced the oil and gas it received from Russia.").

⁹³See Steven Erlanger, *Russia Ratchets Up Ukraine's Gas Bills in Shift to an Economic Battlefield*, N.Y. TIMES, May 10, 2014, http://www.nytimes.com/2014/05/11/world/europe/russia-ratchets-up-ukraines-gas-bills-in-shift-to-an-economic-battlefield.html?hpw&rref=business&_r=2 ("Gazprom, the natural gas giant 50.01 percent owned by the Russian government, keeps ratcheting up the bill for Ukraine, increasing the economic pressure on Kiev in tandem with military pressure along Ukraine's eastern border.").

⁹⁴*Id.*

⁹⁵See Slawotsky, *supra* note 13, at 1255 ("SWFs also have the potential to succeed at forms of activism in which private activist investors have had only mixed results. Professor Fleischer notes the possibility that the U.S. Government's decision to save Fannie Mae and Freddie Mac in the way that it did, diluting shareholder equity while leaving debt holders relatively unscathed, might have been partially related to the fact that China was both companies' largest debt holder.").

⁹⁶Shannon Tiezzi, *Why Taiwan's Allies are Flocking to Beijing*, THE DIPLOMAT, Nov. 19, 2013, <http://thediplomat.com/2013/11/why-taiwans-allies-are-flocking-to-beijing/>.

As vehicles of governments, SWFs maintain this potential for executing investment decisions based upon geo-political interests. Pure private actor corporations would not offer to sell a product cheaply in exchange for advancing a geo-political goal. Private actors are rarely, if at all, interested in obtaining political favors or promoting ideological agendas. Conversely, it would be surprising for some SWFs not to take into account some element of political interest particularly during turbulent economic eras or tense regional conflict.⁹⁷

Additionally, SWFs may enjoy informational advantages that may not be available to private investors due to their relationships with their home governments.⁹⁸ Such information could place SWFs at a huge advantage if their home states possess information regarding investigations or lawsuits involving a portfolio company or its competitors. Consider the potential for abuse if foreign national intelligence agencies supply information to SWFs that was unavailable to private investors.⁹⁹ It is important to remember that these issues involve not only the competing interests of SWFs and fellow shareholders, but also the competing interests of SWFs and the national interests of the United States. Yet, despite the potential negative outcomes, “[h]ost states want to encourage an influx of capital from commercially-minded SWFs while discouraging political investments from others.”¹⁰⁰ Western nations are concerned about SWFs but are in need of capital to fund public sector debt and private commercial development.¹⁰¹

In responding to criticism and concerns over investment motivation and potential negative protectionist measures, various proposals have been examined with respect to ensuring that SWFs do not engage in conduct representing a threat to recipient nations’ economies or security.¹⁰² These proposals can be divided into two groups: One, the self-regulating “Santiago Principles”, which are drafted voluntary codes of conduct on SWF internal governance and behavior.¹⁰³ The other group consists of various suggested regulations including: limiting SWF share voting rights;¹⁰⁴ employing an EU-wide mechanism to screen non-EU SWF investment;¹⁰⁵ invoking international investment law¹⁰⁶ and the creation of a new global tribunal designed to specifically handle SWF disputes.¹⁰⁷ Both self and external regulation are examined in the following section.

D. Regulating SWF investment

1. Self-regulation

In response to the recipient nation concerns, SWFs organized a working group of SWFs and issued a series of guidelines known as the Santiago Principles in 2008. The guidelines – essentially an effort at self-regulation – called for SWFs to establish:

a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability . . . help maintain a stable global financial system and free flow of capital and investment . . . operate on a good faith basis, and invest on the basis of economic and financial risk and return-related considerations . . .

⁹⁷If an SWF has truly independent investment decision makers that may substantially reduce the risk. However, a political element cannot be dismissed since the investment managers may be dependent upon the government for their appointments.

⁹⁸See Slawotsky, *supra* note 13, at 1241.

⁹⁹See Slawotsky, *supra* note 13, at 1251.

¹⁰⁰See Lippincott, *supra* note 4, at 651.

¹⁰¹See Benjamin J. Cohen, *Sovereign Wealth Funds and National Security: The Great Tradeoff*, 85 INT’L AFFAIRS 713, 713 (2009) (“At issue are two competing goals. One is economic: the desire to promote material prosperity by safeguarding opportunities for productive international investment. The other is political: the right and responsibility of every government to defend the nation’s security.”).

¹⁰²Some have argued that protective measures may violate international investment treaties. See Locknie Hsu, *SWFs, recent US legislative changes, and treaty obligations sovereign wealth funds, recent US legislative changes, and treaty obligations*, 43 J. WORLD TRADE 451, 451–77 (2009); See also Yvonne C. L. Lee, *The Governance of Contemporary Sovereign Wealth Funds*, 6 HASTINGS BUS. L.J. 197, 205 (2010) (“protective measures arguably violate relevant provisions in bilateral agreements that protect foreign investments in recipient countries under ‘national treatment’ and ‘most-favored-nation treatment’ principles.”).

¹⁰³INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GENERALLY ACCEPTED PRINCIPLES AND PRACTICES “SANTIAGO PRINCIPLES” [hereinafter SANTIAGO PRINCIPLES] available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

¹⁰⁴See Gilson & Milhaupt, *supra* note 5.

¹⁰⁵See Gallo, *supra* note 49.

¹⁰⁶See Lippincott, *supra* note 4, at 660–663.

¹⁰⁷See Lippincott, *supra* note 4, at 678 (“Another possibility would be to form a new international body to hear disputes pertaining to SWFs.”).

[and ensure] compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.¹⁰⁸

The Santiago Principles are recognized as insufficient and “the governance or regulation of SWF investments must tackle the issues underlying the absence of an international regime of oversight of international financial markets.”¹⁰⁹ While the principles are non-binding, vague and controversial,¹¹⁰ the Santiago Principles have generally been considered a positive introduction.¹¹¹ Yet, remarkably, the Santiago Principles concede the possibility of non-financially motivated investment. The Principles tacitly acknowledge this practice, commenting that “[i]f investment decisions are subject to *other than* economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.”¹¹² Naturally, it is doubtful an SWF would publicly disclose geo-political based decisions. Moreover, these principles are non-enforceable “soft-law” drafted by SWFs and lack a mechanism blocking non-financially motivated investment.

2. External regulation

Several proposals have floated with respect to the regulation of SWFs. One proposal advanced was to remove the voting power of United States listed shares owned by SWFs during the time SWFs own the shares.¹¹³ Ostensibly, this would reduce the ability of SWFs to unduly influence American companies held by the SWF as the SWF would be powerless to elect directors.¹¹⁴ The proposal had several self-acknowledged deficiencies, but in essence was proposed as a way to avoid the perceived dangers of SWFs while simultaneously encouraging investment.¹¹⁵ Drawbacks include the potential for similar retaliatory measures against US investors; the ability of SWFs to influence companies in other ways; the ability of foreign states to influence companies without SWFs and the ability to acquire voting rights through indirect ownership (i.e., derivative contracts, borrowed shares).¹¹⁶

Another suggestion calls on the EU to establish a US CFIUS style review system to evaluate non-EU based SWF investment in EU nations.¹¹⁷ The proposal claims such a mechanism is necessary because SWFs may attempt to influence EU member nations and/or exercise control over member EU member industries as well as exercise control on a EU-wide level.¹¹⁸ According to the proponent, implementing the proposal would reduce the risk that individual EU member states would enact harmful regulations which may escalate into protectionism and the ebbing of crucial FDI.¹¹⁹

Another proposal invokes reliance on international investment treaty law to serve as a “safety mechanism” providing both sides with a forum for resolving tensions between host state protectionist measures taken with respect to SWF politically motivated investment. “Rather than deter foreign investors like Sovereign Wealth Funds (SWFs) with the threat of increased and uncertain regulation, nations should rely on a well-established alternative dispute resolution body such as the International Centre for Settlement of Investment Disputes to monitor and enforce accepted practices of foreign investors.”¹²⁰ According to this proposal, terms of an investment treaty¹²¹ would be violated if the SWF attempted to use the investment for political ends.¹²²

¹⁰⁸*International Working Group of Sovereign Wealth Funds Presents the “Santiago Principles” to the International Monetary and Financial Committee*, INT’L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, Oct. 11, 2008, *supra*, note 103, at 4, 5, 8, <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

¹⁰⁹Lee, *supra* note 102, at 210.

¹¹⁰Lee, *supra* note 102, at 225.

¹¹¹Lee, *supra* note 102, at 237 (“This demonstrates that SWF Principles constitute a credible starting point of consultation, cooperation and coordination that can be effectively utilized by the relevant actors to achieve some consensus in the controversial global economic realm.”).

¹¹²SANTIAGO PRINCIPLES, *supra* note 103, at 8 (emphasis in original). Acknowledging that investment decisions may indeed be non-financially based, the comments to the Principles state: “Some SWFs may exclude certain investments for various reasons, including legally binding international sanctions and social, ethical, or religious reasons (e.g., Kuwait, New Zealand, and Norway). More broadly, some SWFs may address social, environmental, or other factors in their investment policy. If so, these reasons and factors should be publicly disclosed.” *Id.* at 22.

¹¹³See Gilson & Milhaupt, *supra* note 5, at 1345.

¹¹⁴See Gilson & Milhaupt, *supra* note 5, at 1364–65.

¹¹⁵See Gilson & Milhaupt, *supra* note 5, at 1365–68.

¹¹⁶See Gilson & Milhaupt, *supra* note 5, at 1365–68.

¹¹⁷See Gallo, *supra* note 49.

¹¹⁸See Gallo, *supra* note 49.

¹¹⁹See Gallo, *supra* note 49.

¹²⁰See Lippincott, *supra* note 4, at 660-66.

¹²¹The most popular international investment treaty is a bilateral investment treaty (BIT).

¹²²See Lippincott, *supra* note 4, at 660-61.

For example, it would be a violation of the BIT provisions for a government to bail out a company because an SWF investor in that company threatened a deterioration of other diplomatic relations with the government otherwise. This would be discriminatory treatment of private investors without political ties. BITs could also protect SWFs from host states regulating or disfavoring SWF investments in order to sanction their sovereign owners by giving SWFs recourse for differential treatment.¹²³

The proposal notes that state-owned entities such as SWFs should be formally classified as investors, otherwise a general BIT may be inapplicable as arbitration does not involve state-state disputes but rather state-investor disputes.¹²⁴

The Santiago Principles could also be codified in BITs. Including references to international law (like the Santiago Principles) in the choice of law provisions of BITs would ensure compliance with international investment standards. Backed up by an international arbitration regime willing to enforce the terms of these BITs, this poses the strongest and most immediate option for depoliticizing SWFs.¹²⁵

Doing so would obviate the risk of protectionism and encourage cross-border flows of capital while screening out ulterior motive-based investment. Another proposal is to “level the playing field” by applying The General Agreement on Trade in Services (GATS)¹²⁶ which protects investors in the services sector from discrimination. Invoking GATS could enable a claim for international arbitration.¹²⁷

Others have suggested there is no need for regulation: “a policy of watchful waiting is preferable to any immediate effort to impose special restrictions on SWFs.”¹²⁸ According to these advocates, “to date there is little evidence that any SWF has actively sought to lever its investment positions for either political or collateral business purposes.”¹²⁹ Proponents of “no regulation” claim that although SWFs could potentially use their influence to obtain collateral objectives, this is no different than other non-SWF investors who act the same way, and therefore unique regulation of SWFs is not required.¹³⁰

In sum, while several regulatory suggestions have been made to date, only the self-regulatory and non-enforceable Santiago Principles, (which do not bar non-financially motivated investment), have been effectuated. The next section will discuss the phenomenon of activist investing, and in particular, the increased prospects of SWFs to engage in activist investing.

II. THE PHENOMENON OF ACTIVIST INVESTING

Activist investing in American equity markets is not new. Surging to prominence in the 1980s, activist investors commenced taking very aggressive approaches with publicly traded companies in the late 1970s and early 1980s.¹³¹ The activist investor of the 1980s in the American markets was likely a sole investor, a financial entrepreneur, whose stated goals were to shakeup a corporation and unlock shareholder value.

It has been a busy few weeks for Carl Icahn, the billionaire financier who gained fame—some would say notoriety—in the 1980s by taking over Trans World Airlines (TWA) and agitating for change at the likes of Texaco and RJR Nabisco.¹³²

Another legendary activist shareholder is T. Boone Pickens who was involved in numerous corporate takeover disputes such as with Newmont Mining and Unocal Oil. Pickens was so

¹²³See Lippincott, *supra* note 4, at 661.

¹²⁴Lippincott, *supra* note 4, at 663.

¹²⁵See Lippincott, *supra* note 4, at 662.

¹²⁶1869 U.N.T.S. 183 (1994).

¹²⁷See Lippincott, *supra* note 4, at 663–64.

¹²⁸Epstein & Rose, *supra* note 8, at 113.

¹²⁹Epstein & Rose, *supra* note 8, at 116.

¹³⁰Epstein & Rose, *supra* note 8, at 123–28.

¹³¹See Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 *STAN. L. REV.* 1255, 1274–81 (2008) (discussing the historical transition of influence on corporate activities from a company’s management to its shareholders, particularly through the advent of activist hedge funds).

¹³²Barbara Kiviat, *10 Questions for Carl Icahn*, *TIME*, Feb. 15, 2007, <http://content.time.com/time/magazine/article/0,9171,1590446,00.html#ixzz2n6erdR7o>.

notorious that he was selected as *Time* Man of the Year in 1985.¹³³ The shareholder activism, and the lawsuits such investments spawned, significantly impacted American corporate law. Numerous seminal judicial decisions were ultimately delivered as a result of litigation undertaken by activist shareholders or corporate boards.¹³⁴ These rulings reinforced the corporate governance model of shareholder-value capitalism.¹³⁵

A. The increasing use of activist investing by large funds

Activist investing has enjoyed a robust resurgence in recent years.¹³⁶

The new activists have dramatically upped the pressure on corporate executives and boards. Nearly every business day they target another company . . . Their game is simple: They buy stocks they view as undervalued and pressure management to do things they believe will raise the value, such as giving more cash back to shareholders or shedding divisions that they think are driving down the stock price. With increasing frequency they get deeply involved in governance—demanding board seats, replacing CEOs, and advocating specific business strategies.¹³⁷

There is a vigorous conflict of opinion as to whether activist investors are beneficial or detrimental to shareholders and companies. Some argue that activist investing focuses on short term results and is damaging to the economy of the United States and its equity markets.¹³⁸ According to detractors of activist investing, “the power of the activist hedge funds is enhanced by their frequent success in proxy fights and election contests when companies resist the short-term steps the hedge fund is advocating.”¹³⁹ Activist opponents also note that “[a]ctivist hedge funds have recently exploited loopholes in existing U.S. Securities and Exchange Commission (SEC) rules under Section 13(d) of the Securities Exchange Act to accumulate significant, control-influencing stakes in public companies rapidly without timely notice to the market.”¹⁴⁰

Proponents of activist investing believe that shareholder value is significantly increased by activism.

Because institutional investors ultimately decide whether an activist’s campaign will succeed, activism potentiates institutional voice by putting choices to the institutions So in sidelining activist investors, the United Kingdom and the European Union are also

¹³³See *TIME Magazine Cover: T. Boone Pickens*, TIME, <http://content.time.com/time/covers/0,16641,19850304,00.html> (last visited Apr. 24, 2014).

¹³⁴See, e.g., *Ivanhoe Partners v. Newmont Mining*, 535 A.2d 1334 (Del. 1987) (upholding directors’ defensive measures such as a large dividend distribution and a new standstill agreement to thwart activist investor since shares were valued more than the offer); *Unocal v. Mesa Petroleum*, 493 A.2d 946 (Del. 1985) (upholding directors’ authorization of a large share buyback funded by new debt to thwart activist investor since shares were valued more than the offer); *Revlon v. MacAndrews & Forbes*, 506 A.2d 173 (Del. 1986) (finding director misconduct in failing to seek highest price available).

¹³⁵The United States model is shareholder centric as opposed to a stakeholder model. See Joel Slawotsky, *Sustainable Capitalism: Revelations from the Japanese Model*, 2012 HASTINGS L.J. VOIR DIRE 10, <http://www.hastingslawjournal.org/wp-content/uploads/Slawotsky-Voir-Dire.pdf>. The rulings cited *supra* note 134 reflect this shareholder based corporate governance model. In contrast, Norway’s ethics based methodology is not solely designed to enhance shareholder value but rather to enforce corporate compliance with Norway’s notions of social responsibility. This reflects Norway’s stakeholder corporate governance system. See Roger Blanpain, William Bromwich & Olga Rymkevich, *RETHINKING CORPORATE GOVERNANCE: FROM SHAREHOLDER VALUE TO STAKEHOLDER VALUE* 121 (2011) (Norway has a stakeholder model of governance as opposed to a shareholder model). Interestingly, Norway appears to be shifting towards a broadening scope of activism to include shareholder value. See *infra* notes 187–195.

¹³⁶David Bogoslaw, *Icahn’s new megaphone for shareholder activism*, CORPORATE SECRETARY, Oct. 25, 2013, <http://www.corporatesecretary.com/articles/proxy-voting-shareholder-actions/12567/icaohns-new-megaphone-shareholder-activism/> (describing the increasing popularity of shareholder activism).

¹³⁷Bill George & Jay W. Lorsch, *How to Outsmart Activist Investors*, HARVARD BUSINESS REVIEW (May 2014), <http://hbr.org/2014/05/how-to-outsmart-activist-investors/ar/1>.

¹³⁸See Robert Lenzner, *The Hedge Fund Activists Are Not The Flavor Of The Month For The Chief Justice Of The Delaware Court*, FORBES, Mar. 30, 2014, <http://www.forbes.com/sites/robertlenzner/2014/03/30/activist-hedge-fund-corporate-meddlers-take-it-in-the-chops-from-the-high-and-mighty/> (noting how the Chief Justice of the Delaware Supreme Court criticizes hedge fund activists and “questions why the directors and managers of large public corporations ‘must follow the immediate whim of a momentary majority of shareholders’ tempted by the activists into some short-term adventure that could push the stock up.”).

¹³⁹Martin Lipton, *Current Thoughts About Activism*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Aug. 9, 2013, 9:15 AM), <http://blogs.law.harvard.edu/corpgov/2013/08/09/current-thoughts-about-activism/#more-50945>.

¹⁴⁰*Id.*

sidelining the institutions—just those whose roles are simultaneously sought to be expanded into stewardship.¹⁴¹

Regardless of whether activist investing is beneficial or detrimental, the fact remains that activist investing is a popular tactic.¹⁴² Activist investors have a variety of available strategies. At times, activists take stakes with the intent (or hope) of forcing a White Knight to save the company by entering the fray and making a generous offer.¹⁴³ Sometimes, activists take a stake and want to break up the company because they believe the company's parts are worth more than the whole.¹⁴⁴ The strategy of Greenmail – the buying of shares often accompanied by litigation or threats of the same – is designed to force the management to buy the shares back from the investor at a premium.¹⁴⁵ “Hushmail” is the practice of the activist withdrawing their corporate governance concerns in return for the company buying their shares.¹⁴⁶ Activists also at times attempt to influence a corporation to issue dividends.¹⁴⁷

Private financiers were the archetype activist investors in the 1980s and 1990s, and large institutions did not generally participate in activist investing (although the California Public Employees' Retirement System (CalPERS) and Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) did commence using socially responsible investing benchmarks in the 1970s and 1980s).¹⁴⁸ While large institutions traditionally refrained from engaging in activist investing, large institutional funds are turning increasingly active. Once the purview of solo activists such as Icahn and Pickens, activist investing has become mainstream and constitutes an accepted investment strategy. Moreover, this institutional activism has shifted from the socially responsible context of CalPERS and TIAA-CREF to a more profit-centric model.

Activist investors like Carl C. Icahn, Daniel S. Loeb and William A. Ackman are getting deep-pocketed imitators. Some of the biggest public pension funds, which have sought to influence companies for years, are now starting to emulate these investors by engaging with, and sometimes seeking to oust, directors of companies whose stock they own.¹⁴⁹

¹⁴¹See Gilson & Gordon, *supra* note 12, at 906.

¹⁴²See, e.g., Abram Brown, *Icahn Wants A Seat For Himself On Dell's Board; Activists Unveil Proposed Directors*, FORBES (May 14, 2013, 8:43 AM), <http://www.forbes.com/sites/abrambrown/2013/05/14/icahn-wants-a-seat-for-himself-on-dells-board-activists-unveil-proposed-directors/> (DELL); Ian Sherr & David Benoit, *Carl Icahn Uses Twitter to Say He Took 'Large' Bite of Apple Stock*, WALL ST. J. (Aug. 13, 2013, 8:02 PM), <http://online.wsj.com/news/articles/SB10001424127887324085304579010971386703480> (AAPL).

¹⁴³Bryan Rich, *Watsa's Blackberry Bid May Not Be The Last One*, FORBES (Sept. 24, 2013, 10:03 AM), <http://www.forbes.com/sites/greatspeculations/2013/09/24/billionaire-watsas-blackberry-bid-may-not-be-the-last-one/>.

¹⁴⁴Mark Scott, *Activist Investor Seeks Breakup of UBS*, DEALBOOK (May 2, 2013, 7:18 AM), http://dealbook.nytimes.com/2013/05/02/activist-investor-seeks-breakup-of-ubs/?_r=0.

¹⁴⁵Michael Parrish, *Occidental Ends Lawsuits Over Cost of Buyout: Settlement: Oxy will pay \$3.65 million to shareholders who objected to the price David Murdock got for his shares in 1984*, L.A. TIMES, Mar. 21, 1992, http://articles.latimes.com/1992-03-21/business/fi-4044_1_david-murdock. The practice of Greenmail has been reduced due to regulations imposed to discourage this practice. But the line between Greenmail and Hushmail is often not clear.

¹⁴⁶See Mark D. Gerstein, *Hushmail: Are Activist Hedge Funds Breaking Bad?*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (July 7, 2014, 9:08 AM), <http://blogs.law.harvard.edu/corpgov/2014/07/07/hushmail-are-activist-hedge-funds-breaking-bad/#1> (Describing the phenomenon of “hush money” being paid to activist investors who no longer want to own the company's shares and sell the shares back to the company at a slight premium or discount to avoid dumping the shares and incurring losses. Following the transaction “the activist may enter into a standstill and non-disparagement agreement with the target.”)

¹⁴⁷Elisabeth Behrman & Yuriy Humber, *Transocean Reaches \$1.1 Billion Dividend Accord With Icahn*, BLOOMBERG (Nov. 11, 2013, 3:20 PM), <http://www.bloomberg.com/news/2013-11-11/transocean-reaches-accord-with-icahn-on-dividend-plan-and-board.html>.

¹⁴⁸See CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, TOWARDS SUSTAINABLE INVESTMENT: TAKING RESPONSIBILITY (2012), available at <http://www.calpers.ca.gov/eip-docs/about/pubs/esg-report-2012.pdf> (describing CalPERS' efforts at sustainable investing including climate change, environmental and labor); *Socially Responsible Investing (SRI)*, TIAA-CREF, <https://www.tiaa-cref.org/public/about-us/investing/responsible-investing-ri> (last visited Apr. 24, 2014) (“In the early 1970s, we became one of the first institutional investors to engage with companies on social issues. We believe that effective social responsibility policies may help companies manage risk and improve financial performance . . . Where appropriate, we incorporate Environmental, Social and Governance (ESG) considerations into the selection and monitoring of our investments across a variety of asset classes and products, including our responsible investment funds, community and impact investing programs, alternative investments, real estate, as well as the individual portfolios that we offer at our clients' request.”).

¹⁴⁹See Randall Smith, *Some Big Public Pension Funds Are Behaving Like Activist Investors*, http://dealbook.nytimes.com/2013/11/28/some-big-public-pension-funds-are-behaving-like-activist-investors/?_r=0 November 28, 2013.

Large institutional pension and private hedge funds have become extensive participants in profits-centric activist investing: “Calpers is one of several big United States public funds that have played roles in shareholder uprisings in recent years.”¹⁵⁰ Large pension funds have become activists and played roles in break-ups of companies and forcing director resignations.¹⁵¹ Activist funds wielding large pools of capital such as hedge funds can substantially influence a corporation:¹⁵²

[Hedge funds] target companies, take large positions in their stock, criticize their business plans and governance practices, and confront their managers, demanding action that enhances shareholder value. When one hedge fund announces a five or ten percent position in a company, others follow, forming a “wolf pack” that sometimes has the voting power to force management to address its demands.¹⁵³

Activist hedge funds are increasingly taking on corporate managers and demanding the companies act to enhance shareholder value.

Taking advantage of regulatory changes and a public mood, oriented toward rooting out corporate misdeeds, a growing number of hedge fund managers have taken up Mr. Icahn’s tactics to wage populist battles against chief executives. In letters, often colorfully worded, tacked on to filings with the Securities and Exchange Commission, they are demanding that executives sell off units, pay dividends or take other actions to raise stock prices quickly.¹⁵⁴

As more large funds – including pension funds – become activist, it seems to be merely a question of time before SWFs also join the ranks of large institutions that engage in activist investing.¹⁵⁵

Until recently, SWFs did not engage in activist strategies.¹⁵⁶ As previously discussed, in 2006-2007 SWFs commenced diversifying their assets from stable governmental debt obligations to a variety of investment allocations.¹⁵⁷ Parallel with global investment diversification, questions arose with respect to SWF motives. SWFs were concerned that recipient nation governments would act to block SWF investment which served to obviate any activist leanings. “Agitating for change at foreign companies leaves [SWFs] open to accusations that it is interfering inappropriately in the affairs of other countries. That charge has mostly been levelled at sovereign wealth funds (SWFs) from the Middle East and Asia that have taken high-profile stakes in Western companies.”¹⁵⁸

SWFs thus embarked on a campaign outlining their role as passive investors assuring governments that their motivations were purely financial to avoid regulatory action. “SWFs have typically been cautious passive investors, a judicious strategy in the past considering the potential in both the U.S. and Europe for intensified regulatory interest in how the investment arms of foreign governments buy up domestic properties.”¹⁵⁹ This passive strategy served to detract from the argument that SWFs were Trojan investors looking for opportunities to advance their national interests. Illustrative of the passive nature of SWFs, is a *Wall Street Journal* article from 2007 that describes SWFs as “taking small stakes” in various companies and being “quiet.”¹⁶⁰ As recently as

¹⁵⁰*Id.*

¹⁵¹*Id.*

¹⁵²Juliet Chung & David Benoit, *Activist Investors Build Up Their War Chests*, WALL ST. J. (Sept. 11, 2014, 11:01 PM), <http://online.wsj.com/articles/daniel-loebs-third-point-raised-2-5-billion-in-two-weeks-1410458404> (“CEOs, beware: Activist investors who target America’s corporations are gathering more ammunition. A number of the largest activists are raising billions of dollars, in an effort to take advantage of their increasing clout in boardrooms and above-average hedge-fund returns.”).

¹⁵³William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1379 (2007).

¹⁵⁴Riva D. Atlas, *Some Funds Taking Role Far Beyond Just Investor*, N.Y. TIMES, Aug. 16, 2005, http://www.nytimes.com/2005/08/16/business/16invest.html?adxnlnx=1124197489-TzwLymvE924SNb1QwP/CA&pagewanted=all&_r=0. Sometimes the activists seek board seats. Katya Kazakina, *Billionaire Loeb Confirmed as Sotheby’s New Board Member*, BLOOMBERG (May 29, 2014 9:02 AM), <http://www.bloomberg.com/news/2014-05-29/billionaire-loeb-confirmed-as-sotheby-s-new-board-member.html> (“Billionaire hedge-fund manager Dan Loeb was confirmed as Sotheby’s (BID) newest director following a closely watched proxy fight between the auction house and its largest shareholder. Loeb and five others were officially appointed to the board today at Sotheby’s annual shareholder meeting in New York. The activist investor sat in the front row of the room. His Third Point LLC owns 9.65 percent of Sotheby’s shares, according to a regulatory filing.”).

¹⁵⁵Norway’s SWF has engaged in socially responsible activist investing although as noted *infra* notes 176–186, the fund is beginning to engage in a shareholder value model of activist approach.

¹⁵⁶With limited exceptions. See Norway’s ethics based decisions *infra* notes 176–186 and accompanying text.

¹⁵⁷See Slawotsky, *supra*, note 13, at 1246–47.

¹⁵⁸Alexander Smith, *Norway SWF Wages Lone Governance Crusade*, REUTERS, Oct. 8, 2009, <http://blogs.reuters.com/breakingviews/2009/10/08/norway-swf-wages-lone-governance-crusade/>.

¹⁵⁹Levick, *supra* note 11.

¹⁶⁰See Chip Cummins & Rick Carew, *The New Deal Diplomacy*, WALL ST. J. (Nov. 28, 2007, 12:01 AM), <http://online.wsj.com/news/articles/SB119621328472106044>.

2010, scholars noted “[a]dditional evidence of a passive role of SWFs is offered in an analysis of engagement and voting by SWFs presented . . . which finds ‘few cases in which SWFs held seats at their portfolio companies’ and that ‘the funds appear to stick to their claims that they are relatively passive investors.’”¹⁶¹

As outlined above, since investing in global markets, SWFs have generally avoided activist behavior. However, recent developments suggest that the era of SWF acquiescence to passivity and/or to corporate governance mishaps is ending. This transition is normal and expected and in fact SWFs admit to this likelihood.¹⁶² In the coming years, SWFs will become more active, and their ownership of flagship international corporations could allow them to influence corporate boards in dramatic ways, radically transforming corporate governance.¹⁶³ Recent SWF conduct indicates an emergent shift to a more activist position. The nascent SWF investor activism, while at an incipient stage, will likely strengthen and the trend has serious implications. The transference in SWF behavior is discussed in the next section.

B. The turn in SWF behavior

SWF activism is now awakening. The might and financial power of SWFs on an individual fund level is tremendous. Coupled with other SWFs, the combined financial power of these state-owned funds is astounding. For all large investors, it is expected that they will seek to obtain influence in order to protect and advance their financial stake in a business. It is thus not surprising that state actor SWFs also seek the same sway.

Shareholder activism is increasing everywhere and SWFs are no different. These funds are likely to insist that the companies in which they invest are managed more carefully in the future. Sovereign investing may, in the future, redefine the meaning of shareholder activism the way SWFs have begun to redefine the character of state investment in economic markets abroad.¹⁶⁴

As noted by Larry Backer:

[T]hat Norway is acting as a sovereign through its Global Fund and in private markets, and is doing so aggressively, does not mean that SWFs ought to be viewed as a threat any greater than large private investment vehicles that also aggressively intervene in regulatory matters.¹⁶⁵

In other words, SWFs, as large capital rich investors, can be projected to duplicate the conduct of other large investors such as hedge funds. SWF activism is a normal and foreseeable development. The following subsections provide examples of increased SWF activism.

1. General: Board seats

During the initial phase of SWF investments in global stock markets, SWFs were generally careful not to seek board seats. This is understandable as SWFs presented themselves as passive investors and board seats provide opportunities to substantially influence a business.¹⁶⁶

When analyzing the potential influence of the SWFs on their portfolio companies, one key factor is whether the funds seek board seats at the companies in which they invest. Seeking board seats suggests a significant level of active investment behavior, and in such cases, the fund is likely to have more influence on how the company is managed.¹⁶⁷

¹⁶¹Bernardo Bortolotti & Veljko Fotak et al., *Quiet Leviathans: Sovereign Wealth Fund Investment, Passivity, and the Value of the Firm* 28 (Working Paper), available at http://www.ltic.org/IMG/pdf/Working_Paper_Quiet_Leviathans_Venice_Forum2010.pdf at page 28.

¹⁶²However, “taking a more active role in investments [might not be] uncommon for large funds, and might perhaps become a necessity when shareholdings grow as large as CalPERS’s or Kuwait’s.” See *Kuwait Investment Office in London*, KUWAIT INVESTMENT AUTHORITY, <http://www.kia.gov.kw/En/KIO/About/Pages/default.aspx> (last visited Apr. 24, 2014).

¹⁶³See Slawotsky, *supra* note 13, at 1240-41.

¹⁶⁴See Nili, *supra* note 2.

¹⁶⁵Backer, *supra* note 2, at 1280.

¹⁶⁶See Afshin Mehrpouya & Chaoni Huang et al., *An Analysis of Proxy Voting and Engagement Policies and Practices of the Sovereign Wealth Funds*, IRRIC INSTITUTE 21 http://www.irricinstitute.org/pdf/Sovereign_Wealth_Funds_Report-October_2009.pdf, at 21 (“We found few cases in which SWFs held seats at their portfolio companies. Especially following the current focus on the SWFs practices, the funds appear to stick to their claims that they are relatively passive investors, simply relying on the standard voting procedures in order to manage their stakes.”).

¹⁶⁷*Id.*

In contrast to initially refraining from doing so, SWFs have begun to demand board seats as exemplified by the Libyan SWF's efforts.¹⁶⁸ Qatar Holding has also been a leader with respect to obtaining board seats.

It is a matter of national pride that Qatar Holding has taken board seats at big companies, from the owners of Heathrow and Canary Wharf in the UK to Credit Suisse and Volkswagen, making decisions that are relevant to some of the world's most prominent companies. The board seats are seen as a way to groom the next generation that is now taking over.¹⁶⁹

In another example, "two Qatari directors have taken their seats on Heathrow's board following the Gulf state's sovereign wealth fund Qatar Holding's purchase of 20 per cent of BAA for £900 million last year."¹⁷⁰ A further illustration of the Qatari drive for board seats:

Qatar's sovereign wealth fund may seek a supervisory board seat and strategic partnership with Lagardere, potentially deepening its ties with the French media-to-aerospace conglomerate in which it is the biggest shareholder.¹⁷¹

Other examples of SWFs obtaining seats include Singapore's Government Investment Corporation (GIC), which invested in Indian healthcare company Vasan and in return was given a board seat.¹⁷² Abu Dhabi's Mubadala Investment Company, a pre-existing shareholder in chipmaker Advanced Micro Devices since 2008, increased its stake in 2012 in return for an additional board seat.¹⁷³ It is noteworthy that only a few years ago, SWFs did not actively seek directorships in portfolio companies. The envisaged change has expeditiously occurred; within a few years of asset diversification into equities, SWFs are already demanding seats in the boardroom.

2. SWF specific: Qatar

At the forefront of this emerging SWF activist era stands Qatar Holding. In February 2012, Glencore International PLC proposed a merger with Xstrata wherein each Xstrata shareholder would tender their Xstrata share and receive 2.8 shares in Glencore. The transaction received the approval of Xstrata's board of directors. Qatar Holding, an existing shareholder, began actively buying additional Xstrata shares and eventually acquired a 12 percent stake. Under the terms of the transaction, the deal required approval of 75 percent of the non-Glencore held shares' approval, thus necessitating Qatar Holdings approval. Rather than simply acquiesce, Qatar Holding insisted upon higher compensation. After meetings between Qatar Holding and Glencore, Glencore did in fact agree to raise its offer to 3.05 shares. The Xstrata board recommended approval and the shareholders did, in fact, approve the transaction.

The pivotal role played by Qatar Holding in obtaining better terms for Xstrata shareholders personified the quintessential activist shareholder. However, the activist role had previously been the province of hedge and other large funds and private investors – but not SWFs. "It is therefore

¹⁶⁸See Giovanni Legorano, *Libya Wealth Fund to Request UniCredit Board Seat*, MARKETWATCH (June 20, 2012, 12:46 PM), <http://www.marketwatch.com/story/libya-wealth-fund-to-request-unicredit-board-seat-2012-06-20> ("Libya's sovereign-wealth fund will ask for a seat on UniCredit SpA's board, the fund's president said Wednesday, after the term of the member representing Libyan interests expired last month.")

¹⁶⁹Camilla Hall & Simeon Kerr et al., *Qatar: What's next for the world's most aggressive deal hunter?*, FINANCIAL TIMES (July 4, 2013, 8:55 PM), <http://www.ft.com/cms/s/2/dc99ef1e-de45-11e2-9b47-00144feab7de.html#slideo>.

¹⁷⁰See Rob Gill, *Al Baker Takes Seat on Heathrow's Board*, BUYING BUSINESS TRAVEL, Feb. 11, 2013, <http://buyingbusinesstravel.com/news/1120331-al-baker-takes-seat-heathrow's-board> ("Al Baker and Ali Bouzarif, from Qatar Investment Authority, have both been appointed as non-executive directors of Heathrow Airport Holdings, formerly known as BAA, according to filings at Companies House.")

¹⁷¹See *Qatar Sovereign Wealth Fund Eyes Board Seat At Lagardere*, ARAB TIMES, Jan. 3, 2013, <http://www.arabtimesonline.com/NewsDetails/tabid/96/smId/414/ArticleID/178034/reftab/36/t/Qatar-sovereign-wealth-fund-eyes-board-seat-at-Lagardere/Default.aspx>; see also *Southern Arc Announces Results From Annual General Meeting, Including Changes to Board of Directors and Executive Team*, YAHOO! FINANCE (Nov. 8, 2013, 7:00 AM), <http://finance.yahoo.com/news/southern-arc-announces-results-annual-120000264.html> ("Mr. Al-Obaidli was nominated in place of Mohammed Al-Shahwani, CEO of Qatar Mining Company ('Qatar Mining'), as a Director. Mr. Al-Obaidli is the Chief Investment Officer of Qatar Mining, which purchased a 9.99% interest in Southern Arc in June 2011 through its subsidiary, Tadeen Cyprus.")

¹⁷²See *Singapore's GIC invests \$100m in Vasan Healthcare*, TIMES OF INDIA (Mar. 15, 2012, 1:35 AM), <http://timesofindia.indiatimes.com/business/india-business/Singapores-GIC-invests-100m-in-Vasan-Healthcare/articleshow/12269154.cms> ("GIC will be offered one seat on the company's board.")

¹⁷³See Ian King, *AMD Rises as Mubadala Investment Eases Liquidity Concerns*, BLOOMBERG (Dec. 3, 2012, 3:19 PM), <http://www.bloomberg.com/news/2012-12-03/amd-rises-as-mubadala-investment-eases-liquidity-concerns.html>.

something of a watershed moment when an SWF acts like an activist shareholder, which is precisely what Qatar did when it rejected Glencore's offer."¹⁷⁴ Qatar Holding's activist approach with respect to the merger heralds a new activist age for SWFs.

3. SWF specific: Singapore

Singapore's Temasek also has recently demonstrated a shift in behavior. For example, Temasek owned 18 percent of Standard Chartered but was not satisfied with corporate governance at the company. Rather than remain silent, Temasek commenced efforts at instituting governance changes. "Temasek Holdings Pte. Ltd., the Singapore state investment company that is the biggest shareholder of Standard Chartered STAN.LN+0.56% PLC, has been expressing its discomfort with the bank's governance and is pressuring it to appoint more independent directors, people familiar with the investment company said."¹⁷⁵ Singaporean SWFs appear poised to raise their level of conduct with respect to corporate governance.

4. SWF specific: Norway

Yet another example of the behavioral shift is Norwegian activism. Norway's SWF has long been involved in engaging with companies in the corporate social responsibility context opting to divest from portfolio companies based on principles of human rights and ethics.¹⁷⁶ Norway's SWF has acted in a proactive fashion for years and is known for its strong social stances on a variety of issues, taking a "socially responsible" approach to investing.¹⁷⁷ Corporate social responsibility, in the form of exercising shareholder rights, is an important element of the investment strategy of the Norwegian SWF.¹⁷⁸ "Responsible investing focuses on good corporate governance and ethics as a basis for developing portfolio and investment strategies."¹⁷⁹

The ethics guidelines, including an evaluation of alleged international law violations committed by portfolio companies, are overseen by a Council of Ethics.¹⁸⁰

The Ethical Guidelines are based on two premises. The first is that the Fund must be managed to extract a "sound return in the long term." The second is that the first objective is contingent on a number of policy factors, including "sustainable development in the economic, environmental and social sense."¹⁸¹

Norway's SWF is a private market participant seeking profit maximization yet it has a strong political dimension.¹⁸² Therefore, the Norwegian SWF may be conflicted.¹⁸³ For example, usually the SWF accepts the Ethics Council recommendations and divests from or excludes companies.¹⁸⁴ Yet, other times, the SWF apparently chooses to remain invested despite the Ethics Council

¹⁷⁴Levick, *supra* note 11.

¹⁷⁵P. R. Venkat & David Enrich, *Singapore Slings Arrows at Bank*, WALL ST. J., Oct. 3, 2012, <http://online.wsj.com/news/articles/SB10000872396390443768804578034210943017432>.

¹⁷⁶See *Council on Ethics*, NORWAY GOVERNMENT ADMINISTRATION SERVICES, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council.html?id=434879 (last visited Apr. 24, 2014).

¹⁷⁷See Backer, *supra* note 2, at 1276 (noting there is some effort to separate the SWF investment functions from the political functions of the state organs that have oversight responsibility. The division of authority between the Ministry of Finance and Norges Bank is governed by a Management Agreement. Norges Bank's management established the Norges Bank Investment Management (NBIM) on January 1, 1998 as an operational investment management unit for the Global Fund, which hires outside managers to direct some of its investment activities. The Norges Bank Executive Board supervises the operations of NBIM).

¹⁷⁸Backer, *supra* note 2, at 1278.

¹⁷⁹Backer, *supra* note 2, at 1276.

¹⁸⁰*Companies Excluded from the Investment Universe*, NORWAY MINISTRY OF FINANCE, <http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/companies-excluded-from-the-investment-u.html?id=447122> (last visited Apr. 24, 2014).

¹⁸¹Backer, *supra* note 2, at 1277.

¹⁸²Backer, *supra* note 2, at 1277–78 (The Norwegian SWFs "investment policy is driven by political interests. I note three examples: (1) corporate social responsibility; (2) sanctions against Israel; and (3) investment in Burma. The three suggest the way in which public and private interest may merge, and the way in which, as some critics fear, public policy can be deployed within markets.").

¹⁸³Backer, *supra* note 2, at 1277–78 ("The governance and activities of the Norwegian SWF produces a curious tension . . . the maximization of shareholder value in this case requires the Fund be used to affect the global governance goals of the Norwegian state.").

¹⁸⁴See, e.g., *supra* note 180. See also Kjetil Malkenes Hovland, *Norway's Oil Fund Excludes Five Companies from Investment*, WALL ST. J. (Oct. 14, 2013, 3:56 AM), <http://online.wsj.com/article/BT-CO-20131014-700632.html> (noting excluded companies were involved in environmental abuse as well as child labor).

recommendation.¹⁸⁵ The ethics based investing scheme is not without criticism of acting in a subjective and perhaps in a hypocritical fashion.¹⁸⁶

Significantly however, the Norwegian SWF has now embraced a non-human rights based activist modus. The SWF has embarked on a “muscle-flexing” path towards a more activist role with respect to governance expanding the parameters of decisions beyond social responsibility.¹⁸⁷ The Norwegian SWF is thus moving towards a more customary form of profits-centric shareholder value activism. The Norwegian SWF is starting to conduct itself – albeit on a limited level – as a conventional activist investor. “Norway’s sovereign-wealth fund, a big shareholder in some U.S. companies, is pushing to make it easier to replace directors at firms, including Wells Fargo WFC - 0.95% & Co., over concerns about financial performance and governance.”¹⁸⁸ The Norwegian SWF submitted binding shareholder proposals regarding proxy access rights to the Charles Schwab Corporation, Wells Fargo, CME Group, Inc., the Western Union Company, Staples, Inc. and Pioneer Natural Resources Co.¹⁸⁹ The proposals demanded a change to the company’s bylaws to authorize shareholders who have collectively held at least 1 percent of the company’s shares for at least one year to nominate individuals representing up to 25 percent of the company’s board of directors whenever there is any election of directors.¹⁹⁰ Significantly, the statements contained links to the SWF website which levied substantial criticisms of the governance of the companies.¹⁹¹

The Norwegian SWF appears to be laying the groundwork for becoming a demanding activist shareholder. Norges Bank Investment Management isn’t demanding board changes or its own representation at the companies just yet . . . [n]or is it demanding strategic or business changes. But if the boards aren’t becoming more accountable to shareholders, “we will nominate directors. We are not planning that now; we would much rather have a good dialogue with the board.”¹⁹²

The groundwork has advanced meaningfully with Norway’s announcement that a board will be formed for its SWF – “a corporate governance advisory board in an attempt to be a more active investor.”¹⁹³ The appointment of the board marks a dramatic turning point, as the SWF clearly is on the path to an activism not based upon corporate social responsibility. “The move will enable the Norwegian fund to advise on ownership issues when companies go through major strategy changes, takeovers or capital restructuring.”¹⁹⁴

The more consequential aspect of the more hands-on approach, however, could be in the corporate governance sphere. Norway’s SWF will use its heft to influence how the businesses it partly owns are run. It now sits on Volvo’s director nomination committee.

¹⁸⁵See *Oil fund won’t exclude PetroChina*, NEWS IN ENGLISH, Dec. 8, 2011, <http://www.newsinenglish.no/2011/12/08/oil-fund-wont-exclude-petrochina/> (“The Norwegian government is ignoring a recommendation from a state ethics council that it ban investments by Norway’s oil fund in the Chinese oil company PetroChina. Meanwhile, a Chinese shipbuilding company is making inroads on Norway’s west coast.”).

¹⁸⁶Norway’s SWF ethics based investing has been criticized. See Jonathan Watts, *Norway Accused of Hypocrisy over Indonesian Deforestation Funding*, <http://www.theguardian.com/environment/2011/dec/01/norway-accused-hypocrisy-deforestation-funding>, Dec. 1, 2011, (“Norway has been accused of climate hypocrisy in Indonesia, where it has won plaudits for financing forest protection even as its state pension fund allegedly secures even greater revenues from logging, plantations, mining and other environmentally destructive practices.”); see also BROKEN ETHICS, *supra* note 88 (alleging the Norwegian SWF is invested in companies that engage in ethical and international law violations); Sigrid Folkestad, *Economists call Norway’s climate policy hypocritical*, SCIENCE NORDIC (May 4, 2013, 6:32 AM), <http://sciencenordic.com/economists-call-norways-climate-policy-hypocritical> (“More and more economists are critical of Norway’s prevailing climate policy and believe that the country should stop exploiting North Sea oil.”).

¹⁸⁷See *Investor Muscle*, FINANCIAL TIMES (Aug 8, 2013, 11:00 PM), <http://www.ft.com/intl/cms/s/0/8eeb7524-002f-11e3-9c40-00144feab7de.html#axzz2253qenxh>.

¹⁸⁸See Matthias Rieker, *Norway Fund Takes On Some U.S. Firms*, WALL ST. J., Dec. 6, 2011, <http://online.wsj.com/news/articles/SB10001424052970204083204577078651349087974>.

¹⁸⁹NBIM seeks proxy access at six US companies, NORGES BANK (Dec. 6, 2011, 6:00 AM), <http://www.norges-bank.no/en/about/published/press-releases/2011/nbim-seeks-proxy-access/>.

¹⁹⁰The Charles Schwab Corp., Proxy Statement (Form 14A) (Mar. 30, 2012); Wells Fargo & Co., Proxy Statement (Form 14A) (Mar. 15, 2012); CME Group Inc., Proxy Statement (Form 14A) (Apr. 25, 2012); Western Union, Proxy Statement (Form 14A) (Apr. 10, 2012).

¹⁹¹*Id.*

¹⁹²See Rieker, *supra* note 188.

¹⁹³*Norway Oil Fund Appoints Corporate Governance Advisory Board*, REUTERS (Aug. 8, 2013), <http://www.reuters.com/article/2013/08/08/norway-fund-idUSL4NoG95MS20130808>.

¹⁹⁴Ruth Sullivan, *Norwegian Wealth Fund Set to Raise Bar on Governance*, FINANCIAL TIMES (Sept. 1, 2013, 6:41 AM), <http://www.ft.com/intl/cms/s/0/ea0ed56-0fc9-11e3-99e0-00144feabdc0.html#axzz2253qenxh>.

It regularly votes for splitting the role of chair and chief executive at companies where these are combined, notably at JPMorgan.¹⁹⁵

Norway's shift – as well as Qatar's pioneering role in the Glencore deal – are indicative of this emergent trend and will likely encourage other SWFs to become activist investors. With SWFs taking a more aggressive role and with extensive collaboration anticipated, it is likely that some if not many SWFs will contemplate joint strategy directives to advance specific goals. Doing so will inevitably implicate US securities law. The next section will review some relevant securities laws and proposes modifications in light of SWF activism.

III. UNITED STATES FEDERAL SECURITIES LAWS

United States federal securities laws obligate investors to publicly disclose certain market activities and SWFs are required to adhere to these regulations.¹⁹⁶ For example, once a SWF acquires 5 percent of a company's shares, the SWF is obligated to file a 13(d) disclosure.¹⁹⁷ The rule was designed to provide fairness and equal access to information and preclude investors from either taking certain actions alone or in conjunction with other parties without public disclosure.¹⁹⁸ These reporting requirements are not designed or intended to review foreign investment, which, as outlined above, is primarily the responsibility of CFIUS. However, the disclosure requirements can be an additional device useful in alleviating concerns over improper SWF influence. This is particularly relevant to SWFs whose full power has thus far not been exercised but can reasonably be anticipated to be utilized in the next few years.

Therefore, as they increase in size, SWFs may play an increasing role in financial markets and this will lead to a new era in shareholder activism. This is not a short process, and therefore, at least for several years, the SWF policy with regard to activism will not reach the approach of the activist institutional investors. In the same time, we should expect that, as SWFs continue to acquire equity interest in certain nations (e.g. US), the issue of their engagement in corporate governance will continue to raise questions.¹⁹⁹

The following sections discuss several rules and disclosure requirements which are applicable to SWF investors in United States securities markets.

A. Rule 13(d) and Group Action

"[A]ny person" who is an investor in United States markets – including SWFs – must disclose pursuant to section 13(d) of the Securities Exchange Act of 1934 (Exchange Act)²⁰⁰ an acquisition of a 5 percent or greater equity stake in a public company.²⁰¹ 13(d) disclosures produce transparency such as the existence of a conflict of interest as the rule compels the disclosure of any arrangements in which investors maintain their financial interests.²⁰² An illustration of the disclosure of a potential conflict brought about by a 13(d) filing can be seen in the example of the merger between King Pharmaceutical (King) and Mylan Laboratories (Mylan). The obligatory 13(d) filing forced a hedge fund to reveal its hedging positions in the context of the merger battle between Mylan and King.²⁰³ The hedge fund investment was structured to enable an investor to

¹⁹⁵See *Investor Muscle*, *supra* note 187.

¹⁹⁶Such regulations include the filing requirements of 13(d). See Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (2000) [hereinafter Exchange Act] (necessitating a public disclosure upon ownership of 5 percent of a public company's shares and the short-swing profit rules of 10 percent owners pursuant to 16(b)); see Exchange Act, 15 U.S.C. § 16(a)(b) (2000). In addition, institutional money managers must comply with 13(f) which mandates disclosure on a quarterly basis of registered securities totaling \$100 million or more in the fund's portfolio. To the extent SWFs have this amount under management, SWFs are also obligated to file a 13(f).

¹⁹⁷See Exchange Act, *supra* note 196, at § 78m(d)(1); 17 C.F.R. § 240.13d-101 (2008).

¹⁹⁸See *Treadway Cos., Inc. v. Care Corp.*, 638 F.2d 357, 380 (2d Cir.1980) ("[T]he goal of s 13(d) is to alert the marketplace to every large, rapid aggregation or accumulation of securities . . . which might represent a potential shift in corporate control.")

¹⁹⁹See Nili, *supra* note 2.

²⁰⁰Exchange Act, *supra* note 196.

²⁰¹Exchange Act, *supra* note 196, at § 78m(d)(1); 17 C.F.R. § 240.13d-101 (2008).

²⁰²Exchange Act, *supra* note 196, at § 78m(d)(1)(E).

²⁰³See Robert Steyer, *New Player Joins Mylan-King Fray*, THE STREET (Nov. 29, 2004, 6:30 PM), <http://www.thestreet.com/stocks/robertsteyer/10196467.html> (describing how Perry, a hedge fund holding a large number of shares in King subsequently purchased shares in Mylan. Perry then entered into a derivative transaction hedging the fund's exposure to Mylan's share price. Perry thus acquired shares in Mylan but since it had no financial interest in Mylan, the fund had incentive to vote on the basis of its interest as a King shareholder.).

profit from a conflict of interest and that conflict was revealed only through the 13(d) filing. With regard to SWF investments, where such conflicts exist, they may contain elements of political or strategic significance and thus disclosure of conflicts are even more vital.

The issue of group action is important. Under securities law, a group is formed when “two or more persons act[ing] as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer.”²⁰⁴ This “prevent[s] a group of persons who seek to pool their voting or other interests in the securities of an issuer from evading the provision of the statute because no one individual owns more than [5%] of the securities.”²⁰⁵ Thus, under SEC regulations, “beneficial ownership” of the securities held by any group member will be attributed to all members of the group.²⁰⁶ Consequently, the securities law “requires a group that has acquired, directly or indirectly, beneficial ownership of more than five percent of a class of registered equity securities, to file a [Schedule] 13D . . . with the issuer, with the exchanges on which the security is traded, and with the SEC, disclosing, among other things, the identity of its members and the purpose of its acquisition.”²⁰⁷

The existence of personal or professional relationships between investors does not, by itself, establish a “group” under 13(d). Rather, “the touchstone of a group within the meaning of Section 13(d) is that the members combined in furtherance of a common objective.”²⁰⁸ To constitute a group, members of the alleged group must “agree[] to act together for the purpose of acquiring, holding or disposing of [an issuer’s securities.]”²⁰⁹ Because the existence of a group requires an agreement, “there must be evidence that indicate[s] an intention to act in concert over and above the prior and continuing relationships between the various parties.”²¹⁰ To allege the existence of an agreement is not enough to show that the defendants are “related through blood, marriage, business or social relationships.”²¹¹ There must be agreement to act in concert.²¹² The existence of a group will not be inferred solely because multiple investors explored business dealings or exchanged information related to the issuer.²¹³

²⁰⁴Exchange Act, *supra* note 196, at § 78m(d)(3).

²⁰⁵H.R. 90-1711, 90th Cong. (1968), *reprinted in* 1968 U.S.C.C.A.N. 2811, 2814.

²⁰⁶17 C.F.R. § 240.13d-5(b)(1) (“When two or more persons agree to act together . . . the group formed thereby shall be deemed to have acquired beneficial ownership . . . as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons.”).

²⁰⁷*Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, 286 F.3d 613, 617 (2d Cir. 2002) (citing 15 U.S.C. § 78m(d)(3)). The question of whether whether a person can be a member of a “group” without being a beneficial owner, has been addressed by only a few courts. These courts held that beneficial ownership of the equity securities is necessary in order to be a member of a group as defined in section 13(d). *See, e.g., Transcon Lines v. A.G. Becker Inc.*, 470 F.Supp. 356, 373 (S.D.N.Y.1979) (“[I]n light of the purpose of Section 13(d) as evidenced by the legislative history and as interpreted by other courts in analogous cases, the better rule is that one who is not the beneficial owner of any shares of the subject company is not a member of a group within the meaning of Section 13(d)(3).”); *Rosenberg v. XM Ventures*, 274 F.3d 137, 145 (3d Cir.2001) (“[O]ne who does not have beneficial ownership of the equity securities of an issuer cannot be a member of a group of individuals that do have beneficial ownership.”); *Hemisphere Biopharma, Inc. v. Johannesburg Consol. Inv.*, 553 F.3d 1351, 1366 (11th Cir.2008) (“[A] beneficial ownership interest in securities is necessary to become a member of a group within the meaning of section 13(d)(3) of the Exchange Act”). However, “beneficial ownership can arise out of ‘arrangements,’ ‘relationships,’ and ‘devices,’ as well as contracts’ and ‘understandings.’” *See S.E.C. v. Drexel Burnham Lambert, Inc.*, 837 F.Supp. 587, 607 (S.D.N.Y.1993). “[T]he inquiry focuses on any relationship that, as a factual matter, confers on a person a significant ability to affect how voting power or investment power will be exercised, because it is primarily designed to ensure timely disclosure of market-sensitive data about changes in the identity of those who are able, as a practicable matter, to influence the use of that power.” *Id.* (emphasis in original) quotation marks and citation omitted).

²⁰⁸*Roth v. Jennings*, 489 F.3d 499, 508 (2d Cir. 2007) (quoting *Wellman v. Dickinson*, 682 F.2d 355, 363 (2d Cir. 1982)).

²⁰⁹*Morales v. Quintel Entm’t, Inc.*, 249 F.3d 115, 124 (2d Cir. 2001) (quoting 17 C.F.R. § 240.13d-5(b)(1)); *see Corenco Corp. v. Schiavone & Sons*, 488 F.2d 207, 217 (2d Cir. 1973) (“[A]bsent an agreement between them a group would not exist.”).

²¹⁰*Torchmark Corp. v. Bixby*, 708 F.Supp. 1070, 1083 (W.D.Mo. 1988) (quoting *K-N Energy, Inc. v. Gulf Interstate Co.*, 607 F.Supp. 756, 765 (D.Colo. 1983)).

²¹¹708 F.Supp. at 1083.

²¹²*Id.*

²¹³*See Vladimir v. Bioenvision, Inc.*, 606 F.Supp.2d 473, 493-94 (S.D.N.Y. 2009) (“[T]he fact that [the CEO] may have been in constant contact with Bioenvision board members is neither unusual nor inappropriate-board members of a public company may speak with officers of the company about any number of topics pertaining to that company’s business.”); *K-N Energy, Inc. v. Gulf Interstate Co.*, 607 F.Supp. at 767 (“finding that sharing of information regarding issuer, among alleged members of group, “provides little support” for claim that alleged group members “agreed to act in concert with others to acquire [issuer’s] stock”).

Written evidence (such as emails) is not required to find a group.²¹⁴ The existence of a group may be shown by circumstantial evidence, including “prior relationships and trading patterns . . . discussions between the defendants [and evidence of] . . . a particular modus operandi.”²¹⁵ Moreover, courts have held that “[m]atters of group purpose are . . . difficult to discern, for intent may not always be fully formed, but may mature and manifest at any point in a continuum.”²¹⁶ The question of whether a group is formed is important yet not easily discernable. The subject of group formation will likely arise as SWFs are working together and pooling resources in their global investment forays. The next section discusses collaboration between SWFs and other investors both SWF and non-SWF.

1. Increased collaboration: The prospect of SWF group action/working together/acting in concert

In addition to becoming more activist, another aspect of recent SWF behavior is a surge in joint activity and coordinated investment. Although SWF collaboration is not new, SWFs are increasing collaboration among themselves as well as other large investors such as hedge funds and state-owned public funds.²¹⁷ In June 2010, the SWFs of Korea, China and Abu Dhabi jointly invested in convertible preferred shares issued by Chesapeake in a \$1.6 billion transaction led by Singapore’s Temasek and Hopu Investments, a private equity fund. Several other large non-sovereign institutional investors participated in the transaction including Blackrock Group and Franklin Templeton.

If not a landmark deal, the Chesapeake Energy transaction was at least emblematic of a new and growing trend: closer cooperation among SWF and between SWF and other like-minded institutional investors. Let’s consider the facts: SWF from various countries, along with other long-term oriented institutional investors, cooperated to invest in a large firm in a third party country.²¹⁸

The French state-owned investment fund Caisse des Dépôts et Consignations (“CDC”) announced a strategy of collaboration with SWFs:

As the first French investment corporation exclusively focusing on sovereign wealth funds, CDC International’s first objective is to pursue the formation of bilateral investment vehicles with Qatar, the United Arab Emirates and the Russian Federation. It will carry the Caisse des Dépôts’ shares in these vehicles and will be responsible for the execution of their investments. It will also be responsible for developing a multilateral investment platform capable of attracting sovereign capital on a wider and more sustainable basis. CDC International will thus become the Group’s instrument of long-term investment in partnership with sovereign wealth funds.²¹⁹

²¹⁴Hallwood Realty Partners, L.P. v. Gotham Partners, L.P., 286 F.3d at 617.

²¹⁵Id. at 617-18.

²¹⁶Rosen v. Brookhaven Capital Mgmt. Co., Ltd., 113 F.Supp.2d 615, 632 (S.D.N.Y. 2000).

²¹⁷See Jake Spring, *Qatar’s wealth fund to launch \$10 billion investment fund with China’s CITIC*, REUTERS (Nov. 4, 2014, 5:10 PM), <http://in.reuters.com/article/2014/11/04/qatar-china-sovereign-wealth-idINKBN0oQU20141104> (“QIA, which is estimated to have around \$170 billion, and state-owned conglomerate CITIC Group signed a memorandum of understanding to launch the 50-50 investment fund . . . QIA is looking for new partners as it plans to invest between \$15 billion and \$20 billion in Asia in the next five years.”); Andrew Woodman, *Apax Reaches \$7.5b Final Close on Latest Global Fund*, ASIAN VENTURE CAPITAL JOURNAL (June 24, 2013, 3:22 PM), <http://www.avcj.com/avcj/news/2276793/apax-reaches-usd75b-final-close-on-latest-global-fund> (noting that the SWFs of China, Singapore and Australia jointly own 10 percent of APAX Partners a private equity fund); *FACTBOX-Recent Investments by Qatar’s Sovereign Wealth Fund*, REUTERS (Dec. 6, 2010, 8:40 AM), <http://www.reuters.com/article/2010/12/06/qatar-investment-idUSLDE6B516E20101206> (Qatar’s SWF partnered with China’s SWF to buy 40 percent of Songbird Estates, owner of London’s Canary Wharf financial district.); Song Jung-a, *S Korean Wealth Fund Joins Forces with Peers* (June 19, 2009, 7:13 PM), <http://www.ft.com/intl/cms/s/o/3ccfa982-5cf9-11de-9d42-00144feabdco.htmlaxzz2253qenxh> (“Korea Investment Corporation, South Korea’s sovereign wealth fund, has signed strategic joint investment deals with its Malaysian counterpart and an Australian state-owned fund. The Korean fund said it had signed agreements with Malaysia’s Khazanah Nasional Berhad and Australia’s QIC to ‘expand co-operation’ in searching for investment opportunities and sharing information.”).

²¹⁸See Scott E. Kalb, *The Growing Trend of Cooperation among Sovereign Wealth Funds*, in SOVEREIGN ASSET MANAGEMENT FOR A POST CRISIS WORLD (Donghyun Park ed., 2011).

²¹⁹See *Caisse des Dépôts is to develop its subsidiary CDC International by dedicating it to investment partnerships with sovereign wealth funds*, CAISSE DES DÉPÔTS, Sept. 30, 2013, http://www.caissedesdepots.fr/fileadmin/Communique/C3%Ag9s%2ode%2opresse/cp/cp_cdc_international_eng.pdf.

Another example is the teaming up of Singaporean and Abu Dhabi SWFs to invest together in Manhattan real estate.²²⁰ Sometimes, a SWF joins other pre-existing SWF investors in ownership of a business.²²¹

[T]he trend [of collaboration] was illustrated in an announcement by the Korea Investment Corporation that it will build a new platform for cross-border private equity investment with its counterpart in Russia, the Russian Direct Investment Fund. Each sovereign fund will put in \$250 million to start with, and the fund is envisaged to rise to \$1 billion at some unspecified stage.²²²

These recent examples of SWF cooperation illustrate an important phenomenon. While the collaboration is grounded on commercial criteria, the significance lies in SWFs working together which may result in efforts to achieve governance objectives without any single fund's holdings raising regulatory red flags. Collaboration among SWFs may also result in unified or joint lobbying in governance matters. The role played by the Qatari SWF in the Glenstrata merger was a wake-up call for boards all over the world which once used to rely upon the passive stance of SWFs.²²³

Joint ownership of publicly traded shares may, depending upon the totality of the circumstances, constitute a group thereby raising the specter of aggregation of several holdings. The collaboration/working together/acting in concert question was analyzed in a significant litigation that dealt with group formation. The next section will discuss a major ruling from the Second Circuit on the formation of groups which is particularly relevant as SWFs are similar to hedge funds in terms of wielding vast capital.

2. The CSX litigation

In late 2007, hedge funds The Children's Investment Fund Management and 3G Capital Partners nominated five candidates to the board of a publicly traded company, CSX.²²⁴ The funds owned 9 percent of the stock directly and an additional 11 percent through long cash-settled derivatives.²²⁵ CSX filed suit claiming the funds were derelict in their obligation to report their cash-settled derivatives as beneficial ownership and moreover, their conduct constituted a "group" pursuant to federal securities laws.

The district court held the funds violated Section 13(d) because they failed to timely disclose that they had formed a group noting that whether entities can be deemed to act as a group is not controlled by the existence of a formal agreement. According to the district court ruling, the agreement "may be formal or informal, and need not be expressed in writing."²²⁶ The court held that circumstantial evidence was sufficient to find group formation²²⁷ and that the circumstantial evidence – including an existing relationship, exchange of views, and meetings between the parties – were indicative of a group.²²⁸

²²⁰Anjali Raval, *Abu Dhabi and Singapore wealth funds invest in trophy Manhattan property*, FINANCIAL TIMES (Nov. 13, 2013, 10:31 PM), <http://www.ft.com/cms/s/0/27550c5c-4c71-11e3-958f-00144feabdco.html>.

²²¹See Santiago Perez, *Qatar Holding Buys 20% Stake in BAA for \$1.4 Billion*, WALL ST. J. (Aug. 17, 2012, 1:06 PM), <http://online.wsj.com/news/articles/SB10000872396390444375104577595242977156080> (Qatar joins Singaporean SWF in ownership interest in BAA).

²²²See Chris Wright, *Korea And Russia's Sovereign Wealth Funds To Build Private Equity Together*, FORBES (Nov. 14, 2013, 4:25 AM), <http://www.forbes.com/sites/chriswright/2013/11/14/korea-and-russias-sovereign-wealth-funds-to-build-private-equity-together/>.

²²³See Nili, *supra* note 2.

²²⁴See *CSX Corp. v. Children's Investment Fund Management (UK) LLP*, 562 F.Supp.2d 511, 518 (S.D.N.Y.2008).

²²⁵See *CSX Corp. v. Children's Investment Fund Management (UK) LLP*, 562 F.Supp.2d 511, 516-527 (S.D.N.Y.2008). This article does not discuss whether derivative based holdings should be counted. There has been some scholarship on this topic. See, e.g., Michael C. Schouten, *The Case for Mandatory Ownership Disclosure*, 15 STAN. J.L. BUS. & FIN. 127 (2009).

²²⁶*Id.* at 552.

²²⁷*Id.* ("The existence of a group turns on "whether there is sufficient direct or circumstantial evidence to support the inference of a formal or informal understanding between [members] for the purpose of acquiring, holding, or disposing of securities.") quoting *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, 286 F.3d 613, 617 (2d Cir.2002).

²²⁸*Id.* at 554 ("These circumstances—including the existing relationship, the admitted exchanges of views and information regarding CSX, 3G's striking patterns of share purchases immediately following meetings with Hohn and Amin, and the parallel proxy fight preparations—all suggest that the parties' activities from at least as early as February 13, 2007, were products of concerted action notwithstanding the defendants' denials.").

The Second Circuit disagreed holding that greater proof was required to establish that the two funds were acting in concert.²²⁹ Mere evidence that the funds “met” and were acting together “generally” was held insufficient. The Second Circuit held that plaintiff needed to demonstrate proof the funds were acting to acquire CSX shares.

Although the District Court found the existence of a group “with respect to CSX securities,” the Court did not explicitly find a group formed for the purpose of acquiring CSX securities. Even if many of the parties’ “activities” were the result of group action, two or more entities do not become a group within the meaning of section 13(d)(3) unless they “act as a . . . group for the purpose of acquiring . . . securities of an issuer.”²³⁰

Thus, the mere meetings between the two hedge funds were held insufficient to demonstrate a group had been formed. According to the Second Circuit, forming a group needs to be proven by “a precise finding, adequately supported by specific evidence, of whether a group existed for purposes of acquiring CSX shares outright during the relevant period needs to be made in order to facilitate appellate review.”²³¹ The Second Circuit thus held that the lynchpin of finding a “group” depends upon the adequacy of evidence supporting the inference of either a formal or informal understanding between members of the alleged group for the specific purpose of either acquiring, holding, voting or disposing of securities. Without the specific goal of acquisition, holding, voting or disposition of securities, it will be difficult to prove a group has been formed.²³²

As SWFs become more activist, the question that will arise is: When will multiple SWFs (or SWFs and other funds) “working together” constitute a “group” within the meaning of the securities laws. The affiliation may be with other SWFs or with a non-SWF investor. “Communication” or “partnering” among SWFs (and between SWFs and other investors) may subject them to claims that the SWFs formed an undisclosed 13(d) group. The CSX ruling did not give any bright-line test nor any specific factors a court should examine. Moreover, to date there has not been any SEC guidance with respect to defining what determines group action.

There is inherent ambiguity regarding which factors will militate towards the finding of a group. Ostensibly SWFs are able to form groups to discuss various investment strategies yet at times the rubicon of concerted action will be crossed. In the context of SWF relationships, a regional alignment of SWFs may not create a group per se, but coordinated policy and activity may potentially transform the individual members into a group. Concerted action must be distinguished from parallel action although practically, it may be interchangeable. Take for example SWFs meeting at a working group and exchanging views on the price of a commodity. It is conceivable that multiple SWFs will leave the group intuitively knowing that it is in their financial interests to take parallel action on the shares of a commodity producer and will in fact do so to their mutual beneficial interests. Yet no agreement was made and officially no group has been formed.²³³ However, for all practical purposes, the group has internalized that a concerted effort will occur. In this respect, SWFs are not different than multiple hedge funds or any private investor. But as government controlled entities with immense wealth, should SWFs be subject to enhanced scrutiny?

B. Section 16(b) of the Exchange Act - “Short-swing” profits

An important securities regulation is Section 16(b) which compels disgorgement of trading profits earned within a six-month time frame when trades are engaged in by “insiders” such as directors, officers, or holders of 10 percent of the shares.²³⁴ Section 16(b) of the 1934 Act provides, in relevant part:

²²⁹654 F.3d 276, 278 (2d Cir. 2011).

²³⁰*Id.* at 284 (citation omitted).

²³¹*Id.*

²³²At least in the Second Circuit which is a leading court for federal securities law.

²³³SWFs are generally counseled by large law firms who undoubtedly will advise their clients to avoid the formal trappings of “group formation.”

²³⁴See Exchange Act, *supra* note 196, at § 16(b) which provides for the disgorgement of profits that corporate insiders realize “from any purchase and sale, or any sale and purchase, of any equity security.” See *Gibbons v. Malone*, 703 F.3d 595, 597 n.1 (2d Cir. 2013) (“The term ‘insider’ is frequently used in this context as a short-hand way of referring to any person ‘who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 781 of this title, or who is a director or an officer of the issuer of such security.’ 15 U.S.C. § 78p(a)(1) (“Section 16(a) of the 1934 Act”). Unanswered questions were raised in *Gibbons*, but not resolving, whether convertibility between financial instruments

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction This subsection shall not be construed to cover . . . any transaction or transactions which the [SEC] by rules and regulations may exempt as not comprehended within the purpose of this subsection.²³⁵

“[L]iability under Section 16(b) does not attach unless the plaintiff proves that there was (1) a purchase and (2) a sale of securities (3) by an [insider] (4) within a six-month period.”²³⁶

These investors must return back to the company any “profits” made from purchases and sales made within a six-month period. Significantly, if two or more investors form a “group,” each group member may be liable under Section 16(b) if, in the aggregate, the group’s holdings exceed ten percent of the company’s nonexempt, registered equity securities. The regulation does not require actual use or knowledge of insider information – the rule operates on a strict-liability basis.

In practical terms:

Notably, although § 16(b) is designed to curb the use of nonpublic knowledge by corporate “insiders,” . . . the provision offers merely the “prophylactic” remedy of disgorgement, . . . and “operates mechanically, with no required showing of intent” to profit from the use of inside information, . . . The statute, in other words, “imposes a form of strict liability.”²³⁷

The current trigger for Section 16(b) applicability is a 10 percent ownership threshold. Under the current regulatory structure, two or more SWFs (or an SWF and a non-SWF) could potentially own less than 10% and engage in short-swing profit activity.²³⁸ Are SWF investors sufficiently different as to justify heightened regulation?²³⁹

C. 13(f) Reporting

Large institutionally managed funds must disclose their equity holdings quarterly pursuant to Section 13(f).²⁴⁰ While mutual and hedge funds are commonly known to qualify as funds which encompass the 13(f) obligation, any institutionally managed fund totaling \$100 million or more must report.²⁴¹ SWFs fall within the purview of 13(f)’s reporting requirements.²⁴²

SWFs are thus obligated to file quarterly reports - a “Form 13F Report” - with the SEC, disclosing, among other things, the names, shares, and fair market value of the securities over which the institutional manager exercise controls.²⁴³

Footnote continued

might be a sufficient condition to make those instruments matching securities under § 16(b). *Gibbons*, 703 F.3d at 603-04 (noting the court so held in *Gund v. First Florida Banks, Inc.*, 726 F.2d 682 (11th Cir. 1984)). Various innovative financial products raise creative questions with respect to 16(b) applicability. As one court noted, “the creativity of Wall Street lawyers and bankers is boundless.” See *Chechele v. Sperling*, 758 F.3d 463, 467 n.4 (2d Cir. 2013) (discussing whether a particular transaction constituted a 16b transaction).

²³⁵See Exchange Act, *supra* note 196, at § 16(b).

²³⁶*Gwozdzinsky v. Zell/Chilmark Fund, L.P.*, 156 F.3d 305, 308 (2d Cir.1998).

²³⁷*Id.*

²³⁸Groups can also be formed for 16(b) purposes. See *Roth v. Perseus*, 522 F.3d 242, 246 n.4 (2d Cir. 2008) (citing *Roth v. Jennings*, 489 F.3d 499, 507 (2d Cir. 2007). Subsection 13(d)(3).

²³⁹Globalization and financial innovation demand that securities laws be examined with a view towards amending. Even courts have remarked that the recent revolution in “securities” raise questions. See *Roth v. Goldman Sachs Group, Inc.*, 740 F.3d 865, 867 (2d Cir. 2014) (“Although Section 16(b) is long in the tooth-older even than the author of this opinion-and the subject of countless judicial interpretations, it seems to be an ever-growing fount of close questions as to its meaning.”).

²⁴⁰Exchange Act, *supra* note 196, at § 13(f), 15 U.S.C. § 78m(f) (2000). While the Dodd-Frank Wall Street Reform and Consumer Protection Act renumbered paragraphs (2), (3), (4), and (5) of Section 13(f) as paragraphs (3), (4), (5), and (6). Pub.L. No. 111-203, s 929X, 124 Stat. 1376, 1870 (2010) this article employs the pre-Dodd-Frank numbering system.

²⁴¹Section 13(f)(5)(A) defines “institutional investment manager” as “any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.” 15 U.S.C. s 78m(f)(5)(A).

²⁴²According to the SEC, SWFs do have 13(f) reporting requirements. Ethiopis Tafara, *Testimony Concerning The Regulatory Framework for Sovereign Investments*, U.S. SECURITIES AND EXCHANGE COMMISSION, Apr. 24, 2008, <http://www.sec.gov/news/testimony/2008/ts0342408et.htm>. Thus, to the extent SWFs do not file a 13(f) they are violating this obligation.

²⁴³See 17 C.F.R. s 240.13f-1(a)(1) (requiring quarterly disclosure on Form 13F); 15 U.S.C. s 78m(f)(1) (2010) (delineating disclosure requirements).

Interestingly, the SEC has granted exemptions to the disclosure requirements.

The Commission must make 13F information publicly available unless either of two exemptions applies. First, under paragraph 13(f)(2), “[t]he Commission, by rule, or order, may exempt, conditionally or unconditionally, any institutional investment manager” Second, under paragraph 13(f)(3), the Commission “may delay or prevent public disclosure” “as it determines it to be necessary or appropriate in the public interest or for the protection of investors.” Managers seeking a permanent exemption under paragraph 13(f)(2) or temporary confidential treatment under paragraph 13(f)(3) must submit enough information on Form 13F for the Commission to make an informed judgment as to the merits of the request.²⁴⁴

There are two concerns which need to be addressed. One, are all SWFs currently filing 13(f)s? To the extent SWFs do not file a 13(f) they are violating this obligation. Does the SEC ensure that all SWFs file? Two, has the SEC granted either filing or confidentiality exemptions to SWFs or should it do so if requested? Do SWFs present circumstances that obviate the interests in granting an exemption?

IV. PROPOSALS FOR A REGULATORY UPDATE

For the immense financial power of SWFs and their potential political motivations, there is no practical difference justifying any regulatory update; SWFs, however, are different. Does the current regulatory structure adequately address the uniqueness of SWFs? Inasmuch as SWFs are truly a hallmark of a new global financial order, the existing rules – while providing an excellent framework – should be modified. While any proposals cannot completely prevent abusive conduct (any more or any less than the current regulations) the suggested proposals comprise a reasonable attempt to balance the competing interests of encouraging investment while mindful of the extraordinary characteristics of SWFs.

Anxieties regarding SWFs are heightened given that multiple SWFs may act together as a group. An alliance of interests by several nations acting in concert to advance a financial goal should be cause for concern to US regulators. Multiple nations may seek to control a company or a specific strategic economic sector by purchasing individual stakes small enough to avoid reporting requirements, while jointly owning at least a 5 percent holding or a controlling percentage of a company. Such a position would allow them to pressure management, or engage in other activist (or illegal behavior) without filing the required disclosure statements. Multiple SWFs can easily engage in sweeping corporate influence with barely a dent in their portfolios and without attractive regulatory or investor attention.²⁴⁵

What if an SWF has a relationship with a hedge fund or with a venture capital firm (or owns a part of such fund) and both parties enter into an understanding that the SWF will use its considerable influence to persuade a SWF held portfolio company to allocate a special class of newly issued shares to the hedge fund or venture capital firm? Such an agreement might implicate the question of whether, under Rule 13(d), the SWF and the other fund acted as a “group” for the purposes of the newly issued shares. There are numerous permutations of this potential. The point is that SWFs can be expected to utilize their status as financial superstars to influence companies to allocate benefits with respect to “acquiring or disposing” of shares and by doing so, 13(d) concerns are raised.

13(d) disclosures also produce transparency such as the existence and extent of a conflict of interest. Section 13(d) compels the disclosure of any arrangements in which investors maintain their financial interests.²⁴⁶ Sometimes it is this 13(d) requirement that forces investors to reveal conflicts. For example, hedge fund Perry divulged its hedging positions in the Mylan-King take-over battle.²⁴⁷ Where such conflicts exist, they would have to be disclosed in a 13(d) filing. Hedge fund Third Point’s 13(d) filing on Sotheby’s shares corroborates 13(d)’s benefits of conflicts disclosure.²⁴⁸

²⁴⁴See *Full Value Advisors LLC, v. SEC*, 633 F.3d 1101, 1104-05 (D.C. Cir. 2011) (citations omitted).

²⁴⁵SWFs interests may conflict with the interests of other shareholders but that is similar to other large investors. For example, SWFs can buy shares in ExxonMobil and attempt to use that position to increase the value of a stake in another company rather than to maximize the share price of ExxonMobil. However, this phenomenon is not unique to SWFs but is applicable to other large investors as well.

²⁴⁶Exchange Act, *supra* note 196, at § 13(d)(1)(E).

²⁴⁷See Steyer, *supra* note 203.

²⁴⁸See Sotheby’s, Schedule 13D (Aug. 15, 2013), available at <http://www.sec.gov/Archives/edgar/data/823094/000119312513346480/d588939dsc13d.htm> (“Certain of the Funds have entered into swaps with respect to the Shares. Under the terms of the swaps, (i) the relevant Fund will be obligated to pay to the counterparty any negative price

Activist investors are known to inform other investors of their trades – particularly since 13(d) provides a 10 day window before filing is required.²⁴⁹ Hedge fund corporate activism is generally waged as a quasi-political campaign – with a media blitz, publicly disclosed letters to management, and press releases even prior to reaching the 5 percent trigger.²⁵⁰

The way US securities law works, if you buy more than 5 percent of a public company's stock, you have to disclose what you're up to. But you get 10 days from the time you cross over 5 percent until you have to make the disclosure on Schedule 13D. That gives you 10 days to keep buying in secret, so that when you actually disclose you might have 6 or 7 or 10 or 30 percent of the stock instead of just the 5 percent.

The Wall Street Journal has a pretty good story about what you might be doing during that time, at least if you're an activist investor or noisy short seller. You're telling all your little hedge-fund buddies about the stake you've built, so they can buy in too.²⁵¹

However, SWFs from nations with less accountable regimes may act opaquely to acquire a position. Hedge fund activism engenders a substantially less urgent market hazard. Moreover, what if multiple SWFs amass shares of a company – with or without tipping – similar to how other activist investors buy into the same company? Given the strategic depth of financial resources available to SWFs, it is not beyond the realm of the remote that multiple SWFs will act in concert, both in the acquisition of shares and in activist activities such as the pressuring of management. Thus, SWF compliance with the required disclosure obligations under section 13(d) is vital and underscores the necessity of updating the reporting requirements.

A. A lower threshold for 13(d) disclosure

As outlined above, US securities laws are meant to prevent improper acquisitions of shares without proper public disclosure. The problem with the current regulatory structure is that it was developed as a way to regulate private actors. SWFs, however, raise serious concerns due to their dual public and private characteristics. The 5 percent disclosure trigger needs to be updated. As government-owned entities with concomitant latent political risks, SWFs require a modified rule. However, the free movement of investment capital across borders must be encouraged. Therefore, the obligations must balance both interests. Under the current requirements, two or more SWFs from different nations could potentially own less than 5 percent and not file. Therefore, a disclosure filing should be required whenever a SWF holds 2.5 percent or more of a company's shares as opposed to 5 percent. This will eliminate the filing requirement when a SWF holds an inconsequential amount of shares. For example, if a SWF simply wants to diversify its holdings across a broad array of companies investing up to 2.5 percent in each company will not trigger any obligation. SWFs will not feel heightened scrutiny for mere diversification. Yet, providing a lower trigger percentage for such funds will allow government regulators and other interested parties to become aware of the SWF share acquisition and significantly will provide a more extensive ability to observe potential group activity. Lowering the trigger percentage will substantially increase transparency without unduly burdening or discouraging SWF investment.

This proposal would require SWFs to file more frequently as the threshold is lower. Several drawbacks exist to this proposal. For SWFs, this would mean a lower amount of shares that can be acquired without calling attention to the investment. The proposal would also require SWFs to adjust internal record keeping to ensure the 2.5 percent limit is not breached without filing. SWFs

Footnote continued

performance of the specified notional number of Shares subject to the swaps as of the expiration date of such swaps, plus interest rates set forth in the applicable contracts, and (ii) the counterparty will be obligated to pay the relevant Fund any positive price performance of the specified notional number of Shares subject to the swaps as of the expiration date of the swaps.”).

²⁴⁹Concerns have been raised regarding activist funds “tipping” other funds about acquisitions. See Theodore Mirvis, *Activist Abuses Require SEC Action on Section 13(d) Reporting*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Mar. 31, 2014, 9:09 AM), <https://blogs.law.harvard.edu/corpgov/2014/03/31/activist-abuses-require-sec-action-on-section-13d-reporting/> (arguing for a shortened time frame for reporting from ten days to one day).

²⁵⁰See, e.g., Li Yuan & Christopher Rhoads, *Icahn Bid Adds to Woes Dogging Motorola's CEO*, WALL ST. J., Jan. 31, 2007, at A1 (article on Carl Icahn's purchase of a 1.39 percent stake in Motorola).

²⁵¹See Matt Levine, *Should Activist Shareholders Be Allowed to Talk to Their Buddies?*, BLOOMBERG (Mar. 28, 2014, 11:53 AM), <http://www.bloombergview.com/articles/2014-03-28/should-activist-shareholders-be-allowed-to-talk-to-their-buddies>.

may also incur slightly increased administrative responsibilities and legal fees. Moreover, compliance with an update regulatory requirement may potentially discourage SWFs from investing in United States equity markets. However, these costs and risks are worthwhile. Global regulatory authorities, including the SEC, are requiring greater transparency from public companies and their executives, the same policy concerns demand greater transparency with respect to investors particularly given the quasi-governmental nature of SWFs.

The most widespread fear is that SWFs may act under the pressure of the home State with the aim of advancing and achieving political and geo-political goals, rather than acting as purely market investors that intend to pursue economic objectives. Therefore, SWFs investment decisions – *especially when they take the form of mergers and acquisitions* – may harm the socio-political-economic stability of the host State.²⁵²

The acquisition of shares by SWFs deserves superior transparency. Therefore, a lower threshold is an appropriate response and will not prevent or discourage legitimate SWF investment.

B. Multiple SWFs from the same nation

Multiple SWFs from the same nation should be treated as members of a group and their several holdings of any qualifying security should be aggregated. Rule 13(d) mandates aggregation of all holdings in which the owner has a direct or beneficial interest in. Pursuant to current regulation, multiple SWFs from the same nation could potentially be considered as separate investors. After all, these funds may have separate management teams, separate directors, separate investment managers and varying goals and purposes. Yet, despite the differences, the SWFs have a common controlling parent – the specific state. The key is whether the different investors are under the “control” of a specific party. Similar to traditional domestic investment funds created as part of a family of funds, SWFs from the same nation are inextricably linked by a common sponsor or ultimate owner – in this case the sovereign.

Regulators must assume that the parent sovereign is a controlling participant in the management and policy of such SWFs. Therefore, a rebuttable presumption should exist that SWFs created by the same sovereign share the same owner, and therefore are under the control of a single entity. The Investment Company Act (ICA)²⁵³ provides a relevant example from securities law of such a presumption. Under the ICA, an “interested person” is “any affiliated person” of an investment adviser or principal underwriter.²⁵⁴ An “affiliated person” is defined as “directly or indirectly controlling, controlled by, or under common control with, such other person.”²⁵⁵ “Control,” in turn, is defined as “the power to exercise a controlling influence over the management or policies of a company.”²⁵⁶ Accordingly, utilizing the ICA definition, control is the power to exercise a controlling influence over the management or policies of a company, a link connecting not only affiliates of both the controlling and controlled parties, but also parties under mutual control. Applying this model to the regulation of SWF investment, the sovereign would be presumed to exercise a controlling influence on the management and policy of the SWF.²⁵⁷ As owners, the power to elect directors, make business decisions and guide the overall functioning of the SWF, the state parent would be in overwhelming overall control of all of the “family of SWFs.”

To be sure, there might arise unusual circumstances whereby a SWF can demonstrate true independence from other SWFs from the same nation. This would seem dependent upon demonstrating true and meaningful lack of state control over the particular SWF. Perhaps the SWFs have different lawyers and accountants. Perhaps the SWFs do not share directors. Maybe the SWFs have different investment managers. These factors would cut against finding the SWFs under the control of the parent. Yet, the fact that the state is the ultimate owner of the SWFs should weigh significantly in finding state control despite the distinctions. Accordingly, all share holdings from multiple SWFs from the same nation should be aggregated for 13(d) disclosure purposes.

²⁵²See Gallo, *supra* note 49, at page 5 (emphasis added).

²⁵³15 U.S.C. § 80a-2 [hereinafter ICA].

²⁵⁴*Id.* at § 80a-2(a)(19)(B).

²⁵⁵*Id.* at § 80a-2(a)(3)(C).

²⁵⁶*Id.* at § 80a-2(a)(9).

²⁵⁷See *Savino v. E.F. Hutton & Co.*, 507 F. Supp. 1225, 1243-44 (S.D.N.Y. 1981); *In re Citisource, Inc. Securities Litigation*, 694 F. Supp. 1069, 1076 (S.D.N.Y. 1988); see also 17 C.F.R. § 240.12b-2 (2009).

In sum, the state, as owner or controlling party of the SWFs, should be deemed to be the beneficial owner of securities in all their SWF “same family” accounts over which it exercises control.

C. Multiple SWFs from different nations

Another area for potential updating is when multiple SWFs from different nations acquire shares in the same company. SWFs that are owned by separate states present a more difficult issue. Generally, investments by SWFs from different nations would be considered separate. However, if different SWFs were part of a group then each member’s holdings would be aggregated. In light of CSX, finding group formation is not easy. Consider the possibility that when SWFs from different nations obtain stakes in the same entity they may be doing so for a shared financial motive. Such motive may also be trumped by a shared ideological agenda. States have in the past acted for ideological reasons and willingly lost money as long as they advanced a political goal. For example, the former Soviet Union lost considerable sums of money for many years by buying sugar from Cuba at above-market prices in exchange for oil sold at below-market prices.²⁵⁸

Guarding against such activity wherein multiple SWFs from different nations constitute a group is difficult. It is expected that pure financial motivations as opposed to political interests may constitute a primary driving force of investment decisions. Oil and natural gas exporters may wish to drive up or cause a temporary decline in the price of energy commodities or capture particularly lucrative export markets. As a result, the respective governments may influence their SWFs to exercise influence to induce portfolio companies to make decisions in the interest of the sovereigns. Under CSX, tacit alignments may be insufficient to establish concerted action. Even without direct evidence of group activity, membership in an organization dedicated to the upward movement of commodity prices should at least cause regulators to look more closely at the investments made by SWFs from member states. Examples of suspicious activity could include the elimination of plans to open new sources of production or the decision to scrap exploration plans. To tackle this problem, the SEC should employ an aggressive approach, perhaps establishing a department to monitor SWF 13(d) and 13(f) filings. There are circumstantial markers of group activity that, together with a reduced trigger for filings, may allow open and active investment capital while simultaneously thwarting abusive conduct.

Another example is investments from SWFs controlled by that particular nation’s elites. Governing without accountability, such nations may easily forge an alliance of interests with other similarly governed sovereigns to benefit the ruling elites, forming a sort of “investment club” for their mutual benefit. “[I]n certain . . . countries, all or most of the country’s economic endeavors emanate from the government This troublesome situation is further complicated by the fact that in many countries it is difficult to separate investment by the ruling class, as individuals, from investment by a foreign government.”²⁵⁹ Therefore, a group of nations with like-minded rulers may be motivated to utilize their SWFs in a coordinated fashion. These markers for heightened government scrutiny explored above are only examples of a variety of factors that regulators may wish to consider.

As described above, an alignment of interests is an indication of whether the SWFs share a common purpose, which is a potential marker of whether a group exists. Nations in such a bloc may seek to exercise influence in the boardroom for the benefit of the collective community. Therefore, absent a showing of independence, the several interests of SWFs belonging to a bloc of nations that share the same community aspirations should lead to heightened scrutiny. The SEC should establish a dedicated department to monitor filings of SWFs with a view towards ensuring multiple allied or bloc member SWFs have not formed a group.

D. A lower threshold for 16(b)

The 10 percent short-swing bright line trigger needs to be updated. As government-owned entities with concomitant latent political risks, a different rule is needed. However, the free movement of investment capital across borders must be encouraged. Therefore, the suggested rule must balance both interests. 16(b) should be amended to requiring disgorgement whenever a SWF

²⁵⁸See *Timeline: Post-Revolution Cuba*, *supra* note 90.

²⁵⁹See Brett R. Dick, *U.S. Income Taxation of Foreign Governments, International Organizations and Their Employees*, 913-3RD TAX MGMT. PORTFOLIO, 2005, at A4.

holds 5.0 percent or more of a company's shares as opposed to 10 percent. This will encourage SWFs to invest for financial returns on a long-term basis which is their often stated goal. The 5 percent rule will not burden SWFs and after the six months they are free to make a trade and keep their profits. However, it should discourage SWFs from making trades based upon any information it garners outside public channels. Moreover, SWFs who merely want diversification over a large base of companies should not be affected whatsoever. Yet it will simultaneously caution SWFs who may want to coordinate with other investors and form a group from engaging in trading on inside information.

E. 13(f) monitoring

Regarding 13(f), it is unclear whether all SWFs are in compliance with this obligation.²⁶⁰ For example, China's CIC did not file a 13F until 2010 despite having a huge portfolio of shares prior to that date.²⁶¹ "China Investment Corp (CIC), a \$300 billion sovereign wealth fund based in Beijing, filed its first quarterly disclosure on US equity holdings, reporting that it owned stocks valued at \$9.63 billion as of December 31."²⁶² To tackle the problem of non-reporting, the SEC should employ an aggressive approach and the SEC should establish a special department dedicated to monitoring 13(f) filings to ensure all SWFs are in compliance. In addition, given the foreign government – private actor dualism intrinsic to SWFs, the SEC should not grant exemptions to the 13(f) filing or public disclosure requirements.

CONCLUSION

Activist investing, once the domain of financial entrepreneurs, has become a normal activity of large institutional funds. Iconic government pension funds such as CalPERS have joined hedge funds in engaging in profits-centric shareholder activism. SWFs, as a category of large investment funds, can be anticipated to implement a more activist investing style. While SWFs share many of the same attributes as any other large investor, they are inherently different. As state-owned or controlled, and guardians of public assets, SWFs are not pure private market actors. United States Government regulations cannot simply overlook the fact that SWFs are intrinsically different since SWFs are foreign government owned as opposed to being under the control of a purely private actor. Although CFIUS is the principal mechanism to block foreign control or influence over key United States industries, the securities laws can serve as an important secondary device to thwart such conduct. Moreover, in light of the *Ralls v. Obama* appeals court ruling, and the potential of changes to CFIUS, securities laws are even more vital. While the disclosure laws were intended to prevent inequitable or prejudicial takeovers and not designed to screen foreign ownership, the disclosure rules can serve as an important complement.

This article proposes that due to the extraordinary nature of SWFs, the trigger percentage for 13(d) filings be reduced from 5 percent to 2.5 percent. In addition, several holdings of a company's shares owned by multiple SWFs from the same nation ought to be treated in the aggregate. Regulators should be on the alert for potential group action by SWFs from different nations and between SWFs and other large investors. The trigger percentage for 16(b) disgorgement should be lowered to 5 percent. In addition, regulators should strive to ensure SWFs comply with their 13(f) reporting obligations and ensure no exemptions are granted to SWFs. The proposals seek to strike a reasonable balance between concerns over SWFs and unfairness to SWFs. The suggested modifications will allow legitimate SWF investment to proceed without unduly harming or discouraging such investment. Simultaneously, stronger regulatory oversight and enhanced disclosure will serve as another mechanism in detecting improper SWF conduct. Doing so is particularly important in the context of increasing activism on the part of large funds. Activism has

²⁶⁰See, e.g., *Turmoil in U.S. Credit Markets: Examining the U.S. Regulatory Framework for Assessing Sovereign Investments*, 110th Cong. (2008), available at <http://www.gpo.gov/fdsys/pkg/CHRG-110shrg50400/html/CHRG-110shrg50400.htm> ("There are a large number of entities that have filed Forms 13F, most of which are not sovereign wealth funds or state-owned enterprises.")

²⁶¹See Guo Li, *Demystifying the Chinese Sovereign Wealth Fund Amidst U.S. Financial Regulation*, 2 TSINGHUA CHINA L. REV. 353, 368 (2012). The 13(f) revealed extensive US holdings. China Investment Co., Holdings Report 13F (Feb. 5, 2010), available at China Investment Co., Holdings Report (Form 13F) (Feb. 5, 2010), <http://www.sec.gov/Archives/edgar/data/1468702/000095012310009135/c95690e13fvhr.txt>.

²⁶²*Id.*

not merely been growing but the desire and ability to exploit the existing rules have also increased. “[A]ctivist hedge funds have grown more brazen in exploiting the existing reporting rules to the disadvantage of ordinary investors.”²⁶³ SWFs and large pension and hedge funds present a powerful combination of potential influence in corporate America. Modifying the rules as to SWFs will serve to lessen anxiety over foreign governmental intervention thus preventing measures which may harm FDI.²⁶⁴

²⁶³See Mirvis, *supra* note 249 (arguing that the current ten day reporting window for 13(d) is outmoded given the immense changes in technology since 1968).

²⁶⁴A balanced approach reflecting the competing goals of enhanced scrutiny and encouraging capital investment.