

COURTING THE SOVEREIGN

**‘The Sovereign Wealth Fund Phenomenon: Is New Zealand
prepared?’**

Nicholas J. Hansen

October, 2008

*A dissertation submitted in partial fulfilment of the degree of Bachelor of Laws (Honours) at the
University of Otago*

Faculty of Law
University of Otago
Dunedin, New Zealand

Acknowledgements

I would like to thank the following people:

Dr Tracey Epps for all the chats and all the help, but more than anything, her confidence in my topic.

My Mum and Dad for all their support from across the Tasman, in all its many, many forms.

Tim, Harriet and everybody else who made my 6th and final year in Dunedin one of the more memorable.

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Abbreviations

AIAL	Auckland International Airport Limited
CPPIB	Canada Pension Plan Investment Board
CKI	Cheung Kong Infrastructure Limited
CFIUS	Committee on Foreign Investment in the United States
EU	European Union
FINSA	Foreign Investment and National Security Act 2007
FIRB	Foreign Investment Review Board (Australia)
GAPP	Generally Accepted Principles and Practices for Sovereign Wealth Funds
GATT	Greater Agreements of Tariffs and Trade
ICA	Investment Canada Act
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IWG	International Working Group of Sovereign Wealth Funds
OECD	Organisation for Economic Co-Operation and Development
OIA	Overseas Investment Act 2005
OIO	Overseas Investment Office (NZ)
SWF	Sovereign Wealth Funds
SGC	State-Grid Corporation of China
SOE	State-Owned Enterprises

Introduction

Over the past two years there has been a rapid and dramatic rise in the level of foreign government investment globally.¹ This phenomenon can largely be attributed to the activity of Sovereign Wealth Funds (SWFs) who have begun to make increasingly controversial movements into western financial markets. Western governments and multilateral institutions have identified an inherent difference associated with SWFs when compared to the traditional foreign private investor² and a number have adjusted their foreign investment regimes accordingly. Principally, it has been the foreign government controlled aspect of SWFs, as well as their immense size, that has caused most concern. However, SWFs also offer considerable benefits to host countries as a significant source of capital. It is crucial that New Zealand has a foreign investment regime in place that will allow New Zealand to share in the benefits.

Chapter 1 of this dissertation will begin by providing an introduction to SWFs by way of a definition and background information. This will be followed by identifying the inherent difference between SWFs and foreign private investors as well as setting out some of the principle concerns western governments have had with SWF investment.

Chapter 2 will assess how New Zealand's foreign investment regime might respond to an instance of SWF investment, by considering a hypothetical scenario. It is crucial that New Zealand has an open and predictable regime that is able to clearly assess factors relevant to SWF investment. It is argued that this is not currently the case. Given the political sensitivity expected to surround any proposed SWF investment, if New Zealand's regime does not provide a sound structure for considering factors relevant to SWF investment, there is the danger that the process may be hijacked for short-term political reasons. Any such political

¹ Assets under management of SWFs more than doubled between 2001 and 2007, and now sits at around US\$ 3.3 trillion; International Financial Service London, 2008, 'Sovereign Wealth Funds 2008', *IFSL Research* (April 2008), available online at <http://www.ifsl.org.uk/upload/CBS_Sovereign_Wealth_Funds_2008.pdf>

² The United States, Canada and Australia have all adjusted their foreign investment regimes to account for the rise in foreign government controlled investment over the last 2 years.

involvement will only serve to increase the confusion surrounding New Zealand's investment regime and risk threatening future investment by SWFs.

Chapter 3 will outline actions taken by the United States, Canada and Australia in response to SWF investment and also discuss recent multilateral efforts at avoiding a possible protectionist backlash. It is possible that alterations made overseas may be suitable for adoption in New Zealand. Chapter 4 will propose a number of adjustments to New Zealand's foreign investment regime, which should help to avoid a reactive response to the first instance of SWF investment.

Chapter 1:

What is a Sovereign Wealth Fund?

1.1 A Definition

Sovereign Wealth Funds (SWF) are a relatively recent phenomenon in world financial and investment markets, perhaps explaining why there is no generally accepted definition. The Organisation for Economic Co-Operation and Development (OECD) defines them as “government owned investment vehicles that are funded by foreign exchange assets”.³ Typically they are owned by the government and predominantly focus on overseas investment. SWFs come in a number of forms, but can generally be classified into four main categories:⁴

1. Stabilisation funds which are used primarily by commodity exporters (such as Kuwait and Russia) to balance fluctuating revenue flows and insulate the economy.
2. Funds which invest in bonds, equities and alternatives, but generally avoid management involvement (Government of Singapore’s Investment Corporation).
3. Sovereign private equity funds or government investment companies which are aggressive investment vehicles that take on management stakes, rely on leverage and target high returns (such as Temasek of Singapore, Qatar’s Investment Authority, Dubai International Capital and Abu Dhabi’s Mudabala).
4. State-owned enterprises [SOEs] which engage in foreign acquisitions (such as Abu Dhabi’s National Energy Company TAQA, the China National Offshore Oil Corporation CNOOC, Russia’s Gazprom and Dubai’s Dubai World).⁵

³ OECD, 2007, ‘International Investment of sovereign wealth funds: are new rules needed?’ *OECD - Investment Newsletter*, October 2007, Issue 5, p 4, hereafter ‘OECD Rules’

⁴ D. Steger, 2008, ‘State Capitalism: Do We Need Controls?’, *Canada-Asia Commentary*, April 2008, Issue 50, hereafter ‘State Capitalism: Do We Need Controls?’

⁵ Although the OECD definition relates primarily to those SOEs that are funded from foreign exchange assets, all SOEs will be included in this definition a government controlled investment vehicle.

While the above definition is very broad, it is appropriate for the purposes of this paper as it covers almost every form of government controlled investment vehicle. While most recent media attention has focussed on the second and third type of SWF (principally due to their immense size), for the purposes of this paper it is not generally necessary to distinguish between the different forms.⁶ The common characteristics of government ownership and foreign investment are the crucial elements. It should be noted that SWFs are distinct from government-owned pension funds which will typically have well-defined liabilities. Otherwise, any reference to SWF will be to the broad definition above.

1.2 Background

SWFs are not new. Some of the longer established funds – for example those of Kuwait, Abu Dhabi and Singapore – have existed and invested globally for decades.⁷ Until recently there have been no investments that have caused much incident. While SWFs have not made a sudden appearance in the global economy, over the past two years they have become increasingly active. In the past SWFs primarily limited themselves to more conservative investments, such as government bonds and small passive holdings. But recently, high oil prices, financial globalisation, and sustained large global imbalances have resulted in the rapid accumulation of foreign assets, particularly by oil exporters and several Asian economies.⁸ These huge holdings have allowed SWFs to make more aggressive and high risk investments into public companies across a wide range of sectors.⁹ Given these recent conditions, it is no surprise that the scale and number of SWFs is growing at an exponential rate. Nor is it surprising to see their presence in the international capital market becoming more and more significant and noted.

⁶ While media attention has focussed on the immense size of the second and third type of SWF, most government reaction has been in response to proposed investment by SOEs.

⁷ Early SWFs have clear origins dating back to the first oil shock. The first true SWF is considered to be the Kuwait 'General Reserve Fund' established in 1960. Singapore's 'Temasek' was established in 1974 and The United Arab Emirates' 'Abu Dhabi Investment Authority' was established in 1976. For further examples see E. M. Truman, 2007, 'Sovereign Wealth Funds: The Need for Greater Transparency and Accountability', *Peterson Institute for International Economics: Policy Brief 07-6* (August 2007), hereafter "SWFs: The Need for Greater Transparency and Accountability".

⁸ Asian central banks held more than US\$3.1 trillion in reserves at the end of 2006 – more than triple the amount held in 2000, S.E. Eizenstat and A. Larson, 2007, 'The Sovereign Wealth Explosion', *The Wall Street Journal*, (November 1 2007) p A19

⁹ For example, the Chinese Investment Corporation (CIC) invested more than US\$3 billion into Blackstone Group in the United States; Dubai and Qatar have both purchased major shares of both the Nasdaq and the London Stock Exchange.

1.3 Potential Growth

Recent estimates indicate that SWFs may hold something in the range of US\$2.5 to US\$3 trillion in foreign assets.¹⁰ While not significantly larger than the holdings of global hedge funds (somewhere in the order of US\$1.7 trillion)¹¹ the consolidated nature of SWFs as well as their growth potential set them apart.¹² While there are thousands of hedge funds operating globally (the majority of which are based in the developed world), SWFs number just a few dozen.¹³ Significantly, the holdings of this relatively small number of SWFs are expected to grow to at least US\$12 trillion by 2015, far outpacing that of private hedge funds.¹⁴ While the holdings of SWFs may seem insignificant when compared to the US\$190 trillion of global financial assets, they are sufficient to spark huge debate about the merits of extensive government involvement in the global economy.¹⁵ Significantly, while historically most foreign direct investment has been directed towards the developing world, the majority of SWF investment is from the developing world into the developed world's economies.¹⁶ Algeria, China, Kuwait, Libya, Qatar, Saudi Arabia, and the United Arab Emirates have seven of the world's 10 largest SWFs.¹⁷ None of these countries is a true democracy. One, China, is fast becoming the fiercest economic competitor of the United States. Of the eight largest SWFs, three of them are based in Middle Eastern countries (Kuwait, United Arab Emirates and Abu Dhabi) and three in Asian countries (China, Singapore has two).¹⁸

¹⁰ The above estimate range appears in almost every news article and report relating to SWFs and is endorsed by the IMF; J. Lipsky, Speech entitled: 'SWFs: Their Role and Significance', *International Monetary Fund*, (3rd September 2008) hereafter 'SWFs: Their Role and Significance'

¹¹ Ibid

¹² The comparison is worth noting as Hedge Funds, (a form of private investment fund) are a very recent form of investment vehicle that have attracted a lot of attention due to their ability to heavily influence the market and often operate outside the standard regulatory framework.

¹³ SWFs: Their Role and Significance, above note 10; the IMF identifies 38 existing SWFs but there are constantly rumours new funds will be established (in India and Japan for example). This figure does not include the many SOEs who have recently begun to operate on a more global scale and are included in my broad definition of SWFs for the purpose of this paper.

¹⁴ S. Jen, 'How Big Could SWFs be by 2015', *Morgan Stanley* (3rd May 2007).

¹⁵ M. Alen and J. Caruana, 2008, 'SWFs – A Work Agenda', *International Monetary Fund*, (29th February 2008) p6, hereafter 'SWFs – A Work Agenda'

¹⁶ L. Summers, 'Funds that shake capitalist logic', *Financial Times*, (29th July 2007)

¹⁷ S. M. Davidoff, 'US may already have the tools to monitor SWFs', *International Herald Tribune*, (2nd April 2008)

¹⁸ *SWFs – A Work Agenda*, above note 15.

1.4 Finding an inherent difference

The rapid rise of SWF investment and the forecasts for further growth have been met with a wide range of reactions. On the one hand, many commentators point to the clear benefits SWFs can have on developed economies. In 2008 alone, numerous major United States and British banks and financial institutions have been forced to accept SWF investment to bail them out of trouble.¹⁹ SWFs with their vast pools of cash have been able to offer assistance at a time when there was none else available, providing much needed liquidity. Those who support continued SWF investment point to their past record as long term, often unleveraged²⁰, passive investors. There is little doubt that the rise in sovereign wealth has come at a beneficial time for the developed world. If anything, the SWFs' actions over the past year have shown that they can play a shock-absorbing role in global financial markets, at least in terms of dampening short-term market volatility.²¹

Nevertheless, while numerous governments and commentators have recognised these benefits, many have also identified a number of concerns. Within the last 18 months the United States, Canada, the European Union and Australia have all reacted to increased foreign government investment by making adjustments to their foreign investment regimes. In most cases this has meant formally recognising the inherent difference of SWFs and providing special factors for consideration for any foreign investments they are involved in.

Before considering some of the much publicised concerns many recipient countries have with foreign government investment it is worth looking at two clearly distinguishable aspects of SWFs - the nature of the SWF as both 'government owned' and 'foreign'. Clearly, a large proportion of initial concern is influenced by these two factors.

¹⁹ See: J. Garten, 'The unsettling zeitgeist of state capitalism', *Financial Times (Online Edition)*, (14th January 2008); where it is noted Merrill Lynch, Citigroup, Morgan Stanley, Bear Stearns, and UBS have all turned to SWFs for financial lifelines; and also Economist, 'Keep your T-bonds, we'll take the bank', *Economist*, (28th July 2007); which comments on the holdings by both Chinese and Singaporean SWFs in Barclays Bank.

²⁰ Compared to other financial institutions like Hedge Funds which can be highly leveraged and volatile.

²¹ SWFS: Their Role and Significance, above note 10.

1.4.1 Government Ownership

Almost all foreign investment legislation globally, including New Zealand was originally created with private investors in mind. In this sense it is significant that SWFs are clearly distinguishable from private investors on several levels. It is a commonly held assumption that states often operate with non-commercial considerations. However, private investors have traditionally operated predominantly on a commercial basis and in most cases with ‘profit maximisation’ as their end objective. As will be discussed later, this difference is one of the major concerns critics have with SWF investment. Government owned investment vehicles may also have different governance structures, operating principles, and fiduciary obligations as well as operate in quite a distinct regulatory framework. As they are so closely linked to the government, in a number of countries they may not have any formal system of oversight, except possibly from their political masters.

Highlighting the significance of this distinction, the OECD has recognised the special factors that characterise state owners and create new issues for them and the countries in which they invest:

“A major challenge is to find a balance between the state’s responsibility for actively exercising its ownership functions, such as nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company.”²²

1.4.2 Source of SWFs

The second issue immediately apparent about SWFs is the source of the investment. Most developed economies today have relatively open markets to international investors. Foreign ownership of companies in the United States, Canada, Europe, Australia and New Zealand is now reasonably well accepted, if not standard practice²³ As such it cannot simply be the fact that SWFs are foreign entities that is causing concern. More likely is that, in the main, they

²² OECD, 2005, ‘OECD - Guidelines on Corporate Governance of State Owned Enterprises’, (*OECD 2005*) p 3, hereafter ‘OECD Governance’.

²³ Except perhaps in election year, in the case of New Zealand.

are based in non-democratic and non-western countries. Whether a legitimate concern or not, there is clear anxiety amongst western governments and their public about the possibility that large parts of their economy, including flag-ship companies may be owned in part by foreign governments in countries with whom the west has not had a long history.²⁴

Initially, therefore, it seems to be the ‘government ownership’ and ‘foreign’ source of SWFs that is causing most concern amongst western governments. As mentioned above, government ownership is a relatively new phenomenon. Up until recent action in several Western countries, few foreign investment regimes formally recognised the government-owned status of the investor as relevant. Though this does not preclude the possibility of the issue being considered by some other means, it does highlight how quickly and assertively SWF investment has made its impact.

1.5 Concerns of western governments with SWF Investment

While the nature of the SWF as government owned and foreign based attracts considerable attention, there are a number of more significant and possibly legitimate concerns. National security issues, the risk of political motivation, a lack of transparency and non-adherence to market principles have all been put forward as strong arguments for special treatment of SWF investment.²⁵

The writer does not consider that these arguments should be used to justifiably impose restrictions on foreign government investment in all cases. Some of these concerns have little evidential support while others may be more legitimate. Regardless, the view advanced is that whether or not the inherent difference is sufficient to warrant a formal tightening of the rules, these are clearly identifiable concerns that will inevitably be considered in any foreign investment review process. The political sensitivity associated with SWFs and the high degree of political intervention in the foreign investment process in most jurisdictions will ensure this. It is worth therefore considering them, regardless of their individual merit.

²⁴ In the New Zealand context, there was considerable public pressure on the Government to stop a proposed investment in Auckland International Airport by a Dubai SOE, ‘Dubai Aerospace’, in late 2007.

²⁵ *SWFs – A Work Agenda*, above note 15

1.5.1 National Security

While ‘national security’ is the entire premise of the United States’ foreign investment law²⁶ and a consideration of a number of other countries’ regimes, the concept makes no appearance in the New Zealand regime. Nevertheless, it would seem a legitimate concern when considering SWF investment so long as the term is construed narrowly. An obvious example would be an attempt by a foreign, non-friendly or non-politically aligned state to acquire a controlling interest in a defence manufacturer. One would expect that such an attempt to invest in certain “sensitive” industries may well be blocked on national security grounds.

While such an example is limited in how often it can occur, as a rationale for a more intensive review of foreign government investment, ‘national security considerations’ are difficult to argue against. A number of critics of increased restrictions on SWFs point out that there would also seem to be concerns where the investor was non-government.²⁷ In a number of non-western countries, it can become difficult to tell the difference between the state and private sector participants who may be closely linked to the government. Regardless, it is obviously a more significant issue when foreign governments are involved.

Critics of the use of national security as a justification for greater review of foreign government investment also point to a difficulty in defining the term. In the United States there is a lot of debate over what is required to invoke the use of ‘national security’. Specifically, there is debate as to whether a ‘national security’ consideration should allow for restrictions on purchases of ‘critical infrastructure’, and what ‘critical infrastructure’ actually encompasses.²⁸ For example, in the recent sale of the Vector Wellington Electricity Network Limited, the State Grid Corporation of China was a bidder (see discussion below). This private Chinese governed corporation, if successful in its bid, would have owned the means of supplying electricity to the New Zealand government, the Wellington Airport, the Navy and most central government offices. Is this an issue of ‘national security’? Many would

²⁶ In 1988 the *Exon Florio Provision* was added to the *Defense Production Act 1950* and granted the President the authority to prohibit or reverse and foreign acquisition, merger or takeover that was considered a threat to national security.

²⁷ Under United States foreign investment legislation, the issue of national security is considered whether the proposed foreign investor is private or state controlled.

²⁸ C. Binham, ‘Rational Security’, *The Lawyer*, (30 August 2007) available online at www.thelawyer.com

answer in the affirmative. Another issue is whether ‘economic security’ can be considered within national security. The argument is that widespread foreign ownership could make an economy more at risk and volatile, thereby indirectly affecting national security.²⁹

The potentially broad scope of ‘national security’ and the difficulty of limiting its interpretation often lead to unintended uses (such as protectionist goals). It follows that considering ‘national security’ as a reason for restricting foreign investment, specifically foreign government investment, can be dangerous if the term is construed too widely. Some countries however, cannot avoid the consideration, though the United States has been reluctant to block foreign acquisitions under this premise.³⁰

Interestingly the *Greater Agreement on Tariffs and Trade* (GATT) managed to provide a narrow definition of national security.³¹ Should a multilateral investment treaty ever come into existence it would inevitably contain some mechanism for considering national security. It follows that it would be inappropriate to expect countries not to have some form of national security provision. If a definition along the same lines as the one used in GATT is adopted there would be no obvious issues as it is a narrow definition not capable of being interpreted widely. Problems arise when the definition is so broad and not supported by guidance that almost any investment has the potential of being restricted by national security considerations.

1.5.2 Issues of transparency

Another major concern of governments and commentators with SWFs is their lack of transparency. Given that one of the major worries many critics have with SWFs has to do with their investment objectives and their ability to impact on financial markets, it seems a

²⁹ B. W. Setser, ‘Sovereign Wealth and Sovereign Power – The Strategic Consequences of American Indebtedness’, *Council on Foreign Relations, Council Special Report No. 37*, (September 2008), p42

³⁰ Since 1988 the committee in charge of foreign investment, CFIUS has received more than 1500 notifications, 25 of which required a full investigation. In 13 of these a party withdrew and of the remaining 12 the President only prohibited a single investment; S. H. Thal and F. Von Eyb, ‘Foreign Investors in the USA Under Suspicion’, *Phillips Nizer LLP Articles* (2007)

³¹ GATT, (1947), *Article XXI: Security Exceptions, The General Agreement on Tariffs and Trade 1947* (GATT 1947) permits countries to take action which they consider necessary for the protection of their essential security interests, where such concerns relate to fissionable materials, the trafficking of arms and ammunition, or actions taken in time of war or another emergency in international relations. Available online at <http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm#top>.

legitimate concern that most SWFs reveal so little about themselves. Very few of them publish information about their assets, liabilities, or investment strategies. Recent regime changes in Australia and Canada have specifically identified the opaque nature of SWFs as a principal concern. It is clear governments traditionally open to foreign investment do not look kindly on big investors operating in shadows.

Except for any required disclosure by the relevant securities law in the host country there is no substantial regulation or supervision of SWF activities. Since SWFs are assumed to be managed independently from a country's foreign exchange reserves, they are excluded from transparency mechanisms such as the IMF maintains for foreign exchange reserves.³² Also, given the political nature of most SWFs' home states it comes as no surprise that there are few means of oversight by the respective citizens for whose futures the funds are apparently investing. While some states are models of transparency³³, others have opted not to disclose holdings, strategies and management.³⁴ The extreme differences in the amounts disclosed by SWFs are a major impediment to uniform treatment.

There is concern that as so little is known about the activities of SWFs they may prove to be a destabilising force in the market. The information shortage could be so great that should a SWF make a bad bet and decide to withdraw from its investment without disclosing any reasons, market participants would be at an information disadvantage. There is also the danger that, given the lack of any 'real' information available, any minor rumour may increase volatility in the market.³⁵

In September 2008 a proposed set of voluntary principles (Santiago Principles) were drafted by the International Working Group of Sovereign Wealth Funds (IWG) in an attempt to settle concerns over transparency. The hurry with which they were developed highlights the

³² The International Monetary Fund's *Special Data Dissemination Standard* (SDDS)

³³ The Norwegian SWF for example provides the general public with extensive information on its investment strategy and investment results on a quarterly basis. The Singaporean SWF Temasek Holdings has begun publishing an annual report containing considerable detail on its investments. See *Sovereign Wealth Funds: The Need for Greater Transparency and Accountability*, above note 7.

³⁴ In a ranking system designed by SWF expert Lawrence Summers to judge transparency [which was subsequently presented to a Senate committee meeting in the USA] the Abu Dhabi Investment Authority ranked dead last, scoring only one half of a point out of a possible 25. The same SWF has a one page website with only a logo and contact address.

³⁵ Economist, 'Keep your T-Bonds, We'll Take the Bank', *Economist*, (26th July 2007)

desire and potential value available to both sides of remedying the non-transparent nature of SWFs. The Santiago Principles, which identify best practices in transparency and accountability are hoped to convince some of the more non-transparent funds to make greater disclosures. As will be discussed later, those who have serious concerns over what SWFs may be hiding are unlikely to be satisfied by the new principles. They are voluntary and have no enforcement provisions and as such are unlikely to stop any SWFs from keeping certain information secret if it has strong reasons to do so.

As a legitimate argument for treating government investors differently from private investors, 'lack of transparency' faces a number of challenges. More than anything, issues of transparency are associated with a number of different investment vehicles. Hedge funds, not subject to the same disclosure requirements as other investors, often are not terribly transparent and have attracted a lot of criticism. Nevertheless, there is clearly less of an issue with hedge funds and other similar investment vehicles whose primary objective is almost always commercial. As will be discussed next, SWF have the very real potential to be motivated by non-commercial factors.

Whether or not SWFs are the only opaque investors or not, resolving concerns over transparency will inevitably make the maintenance of an open investment environment a simpler task. Should SWFs continue to resist disclosure and remain non-transparent, ammunition for special treatment and restrictions will only grow. Given that the SWFs have signed up to a voluntary code of conduct, it would seem natural to see how successfully it functions. It is likely that most SWFs will comply, but it's not the compliant SWFs which concern governments and commentators. Should a rogue SWF not fully comply with the newly proposed principles, it is likely to be too late, given that the Santiago Principles are not expected to have any enforcement or monitoring provisions. Nevertheless, hopefully the principles will ease protectionist pressures and allow governments to put more faith in SWFs.

1.5.3 Political motivation and non-commercial objectives

Possibly the most raised concern is that a SWF will make an investment into strategically sensitive assets or infrastructure with the intention of using resulting control for non-

commercial purposes. The consistently quoted example of the danger that a SWF will be used to pursue non-commercial objectives involves ‘Gazprom’, the Russian SOE that controls almost a quarter of the world’s natural gas supply.³⁶ The Russian state has reportedly used Gazprom’s economic power as an instrument to achieve its own political ends. In January 2006, Gazprom cut off gas supplies to the Ukraine, apparently because of a price dispute, but some regarded it as Russia’s response to the election of a Ukrainian government that was not friendly to Russia.³⁷ The head of Gazprom has also threatened the EU that it would divert supplies from Europe if the EU thwarted Gazprom’s plans to purchase interests in European energy companies.³⁸ The Russian example illustrates how a SWF can, if the circumstances are right, be used as a political tool in order to harm the host nation’s economy or as a bargaining tool. Realistically, this would be a rare occurrence and would require a number of factors to fall into place before a government would be able to exert sufficient pressure through its investment vehicle.

A more likely danger is associated with foreign government ownership of financial, telecommunication or electricity type networks. In such a case there are dangers that do not require any actual intention to harm a host country’s economy or public interests. Should a SWF that has invested in such an asset not operate with solely commercial interests there is the very real danger that any non-commercially motivated decision could lead to an undermining of the respective system or network. In most cases however, there would likely be sufficient domestic regulation to counter such activity. Nevertheless, the concern is quite rightly more legitimate when it is appreciated that government ownership can often involve non-commercial decision making. Merely pulling out of an investment for non-commercial reasons could seriously shock certain sectors of industry.

There is further concern associated with any investment by a SWF in a company that produces a valuable product or resource sought after by the home state government. Instructions from the home government could lead to price distortions and possible re-routing of trade. It is understandable that a host government would want to limit foreign

³⁶ International Eurasian Institute for Economic and Political Research, ‘The Big Question: Should We Fear Kremlin Control of Europe’s Energy Supply’, *International Eurasian Institute for Economic and Political Research*, available online at [www.iicas.org/libr_en/all/libr28_04\)06.htm](http://www.iicas.org/libr_en/all/libr28_04)06.htm) (last accessed 2nd October 2008)

³⁷ V. Kovalev, ‘Gazprom’s Power Play’, *Business Week*, (6th March 2007)

³⁸ Ibid

government investment intended solely to source out cheaper resources. Obviously this exact type of action is a very common reason for takeovers amongst private actors, where a producer may wish to purchase a supplier for efficiency reasons. However, when a foreign government is involved, it would seem far more likely for non-commercial decisions to be made. The Canadian government, aware of its country's reliance on natural resources, has given its foreign investment review body the power to impose undertakings on SWFs where such concerns exist.

Thus, if a Chinese SWF sought to purchase natural gas properties in Canada and intended to divert market sales of natural gas from the United States (Canada's major political and economic partner) to China (in liquefied form) one might well expect the Canadian government to require enforceable undertakings from the SWF not to materially diversify existing export patterns.

1.6 Summary

Over the past year and a half SWFs have made substantial investments into a number of sectors of the global economy. While the majority of these investments have been focussed on the struggling banking sector, there appears to be no limit to the type of asset invested in by SWFs.³⁹ SWFs have invested in the telecommunication, electricity and financial sectors as well as in ports, stock exchanges and energy companies. Notably, almost all investment by SWFs so far has been extremely positive and sought after.

However, such clear benefits of SWF investment do not completely negate some of the concerns held by western governments. Although it is very arguable whether any of the concerns raised above are sufficient to justify any increased restrictions on SWFs, they do highlight the inherent difference between foreign government and private investment. This inherent difference is likely to be a consideration of western policymakers and foreign investment decision makers whether the relevant regimes allow for it or not.

³⁹ The Abu Dhabi United Group recently purchased Manchester City Football Club for example, immediately making it the richest football club in the world.

Chapter 2:

How would New Zealand's foreign investment regime respond to SWF investment?

Having identified an inherent difference between foreign government investment and foreign private investment, how would the current New Zealand foreign investment regime treat an investment by a SWF? If there is no mechanism within the regime that allows for consideration of the government owned status of a SWF, any decision that takes such a consideration into account will be made outside of the rules. Arguably, the decision could then be open to a judicial review. Perhaps more significant is that any foreign investment decisions that lack clarity and transparency, may well cause general concern in international markets and risk threatening possible future investments. In the case of SWF investment, this risk may soon become substantial given that they are expected to be a significant source of capital.⁴⁰ If the current regime does not address the issue appropriately, some changes will be required.

2.1 New Zealand's Foreign Investment Regime – Overview

New Zealand has a long history of foreign investment. The sale of assets to foreign interests has always been a sensitive subject in New Zealand, both within the government and the wider public. Recently, New Zealand's interest in the issue has grown, largely in response to a number of companies being purchased by foreign interests.⁴¹ Foreign ownership and

⁴⁰ Their significance was highlighted in September when several US institutions including Merrill Lynch and AIG approached SWFs in a final effort to avoid bankruptcy.

⁴¹ For example, the extent of foreign ownership in New Zealand's banking sector has grown significantly over time with 98% of New Zealand banking assets now foreign owned, 85% are Australian-owned. See: A. Bollard, 'Bank Regulations and Supervision in New Zealand', address to the *Australasian Institute of Banking and Finance* (23rd March 2005)

investment has once again become an extremely politically sensitive issue. Many commentators point to recent bids by Dubai's 'Dubai Aerospace' and the Canada Pension Plan Investment Board (CPPIB) for ownership stakes in Auckland International Airport Limited (AIAL) as clear examples of politics becoming overly involved in the foreign investment review process.⁴²

2.2 Recent Deals

New Zealand's foreign investment regime has been called into play on two recent and significant occasions. In April 2008 the CPPIB sought approval under the Overseas Investment Act (OIA) to acquire a 40 per cent stake in AIAL.⁴³ The proposed investment attracted immense media attention and became a very sensitive political issue.⁴⁴

The proposed investment is significant for a number of reasons. Firstly, AIAL can rightly be considered one of New Zealand's most significant assets.⁴⁵ Secondly, the manner in which the application was considered highlights clearly just how flexible the New Zealand foreign investment regime can be and how easily it can be hijacked for political purposes. The details of the assessment process will be discussed in greater detail later. For present purposes it is worth understanding that shortly before the application's assessment the New Zealand Government introduced a new regulation that had the effect of blocking the proposed investment.

More recently, in May 2008 the sale of Vector Wellington Electricity Network Limited (Wellington Electricity Network)⁴⁶ to a Hong Kong based Chinese infrastructure company,

⁴² C. Trevett, 'Treasury Spurned in airport decision', *NZ Herald*, (24th April 2008) and F. O'Sullivan, 'Fran O'Sullivan: Airport class action possible', *NZ Herald*, (27th April 2008)

⁴³ Land Information New Zealand and Overseas Investment Office, 'Report Number 794/200720116/200810020', (1st April 2008), hereafter 'OIO - AIAL Report' available at <<http://www.linz.govt.nz/overseas-investment/decisions-stats-news/decision-summaries/2008-04/D200810034.aspx>>. Prior to CPPIB's proposed investment a Dubai SOE, Dubai Aerospace Enterprise considered a 60% investment in AIAL but eventually walked away from the deal. See www.auckland-airport.co.nz/NewsHistory/press_releases.php?rid=203

⁴⁴ The publicity surrounding the investment was likely exaggerated due to it coinciding with an election year.

⁴⁵ Auckland Airport is New Zealand's primary international gateway.

⁴⁶ Significantly, the Wellington Electricity Network is responsible for the supply of electricity to many parts of Wellington including the offices of Government and other significant buildings in central Wellington and is therefore arguably the most important electricity network in New Zealand.

Cheung Kong Infrastructure (CKI), was approved by the Overseas Investment Office (OIO).⁴⁷ Given that the network had been foreign owned in the past, the approval for the sale to one of the world's largest public infrastructure companies was expected.⁴⁸ Despite concern over links to the Chinese Government there was relatively little media attention and the deal was successful.⁴⁹

However, since the Wellington approval there has been significant criticism of New Zealand's foreign investment regime, principally directed at the unpredictability and political involvement associated with the decisions. The two above investments faced considerably different 'tests' due solely to the particular type of land involved.⁵⁰ More frustrating, and of particular importance, to interested foreign investors, has been the obvious involvement of politics in the decision making process and the ease with which the intervention was possible.

Significantly, the above two decisions both involved foreign private investors.⁵¹ What is more interesting and distinctly relevant to this paper is the reliable reporting that one of the failed bidders for the Wellington Electricity Network was the State-Grid Corporation of China (SGC).⁵² Controlled exclusively by the Chinese Government, the Chinese SOE is a prime example of a foreign government investor and SWF. Given that potential links between the private investor CKI and the Chinese Government attracted widespread public concern there would surely have been even greater pressure on the Government to intervene

⁴⁷ Land Information New Zealand and Overseas Investment Office, 'Decision Sheet – Decision Number 200820007, *Overseas Investment Office*, (14th July 2008), hereafter 'OIO – CKI Decision Sheet' available at <<http://www.linz.govt.nz/overseas-investment/decisions-stats-news/decision-summaries/2008-07/D200820007.aspx>>

⁴⁸ From 1994 to 1999 the network was owned by Canadian company TransAlta and from 1999 to 2001 by US company Utilicorp.

⁴⁹ A. Bennett, 'Stock Takes: Plucky little bourse', *NZ Herald*, (7th March 2008); noted that there was similar concern when a couple of years ago a lot of xenophobic heat was produced by the prospect that Hong Kong company Hutchison Whampoa might have taken a half stake in Lyttelton Port in Christchurch. Interestingly, Hutchison Whampoa is a member of the Cheung Kong group, which includes Cheung Kong Infrastructure.

⁵⁰ This distinction will be discussed later; but the AIAL investment faced a stricter test as it involved 'sensitive land' that the Wellington Electricity Network did not.

⁵¹ In contrast to SWFs, the CPPIB has been set up to avoid as much as possible any government influence in the day-to-day management of its investments and assets. See *Canadian Pension Plan Investment Board Act 1997, c-40*, section 3 (which states that the CPPIB is not an agent of Her Majesty and that its employees are not members of the federal public administration), section 6 (which describes the Board's powers), and sections 7-10 (which describe the appointment of directors). CKI as noted above is publicly listed on the Hong Kong Stock Exchange.

⁵² P. Oliver, 'Govt Silent on China bid for Vector Lines', *New Zealand Herald*, (9th April 2008); and also *The Dominion Post*, *Blocking of Vector deal 'unlikely'*, *The Dominion Post* (17th April 2008)

had a Chinese SOE won the bid and sought overseas investment approval.⁵³ It is worth considering therefore, how the OIO would have approached the approval process had the Chinese SOE won the bid and made the application instead of CKI.

2.3 The Overseas Investment Act 2005

New Zealand's primary piece of foreign investment legislation is the Overseas Investment Act 2005.⁵⁴ The Act attempts to balance the "privilege for overseas persons to own or control sensitive New Zealand assets" against the desire to encourage positive foreign contribution to the New Zealand economy.⁵⁵ It is worth considering that the OIA and Overseas Investment Regulations 2005 were likely developed with the private investor in mind. Unlike other jurisdictions, the New Zealand government has so far shown no signs of altering its foreign investment regime in response to the growth of SWF investment. It is also worth highlighting that the OIA is distinct from most similar legislation overseas in its clear pre-occupation with land.⁵⁶ While comparative legislation overseas occasionally contains different considerations and thresholds when certain land is involved, none of the United States, Canadian or Australian foreign investment regimes get close to New Zealand's in the emphasis given to land.⁵⁷ The emphasis on land in New Zealand, while it may provide legitimate and desired protection, has added confusion to the overseas investment process that risks threatening future investment.⁵⁸

⁵³ A number of newspapers ran stories, prior to OIO approval, investigating links between Li Ka-Shing [Chairman of the Cheung Kong group which includes Cheung Kong Infrastructure] and the Chinese Government. See: A. Janes, 'China's \$785 million power play', *The Dominion Post*, (29th April 2008)

⁵⁴ The 2005 Act replaced the Overseas Investment Act 1973 and its associated regulations.

⁵⁵ Overseas Investment Act 2005, Section 3 'Purpose', hereafter 'OIA'

⁵⁶ The significantly different requirements for any investment in 'sensitive land' are evidence of this.

⁵⁷ While there may be other pieces of legislation that limit the purchase of native / historic sites there is no express acknowledgment of it in either the United States or Canadian Acts. Australia's *Foreign Acquisitions and Takeovers Act 1989* addresses urban land and real estate. However, where it does, the investment undergoes the same test as business assets.

⁵⁸ Regulatory Review Committee, 'Complaints regarding the Overseas Amendment Investment Regulations 2008', *Report of the Regulatory Review Committee*, (September 2008); Professor Burrows [who was sought for advice by the Committee] identified a "strong flavour of conservation of rural land running through the concept of 'sensitive land'". Hereafter, 'Regulations Review Committee Report'.

The OIA addresses three categories of investment transactions by overseas persons.⁵⁹ Only the first two categories (investments involving ‘sensitive land’ and ‘significant business assets’) are relevant to this paper.⁶⁰ Any direct or indirect investment in either is subject to the OIA and must be approved by the relevant Minister(s) (the ‘Minister’).⁶¹ Under section 32 the Ministers may delegate their powers or functions to the Overseas Investment Office (OIO).⁶²

2.3.1 Sensitive Land and Significant Business Assets

‘Sensitive land’ is given a detailed definition but broadly includes any large area of non-urban land (farm land or non-commercial or residential land) and any land that includes the foreshore or seabed, the bed of a lake, conservation land and the like.⁶³ Notably, the AIAL investment was one involving sensitive land as the investment included an offshore island⁶⁴ and adjoined the foreshore and seabed.⁶⁵ An investment in a ‘significant business asset’ is any investment that results in the overseas investor acquiring 25% or more ownership or control of a New Zealand person or company and the value of the consideration provided exceeds

⁵⁹ Section 7(1) of the Act provides that persons are overseas persons if they themselves are overseas persons or they are 25% (or more) owned or controlled by an overseas person or persons. An overseas person is defined in section 7(2) as including an individual who is neither a New Zealand citizen nor ordinarily resident in New Zealand; a body corporate that is incorporated outside New Zealand or is a 25% or more subsidiary of a body corporate incorporated outside of New Zealand.

⁶⁰ The third category which addresses ‘fishing quotas’ is dealt with in Sections 56 to 58B of the Fisheries Act 1996 following amendments to it brought about by the Overseas Investment Act 2005 overhaul.

⁶¹ Under section 24 of the OIA an application must be decided, in the case of a land decision, by the Minister and the Minister for Land Information; and in the case of a business decision by the Minister. Under section 6 of the OIA the Relevant Minister is “the Minister of the Crown who, under the authority of any warrant or with the authority of the Prime Minister, is responsible for the administration of the Act”. At the time of the above two decisions, the Minister was the Associate Minister of Finance, the Honourable Clayton Cosgrove.

⁶² Under section 32(5) a delegation does not prevent the delegator from exercising the power or function that has been delegated. While the OIO deals with most overseas investments, the Ministers have the final say on any investment application (as was the case in AIAL example where the Ministers went against the recommendation of the OIO).

⁶³ Land is sensitive under Part 1 of Schedule 1 of the Act if (i) the land is or includes non-urban land (being farm land; or any land other than land in an urban area that is used for commercial, industrial, or residential purposes) exceeding five hectares in area, land on certain specified islands exceeding 0.4 hectares in area, any land on other non-specified islands, foreshore and/or seabed, bed of a lake exceeding 0.4 hectares in area, land held for conservation purposes or to be used as a reserve, public park, open space or for recreation purposes, land subject to a heritage order or including an historic place or wahi tapu area, in any case exceeding 0.4 hectares in area; or (ii) the land adjoins any foreshore and the land exceeds 0.2 hectares in area, other sensitive land such as the bed of a lake, certain land held for conservation purposes, reserve land, regional or public park land, certain land adjoining the sea or a lake, land subject to a heritage order or including an historic place or wahi tapu area, where the land exceeds 0.4 hectares in area.

⁶⁴ Wiroa Island

⁶⁵ OIO – AIAL Report, above note 43, Summary

NZ\$100 million.⁶⁶ The sale of the Wellington Electricity Network was an investment in a significant business asset as CKI sought to purchase 100 per cent of the Wellington Electricity Network shares for a total consideration of \$785 million.⁶⁷

Certain factors must be taken into account by the Ministers when considering an overseas investment subject to the OIA. Any investment in a ‘significant business asset’ must satisfy the ‘investor test’ in section 18. In the case of ‘sensitive land’, the exact same considerations are required under section 16(1)(a)-(d), though there are also further factors for consideration where sensitive land is involved. The ‘investor test’ has four criteria that must be satisfied. The relevant overseas person must have business experience and acumen relevant to the overseas investment;⁶⁸ be able to demonstrate financial commitment to the overseas investment;⁶⁹ be of good character;⁷⁰ and may not be an individual of the kind referred to in section 7(1) of the Immigration Act 1987.⁷¹⁷²

Additionally, where ‘sensitive land’ is involved, the overseas person must demonstrate that the investment will ‘benefit New Zealand’,⁷³ sometimes ‘substantially’.⁷⁴ Broadly the ‘benefit New Zealand’ test required for any investment in ‘sensitive land’ involves an assessment of the value of the investment. The exact parameters of the test will be discussed shortly.

2.4 Hypothetical Applications

A hypothetical example will be used to analyse whether the New Zealand overseas investment regime permits the Ministers to consider the ‘government owned nature’ of an

⁶⁶ OIA, Section 13. Other types of investment in significant business assets are set out in the section 13 but this is the principal type.

⁶⁷ OIO – CKI Decision Sheet, above note 47

⁶⁸ OIA, Section 16(1)(a) in the case of ‘sensitive land’ and section 18(1)(a) for ‘investments in significant business assets’

⁶⁹ OIA, Sections 16(1)(b) and 18(1)(b)

⁷⁰ OIA, Sections 16(1)(c) and 18(1)(c)

⁷¹ OIA, Sections 16(1)(d) and 18(1)(d)

⁷² The application of Section 7(1) of the Immigration Act 1987 broadly prohibits investment by persons convicted of serious crimes, person who have been deported, persons associated with terrorist organisations and persons who in the light of international circumstances constitute a danger to the security or public order of New Zealand.

⁷³ OIA, Section 16(1)(e)(ii)

⁷⁴ Any investment that includes non-urban land greater than five hectares must have a benefit that is substantial and identifiable (OIA, Section 16(1)(e)(iii)). Section 6 defines ‘non-urban land’ as “farm land; and any land other than land that is both in an urban area and used for commercial, industrial, or residential purposes.

overseas investor as a factor in an investment application. The hypothetical example will consider what may have eventuated had the SGC been the successful bidder in Vector's sale process. The Ministers would have been faced with the prospect of a SWF seeking approval to purchase a significant piece of New Zealand infrastructure. Just to make clear, the purpose of this hypothetical example is not to examine the justifications for special treatment of SWFs or foreign government investors. It has already been argued above that there are inherent differences associated with SWF investors and that these differences are likely wanted to be considered by the Ministers, perhaps justifiably. Instead the purpose of this example is only to examine whether the OIA allows the Ministers to take into account the state-owned nature of the buyer. If it is found that there are no explicit grounds for taking into account the nature of the investor as foreign government controlled, any such consideration will have been made outside of the parameters of the OIA. However, it will be argued that there may be ways in which politically motivated decisions relating to SWF investment could be made and 'hidden' due to the flexible nature of the Act.

The application for the purchase of the Wellington Electricity Network was determined to be an investment involving a 'significant business asset'. Significantly, the OIO⁷⁵ saw no reason to treat the investment as one that also involved sensitive land.⁷⁶ As such the application was considered under section 18 of the OIA only and did not invoke the 'benefit New Zealand' test. What might have happened then if the SGC had to satisfy section 18?

2.4.1 The 'Investor Test' – SGC and the Wellington Electricity Network

The first requirement is that the overseas investor must have business experience and acumen relevant to the overseas investment. An investor specialising in electricity distribution will have at least the minimal required experience for this investment. SGC would surely have had no problem satisfying the first requirement. The fact that the investor is a SWF is irrelevant. Even if SGC were not a SOE specialising in electricity distribution it is expected the requirement would still have been met. Overseas investors can satisfy this

⁷⁵ The OIO had delegated authority to assess the investment

⁷⁶ It is possible that the proposed investment was structured specifically to avoid the more intense 'sensitive land' requirements under the OIA.

requirement even where they have no apparent experience in the industry. For example, the Ministers deemed CPPIB to have satisfied this requirement in relation to the proposed purchase of shares in AIAL even though CPPIB did not specialise in airports. Nevertheless, experience in the relevant industry will virtually guarantee satisfaction of the requirement.

The second requirement, that the applicant must demonstrate financial commitment towards the overseas investment, is normally satisfied by evidence of consideration.⁷⁷ In the case of the AIAL application, a disclosure of how the acquisition was to be funded was sufficient. With SGC, it is presumed there would be no problem. Any attempt to challenge the purpose of the investment would seem very unlikely. For example, if the Ministers were to propose that SGC's investment may be for a non-commercial purpose and therefore claim financial commitment was not guaranteed, any such statement would appear to be outside the accepted considerations for this requirement. In any case, having satisfied the consideration element, it would be difficult for the Minister to find any evidence to indicate a non-commercial or non-financial intention.

The third requirement under the 'investor test' demands that each individual that exercises control over the overseas investor be of 'good character'.⁷⁸ In the AIAL decision it was sufficient that the Managing Director of CPPIB had produced a statement guaranteeing that all the individuals with control of the relevant overseas investor were of good character.⁷⁹ However, the OIA requires that the Minister must take into account any contraventions of the law and any other matters that reflect adversely on the person's fitness to have the particular overseas investment.⁸⁰ This requirement raises an important issue about the nature of SWF investors. In the case of SGC, or for any SWF for that matter, it becomes extremely difficult to determine who in fact has control over the affairs of the overseas investor. While a SOE typically has its own Board of Directors, they can sometimes act as an arm of Government. In the case of a SOE from a non-democratic country, there are less likely to be clear divisions between the SOE and the respective Government. As such, determining

⁷⁷ OIO – AIAL Report, above note 43, [23] and OIO – CKI Decision Sheet, above note 47, 'Rationale'.

⁷⁸ This offers only short-term protection as those in control could change immediately after Ministerial approval (by replacing Board members for example).

⁷⁹ OIO – AIAL Report, above note 43, [24]; where the OIO held that as the statement was in the form of a statutory declaration which complied with the requirements of the Oath and Declarations Act 1957 it could be relied upon.

⁸⁰ OIA, Section 19(1)

exactly who must be of ‘good character’ becomes a crucial and difficult issue. While it is not necessarily any simpler when faced by a private company, which will often have Directors that are instructed from above, the added element of government involvement clouds the issue. In the case of SGC it is possible that the relevant Directors and possibly the Minister in charge of the enterprise will be required to be of good character. Saying that, in the case of the CPPIB the Ministers did not find it necessary to have a guarantee of good character on behalf of the Canadian Government, presumably on the basis that CPPIB is not controlled by the government.⁸¹ In any case, it would be a very significant decision, affecting foreign relations tremendously, for the Minister to conclude that the Chinese Government was not of ‘good character’ for the purposes of an overseas investment. This is especially so given that New Zealand has recently signed a Free Trade Agreement with China.⁸²

The final, and perhaps least contentious requirement, is that any person with control over the relevant overseas investor must not be prohibited by their status under the Immigration Act 1987. Section 7(1) of the Immigration Act 1987 ensures that any person immigrating to New Zealand has no serious convictions overseas or links to terrorist organisation. While the overseas investor does not have to satisfy the Immigration Act 1987 completely as there is no requirement for immigration, section 7(1) is employed by the OIA to ensure every overseas investor is a suitable person. Given that it is unlikely any person associated with SGC will fail the section 7(1) test, the SOE would surely satisfy this final requirement.

It appears then that had the Chinese SGC won the right to purchase the Wellington Electricity Network, it would have been able to satisfy the only four requirements for an overseas investment in a ‘significant business asset’. Considering the attention possible links between CKI and the Chinese Government attracted, one can imagine the political sensitivity of the decision had the investor in fact been the Chinese government. It is hard to imagine how the New Zealand government would justify to the public any approval of a sale of control of the capital’s electricity supply to a foreign government.⁸³ There is the very real risk that the Government would attempt to intervene somehow to either block the

⁸¹ Canadian Pension Plan Investment Board Act, above note 51

⁸² New Zealand – China Free Trade Agreement, signed on 7th April in Beijing, available at <http://chinafta.govt.nz/1-The-agreement/2-Text-of-the-agreement/index.php>, hereafter ‘NZ-China FTA’

⁸³ Again, this is not intended to suggest such an investment should be restricted. It merely highlights, that in New Zealand especially, there would be huge public pressure to block the investment.

investment or impose conditions or undertakings. However, while such action may have been possible in the context of AIAL where sensitive land was involved (and therefore the benefit New Zealand' test is employed), it would be far more difficult under the limited 'investor test'.⁸⁴

In the case of a Chinese SWF like the SGC, the recently signed Free Trade Agreement with China⁸⁵ would arguably provide further pressure on the government not to intervene.

However, despite thoughts that Chinese investors are required to be treated the same as New Zealand investors, this is not the case.⁸⁶ There is only a requirement for equal treatment of Chinese investors in the context of an established investment and not in the case of acquisition of new investments.⁸⁷

Significantly however, Article 139 gives 'most favoured nation status to the Chinese in "like circumstances"'.⁸⁸ As such, any investment by a Chinese enterprise would have to be treated no less favourably to an application by an enterprise from any third party country. The significant issue is what effect the status of the Chinese investor as a SWF might have. Given that Article 135 includes government controlled entities in its definition of "enterprise", if New Zealand has no specific SWF investment laws it may have to treat a Chinese SWF the same as it would a private Chinese enterprise.⁸⁹ If New Zealand does happen to have SWF laws or laws that are capable of distinguishing SWF investors, then any new investment by a Chinese SWF will still have to be treated no less favourably [by New Zealand] to an

⁸⁴ Significantly there is no possibility of creating regulations that will directly affect the criteria of the 'investor test'. Such action is possible under sections 16 and 17's 'benefit New Zealand' test.

⁸⁵ NZ-China FTA, above note 82.

⁸⁶ NZ Herald, 'No Special Treatment for Chinese Investors – Govt', *NZ Herald*, (18th April 2008).

⁸⁷ NZ-China FTA, above note 82, Chapter 11, Article 138 'National Treatment' specifies that 'each party shall accord to investments and activities associated with such investments, with respect to management, conduct, operation, maintenance, use, enjoyment or disposal, by the investors of the other Party treatment no less favourable than that accorded, in like circumstances, to the investments and associated activities by its own investors.'

⁸⁸ NZ-China FTA, above note 82, Chapter 11, Article 139, 'Most-favoured-nation Treatment', which says 'each party shall accord to investors, investments and activities associated with such investments by investors of the other Party treatment no less favourable than that accorded, in like circumstances, to the investments and associated activities by investors of any third country with respect to **admission, expansion**, management, conduct, operation, maintenance, use, enjoyment and disposal'. [Emphasis added]. Note the inclusion of 'admission' and 'expansion' in Article 139, terms not included in Article 138.

⁸⁹ NZ-China FTA, above note 82, Chapter 11, Article 135, 'Definitions'

application by any similar SWF from anywhere else. While interesting, the issue would require a far greater investigation than is possible in this paper.

As such, although there may be legitimate justifications for considering SWFs as inherently different, it appears that at least where an overseas investment in New Zealand only requires satisfaction of the ‘investor test’, there may be no grounds for treating a SWF any differently from a private investor. Should decisions made in the future take into account considerations not provided for in the relevant ‘investor test’ there may be grounds for judicial review. Even if no judicial review eventuates, the effects of such action would seriously impact the likelihood of any possible future investment by SWFs, who would not be at all impressed by an approval process that does not conform to the formal requirements.

2.4.2 The ‘benefit test’ – CPPIB and AIAL

The above hypothetical example and discussion relates only to those overseas investments that involve a ‘significant business asset’ and not ‘sensitive land’. Given that there are likely to be very few significant business assets that are not also on sensitive land, the likelihood that a SWF will attempt to invest in one is reduced.⁹⁰ However, given the tendency for New Zealanders to react strongly to even small foreign investments, an investment in a significant business asset could become a serious political issue.

As has already been identified, when an overseas investment involves ‘sensitive land’, there are requirements beyond the initial ‘investor test’.⁹¹ Any investment involving ‘sensitive land’ must benefit New Zealand. In assessing whether the overseas investment benefits New Zealand the Ministers will have regard to a long list of often vague factors.⁹² It follows that, where ‘sensitive land’ is involved, there may be a greater likelihood that the Act allows the nature of the SWF as state-owned to be taken into account. Given that the majority of New

⁹⁰ Investments that might meet fit this model may include investments in the banking sector, electricity networks, telecommunications. Should NZ Post ever be privatised it may also fit the model.

⁹¹ For sensitive land, the ‘person test’ is found in section 16(1)(a)-(d) of the OIO and is identical to that found in section 18.

⁹² OIA, Section 17

Zealand's prime assets will likely involve sensitive land, chances are that any significant investment by a SWF will be subject to the 'benefit' test in section 17.

The factors that must be considered when determining whether the overseas investment 'benefits New Zealand' include:

- whether the investment will result in new jobs, introduction of new technology or business skills, increased exports, added market competition, improved efficiency or production, additional investment for development, or increased primary processing;⁹³
- whether there are adequate mechanisms to protect significant aspects specific to the land in question including significant flora and fauna, wildlife, historic heritage, walking access and areas of foreshore and seabed;⁹⁴ and
- any other factors set out in the regulations; currently including any consequential benefits to New Zealand, the relevant investor's current or future New Zealand investment position, matters relevant to New Zealand's trade or international relations and compliance with its international obligations, or to the advancement of significant government policy or strategy.⁹⁵

Clearly there are far more factors that require consideration when the investment involves 'sensitive land' and not only a 'significant business asset', seemingly reflecting the special status of land in New Zealand.⁹⁶ While a number of other countries recognise particular types of investment as requiring different considerations New Zealand appears to be alone in the way it distinguishes only between 'significant business assets' and other investments in 'sensitive land'.⁹⁷ In a sense this is understandable. Countries are free to determine what particular assets are crucial to their economy and society and are also largely permitted to impose tighter restrictions on foreign investors. New Zealand has always considered its land of immense significance and therefore when an investment involves 'sensitive land' it is understandable that special factors are addressed.

⁹³ OIA, Section 17(2)(a)

⁹⁴ OIA, Section 17(2)(b)-(e)

⁹⁵ OIA, Section 17(2)(g) and the *Overseas Investment Regulations 2005*, Regulation 28(a)-(h)

⁹⁶ *Commentary as reported from the Finance and Expenditure Committee on the Overseas Investment Bill 2004* (2004)

⁹⁷ In Australia for example, a number of sectors have specific caps on foreign ownership, including the Banking, Civil Aviation, Shipping, Telecommunication and Media sectors.

The issue with the New Zealand regime, however, is that it is difficult to understand why an investment in a significant asset like AIAL involves the far stricter ‘benefit test’ than an investment in Wellington’s principal electricity network simply because the airport is on sensitive land. Most of the ‘benefit New Zealand’ test factors have very little to do with land and the fact that those relating to land were the only factors satisfied in the AIAL assessment adds further confusion.⁹⁸ It would seem that where the land is empty and undeveloped such a test would be relevant, ensuring that any future change to the use of the land would be suitable and desirable in the circumstances. But where the land has been developed to the extent that the Auckland airport land has, there is no obvious reason why it should be treated differently to any other piece of developed land, whether urban or not. It seems somewhat absurd that an investment in a factory located on non-urban land⁹⁹ should be subject to a significantly different test, involving factors completely unrelated to the land directly, than might an investment in the same factory located in an urban area.¹⁰⁰ While it is not the purpose of this paper to challenge the justification for the different tests, it should be clear that such distinctions are probably responsible for much frustration amongst overseas investors.¹⁰¹

What is crucial to this topic is whether the different factors required for consideration under the ‘benefit New Zealand’ test might allow the Minister to take into account the foreign government owned status of a SWF overseas investor. While the factors for consideration under the test are often extremely broad, none of them appear to allow for any consideration of the nature of the investor. The ‘benefit New Zealand’ test involves an assessment of the value of the investment, what effects it might have and whether these will be positive or negative. It would seem that any determination on resulting job opportunities, market

⁹⁸ In their decision the Ministers held that the factors relating to indigenous fauna (section 17(2)(b)), significant habits of wildlife and game (section 17(2)(c)) and increased processing of primary products (section 17(2)(a)(vi)) were not relevant. The Ministers further positively assessed the factors relating to the protection of historic heritage (section 17(2)(d)) and the provision or improvement of walking access (section 17(2)(e)). These five factors are the only factors that can be considered to directly relate to the land involved.

⁹⁹ OIA, Section 6 defines ‘non urban land’ as farm land and any land other than land that is both in an urban area and used for commercial, industrial, or residential purposes.

¹⁰⁰ Regulations Review Committee Report, above note 58, pp 9 and 10; Professor Burrows considered that the “link between strategically important infrastructure and sensitive land is tenuous” and that “AIAL would logically be dealt with under the Act as a significant business asset rather than as sensitive land”.

¹⁰¹ Ibid, Professor Burrows noted that “the government took advantage of the coincidence that a piece of strategically important infrastructure which was really a significant business asset, happened to be on sensitive land”.

competition or export receipts has little to do with the nature of the buyer but instead the impact of the investment. Of course in some cases these may be interlinked, and some commentators might argue a SWF would be more likely to redirect trade and possibly steal employment opportunities by removing production and processing. More likely is that rather than focussing on any risks involved with SWF investment, if a Minister wanted to restrict an investment, they might instead focus on the opaque nature of SWFs. The fact that SWFs often have very non-transparent investment objectives may mean Ministers are unable to determine any identifiable benefits. As was the case with the CPPIB's investment application, when no benefits were clearly identifiable, the Ministers can be remarkably quick to restrict investment.

It would appear then that in the case of a very non-transparent SWF it would be easy for Ministers to justify restricting an investment on the grounds that as very little is known about the investor's intentions, a benefit to New Zealand may be hard to identify. However, where a SWF meets standard disclosure requirements and operates relatively transparently it would appear difficult for a Minister to find any other factors in the 'benefit New Zealand' test that might allow for a consideration of the government owned status of a SWF. Where the SWF can identify clear benefits to New Zealand there is no reason why under the current OIA they should be treated differently from a private investor in the review process.

Continuing with the assumption that any direct investment by a SWF is likely to be immensely politically sensitive, there is the danger that where the SWF is transparent and appears to satisfy the 'benefit New Zealand test' the Ministers will apply 'politically motivated considerations' in a hidden fashion. If the 'benefit New Zealand test' is flexible enough there may be no actual need to publicly consider the nature of the SWF as government owned as the Minister can likely justify any restrictions by manipulating the current list of factors. Political manipulation of the regime would not be without precedent. As discussed above, the CPPIB's attempted investment in AIAL was for all intents and purposes ruined by political determinations. Shortly before the proposed investment was due for an initial OIO recommendation, the New Zealand Government requested from The Treasury Department "a cabinet paper and draft legislation to enable the government to

restrict foreign ownership of [AIAL].”¹⁰² The Treasury Department considered that any such action would be inadvisable and they advised against “any intervention in the current share market transaction”.¹⁰³ In the end, the Treasury recommended alternative methods of intervention (should the Government still consider it necessary), specifically the amendment of regulations under the OIA to provide additional criteria to be considered by Ministers or alternatively the issuing of a government policy statement which would need to be considered in assessing the CPPIB application. The Government chose to amend the Overseas Investment Regulations 2005 and in doing so added even greater flexibility and significant difficulties of interpretation to New Zealand’s overseas investment regime. The proposed overseas investment inevitably failed to gain Ministerial approval, but only after a significant amount of time and resources had been invested by the CPPIB in the process.¹⁰⁴

The AIAL Decision

It is worth considering further the decisions by the OIO and the Ministers with regards to the proposed AIAL investment. The two decisions highlight the extent of the flexibility offered by the ‘benefit New Zealand’ test and the subsequent ease with which overseas investment applications can be politically hijacked.¹⁰⁵ There are a number of ways in which the structure and content of the ‘benefit New Zealand’ test allows for such intervention.

The first major criticism of the ‘benefit New Zealand test’ is that the OIA provides no clear statutory weighting system; under section 17(1)(c) the Minister has the discretion to determine the relevant importance given to each factor.¹⁰⁶ Even more frustrating for market participants is that neither the OIO nor the Ministers have been willing to discuss or disclose what weighting they give to the long list of factors.¹⁰⁷ For example in the assessment of the

¹⁰² The Treasury Department, ‘Treasury Report: Restricting Foreign Ownership of Auckland International Airport, Report No: T2008/297’, *The New Zealand Treasury Department*, (29th February 2008).

¹⁰³ Ibid, ‘Executive Summary’

¹⁰⁴ Brian Gaynor of the NZ Herald commented: “Cullen’s decision was announced nearly a decade after the Crown sold its 51.6 per cent controlling interest in the airport and more than seven months after the first offer for AIA was revealed. As a result the offer has been a terrible waste of resources - the airport had already spent \$5.8 million on the process by the end of December. B. Gaynor, ‘Govt could intervene again on assets’, NZ Herald, (19th April 2008)

¹⁰⁵ There were two decisions; initially the OIO held the investment satisfied the requirements of the OIA, only for the Ministers to disagree and hold the application unsuccessful.

¹⁰⁶ OIA, Section 17(1)

¹⁰⁷ See: Simpson Grierson, ‘New Zealand Government creates legal quicksand for overseas investors in strategic infrastructure’, *Corporate Advisory FYI*, Simpson Grierson, (March 2008), available at

AIAL investment the Ministers categorised the factors as either of low, medium or high importance.¹⁰⁸ However, there is no guarantee that these loose weightings apply to all investments and they may have only applied to the AIAL application. If, as is suspected, the weightings are only relevant to the AIAL decision there is no guidance for any future investment applications. It would appear possible that the Ministers could come up with any weighting system that may aid the sought after result.

A second concern with the test is that most factors are often left undetermined. In the AIAL application, factors for considerations were given ‘positive’, ‘negative’ or ‘unknown’ determinations by the OIO and the Ministers. In most cases it was found that there was not enough information to come to a conclusion and so the effect on most factors was left ‘unknown’. While some criticise the OIO and Ministers for failing to make determinations, in a number of cases the factors for consideration are so vague and broad that almost any result is possible.¹⁰⁹ As such it is no surprise that factors are left ‘unknown’. In some cases the OIO has failed to even interpret what the Act and Regulations require to be considered. The newest factor, introduced during the AIAL assessment process, is the prime example and is worth considering in depth. More than any other, the new Regulation 28(h) (‘the new regulation’) highlights the difficulties associated with the OIA.

2.4.3 Regulation 28(h) of the Overseas Investment Regulations¹¹⁰

Following the decision by the New Zealand Government to intervene in the proposed investment by CPPIB, the Ministers are now obligated to consider, when confronted by any overseas investment in sensitive land, “whether the overseas investment, will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land”.¹¹¹ According to the New Zealand Finance Minister the

www.simpsongrierson.co.nz; and also Minter Ellison Rudd Watts, ‘Changes to the Overseas Investment Rules’, *Corporate Update*, Minter Ellison Rudd Watts, (March 2008), available at www.minterellison.co.nz.

¹⁰⁸ In the OIO decision sheet no indication of weighting was provided.

¹⁰⁹ For example, Regulation 28(a) requires the consideration of any “consequential benefits to New Zealand”. Quite how a determination is to be made on this is unclear.

¹¹⁰ Regulations Review Committee Report, above 58, the September 2008 report of the Regulations Review Committee was very critical of the Governments actions relating to introduction of the new regulation. While some references will be made to the report in the form of footnotes, the timing of the release has meant full consideration has not been possible.

¹¹¹ Overseas Investment Regulations 2008, Regulation 28(h)

regulatory change was “made in response to the uncertainty and debate that have emerged surrounding the [CPIIB’s] offer to shareholders in AIAL”.¹¹² This statement clearly highlights the extent to which the process was openly taken over by political considerations. The new regulation appears to provide the Government with a mechanism to impose conditions on any overseas investment in a strategic piece of infrastructure.¹¹³ As such, the ad hoc two line regulation change will surely create immense uncertainty for overseas investors looking to invest in New Zealand infrastructure assets. Generally, the new regulation highlights the extent to which the Government can involve itself in the foreign investment review process.¹¹⁴ A number of specific issues have arisen with regard to the new regulation, namely what weighting it will receive and how broadly it is intended to be interpreted.¹¹⁵

The OIO, in its recommendation to the Ministers that the AIAL overseas investment be approved, clearly struggled with the new regulation.¹¹⁶ The result was that the OIO was ‘unknown’ as to whether the overseas investment by CPIIB would ‘assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land’.¹¹⁷ Perhaps an understandable result given some of the difficulties of interpretation the regulation creates.

Firstly, no definition of ‘strategically important infrastructure’ was provided alongside the regulation and none exists elsewhere in the OIA. Despite requests to produce a list of assets covered by the new Regulation the Government has so far failed to provide any clear parameters defining what will constitute “strategically important infrastructure”.¹¹⁸ The only real guidance has been a statement by the Finance Minister that the term will cover a very

¹¹² M. Cullen, ‘Strategic assets to be protected in national interest’, *NZ Government Press Release*, (3rd March 2008) available at www.beehive.govt.nz

¹¹³ In the sense that the Government will be able to ‘ask’ for undertakings with regards to voting rights, future share purchases and other similar requests.

¹¹⁴ Regulations Review Committee Report, above note 58, at 12; the report notes that Professor Burrows considered the regulatory making power of section 17(2)(g) to be ‘undesirable’, and ‘a form of Henry VIII clause’. He also considered the new regulation ‘effectively amended primary legislation’

¹¹⁵ The effects and difficulties associated with the regulatory change are highlighted by the amount of public commentary from leading commercial law firms. Simpson Grierson, Kensington Swan and Minter Ellison Rudd Watts have all released client guidelines that are available online.

¹¹⁶ OIO – AIAL Report, above note 43

¹¹⁷ OIA – AIAL Report, above note 43, [48]

¹¹⁸ B. Gaynor, above note 104; and F. O’Sullivan, ‘Fran O’Sullivan: Time to list strategic assets’, *NZ Herald*, (16th April 2008); and ‘Changes to the Overseas Investment Rules’, above note 107.

narrow range of important assets.¹¹⁹ Other possible guidance may be found in the Resource Management Act 1991 which defines ‘infrastructure’¹²⁰ and the Local Government Act 2002 which contains a definition of ‘strategic assets’¹²¹ It is significant that neither the OIO nor the Ministers resorted to either of the above two Acts when assessing the AIAL application. However the above two Acts clearly highlight how broadly the definition can be interpreted. Imposing restrictions on specific assets, including infrastructure assets, is not new in New Zealand¹²² and is common practice globally.¹²³ What is frustrating for investors is that the new regulation does not make clear exactly which specific assets may be subject to the new regulation. It would seem that the Ministers are capable of interpreting the term to suit any political intentions they may have.

The second obvious difficulty is deciding exactly how, based on a plain reading of the regulation, any overseas investment could ever “assist New Zealand to maintain New Zealand control” of an asset. Any overseas investment will necessarily result in the transfer of control from New Zealand interests to overseas interests. As already mentioned, it appears that the law change may be designed to give the Government a mechanism to impose conditions on any relevant overseas investment.¹²⁴ The only way in which it may be possible to satisfy the rule, would be if the overseas investor were to limit its investment or control to preserve a level of New Zealand control. In the AIAL investment application, CPPIB agreed to cap its current and future investment at a certain level and agreed to cede some degree of control back to New Zealand. CPPIB entered into a deed which restricted its ability to vote on resolutions to appoint and remove directors of AIAL and clarified that it proposed to acquire a minority stake only (which it argued would not give it control).¹²⁵ Other possibilities might include an agreement to implement a Kiwi-Share type deal or to be

¹¹⁹ M. Cullen, above note 112.

¹²⁰ The definition provided in section 2 of the Resource Management Act 1991 is extensive and includes gas or energy pipelines, telecommunications and radio-communications networks, power stations and lines networks, water supply networks, structures for transport on land (roads railways, cycle-ways and walkways), port companies and airports.

¹²¹ Section 5 of the Local Government Act 2002 defines ‘strategic asset’ broadly as an ‘asset that the local authority considers important to retain if it is to maintain the current or future well-being of its community’.

¹²² Both Telecom and Air NZ have existing legislation providing foreign ownership restrictions.

¹²³ Australia has limitations on foreign ownership of its international airports for example.

¹²⁴ Simpson Grierson, above note 107

¹²⁵ The deed was entered into by CPPIB with the guidance of the OIO and is included in the OIO’s decision sheet as Appendix A. AIAL reduction of its voting rights to 24.9% was made in response to comments by the New Zealand Finance Minister that suggested the airport was set to become foreign controlled. At that stage, CPPIB proposed to purchase a 40% stake.

subject to regulatory oversight of the business to ensure New Zealand control is maintained.¹²⁶ In the end, while the OIO were left confused by the regulation, the Ministers found that the CPPIB's attempts to satisfy the regulation were not sufficient. They decided that the overseas investment was not likely to assist maintenance of New Zealand control, and that this would be particularly so if the proposed investment was taken in conjunction with potential further small acquisitions of shares by overseas investors in AIAL.¹²⁷ Arguably this is the only decision the Ministers could have come to, as it seems that the way the regulation is phrased makes satisfaction of it inherently impossible, subject to the imposition of significant conditions. However, even more absurd is that in limiting its potential control in an attempt to satisfy the new regulation, CPPIB apparently reduced its ability to make positive changes to the airport and add value, according to the Ministers.¹²⁸

Another related issue that arises out of the regulation is how to define 'control' for the purposes of the regulation. As mentioned above, CPPIB attempted to reduce its voting power below 25% after the Finance Minister suggested that control could be obtained with something substantially less than a majority ownership. The term 'control' is not defined in the Act but the phrase "25% or more ownership or control" is constantly referred to¹²⁹ and defined to mean a beneficial interest in 25% or more of the relevant securities, the power to control the composition of 25% or more of the governing body, or the right to exercise or control the exercise of 25% or more of the voting power at a shareholder meeting.¹³⁰ The constant use of the term "25% or more" indicates that it could well be the applicable threshold that Ministers will use in the context of the new regulation, but this is far from certain.

One final issue is that the regulation uses the term "maintaining New Zealand control". On a plain reading it would appear that the regulation could therefore only relate to investments under New Zealand control. More precisely, the regulation seems to suggest that should an

¹²⁶ Simpson Grierson, above note 107

¹²⁷ Overseas Investment Office, 'Reasons for the decisions by the relevant Ministers', *OIO*, (19th April 2008), 'Regulation 28(h)'.

¹²⁸ For example, the Minister's determined that the investment did not satisfy Section 17(2)(a)(iii) of the Act as they were uncertain CPPIB would be able to influence the AIAL board and implement initiatives to increase exports given its restricted voting rights. These restricted voting rights were the direct result of attempts to satisfy the new regulation.

¹²⁹ OIA, Sections 6(1), 7(1),(2), 13(1), and 15(2).

¹³⁰ OIA, Section 6(1)

overseas investor seek to invest in an asset controlled by foreign interests, for example by an Australian company, it would not be subject to the regulation. This likely reflects the view of the current Government that more than enough control has left New Zealand hands and that further loss of control should be prevented. The uncertainty around the interpretation of this final element adds further confusion to all overseas investors.

2.5 Conclusion on New Zealand's foreign investment regime

What is clear is that the scope of a section 17 'benefit New Zealand' test is enormous and covers a whole host of factors. While none of the 'benefit New Zealand' test factors directly address the nature of ownership (which is dealt with in the earlier 'investor test'), it would seem that where a SWF operates non-transparently (as many of them do) the Ministers will find it more difficult to find a 'benefit' and easier to justify restrictions. Significantly, such a decision still will not directly address the state-owned nature of the SWF but more the non-transparency with which it operates. Where a SWF operates transparently and along the same lines as a private investor there would appear to be fewer ways in which a Minister could justify any restriction. In this case, there is the serious danger that a Minister could make politically motivated decisions¹³¹ and use the flexible and unclear nature of the regime to hide such a decision.¹³² The flexibility of the Act is clear from the lack of weighting given to and the broad nature of the factors under the 'benefit New Zealand test' as well as the obvious flexibility in interpretation presented by factors such as the new regulation.

If the purpose of the Act is to promote New Zealand as open to foreign investment the possibility of politically motivated decision making does not help. If decisions are made by manipulating the regime it is likely that they will appear arbitrary and unclear. Both are characteristics foreign investors do not take kindly to when seeking out investment opportunities.¹³³

So far, the New Zealand Government has made no statement on its position on SWF investors. As such there is no guidance available to SWF allowing them to weigh up the risks associated with attempted investment in New Zealand. Given that a number of other western countries have identified the inherent differences associated with SWF investment and altered their regimes accordingly, it appears that New Zealand is either lagging behind or

¹³¹ It is difficult to believe that the Ministers are immune from pressures from higher ranking members of Government. Under the current government the Minister of Finance (Michael Cullen) is the relevant Minister for any investment in significant business assets. However he has delegated his decision making to the Deputy Finance Minister.

¹³² Regulations Review Committee Report, above note 58, at 10, again Professor Burrows noted that the new regulation has made it "easier for future governments to take a more selective approach to foreign investment and this in itself may raise uncertainty."

¹³³ F. O'Sullivan, above note 118

disinterested. It is unlikely to be the latter. As stated, it is hard to imagine any SWF investment in New Zealand going unnoticed. The merits of such an investment will be fiercely debated both within government and the public at large. If New Zealand is serious about attempting to attract quality foreign investment, as it should be, some guidance to SWFs must be provided. As it stands, based on events surrounding the AIAL investment, New Zealand may appear as too risky a location (in terms of its investment regime) for investing in.¹³⁴ Any decision making process must be open and transparent. Most investors have no problem with accepting clearly defined restrictions. These can be worked around and planned for. However there is “considerable disquiet when policy decisions are inconsistent, retrospective and mainly driven by short-term political considerations”.¹³⁵ Unfortunately this is the situation at present and it appears it will be only worse when considering possible SWF investment. There is a clear need to make adjustments to the New Zealand regime in order to attract one of the few current sources of significant capital.

¹³⁴ Clearly there are other reasons why New Zealand may attract substantially less attention from SWFs than other countries. However, an unsettled investment regime may compound other factors such as New Zealand’s small population, remote location, and lack of major assets.

¹³⁵ B. Gaynor, above note 104.

Chapter 3:

Responses Elsewhere

3.1 Overview

While New Zealand has so far not signalled its position on SWFs, a number of other countries have responded to the increase in SWF investment by making changes to their respective foreign investment regimes. These changes are in most cases very recent and their nature varies considerably across jurisdiction. One possible explanation for New Zealand's lack of response is that most of these jurisdictions have only sought to adapt their rules following a specific instance of proposed SWF investment. While there may be legitimate and globally voiced concerns to justify the special consideration of SWFs, changes seem to have only occurred when governments have been faced with their own domestic situation. New Zealand would do well to avoid a reactive response and instead produce a clear set of guidelines now.

3.2 United States

The United States was the first major western jurisdiction to unilaterally respond to increased SWF investment. In August 2007, the Foreign Investment and National Security Act 2007 (FINSIA) was enacted.

3.2.1 Background: Exon Florio

The United States government has had the power to review foreign investments on national security grounds since the 1988 enactment of the Exon-Florio provision (Exon-Florio).¹³⁶ Under Exon-Florio, the President is authorised to prohibit or reverse any foreign acquisition

¹³⁶ The amendment was passed into law under the Omnibus Trade and Competitiveness Act of 1988 and amended Section 721 of Defense Production Act of 1950.

(by a private or government investor) that is considered a threat to national security. National security is not defined but Exon-Florio lists a number of factors that the President may consider.¹³⁷ Notably, these factors are mainly related to the military and defense industry.

The federal inter-agency body charged with administering Exon-Florio is the Committee on Foreign Investment in the United States (CFIUS).¹³⁸ The process provides for an initial 30-day review period, which often leads to CFIUS approval without any further investigation.¹³⁹ In more complex cases,¹⁴⁰ the 30-day review is followed by a further 45-day investigation,¹⁴¹ after which a recommendation is given to the President for final approval.¹⁴² Although the withdrawal of applications is common where the overseas investor becomes aware of insurmountable national security related concerns, there has only been one instance where the President formally forced divestiture pursuant to the Exon-Florio law.¹⁴³

In recent years, a number of proposed acquisitions of US companies by SWFs have caused widespread political debate in the US. The most controversial involved the proposed acquisition of port-facilities operator ‘Peninsular and Oriental Steam Navigation Company’ by ‘Dubai Ports World’, a United Arab Emirates government controlled entity. Another involved a proposed acquisition of ‘Unocal’ (the Union Oil Company of California) by the China National Offshore Oil Corporation, a Chinese government controlled entity.¹⁴⁴ While

¹³⁷ These factors include: whether domestic production is needed for national defence requirements; the capability of domestic industries to meet national defence requirements, including the availability of human resources, products, technology, materials and other supplies / services; the potential effects of the transaction on the sale of military goods, equipment or technology to a country that supports terrorism or proliferates missile technology or chemical and biological weapons; and the potential effects of the transaction on US technological leadership in areas affecting US national security.

¹³⁸ CFIUS is chaired by the Treasury Department and includes members from six Administration departments and six White House agencies.

¹³⁹ There is no requirement to seek approval prior to investment but parties generally seek approval voluntarily so as to mitigate the risk that the investment will be reversed at a later date.

¹⁴⁰ Prior to recent changes the extended 45 day investigation took place where CFIUS identified a security risk that could not be eliminated through a Mitigation Agreement (the imposition of conditions and undertakings).

¹⁴¹ The 45 day investigation is required where the 30 day review identifies a potential security risk. The extra 45 day investigation period gives CFIUS greater time to evaluate the extent of that risk by assessing the effect of the investment against five factors (which predominantly relate to national defence requirements, the sale and production of military goods and technology and other similar areas).

¹⁴² The President has a 15-day window to approve or reject the proposed transaction on national security grounds

¹⁴³ In 1990, President Bush ordered the Chinese National Aero Technology Import and Export Corporation to divest all of its interest in MAMCO Manufacturing Inc, a Seattle-based-company that produced aircraft parts.

¹⁴⁴ Unocal is now a defunct company having since been merged into Chevron Corporation in August 2005.

neither of the transactions ultimately succeeded, the political outcry they generated has been followed up by recent and further amendment to the Exon-Florio legislation and United States' foreign investment regime.

3.2.2 Foreign Investment and National Security Act 2007

FINSA has expanded the category of transactions subject to a mandatory 45-day investigation.¹⁴⁵ Now, any transaction that will result in foreign government control over a US entity, regardless of size or significance will be required to undergo an extended investigation.¹⁴⁶

The changes are an obvious response to increased concerns with state controlled investors. There are now markedly different requirements for investment when it comes to SWFs in the United States. Any SWF now faces a more extensive investigation of any possible threats to national security. However, the fact there is now a mandatory 45 day investigation does not necessarily mean the barriers have been raised higher.¹⁴⁷ While FINSA has identified investments in “critical infrastructure” as possibly representing a national security threat,¹⁴⁸ it does not outline what specific elements of government controlled investment require further consideration.¹⁴⁹ However the new law does require an assessment of the foreign country's compliance with US multilateral counter-terrorism, non-proliferation and export control regimes as part of the 45 day investigation.¹⁵⁰ In most cases, SWFs should have no issue satisfying these considerations.

In another sense FINSA may be considered beneficial for SWF investors. Because the new law essentially codifies existing practice and timeframes, the system now has “buy-in” from Congress.¹⁵¹ This should mean that if a transaction gets approved pursuant to the CFIUS

¹⁴⁵ Previously the extended 45 day review period was only required where there were clear security concerns.

¹⁴⁶ Also requiring extended investigation are any transactions that will result in foreign control of any “critical infrastructure” of or within the United States that could impair US national security.

¹⁴⁷ Any SWF that was identified as a security threat would have still been investigated prior to FINSA.

¹⁴⁸ This is whether the investment is by a foreign government or a private investor.

¹⁴⁹ Both the Canadian and Australian reactions have identified specific elements of SWFs that justify further consideration.

¹⁵⁰ Defense Production Act, above note 136

¹⁵¹ E. Gerwin Jnr and L. Kiern, ‘Exon-Florio Amendment Now US Law’, *The Deal*, available online at <<http://www.winston.com/siteFiles/publications/Gerwin-KiernSept.2007Dealarticle.pdf>>, last accessed (5th October 2008).

process, the deal should be less susceptible to political criticism.¹⁵² In the case of ‘Dubai Ports World’s’ proposed investment, CFIUS approval was granted but political pressure later forced the investor to sell off some of its assets to United States companies.

FINSA reflects clearly identifiable concerns with SWFs. While the changes made relate principally to national security concerns, the mandatory investigation now required for any investment by a SWF highlights that there are inherent differences associated with foreign government investors that it felt necessitate further consideration. Whether the United States identified this need solely due to increased national security issues associated with SWFs or also saw issues of transparency and possible non-commercial objectives as significant is unknown.

3.3 Canada

In December 2007, the Canadian government produced new guidelines (the Guidelines) for the review of foreign SOEs.¹⁵³

3.3.1 Background: The Investment Canada Act

The broad purpose of the Investment Canada Act (ICA) is “to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada.”¹⁵⁴ Investment by a non-Canadian¹⁵⁵ will be reviewable if a Canadian business is being acquired and its asset value equals or exceeds the financial threshold in the Act.¹⁵⁶ Applications for review must show that the foreign investment is of “net benefit” to Canada by addressing a number of broad factors along similar lines to the ‘benefit New Zealand’

¹⁵² Rational Security, above note 28

¹⁵³ Industry Canada, 2007, ‘Guidelines – Investment by State Owned Enterprises – Net benefit assessment’. The guidelines were issued under section 37 of the Investment Canada Act (ICA), available online at <<http://www.ic.gc.ca/epic/site/ica-lic.nsf/en/lk00064e.html>>

¹⁵⁴ ICA, Section 2

¹⁵⁵ ICA, Section 3 ‘Definitions’; ‘an entity not controlled or beneficially owned by Canadians’

¹⁵⁶ The thresholds are reviewed annually and are dependant on World Trade Organisation membership. Currently, where the home state of the investor is a WTO member the threshold is \$281 million in book value of worldwide assets. Investments by non-WO investors and investments by all investors in certain sensitive sectors – such as cultural industries, financial services, transportation services and the production of uranium and the ownership of uranium-producing property – are subject to lower review thresholds which vary depending on whether the acquisition of the Canadian business is direct or indirect. (Section on thresholds)

test.¹⁵⁷ Given that there is no weighting attributed to the relevant factors, the Ministers have a great deal of discretion.¹⁵⁸ As such, the review process prior to the release of the new Guidelines has not been known for its transparency or due process guarantees.¹⁵⁹ The criteria are not clear and there is no requirement for reasoned, published decisions.

Significantly, the ICA does not explicitly make the identity or the nature of the buyer a factor in assessing net benefit.¹⁶⁰ It follows that, prior to the new Guidelines, there was no clear statutory basis for considering the nature of the foreign investor as government controlled in evaluating a proposed transaction. However, it may have been possible for a Minister to argue that a particular takeover by a foreign SWF was not compatible with Canada's "national industrial, economic and cultural policies".¹⁶¹

3.3.2 The New SOE Guidelines

The Guidelines were the result of a commitment by the federal government to "address the concern that some investments by SOEs¹⁶² in Canada may not be to the benefit of Canadians".¹⁶³ The government's main worry was that some companies controlled by foreign governments may have "unclear corporate governance and reporting" and may not operate with "commercial" objectives.¹⁶⁴

The Guidelines may therefore be seen as "clarifying" the government's policy on investment by SWFs. Once the government-owned status of a SWF is established, the Ministers will

¹⁵⁷ ICA, Section 20; the factors include the effect of the investment on the level of economic activity in Canada; the degree and significance of participation by Canadians; the effect of the investment on productivity and industrial efficiency; the effect of the investment on competition within any industry in Canada; the compatibility of the investment with national industrial, economic and cultural policies; and the contribution of the investment to Canada's ability to compete in world markets.

¹⁵⁸ Similarly to the wide discretion the Ministers have in New Zealand under the OIA, especially where 'sensitive land' is involved.

¹⁵⁹ State Capitalism: Do We Need Controls, above note 4.

¹⁶⁰ Except when determining financial threshold according to WTO status. But given that as of July 2007, the WTO had 151 member states; the result is that most countries in the world benefit from the WTO investor status – including many of the home states of SWFs.

¹⁶¹ One of the factors for consideration under the ICA test for "net benefit"; though one would expect some statement to that effect may have been required.

¹⁶² The guidelines use the term 'SOEs' but the definition provided; "an enterprise that is owned or controlled directly or indirectly by a foreign government" includes any SWF.

¹⁶³ State Capitalism: Do We Need Controls?, above note 4

¹⁶⁴ Ibid

then determine whether the investment is of “net benefit to Canada”.¹⁶⁵ In addition to the pre-existing factors in the ICA, the Guidelines set out additional criteria that will allow for an examination of the corporate governance and reporting structure of the SWF as well as an inquiry into the extent to which the investment entity will operate on a commercial basis after the acquisition.¹⁶⁶

The Guidelines stipulate that the SWF will be judged against Canadian standards for corporate governance as well as all other laws and practices. In determining the extent to which the target company will operate on a commercial basis, consideration will be given to a number of factors including the ability of the SWF investor to determine export destination, process location and the participation of Canadians in its operations in Canada. The Guidelines encourage non-Canadian SWF investors to support their application by providing specific undertakings, including the employment of Canadians in senior management, the participation of Canadians in its operations in Canada; the appointment of Canadians to the board of Directors, incorporation of the business in Canada and listing of shares on a Canadian stock exchange.¹⁶⁷

3.4 Australia

In February 2008, the Australian government issued new guidelines that apply to all investments by foreign governments.¹⁶⁸ The guidelines complement the existing Foreign Acquisitions and Takeovers Act 1975 (FATA) by outlining six principles against which proposed investment by foreign government entities will be assessed. The timing of the release highlights Australia’s principal concern with SWFs – their role in the consolidation of the resource sector.¹⁶⁹

¹⁶⁵ ICA, above

¹⁶⁶ SOE Guidelines, above note 153

¹⁶⁷ SOE Guidelines, above note 153

¹⁶⁸ W. Swan, ‘Treasurer of the Commonwealth of Australia, 2008, ‘Government Improves Transparency of Foreign Investment Screening Process’, *Media Release 009 of the Treasury of the Commonwealth of Australia*, (17th February 2008)

¹⁶⁹ Chinese companies have been rapidly building their investments in Australia’s resource industry. The Chinalco investment in Rio Tinto is an example. D. Uren, ‘Swan reins in foreign investors’, *The Australian*, (18th February 2008)

3.4.1 Background: *Foreign Acquisitions and Takeovers Act 1975*

Various types of foreign investments into Australia are subject to FATA approval. Principally, any acquisition of a substantial interest¹⁷⁰ in an Australian business where the value of its gross assets is above A\$100 million requires prior approval.¹⁷¹ More significantly for the issue of SWF investment is that Australia's FATA has always required that any direct investment by foreign governments and their agencies irrespective of size, undergo the assessment and approval process.¹⁷² As such, Australia has had a statutory basis for considering SWF investments since prior to the recent SWF developments that seem to have triggered reactions elsewhere.

Broadly, under the FATA, the Treasurer may prohibit any investment that is deemed to be 'contrary to Australia's national interest'.¹⁷³ The Treasurer "determines what is contrary to the national interest by having regard to the widely held community concerns of Australia".¹⁷⁴ According to this description, these provisions constitute a "negative test". It follows that the onus is on the Australian government to find reasons to reject a proposed investment. When assessing foreign investments a number of industry sectors that are regarded as 'sensitive' require separate considerations and may have more onerous foreign ownership limits.¹⁷⁵

Despite the negative test, which is *prima facie* more easily satisfied by foreign investors than is the positive test imposed in Canada and New Zealand, there appears to be significant discretion available to the Treasurer. Unlike the Canadian and New Zealand regimes there is

¹⁷⁰ Foreign Acquisitions and Takeovers Act 1989, Section 9 and 9A; a 'substantial interest' is where a single foreigner (and any associates) has 15 per cent or more of the ownership of a corporation, business or trust. (and any associates) have 40 per cent or more in aggregate of the ownership of a corporation, business or trust.

¹⁷¹ There are a number of other types of investment that require prior approval, including proposals to establish a new business involving a total investment of \$A10 million; portfolio investments in the media of 5 per cent or more and all non-portfolio investments irrespective of size; takeovers of offshore companies whose Australian subsidiaries or gross assets exceed A\$200 million and represent less than 50 per cent of global assets; and various acquisitions of interests in Australian urban land.

¹⁷² In fact, the Australian Treasurer has made it clear that the new Guidelines "are consistent with the approach that has been put in place by the Foreign Investment Review Board and by previous governments" – W. Swan, 'Speech at a press conference at Waterfront Place, Brisbane' (17th February 2008), available online at <<http://assistant.treasurer.gov.au>>

¹⁷³ FATA, Section 18; this was the case prior to and after the release of the new Guidelines

¹⁷⁴ Australian Government, 'Summary of Australia's Foreign Investment Policy', Australian Treasury, (April 2008), [5], available at <www.firb.gov.au/content/_downloads/General_Policy_Summary.pdf>

¹⁷⁵ The list of sensitive sectors includes Australian urban land; banking; civil aviation; airports; shipping; media; and telecommunications. For example the *Airports Act 1996* stipulates a 49% foreign ownership limit.

no statutory definition of the criteria that are used in assessing a foreign investment in Australia. The guidance offered in the policy document is not anywhere near as comprehensive as the Investment Canada Act or the Overseas Investment Act 2005, which both offer an extensive list of relevant factors for consideration. However it must be said that despite the provision of factors for consideration, both the Canadian and New Zealand regimes have also remained extremely flexible.

3.4.2 Australian Guidelines on SWF Investment

The Australian guidelines were released following a number of significant events. In late 2007 a Treasury study called for multilateral action to impose standards that would stop investment funds owned by sovereign governments from buying a majority or controlling stake in foreign corporations.¹⁷⁶ The Australian regime has so far resisted temptations to go down this track and recent multi-lateral meetings suggest any such action is unlikely. Regardless, the study highlights the position in Australia that SWFs could cause “broadly based domestic concerns”.¹⁷⁷ Perhaps more crucial to the sudden announcement of the Guidelines was the eventually successful purchase by Chinalco (the Chinese state-owned mining company) of 11 per cent of the shares in Rio Tinto (the Anglo-Australian mining group). While the investment was never actually restricted there was significant concern within the government, industry and wider public about the prospect of Chinese government involvement in one of Australia’s flagship companies.¹⁷⁸

Regardless of what the actual reasons were, the Australian treasurer made it clear that the new Australian government intended to increase transparency and ensure any investment was consistent with national interest.¹⁷⁹ The new guidelines outline additional factors that are examined when the Foreign Investment Review Board (FIRB) and Treasurer assess any investment by a foreign government.¹⁸⁰ Firstly, the FIRB will have regard to whether the

¹⁷⁶ D. Uren, ‘Curb sovereign funds, warns Treasury’, *The Australian*, (18th December 2007)

¹⁷⁷ Ibid

¹⁷⁸ B. Clegg and J. Chessell, ‘Revealed: BHP Billiton’s bid to keep China at bay’, *The Australian Financial Review*, (17th March 2008)

¹⁷⁹ ‘Swan reins in foreign investors’, above note 169

¹⁸⁰ A foreign government investor is defined in the *Foreign Acquisition and Takeovers Regulations 1989* to cover any entity that is at least 15% controlled by a foreign government. The threshold is so low that it would make the US company ‘Nasdaq’ (the US stock exchange) a prescribed foreign government investor due to a 19% holding by a Dubai SOE.

investor's operations are independent from the relevant foreign government (whether the investor operates at "arm's length"). This allows the FIRB to consider whether the prospective governance arrangements could facilitate actual or potential control by a foreign government. Secondly, the commercial objectives of the investor will be examined by considering to what extent the investor is subject to and adheres to the law and observes common business behaviour. In the case of a SWF, the FIRB would also consider the fund's investment policy and how it proposes to exercise voting power. The remaining factors focus on the possible effects of the foreign government investment on competition; revenue; national security and the operations and directions of Australian businesses and the economy as a whole. This last factor allows for a consideration of any impact on imports, exports, local processing of materials, research and development and industrial relations.

Broadly, the principles address a number of the widespread concerns about foreign government investment highlighted at the beginning of the paper. While the guidelines are seen by some as valuable because they would only allow investments to be vetoed if they were breached, critics say they remain extremely vague.¹⁸¹ The publication of the areas the government looks at when faced with a foreign government investment will help potential investors and go some way to reigning in political decision making. However, transparency would be greatly improved if the FIRB was required to provide a detailed explanation for any veto, including the release of the Board's full advice.¹⁸²

3.5 Multilateral Efforts

Individual host governments have not been the only bodies to respond to the growth of SWFs. A number of multilateral economic institutions have also recognised the significance of increases in SWF activity.¹⁸³ Both the IMF and OECD have released discussion documents recognising the inherent difference of SWFs and warning that if SWFs continue to operate non-transparently there is a real risk that it could lead to protectionist reactions by

¹⁸¹ 'Swan reins in foreign investors' above note 169; particularly Melbourne Business School's Paul Kerin and Mallesons partner Tony Bancroft.

¹⁸² In much the same way that the OIO and relevant Ministers do under the Overseas Investment Act 2005 in New Zealand.

¹⁸³ The IMF, OECD, and International Center for Monetary and Banking Studies all released statements detailing the issues surrounding SWFs.

host governments.¹⁸⁴ Given their mandates of open markets and free capital movement the observation is not surprising.¹⁸⁵

Extensive research by individuals and multilateral institutions on issues surrounding SWFs,¹⁸⁶ has identified their non-transparent nature as the most crucial impediment to open investment and the most likely cause of protectionist reactions.¹⁸⁷ Most of the concerns outlined in chapter one are founded on the lack of disclosure and openness of many SWFs. Any concerns with objectives and investment strategies, corporate governance structure, government control and fund holdings would become less heated should SWFs make relevant information more available to host governments and their foreign investment review bodies. The IMF and OECD both support increased transparency as the preferred solution to the threat of a protectionist reaction.¹⁸⁸

3.5.1 Santiago Principles

The IMF has been particularly active; working with a newly formed International Working Group of Sovereign Wealth Funds (IWG)¹⁸⁹ on a proposed ‘voluntary code of conduct’ intended to increase the transparency of SWFs and reverse the current trends of host country response.¹⁹⁰ The OECD has recognised for example that many host governments have already taken ‘restrictive’ action in response to SWF activity.¹⁹¹

¹⁸⁴ SWFs – A Work Agenda, above note 15 and OECD, ‘Sovereign Wealth Funds and Recipient Country Policies’, *OECD – Investment Committee Report*, (4 April 2008)

¹⁸⁵ *Ibid*, p 2

¹⁸⁶ See broadly: A. Mattoo and A. Subramanian, ‘Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organisation’, *Peterson Institute for International Economics Working Paper* (January 2008); E. M. Truman, ‘Sovereign Wealth Funds: The Need for Greater Transparency and Accountability’, *Peterson Institute for International Economics Policy Brief*, (August 2007); S. Johnson, ‘The Rise of Sovereign Wealth Funds’, *IMF – Finance and Development Talk*, (September 2007); and P. M. Hildebrand ‘The Challenge of Sovereign Wealth Funds’, *International Center for Monetary and Banking Studies*, (18 December 2007).

¹⁸⁷ *IMF - A Work Agenda*, above note 15, [26] and ‘OECD Rules’, above note 3.

¹⁸⁸ *Ibid*

¹⁸⁹ IWG is a body representing 26 IMF member countries with Sovereign Wealth Funds, including such countries as China, Australia, Libya, Norway, Russia, the US, the United Arab Emirates, Abu Dhabi, Kuwait.

¹⁹⁰ Government reactions have primarily been to add additional conditions and requirements to the foreign investment regime where the investor is government controlled – see above discussion on the United States, Canada and Australia.

¹⁹¹ *Sovereign Wealth Funds and Recipient Country Policies*, above note 182; discusses primarily the use of national security type provisions as the major tool.

So far, work between the IWG and IMF has resulted in a recently drafted set of principles¹⁹², the *Generally Accepted Principles and Practices for Sovereign Wealth Funds* (GAPP), referred to as the ‘Santiago Principles’.¹⁹³ While the GAPP is only a preliminary agreement on a draft set of principles, the IWG expects to present it to the International Monetary and Financial Committee (IMFC)¹⁹⁴ at its next meeting and have it published shortly afterwards.¹⁹⁵ Despite its preliminary status, the ‘Santiago Principles’ clearly show that SWFs have seized the initiative in order to try to ease concerns in host countries.

The Santiago Principles are expected to cover a set of 24 principles intended to increase transparency of SWFs. Although the preliminary agreement has not been made publicly available, the IWG have confirmed that the principles will largely follow those set out earlier in 2008.¹⁹⁶ Assuming that is the case, they will cover the legal, institutional, and macroeconomic elements of each fund, its governance and accountability arrangements and investment policies and risk management.¹⁹⁷ It is considered that by describing the legal framework and the purpose of the SWF, host governments should become more familiar with the type of investors that they are facing. The planned governance and accountability arrangements should clarify the extent to which the fund operates at arms length from the relevant government owner, and the investment policies and risk management principles are intended to clear up concerns that SWFs may operate with non-commercial motives.¹⁹⁸ The Santiago Principles are also expected to recommend that SWFs avoid buying stakes in sensitive companies, such as Western defence contractors.¹⁹⁹

¹⁹² While the IMF preferred to describe the preliminary agreement as a ‘voluntary code of conduct’, the SWFs preferred to call them ‘principles’.

¹⁹³ The GAPP was developed during a meeting between the IWG, IMF and a number of host government representatives in Santiago, Chile on the 1st and 2nd of September 2008.

¹⁹⁴ The IMFC is the International Monetary Fund’s policy guiding committee

¹⁹⁵ IMF, 2008, ‘International Working Group of Sovereign Wealth Funds Reaches a Preliminary Agreement on Draft Set Generally Accepted Principles and Practice – “Santiago Principles”, *IMF Press Release: Number 08/04*, (2nd September 2008), hereafter ‘IMF Press Release – Santiago #1’; the next meeting of the IMFC is in Washington DC on 11 October 2008.

¹⁹⁶ Mr David Murray (Chairman of the IWG’s Drafting Group, and Chairman of Australia’s Future Fund Board of Guardians) stated that the principles will very closely resemble the IMF’s ‘SWFs – A Work Agenda’ (above note 12) released in February 2008; IMF, 2008, ‘Press Conference Call: International Working Group of Sovereign Wealth Funds’, *IMF: Transcript No. 08/01*, (2nd September 2008), Santiago, Chile, hereafter IMF Press Release, Santiago #2

¹⁹⁷ Ibid

¹⁹⁸ Ibid

¹⁹⁹ D. Robertson, ‘Sovereign wealth funds develop guidelines for behaviour’, *The Times*, (4th September 2008)

While much praise is being heaped on the IWG for their proactive efforts there is concern that the Santiago Principles will not be sufficient to dispel western governments' concerns. The principles agreed in Santiago are perhaps more notable for what is excluded. There will be no requirement on funds to reveal their size, investment holdings, what companies they are bidding for or how they vote on company resolutions.²⁰⁰ Given that a lack of transparency is one of the primary concerns of Western governments, the guidelines may do little to alter perceptions of SWFs as secretive market manipulators. A further issue with the Santiago Principles is that they are only a voluntary framework²⁰¹ and they contain no enforcement or monitoring provisions.²⁰² The primary reason for the lack of enforcement power is that the funds did not see any need for a 'policeman' and they did not want to be put at a disadvantage with other market competitors.²⁰³

Any real judgement of the principles must await publication. Although they show SWFs as keen to improve their image in the global marketplace it would be unlikely if western governments seriously relied on the principles to bring about complete disclosure. A more likely result is that once all the funds' home governments have signed up to the principles, any participating SWFs will be measured against those principles. The principles will therefore provide a benchmark for host governments and market participants to judge funds against each other and other investors. Any further role may only be possible where there are serious enforcement and monitoring provisions that would be capable of identifying and controlling a rogue SWF.

²⁰⁰ Ibid

²⁰¹ IMF Press Release – Santiago #1, above note 195

²⁰² IMF Press Release – Santiago #2, above note 196, [7th question from the end]

²⁰³ Financial Times, 'A bid for trust', *Financial Times*, (5th September 2008)

Chapter 4:

Possible Alterations to New Zealand's Regime

The current framework for overseas investment in New Zealand does not specifically identify foreign government control as a factor for consideration. If this reflected a conscious decision to treat SWFs along the same lines as foreign private investors there would be no immediate issue. However, it would always remain possible for a government to change this policy on SWFs. While the government has so far not indicated a desire to treat SWFs differently, reactions overseas both at the foreign government and multilateral level, would suggest there may be substantial public pressure to consider further factors when faced with SWF investment. Both multilateral institutions and foreign jurisdictions have identified significant inherent differences between SWF and private foreign investment. These differences and a number of legitimate concerns have led major jurisdictions to amend their foreign investment regimes to ensure they are prepared for an accurate assessment of the merit of any SWF investment.

A regime that openly allows for the consideration of the different issues that accompany SWF investment limits the possibility of arbitrary and unclear decision making. While the current regime fails to recognise the inherent differences associated with SWFs, it is hard to believe that the nature of SWFs as foreign government controlled will not be considered by the Ministers in the application process. Broadly, whether identified as a factor for consideration by the OIA or not, there are factors that will end up being considered in an overseas investment application by a SWF. The level of transparency, the possibility of non-commercial motives and possible effects on market stability are some examples. It would be more beneficial to New Zealand in terms of its ability to attract investment and maintain a generally positive reputation in international circles if any SWF investment was considered openly.

4.1 Policy Decisions

The biggest obstacle to a foreign investment regime that allows for a clear and transparent consideration of any SWF investment is the impossibility of separating politics from major investment decisions. The differences associated with SWFs and the widespread concerns they raise only compound the likelihood of political involvement. Governments will always want to maintain flexibility in the regime so that they can retain some element of control over the whole process. If New Zealand is serious about attracting quality foreign investment it cannot afford to have its government put its own short term electoral interests ahead of the country's long term economic interests. Under this premise there are a number of changes that can be made to better equip New Zealand to both prepare for and take advantage of SWF investment.

4.2 Possible Alterations

Two major alterations to New Zealand's foreign investment regime should be considered in an effort to deal with SWF investment.

The first relates to the removal of some of the significant amount of flexibility in the regime which affects all foreign investment into New Zealand, not only that by SWFs. The current regime may be neither objective nor clear enough to take full advantage of the benefits that accompany increased foreign investment. This can be remedied by making the relevant 'tests', specifically the 'benefit to New Zealand test', more objective and predictable. Further, the recently introduced regulation should either be removed immediately or, at worst, accompanied by clear guidance.

The second alteration required is the introduction of a list of factors that must be considered in any overseas investment application by a SWF. This should be in a similar form to the guidelines produced by Canada and Australia. Only then will the OIO and Ministers legally and openly be able to consider the kinds of factors that would inevitably creep into consideration anyway.

4.2.1 Removal of Flexibility

While it is understandable that some flexibility will always be maintained in the overseas investment regime, there is currently too much political involvement and influence in the process. The manner in which the OIA can be hijacked by political interests has already been developed above.²⁰⁴ The ‘benefit to New Zealand test’ that must be satisfied before any investment in sensitive land is permitted lacks objectivity. As was seen in the AIAL application, the factors available for consideration are so broad and vague that almost any conclusion is made possible. The danger with such a flexible test is that politically motivated end results can be achieved by manipulating the loose test. The fact that there is no statutory weighting of the long list of factors adds a further confusion. It appears that the Ministers can develop any weighting system that suits their desired outcome. Further, while the Ministers often release reports explaining their decisions, they tend to be relatively vague.

Unfortunately however this issue is not easily remedied. New Zealand’s OIA is already more objective than Australia’s comparative FATA which fails to even provide a list of factors for consideration in an investment approval process. However, some form of guidance on the weighting of the different factors in the ‘benefit New Zealand’ test would be beneficial and possible. At present there is no indication that any one factor is more significant than any other. Some form of indication as to the relative importance of each factor would provide potential overseas investors with greater guidance, making the decision to invest in New Zealand less risky. Despite the broad nature of the factors for consideration, there would be clear benefits in the Ministers providing more extensive reports on their decisions, especially in the case of major and novel investments.

While it is understandable that a government will not want to give up its entire ability to intervene in the overseas investment process, the introduction of the new regulation was far more intervention than can be justified. The new regulation has added immense confusion and flexibility to the overseas investment regime and represents an impediment to attracting future foreign investment, especially that of SWFs who are primarily interested in the major assets the regulation may deal with. Under the regulation’s current construction, it appears to

²⁰⁴ See: Chapter 2.4 above

give the government complete control over any investment in a major New Zealand asset. While the government will inevitably always retain significant control, more contentious is that the regulation increases the likelihood of arbitrary decision-making. It has already been seen in the AIAL application that the regulation is confusing and arguably impossible to satisfy without the imposition of extensive conditions by the Ministers.

One response would be simply to remove the regulation from the list of factors that must be considered in an overseas investment application. Removal would leave all foreign investors, including SWFs, in a clearer position.²⁰⁵ If not removed, the obvious alternative would be to provide some guidance that might make possible an accurate interpretation of the regulation. As already discussed, there are a number of elements of the regulation that require clarification. Any guidance should provide a list of assets that amount to ‘strategically sensitive infrastructure’. Given that the Finance Minister has already assured the market and investors that the regulation is intended only for a very narrow class of assets, surely it would not be difficult to list those it applies to. A major difficulty would be determining which assets might be politically too sensitive to leave off the list. Retaining an undefined term in a regulation for short term domestic political interests is not going to serve New Zealand’s long term interests of being perceived as an open market. Further, guidance should be given as to how exactly an overseas investor can purchase a share of a ‘strategically sensitive infrastructure’ asset from a New Zealand investor and at the same time “assist New Zealand to maintain New Zealand control” of the asset. If there are any undertakings that will allow the regulation to be satisfied they should be made public.²⁰⁶

Obviously any decision to limit the flexibility offered by the regime and therefore the potential for government intervention is a political one. The current government has shown no signs of removing itself from the process and has seen political benefits in not doing so.²⁰⁷ Should a future government decide to increase the objectivity of the OIA and remove

²⁰⁵ Regulations Review Committee Report, above note 58, the committee criticised the new regulation introduced amidst the AIAL investment application, and recommended that the government take steps to ensure that legislation does not allow regulations to be made that add extra factors or criteria to those listed in legislation, that must be taken into account in ministerial decision making. See also: ‘Overseas Investment Regulations Criticised’, Otago Daily Times [Online Edition], 1 October 2008.

²⁰⁶ CPPIB was unable to come up with self imposed conditions that would allow it to satisfy the regulation.

²⁰⁷ Many considered improvement in Labour’s political poll performances as attributable to the Government’s action in helping to restrict investment in AIAL.

some of the potential for arbitrary political involvement, they would enable the New Zealand regime to become more predictable for overseas investors.

4.2.2 SWF Factors for Consideration

The second major alteration concerns the need for New Zealand's overseas investment regime to allow for the consideration of factors relevant to SWF investment. Currently it does not, opening up a number of potential problems. Firstly, given that the OIA doesn't allow for it, any decision that explicitly takes into account the foreign government owned status of a SWF may be subject to judicial review. Secondly, where the nature of the SWF is taken into account regardless of the threat of judicial review, any resulting decisions will appear arbitrary and risk damaging the potential for further investment by SWFs. End results could appear arbitrary as there is the danger they will be reached by manipulating the flexible considerations and factors allowed for in the OIA. SWFs are far less likely to attempt investment in New Zealand if the application process involves a substantial lack of clarity and openness.

Actions by the United States, Canada, and Australia in response to increased SWF activity have already been discussed above. All three jurisdictions now recognise the inherent difference between SWF and other investment and have provided for separate considerations. It is worth considering whether any of these models might be suitable for New Zealand.

While the United States' new legislation is relevant in that it provides further evidence of the significance of SWF investment, its preoccupation with 'national security' issues and a very different assessment process makes it an unsuitable model for New Zealand. New Zealand has so far seen no need to introduce a 'national security' provision into its OIA and to do so now would make the regime even more open to political considerations without identifying any of the specific issues associated with SWF investment.

Perhaps more appropriate would be the adoption of an Australian / Canadian "style" approach. Both have recently introduced guidelines that provide additional factors that must now be considered alongside their respective foreign investment legislation when the

proposed investment involves a SWF. Broadly, the guidelines now require the respective decision makers to consider such factors as the extent of government control of the SWF, the commercial objectives and investment policy of the SWF, as well as levels of disclosure and transparency.²⁰⁸

While the Australian and Canadian guidelines may not provide an overly objective mechanism for considering SWFs, they do ensure that any assessment is made in relation to pre-determined factors and in a more open and predictable fashion. Much of the criticism in Australia surrounding the new guidelines is compounded by the fact the FATA requires no publication of reasoning for decisions. Because SWFs vary in nature so significantly it will undoubtedly be difficult to introduce very objective criteria against which to judge them. More crucial perhaps would be to provide even more extensive and descriptive reports on decision making than is currently the case. Another possibility would be to make use of considerable multilateral efforts in the area. The proposed Chilean Principles discussed above could provide a useful standard against which to judge whether specific SWFs are operating transparently.

In this sense, the New Zealand government should consider an addition to the Overseas Investment Regulations 2005 that would require certain considerations to be taken into account, along the same lines as Australia and Canada, when a SWF investor is involved.²⁰⁹ Significantly, given the way the regime is currently framed, any new regulation would only deal with investments in 'sensitive land' where the 'benefit test' is involved. Any assessment by the Minister of an overseas investment by a SWF involving a 'significant business asset' that was not on 'sensitive land' would not be permitted to include considerations outlined in the regulations. The regulations are only applicable where sensitive land is involved.

²⁰⁸ The Australian Guidelines also provide for the consideration of 'national security' implications without any narrow definition. If New Zealand adopted such an approach it would be beneficial to define the term narrowly and direct it principally towards terrorist and national defence related issues as has been done in GATT 1947, above note 31

²⁰⁹ An addition to Regulation 28 of the Overseas Investment Regulations 2005 would require consideration by the Ministers.

4.2.3 Sensitive Land Distinction

It follows that should the government want the Ministers to be allowed to consider such factors in the case of ‘significant business assets’ not on ‘sensitive land’ there would need to be new legislation.²¹⁰ If there is going to be new legislation it may be worth contemplating a complete revamp of the structure of OIA. There appear to be a number of legitimate justifications or removing the ‘sensitive land’ distinction entirely. It appears that the ‘catch all nature’ of the term has left a number of explicitly commercial assets subject to a test developed to ensure that New Zealand’s land was developed in the country’s best interest. There now seems to be no coherent rationale for putting so much emphasis and importance on the type of land involved, particularly where the land has already been extensively developed.²¹¹ As such it would seem appropriate to discard the distinction between ‘sensitive land’ and ‘significant business assets’, at least where developed land with a significant business asset is involved, and instead adopt a standard test that is more in line with foreign investment regimes elsewhere. There is no reason why there cannot remain a ‘sensitive land’ test that relates solely to undeveloped rural land. Obviously, the structure of any new regime would have to be considered in far greater depth than is possible here.

²¹⁰ This reinforces the uncertainty that the distinction between ‘sensitive land’ and ‘non-sensitive’ land has produced. The way the OIA has been designed makes it impossible to alter the regime relating to ‘significant business assets’ without legislative change.

²¹¹ F. O’Sullivan, above note 118, recognises it to be a problem that the current rules require the OIO and the Ministers to assess [the AIAL] application against criteria that were initially devised for examining offshore bids to buy up farms and headlands which butt up against lakes, rivers and the foreshore and seabed.

Conclusion

It is only a matter of time before a SWF attempts to invest in a major New Zealand asset.²¹² If New Zealand is to benefit from any such attention it is imperative that it fronts up with a clear and coherent foreign investment regime that will openly consider the merits of the investment. Presently, New Zealand is not able to produce such a regime.

The current OIA does not allow for the Ministers to distinguish between ‘foreign private’ and ‘foreign government’ investors. Accordingly, none of the major concerns, that other jurisdictions and multilateral institutions have endorsed, are able to be considered. Nevertheless, there is a proven danger that the Ministers may yet take some of these concerns and factors into account, either expressly or by manipulating the flexibility inherent in the regime. Doing so may not only raise the possibility of ‘judicial review’ issues but will seriously threaten all future investment by SWFs in New Zealand.

The New Zealand government must address the problem before it is too late. The regime, as it is currently framed, allows for far too much political involvement at the later stages of an investment application. The flexibility of the OIA must be reduced. The first step in the process would be the removal of the most recent regulation. Perhaps more importantly in the case of SWF investment is the need to provide the Ministers with some mechanism which will permit them to consider factors specific to foreign government controlled investment. Attempts have been made overseas which will prove to be useful models. However, the United States, Canadian and Australian alterations have all been made in response to a proposed investment and have all been made quickly. New Zealand should do everything it can to avoid a similar rushed reaction. While other larger countries may be able to get by with an imperfect regime, New Zealand does not have that luxury. New Zealand’s small size and fewer investment opportunities require a more open and more certain investment regime that will attract quality foreign investment. In the case of SWF investment especially, should the first instance result in an arbitrary and unclear response, there is the real danger that it may also be the last.

²¹² There have already been attempts by Dubai’s ‘Dubai Aerospace’ to invest in AIAL and the State Grid Corporation in the Wellington Electricity Network, though neither reached the OIO approval stage.

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