8

Chinese State-Owned Enterprises and International Investment Law

Ming Du

I. Introduction

Despite three decades of extensive state reform and privatisation, recent empirical research shows that state-owned, state-controlled or otherwise state-influenced enterprises and sovereign wealth funds remain an important economic force in the global economy. They are increasingly competing with private firms in global markets for market shares, resources, ideas and intermediate inputs.[1] More recently, in response to the Covid-19 crisis, governments have taken a vast array of measures to support the business sector. In some cases, rescue packages include the acquisition of equity stakes in companies in financial distress, increasing the number and presence of state-owned multinational enterprises (SOEs) to about 1,600 in the global economy in 2020.[2]

SOEs hold a prominent position in China's socialist market economy system.[3] Even market-oriented reforms have enabled China's GDP to grow at an average rate of 9.5 per cent per year over the past 30 years and led to a rapid expansion of the private sector in China, there are still more than 150,000 SOEs in China today and they contributed to 28

---

[1] P Kowalski and K Perepechay, 'International Trade and Investment by State Enterprises', OECD Trade Policy Papers No 184 (OECD Publishing, 2015) 7.

[2] UNCTAD, World Investment Report 2021: Investing in Sustainable Economy (2021) 28.

[3] There is no uniform definition of SOEs. The OECD defines it as 'any corporate entity recognized by national law as an enterprise, and in which the state exercises ownership'. Ownership is defined in terms of control, either by the state holding full or majority of voting shares or otherwise exercising an equivalent degree of control. See OECD, *Guidelines on Corporate Governance of State-Owned Enterprises* (2015 edn) 14–15.

per cent of China's GDP and 16 per cent of employment in 2017.[4] In 2021, 143 Chinese firms appeared on the list of Fortune Global 500, among which 82 were SOEs.[5] It is undisputable that SOEs are, and will be, a hallmark of China's socialist market economy model, rather than a transitional phenomenon leading to liberal capitalism as many critics of SOEs had expected.[6]

Chinese SOEs not only play a key role in Chinese domestic economy, they are also a major force in implementing the Chinese Government's ambitious Belt and Road Initiative (BRI) and 'Made in China 2025' industrial policies, both reinforcing the earlier 'Go Global' strategy adopted in 2000. In 2020, global FDI fell by 42 per cent whilst China's outbound foreign direct investment (OFDI) posted a year-on-year increase of 3.3 per cent, reaching US$130 billion.[7] UNCTAD ranked China third in the world in terms of OFDI in 2020, after the US and Japan.[8] This steady growth trend is expected to continue as Chinese companies increasingly realise that overseas investment is an effective strategy for them to upgrade, transform and become more competitive. Earlier statistics showed that at least 80 per cent of all Chinese OFDI has been funded by SOEs.[9] With the growing strength of Chinese private enterprises, however, a smaller proportion of China's increasing OFDI is coming from SOEs. Still, evidence shows that of 650 Chinese investments in Europe since 2010, roughly 40 per cent have moderate to high involvement by state-owned or state-

---

[4] C Zhang, 'How Much Do State-owned Enterprises Contribute to China's GDP and Employment?' The World Bank Working Paper (15 July 2019).

[5] fortune.com/global500/2021/search/?fg500_country=China.

[6] A Gabriele, 'The Role of the State in China's Industrial Development: A Reassessment' (2010) 52(2) *Comparative Economic Studies* 325, 348.

[7] Chinese Ministry of Commerce, Regular Press Conference (24 January 2021), www.mofcom.gov.cn/xwfbh/20210121.shtml.

[8] UNCTAD, 'World Investment Report 2020: International Production beyond the Pandemic' (2020) 15.

[9] A Wooldridge, 'The Visible Hand', *The Economist* (January 2012) 15.

controlled companies.[10] As of October 2018, Chinese SOEs contracted about half of BRI projects by number and more than 70 per cent by project value.[11]

The purpose of this chapter is to critically analyse how international investment law responds to the challenges brought about by the rise of China's SOEs in the global economy. This article is organised as follows. Section II provides an overview of China SOE reforms since former Chinese paramount leader Deng Xiaoping's historical southern tour in 1992 until today, showing how the Chinese Government has implemented drastic reform measures to make SOEs competitive market players, while retaining effective control to ensure that they follow the political line of the Chinese Communist Party (CCP). Section III explains why Chinese SOEs bring about unique regulatory concerns to host countries. Section IV explores the standing of Chinese SOEs before investor-state dispute settlement (ISDS) and the problems associated with national security mechanisms to screen Chinese SOEs' investments. Section V concludes the chapter.

II. Untangle the Net: Chinese SOEs and the Chinese Party-State

A. China's SOE Reforms

China has practiced state capitalism for many years, but its form, function and implications have changed dramatically over the past decade.[12] To grasp the complexity of China's state capitalism, it is essential to understand China's economic and institutional transformation from a socialist planned economy to a socialist market economy. This transformation was

[10] D Michaels, 'Behind China's Decade of European Deals, State Investors Evade Notice', *Wall Street Journal* (30 May 2020).

[11] R Dossani et al, 'Demystifying the Belt and Road Initiative', Rand Working Paper WR-1338 (May 2020) 13–15.

[12] M Du, 'China's State Capitalism and World Trade Law' (2014) 63 *International and Comparative Law Quarterly* 409, 413–426.

deemed to be necessary to reduce economic losses, increase economic growth and raise living standards, from which the CPP derives its governing legitimacy.[13]

The reform of Chinese SOEs lied at the centre of this grand economic transformation. How Chinese SOEs have been reformed from basically production units in the early 1980s to largely autonomous profit-seeking corporations today was extensively addressed in the literature.[14] In brief, after some experiments in the 1980s, SOE reforms after the historic southern tour of Former Chinese paramount leader Deng Xiaoping in 1992 have gone through several distinct stages. At the first stage, SOEs were required to be modern enterprises characterised by 'clear property rights, well-defined power and responsibility, separation of enterprise from government, and scientific management'.[15] In practice, corporatizstion was seen as a means of achieving this reform goal. The first general Chinese Company Law was enacted to provide for the incorporation of SOEs in 1994. Thereafter, newly incorporated SOEs proliferated all over the country. Along with corporatisation, central to SOE reforms in the 1990s was the policy of 'nurturing the large and letting the small go', a reference to the policy of concentrating the government's resources and control on the larger SOEs in strategic sectors, while relaxing state control over smaller SOEs and retreating from labour-intensive competitive sectors.[16] After this round of reform, the SOEs were streamlined and their advantageous position was further reinforced in the upstream and strategic industries.

---

[13] J Wang, 'The Political Logic of Corporate Governance in China's State-owned Enterprises' (2014) 47 *Cornell International Law Journal* 631, 637.

[14] B Naughton and KS Tsai (eds), *State Capitalism, Institutional Adaptation and the Chinese Miracle* (Cambridge, Cambridge University Press, 2015).

[15] Decision on Issues Regarding the Establishment of a Socialist Market Economic System, para 1(2) finance.ifeng.com/opinion/jjsh/20090906/1199906.shtml.

[16] M Mattlin, 'Chinese Strategic State-Owned Enterprises and Ownership Control' (2010) 4(6) BICCS Asia Paper 8.

The second phase of SOE reforms started in 2003 and focused on reforming property rights and corporate governance in large SOEs. Chinese company law and securities law were revised to achieve more congruence between Chinese law and practice and that of countries with more developed capital markets.[17] One key reform was the establishment of the State Assets Supervision and Administration Commission (SASAC), a quasi-governmental, ministerial level agency operating directly under the State Council, to oversee the management of the SOEs. The SASAC was primarily designed to fulfil the state's ownership function, combining the administrative functions previously carried out by various government agencies. The SASAC is recognised as an 'investor' and assigned the legal rights and duties of a shareholder, holding SOE shares on behalf of the state.[18] As an investor, the SASAC enjoys an owner's equity rights and assumes legal liabilities under Chinese Company Law but it does not intervene directly in SOE operations, so that the ownership rights are separated from those of management.[19]

The establishment of the SASAC contains both centralising and decentralising features. On the one hand, the principle of local control over local SOEs was clarified and institutionalised by clearly separating central, provincial and municipal SOEs and handing control over them to SASAC offices at respective jurisdictional levels. On the other hand, the SASAC serves as a unitary holding company for those key central SOEs that have been selected by the government to be China's national champions and future top global companies. When the SASAC was established in 2003, 196 central SOEs were under its oversight. The number was reduced to 96 by June 2021.[20]

---

[17] J Feinerman, 'New Hope of Corporate Governance in China?' [2007] *The China Quarterly* 590–612.

[18] Chapter 2 of PRC Law on State-owned Assets of Enterprises.

[19] B Chiu and M Lewis, *Reforming China's State-Owned Enterprises and Banks* (Cheltenham, Edward Elgar Publishing, 2006) 61.

[20] www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html.

The SASAC has a broad mandate that includes drafting laws and regulations regarding state-owned assets, managing and restructuring state assets so that their value develops positively, hiring and firing executives of SOEs under its supervision and pushing forward further reforms of SOEs.[21] Though there have been doubts over whether the SASAC is always able to exercise its authority effectively, the SASAC is a very powerful state agency and since its establishment the SASAC has been pushing forward SOE reforms aggressively.[22] As the 'the world largest controlling shareholder'[23], the SASAC set out a major policy of promoting the concentration of state-owned capital in key fields and enhancing the controlling power of the state-owned economy.

The third stage of SOE reforms have started from the convention of the 18th CPC Congress in November 2012 until now. In this 'Xi Jinping era', the Chinese central authorities have brought unprecedented momentum to reform Chinese SOEs. The core document guiding the overhaul of SOEs, *The Guideline to Deepen Reforms of SOEs*, was issued by the CCP Central Committee and the State Council in 2015. This key policy document (the 'One') is supplemented by a wide range of supporting policies (the 'N'). The comprehensive and thorough Chinese SOE reform has been guided by the 'One Plus N' policy framework.

Based on this overall guidance, Chinese SOEs are classified as commercial SOEs and public service SOEs. Commercial SOEs should stick to commercial operations and aim to increase state-owned assets, while public service SOEs exist to improve people's quality of life and provide public goods and services. Commercial SOEs are further divided into perfect competitive sectors and strategic sectors (ie, key industries related to national security and national economic lifelines). Accordingly, different reform measures, growth

---

[21] SASAC, 'Main Functions and Responsibilities of SASAC', www.sasac.gov.cn/n1180/n3123702/n3123717/n3162319/index.html.

[22] C Walter and F Howie, *Red Capitalism* (Chichester, John Wiley & Sons Ltd, 2012)189–191.

[23] Boston Consulting Group, 'SASAC: China's Megashareholder' (2007) www.bcgperspectives.com/content/articles/globalization_strategy_sasac_chinas_megashareholder/.

strategies, regulations, and evaluations are outlined based on this more sophisticated classification of SOEs.[24]

One salient feature of the 'One Plus N' policy framework is that it aims at strengthening the leadership of the CCP in SOEs. For example, SOEs were mandated to incorporate the CPC's leadership role into their Articles of Association. The board of directors also must hear the opinions of the party committee of the company before deciding on important issues. A cross-appointment system for SOE party commitment members to be directors and senior officers was introduced to ensure that party officials hold all key positions and decision-making power. The campaign to insert the CCP into all levels of organisation and decision-making is further institutionalised in *the Trial Regulation on the Work at Primary-Level Party Organization of SOEs* issued by the CCP Central Committee in December 2019.[25] All these measures have closed the gap between SOE boardrooms and the CCP's strategic goals.[26] Other key reform measures during the third stage include the establishment of a mixed ownership structure in SOEs; organisation of state-owned capital investment and operation companies; consolidation of the state-owned SOEs to make them 'stronger, bigger and better', and upgrading corporate governance standards in SOEs in order to entrench their commercial orientation.[27]

As mighty leviathans of the Chinese planned economy, Chinese SOEs were long depicted as 'industrial dinosaurs', 'muscle-bound goons' or the 'relics of a failed economic

---

[24] Notice of the SASAC, the Ministry of Finance, and the National Development and Reform Commission on Issuing the Guiding Opinion on Functional Definition and Classification of SOEs (No 170 [2015] of the SASAC (7 December 2015).

[25] CCP Central Committee, The Trial Regulation on the Work at Primary-Level Party Organization of SOEs (30 December 2019).

[26] J Blanchette, 'From 'China Inc.' to 'CCP Inc.': A New Paradigm for Chinese State Capitalism', 66 China Leadership Monitor (1 December 2020) 7.

[27] J Wang and T Cheng-Han, 'Mixed Ownership Reform and Corporate Governance in China's State-Owned Enterprises' (2020) 53 *Vanderbilt Journal of Transnational Law* 1055, 1089–1099.

experiment', and characterised as possessing a lack of managerial flair, little concern for profit, low employee motivation and mobility and a tendency to maximise corporate size.[28] After the extensive reforms of the past three decades, it is unrealistic today to uphold the simplistic and pessimistic view of Chinese SOEs as industrial and commercial dinosaurs fit only for dismemberment or bankruptcy. Modern corporate governance systems have been established in Chinese SOEs, some of which can rival the best private companies in the world. Chinese SOEs have evolved into major actors in international trade, foreign direct investment and international capital markets, and formidable competitors of firms around the world.[29]

B. SOEs and the Chinese Party-State

One core task of SOE reforms in China is the separation of government functions from enterprise management. Following the reforms, government officials are asked not to intervene in the day to day business operations of SOEs.[30] Nevertheless, the management of Chinese SOEs continues to be heavily influenced by politics and policy considerations. To understand the behavioural logic of Chinese SOEs in both national and international markets, it is enlightening to look at how the Chinese party-state exercises central authority on Chinese SOEs.

One important channel for the CCP to ensure their control over SOEs is by virtue of its power to appoint, evaluate and remove SOEs' top management.[31] The leaders of

---

[28] J Hassard et al., 'China's State-owned Enterprises: Economic Reform and Organizational Restructuring' (2010) 23(5) *Journal of Organizational Change Management* 501.

[29] Li-wen Lin, 'A Network Anatomy of Chinese State-owned Enterprises' (2017) 16(4) *World Trade Review* 583, 593.

[30] W Li and L Putterman, 'Reforming Chinese SOEs: An Overview' (2008) 50 *Comparative Economic Studies* 353–380.

[31] R McGregor, *The Party: The Secret World of China's Communist Rulers* (London, Penguin Books, 2011)

SOEs are appointed in accordance with a highly institutionalised cadre management system to ensure the principle of 'absolute control of the (SOE) executives by the party (CCP)'.[32] In practice the executives of Chinese SOEs face two sets of incentives in promoting their career. On the one hand, they want the SOEs they manage to be profitable because their evaluation will be partly based on the financial performance of the enterprises they manage. On the other hand, their career successes are ultimately determined by the CCP which is more concerned with how well the executives carry out the goals of the state. A top SOE executive judged unresponsive to such direction risks not being promoted or even demoted, even if the SOE performs well financially. These dual criteria for evaluating SOE top executives – to deliver profits and serve the government – usually align. However, when financial and state goals are in conflict, the incentives SOE executives face tend to push them to choose state interests over financial interests of the company and other non-state shareholders.[33] Multiple researchers have revealed that the goals of the state are dominant in SOE executives' decision-making processes.[34] Another key mechanism for the CCP to exercise its authority over SOEs is by institutionalising party committees' leadership role in SOE corporate governance.[35] As in described in section II.A above, the party committee now serves a 'leadership core' function as well as a 'political core' function in SOEs. The party committee also has authority to participate in major decisions involving SOEs' operations, personnel affairs, investment, and spending.

49.

[32] X Jinping, 'Upholding the Party Leadership over SOEs Unwaveringly', *People's Daily* (12 October 2016).

[33] A Szamosszegi and C Kyle, 'An Analysis of State-owned Enterprises and State Capitalism in China', Report to U.S. - China Economic and Security Review Commission (2011) 79.

[34] Y Ruilong et al, 'The Promotion Mechanim of 'Quasi-officials': Evidence from Chinese Central Enterprises' (2013) 3 *Management World* 23–33.

[35] W Leutert, 'Firm Control: Governing the State-owned Economy under Xi Jinping' (2018) 27 *China Perspectives* 30–32.

The recentralisation of the CCP authority over SOEs since 2012 has sent potentially conflicting messages concerning the development of China's SOE reform. China needs to maintain the momentum of its economic development as a crucial support for its legitimacy and stability against the new normal of the market slowdown. Given their pivotal role in the national economy, SOEs are expected to perform well financially. Indeed, Xi Jinping stated that the criteria for measuring the success of SOE reform should be 'the value increase in state capital, improvement of the state sector's competitiveness, and expansion of state capital control'.[36] Precisely for the purpose of increasing economic efficiency, China's SOE reform was premised on the separation of the CCP's political functions from SOEs' business management. However, the more recent emphasis of the party leadership as a core element of corporate governance clearly demonstrates a significant change of the conventional thinking of Chinese SOE reform. Consequently, the principle of party leadership, which inevitably assigns much greater weight to safeguarding the party-state's interests, requires SOEs to follow the party's political line rather than to the principle of corporate governance such as maximising shareholder value in case there is a conflict.[37]

The fact that Chinese governmental policies have a significant influence on Chinese SOEs' overseas acquisitions is borne out by empirical findings. Before the introduction of the BRI in 2013, Chinese acquirers were less likely to pursue targets in BRI countries. By contrast, the BRI has a material impact on the location choice of cross-border M&As by Chinese SOEs. Similarly, targets in industries identified by Made in China 2025 policy become significantly more likely to be purchased by Chinese SOEs after the policy was introduced in 2015. [38]

---

[36] Xi, above n 32.

[37] X Zhang, 'Integration of CCP Leadership with Corporate Governance: Leading Role or Dismemberment?' (2019) 55 *China Perspectives* 58–61.

[38] C Fuest et al, 'What Drives Chinese Overseas M&A Investment? Evidence from Micro Data' (2022) 30 *Review of International Economics* 306, 322.

III. The Challenges of Chinese SOEs to International Investment Law

The meteoric rise of OFDI by Chinese SOEs presents to host countries a vexing policy dilemma. On the one hand, the influx of foreign capital would bring much-needed new capital and job growth that would have positive economic and political ramifications to host countries. On the other hand, due to their political ties with the Chinse Government and concentration in strategic sectors, Chinese SOEs' investment can raise some genuine concerns about national security, fair competition, reciprocity and even the function of free market at home.

A. Levelling the Playing Field

As part of the scheme to support the 'Go Global' strategy, the Chinese Government has offered a range of financial and non-financial incentives to encourage the overseas expansion of Chinese enterprises and particularly SOEs. The financial support takes a number of different forms, including access to loans below market rates, government special funds, direct capital contribution and subsidies associated with the official aid programs.[39] The funds may come either from government ministries such as Ministry of Finance (MOF) and National Development and Reform Commission (NDRC), China's policy banks, such as the China Development Bank (CDB) and the China Export and Import Bank (Exim Bank), or even state-owned commercial banks.[40]

These government-bestowed benefits have raised concerns that SOEs may cause market distortions in host countries. Indeed, much of the public criticism of Chinese SOEs'

[39] OECD, Foreign Government- Controlled Investors and Recipient Country Investment Policies: A Scoping Paper (2009) 90.

[40] E Downs, *China's Superbank: Debt, Oil and Influence, How China Development Bank is Re-writing the Rules of Global Finance* (Hoboken, John Wily & Sons, 2013) 25–27.

takeover bids has focused on the perception that these bids were facilitated by the subsidised financing from the Chinese Government.[41] For example, the NDRC and the Exim Bank jointly announced in 2004 that the Exim Bank would earmark a portion of its budget for OFDI projects supported by the Chinese Government with at least a two per cent interest rate discount and possibly other preferential lending terms. The MOF would cover the gap between the actual market rate and the subsidised rate offered by the Exim Bank.[42] In its bid for Unocal in 2005, China National Offshore Oil Corporation (CNOOC) borrowed US$6 billion from the Industrial and Commercial Bank of China, a Chinese state-owned commercial bank. Another US$7 billion came in the form of subsidised loans from CNOOC's government-owned parent company. For the US$7 billion loan, US$2.5 billion was interest-free for two years with the potential to remain that way for up to 30 years; interest on the remaining US$4.5 billion could be waived by the parent company in the event that CNOOC's credit rating dropped below investment grade.[43] Similarly, investments in the BRI are largely financed by China's state-owned banks.[44] Vale Columbia Center on Sustainable International Investment

Empirical research shows that Chinese SOEs' overseas acquisitions have several unique features compared to Chinese private investors. First, while there are fewer acquisitions by Chinese SOEs, they tend to conduct larger deals and predominantly engage in full or majority acquisitions. Second, Chinese private investors tend to invest in countries where the currency depreciates against the RMB, but the reverse holds true for Chinese

---

[41] DN Fagan, 'The U.S. Regulatory and Institutional Framework for FDI', *Investing in the United States: A Reference Series for Chinese Investors* (Vale Columbia Centre on Sustainable International Investment, Vol 2, 2008) 19.

[42] NDRC and Exim Bank, Circular on the Supportive Credit Policy on Key Overseas Investment Project Encouraged by the State (October 2004).

[43] G Hufbauer et al, 'Investment Subsidies for Cross-border M&A: Trends and Policy Implications', United States Council Foundation Occasional Paper No 2 (April 2008) 2.

[44] Dossani et al (n 11) 13–15.

SOEs. Third, Chinese SOEs tend to acquire less profitable and more indebted targets. These findings suggest that Chinese SOEs may be less financially constrained than other investors because they have financial support from the state-owned banking system which allows them to engage in large-scale transactions and to pursue less cautious investment strategies.[45] However, on the question of acquisition prices, there is no evidence that Chinese SOEs pay higher prices than other investors for targets with comparable characteristics. This contradicts the view that government support enables Chinese companies to outbid other investors in the global M&A market.[46]

Since there is no international treaty on the regulation of M&A subsidies, some states have taken unilateral measures to address potential distortive effects of foreign subsidies in international investment. For example, the European Commission proposed on 5 May 2021 a new instrument under which the Commission will have the power to investigate financial contributions granted by public authorities of a non-EU country which will benefit companies engaging in an economic activity in the EU and redress their distortive effects. If the Commission establishes that a foreign subsidy exists, that it is distortive, and that the negative effects of foreign subsidies outweigh the positive effects, the Commission will have the power to impose redressive measures or accept commitments from the companies concerned that remedy the distortion.[47]

B. Reciprocity in Market Access

Chinese SOEs' overseas investment spree has caused reciprocity concerns. In the past few years, China has selectively liberalised foreign investment restrictions in some sectors. Accordingly, China's Foreign Direct Investment Regulatory Restrictiveness Index was

[45] Fuest et al (n 38) 25.

[46] ibid.

[47] European Commission, 'Commission Proposes New Regulation to Address Distortions Caused by Foreign Subsidies in the Single Market' (5 May 2021).

reduced from 0.43 in 2013 to 0.24 in 2019. Nevertheless, China's FDI regime remained highly restrictive, compared to the OECD average index of 0.06 in the same year.[48] Foreign companies are likely to face various limits to access the Chinese market, especially in key fields and industries that the Chinese Government regards as strategically important for the Chinese political and economy stability.[49] If the Chinese Government would not approve similar investment projects made by foreign investors in China, critics have questioned why a host country should approve such projects launched by Chinese SOE investors. For example, Senator Charles Schumer of New York demanded that when any SOE sought to acquire an American company, an additional study should be performed on reciprocity.[50]

Lifting market access barriers for EU investors in China was therefore one of the EU's key negotiation objectives for China-EU Investment Agreement (CAI).[51] China has made commitments in manufacturing sectors, including electric cars, chemicals, telecommunication equipment and health equipment, and in services sectors, such as cloud services, financial services, private healthcare, environmental services, international maritime transport and air transport-related services. [52] Similarly, in the US- China 'Phase One' deal, China promised to remove restrictions on investment, reduce burdensome regulation, and expeditiously review the pending license applications of US companies in its domestic banking, credit rating, electronic payments, asset management, insurance and securities industries.[53]

---

[48] OECD, 'FDI Regulatory Restrictiveness Index', 2019. stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#

[49] Szamosszegi and Kyle (n 33) 84.

[50] J Bussey, 'Playing Hardball with Chinese Investors', *Wall Street Journal* (25 October 2012).

[51] European Commission, 'Impact Assessment Report on the EU-China Investment Relations' (2013) 20.

[52] G Grieger, 'EU-China Comprehensive Agreement on Investment: Levelling the Playing Field with China', European Parliamentary Research Service Briefing (Mach 2021) 9.

[53] US-China Economic and Security Review Commission, 'The U.S.- China 'Phase One' Deal: A

C. National Security Concerns

Despite the declining share of Chinese OFDI made by SOEs, one of the most popular concerns is that Chinese SOEs may make overseas investment and corporate decisions on political and strategic rather than commercial and market considerations.[54] Chinese SOEs may effectively serve as 'Trojan horses', through which the Chinese Government may acquire increasing power and influence abroad. This threatens to jeopardise the national security, energy security and economic security of a host country.[55] As a consequence of a general suspicion of Chinese SOEs, a number of high-profile overseas acquisitions launched by Chinese SOEs were forced to discontinue in the face of strong opposition from host countries.

For example, the Canadian Government prohibited the US$1.5 billion acquisition of Canadian construction company Aecon Group Inc., by China Communications Construction Company International Holding Limited (CCCC) for national security reasons in 2018. Aecon is a significant player in the construction of infrastructure, including telecommunications networks, transportation, electricity grids and military facilities, as well as the refurbishment of nuclear power plants, while CCCC is majority owned by the Chinese Government. Aecon itself supported the CCCC acquisition as a means of more effectively competing with large global construction companies. However, the Canadian Federal Government concluded that the combination of CCCC's status as a Chinese SOE and Aecon's work on critical infrastructure made the acquisition a material risk to Canada's national security.[56] Similarly, in early 2021 Australia blocked a US$300

Backgrounder' (4 February 2020) 5.

[54] EJ Drake, 'Chinese State-owned and State-controlled Enterprises: Policy Options for Addressing Chinese State-owned Enterprises', 15 February 2012, Testimony before the US- China Economic and Security Review Commission.

[55] JE Mendenhall, 'Assessing Security Risks Posed by State-owned Enterprises in the Context of International Investment Agreements' (2016) 31(1) *ICSID Review* 36–37.

[56] S Walker, 'Canada Prohibits Chinese SOE Acquisitions of Aecon on National Security Grounds', Dentons

million deal that would have seen the state-owned China State Construction Engineering Corporation acquire a major Australian construction company, Probuild, over national security concerns. This has led the Chinese Embassy to accuse Australia of 'weaponising' national security.[57]

D. Ideological Struggle

A deep-rooted ideological concern is the inherent suspicion in some Western countries that foreign state capital is a threat to the free market at home. This is especially the case for countries where recently privatised corporate entities face competition or the prospect of takeover by foreign SOE rivals. Where doubts linger about the commercial and financial autonomy of the foreign SOEs this situation has led to concerns about 'renationalisation' of national champions through a foreign government.[58] For example, after the approval of CNOOC's acquisition of Nexen Inc. in December 2012, the Canadian Government announced new policy guidance with respect to future proposed acquisitions by foreign SOEs. Later the Economic Action Plan 2013 Act introduced several further steps in restricting investment by foreign SOEs in Canada in June 2013.[59] In a statement that made clear the Canadian Government's antipathy towards foreign SOEs, Prime Minister Stephen Harper stated in 2012:

> All investments are not equal… purchases of Canadian assets by foreign governments through state-owned enterprises are not the same as other transactions…To be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our

(25 May 2018).

[57] L Parsons, 'Furious China Accuses Australia of 'Weaponising national Security' by Blocking a $300 Million Takeover of a Major Building Company', *Daily Mail Australia* (13 January 2021).

[58] OECD, 'SOEs Operating Abroad: An Application of the OECD Guidelines on Corporate Governance of State-Owned Enterprises to the Cross-border Operations of SOEs', 4–5 (2010).

[59] M Mackenzie et al, *Bill C-60:* A More Restrictive Approach to Foreign State-owned Enterprises Investment in Canada (June 2013).

own governments, only to see them bought and controlled by foreign governments instead.[60]

IV. Selected Issues in Chinese SOEs and International Investment Law

A. The Status of Chinese SOEs in International Investment Arbitration

As China is the third-largest source of OFDI in 2020, it is no surprise that Chinese SOEs may increasingly fall back on ISDS mechanisms provided in Chinese BITs, which promise to offer them an enforceable procedural remedy against infringing host states. Given the close links between the Chinese SOEs and the Chinese Government, should Chinese SOEs be considered as qualified 'investors' and allowed access to ISDS against a host state? The status of Chinese SOEs is more complicated in the ICSID context. As reflected in its preamble, the ICSID Convention was developed by the World Bank in significant part to encourage private international investment, as distinguished from the sovereign/government investment, for economic development purposes. Article 25(1) of the ICSID Convention provides that the jurisdiction of the ICSID is confined to dispute 'between a Contracting State and a national of another Contracting State'. In other words, the ICSID has no jurisdiction to arbitrate disputes between two states, nor does it have jurisdiction to arbitrate disputes between two private entities. Even if Chinese SOEs are covered in the definition of 'investors' in ILAs, the question whether Chinese SOEs have standing as 'a national of another Contracting State' to bring an ICSID proceeding must be independently answered.[61] A different but analogous issue was whether a complaint

[60] Statement by the Prime Minister of Canada on Foreign Investment (7 December 2012).

[61] B Nalbandian, 'State Capitalists as Claimants in International Investor-State Arbitration', (2021) 81 *Questions of International Law, Zoom Out* 5, 12.

implicating the conduct of a SOE is in fact a dispute with a 'Contracting State'. because the SOE's conduct can be attributed to it.[62]

The definition of 'investor' in Chinese IIAs can provide substantial guidance on the question. Empirical research of the definition of 'investor' and ISDS clauses in 851 IIAs reveals that, with extremely limited exceptions, SOEs have equivalent standing to their private counterparts as an 'investor' in IIAs. Specifically, the definition of 'investor' is not based on the nature of ownership but rather on whether a legal person was duly constituted in accordance with the law of a contracting party.[63] Similar to this global trend, many Chinese IIAs do not specifically address SOEs in the definition of 'investor'.[64] Moreover, a recent trend is that more and more Chinese IIAs expressly provide that any entity, including 'government-owned or controlled enterprises' or public institutions, fall within the applicable definition of 'investor'.[65] Therefore, as a general matter, investment treaties are available to Chinese SOE claimants.

The same conclusion holds true in the ICSID context. SOEs have frequently acted as claimants and their standing to bring arbitral proceedings in ICSID has been seldom seriously questioned by the respondent and never declined by arbitral tribunals.[66] When determining whether an SOE is 'a national of another Contracting State', the ICSID case law has consistently applied the famous Broches test, as it was first proposed by Aron Broches, the first secretary-general of the ICSID and the principal architect of the ICSID

---

[62] *Emilio Agustı´n Maffezini v The Kingdom of Spain*, ICSID Case No ARB/97/7, Decision on Objections to Jurisdiction, 25 January 2000, para79.

[63] JE Low, 'State-controlled Entities as 'Investors' under International Investment Agreements' (2012) 80 *Columbia FDI Perspectives* 1–2.

[64] For example, Art 2 of China-Turkey BIT (2015); Art 1(2) of China-Switzerland BIT (2009).

[65] For example, Art 10(1)(f) of RCEP (2020); Art 12 (1) of Australia-China FTA (2015); Art 2(10)(a) of Canada-China BIT (2012); Art 1(b) of China-Mexico BIT (2008).

[66] C Annacker, 'Protection and Admission of Sovereign Investment under Investment Treaties' (2011) 10 *Chinese Journal of International Law* 531, 552–553.

Convention. Broches observed in 1972 that the classical distinction between private and public investment, based on the source of the capital, was no longer meaningful since many SOEs were practically indistinguishable from the completely privately-owned enterprise both in their legal characteristics and in their business activities. He then concluded that '…for purposes of the Convention a mixed economy company or government-owned corporation should not be disqualified as a 'national of another Contracting State' *unless it is acting as an agent for the government or is discharging an essentially governmental function*'.[67] Specifically, the Broches test addresses two situations: conduct by a person acting under state control (acting as an agent) and conduct by a person exercising delegated state authority. However, the Broches test, in itself, does not prescribe *how* to determine whether SOEs are acting as agents for the government or discharging an essentially governmental function or not.

The arbitral tribunal first applied the Broches test in *CSOB v Slovakia* in 1999. The tribunal made several key findings. First, the legislative history of the ISCID indicates that the term 'juridical persons' as employed in Article 25 and, hence, the concept of 'national', was not intended to be limited to privately-owned companies, but to embrace also wholly or partially government-owned companies.[68] Second, the tribunal held that the Czech's majority ownership of and absolute control over CSOB alone would not disqualify it from filing a claim with ICSID.[69] Finally, and most significantly, the tribunal applied a nature test, which looks at the nature of the party's acts at issue, rather than their motive or purpose, in determining whether CSOB exercises governmental functions. As the tribunal articulated:

---

[67] A Broches, *Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International law* (Dordrecht, Kluwer Academic Publishers, 1995) 202 (emphasis added). *cf* on the Broches test, ch 1, in this volume.

[68] *CSOB v Slovakia*, ICSID Case No ARB/97/4, Decision on Jurisdiction (24 May 1999), para 16.

[69] ibid, para 18.

> [I]t cannot be denied that for much of its existence, CSOB acted on behalf of the State in facilitating or executing the international banking transactions and foreign commercial operations the State wished to support and that the State's control of CSOB required it to do the State's bidding in that regard. But in determining whether CSOB, in discharging these functions, exercised governmental functions, *the focus must be on the nature of these activities and not their purpose*. While it cannot be doubted that in performing the above-mentioned activities, CSOB was promoting the governmental policies or purposes of the State, the activities themselves were essentially commercial rather than governmental in nature.[70]

In determining the nature of the CSOB's activities at issue, the tribunal compared them with what a private entity would do in normal business transactions. The tribunal found that since the steps taken by CSOB to solidify its financial position in order to attract private capital for its restructured banking enterprise did not differ in their nature from measures a private bank might take to strengthen its financial position, they were commercial in nature.[71] In sum, Because the COSB tribunal solely focused on the commercial nature of the activities at issue, the tribunal found that even if the CSOB's activities were driven by state policies or served state interests, this fact did not transform the otherwise commercial nature of these activities into governmental acts.[72]

The CSOB tribunal's sole focus on the nature of the CSOB's acts at issue was heavily criticised as a misapplication of the Broches test. It was suggested that further guidance on how to apply the Broches test should be drawn from the attribution rules in Articles 5 and 8 of the International Law Commission's Draft Articles on State Responsibility (ILC Articles).[73] As will be discussed below, compared with *CSOB v Slovakia*, one particularly noteworthy aspect of ILC Rules is the possibility to consider not only the nature of the SOE's acts but also other factors, including ownership, control, the

---

[70] ibid, para 20.

[71] ibid, para 25.

[72] ibid, paras 21–25.

[73] M Feldman, 'State-owned Enterprises as Claimants in International Investment Arbitration' (2016) 31(1) *ICSID Review* 24, 32–33; P Blyschak, 'State Owned Enterprises and International Investment Treaties' (2011) 6 *Journal of International Law and International Relations* 1, 35.

nature, purposes and objectives of the SOE whose actions are under scrutiny, and to the character of the actions taken, when determining whether the SOE's acts should be attributed to the state.[74]

Several arbitral tribunals have explicitly recognised that the ILC Articles are codification of customary international law on the question of attribution for purposes of asserting state responsibility and that the Broches test is the 'mirror image' of Article 5 and 8 of the ILC Articles. Consequently, the ILC Articles have been widely applied in investment arbitration, both to ascertain whether the SOE was a 'national of another Contracting State',[75] and the analogous issue of whether the conduct of SOEs should be attributed to the Contracting State so that the proper respondent was the Contracting State.[76] In contrast to the question of whether an SOE is a 'national of another Contracting State', which is usually decided at the jurisdictional stage of the proceedings, whether an SOE's conduct is in fact attributable to the respondent state is a merits issue unless there is a 'manifest absence of link' between the state entity and the respondent state.[77]

Article 5 of the ILC Articles, relating to the second branch of the Broches test, prescribes that the conduct of an entity is attributable to the state if the entity is empowered by law to exercise elements of governmental authority and is acting in that capacity in the particular instance. The term 'governmental authority' is not defined in the ILC Draft Articles because what is regarded as 'governmental' depends on the particular society, its history and traditions. In the context of investment arbitration, this would entail activities

---

[74] *Maffezini v Spain* (n 62) para 76.

[75] ibid, paras 79–80; *Beijing Urban Construction Group Co., Ltd. (BUCG) v Republic of Yemen*, ICSID Case No ARB/14/3, Decision on Jurisdiction (31 May 2017), para 34.

[76] *Jan de Nul and Dredging International v Egypt*, ICSID Case No ARB/04/13, Award (6 November 2008), para 156; *EDF (Services) Limited v Romania*, ICSID Case No ARB/05/13, Award (8 October 2009), para 191.

[77] *Gustav F W Hamester GmbH & Co KG v Republic of Ghana*, ICSID Case No. ARB/07/24, Award (18 June 2010), para 144.

such as granting licenses, approve or block commercial transactions, impose quotas, fees or expropriate companies.[78] According to the ILC's commentary, to apply the general standard to varied circumstances, important factors to be considered include the content of the powers, the way such powers are conferred on an entity, the purposes for which they are to be exercised and the extent to which the entity is accountable to government for their exercise. By contrast, how the entity is classified in a given legal system, the existence of a greater or lesser state participation in the entity's capital and the fact that the entity is not subject to executive control are not decisive criteria for the purpose of attribution of the entity's conduct to the state.[79]

Article 5 of the ILC Articles was first applied in *Maffezini v Spain.*[80] The analytical framework outlined in *Maffezini v Spain* was later clarified and refined in *EDF v Romania*. The tribunal in *EDF v Romania* clarified that two cumulative conditions must be fulfilled to trigger an attribution. First, the act must be performed by an entity empowered by the internal law of the state to exercise elements of governmental authority. Second, the act in question must be performed by the entity in the exercise of the governmental authority.[81]

The two-step analytical framework under ILC Article 5 has been followed by other investment arbitral tribunals ever since. In *Jan de Nul v Egypt,* the tribunal first found that the Suez Canal Authority (SCA) is a public entity exercising elements of governmental authority because it is empowered to issue the decrees related to the navigation in the canal

---

[78] R Mohtashami, F El-Hosseny, 'State-owned Enterprises as Claimants before ICSID: Is the Broches Test on the Ebb?' (2016) (3) *BCDR International Arbitration Review* 371, 381.

[79] Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries, in Report of the International Law Commission on the Work of its Fifty-third Session, UN Doc A/56/10 (2001) 43.

[80] The award was rendered before the formal adoption of the ILC Draft Articles in 2001. However, the tribunal referred to Article of the draft (now Art 5).

[81] *EDF v Romania* (n 76) paras 189–191.

and to impose and collect charges for passing through the canal.[82] The tribunal then focused on the nature of the SCA's acts at issue, ie awarding a contract through a bidding process and the refusal to grant a time of extension, and concluded that these acts were not attributable to Egypt because they were not performed pursuant to the exercise of governmental authority. [83] In *Tulip v Turkey*, Emlak is a SOE possessing legal personality under Turkish law separate and distinctive from that state. Even if it enjoyed certain preferential treatment from the Turkish Government with regard to getting construction permits and buying land, the tribunal found that Emlak itself did not exercise elements of governmental authority with respect to any other entity or object.[84]

Article 8 of the ILC Articles relates to the first branch of the Broches test, ie, SOEs acting as an agent for the government. Different from Article 5, the attribution under Article 8 is independent of the status of a person and dependent only on whether the person is 'in fact acting on the instructions of, *or* under the direction or control of, that State in carrying out the conduct'. Such acts could therefore be attributable not because they are the result of the use of governmental power, but because they are under the direct command or effective control of the state.[85] The commentary on Article 8 explains that although SOEs are owned by and in that sense subject to the control of the state, they are considered to be separate and that their conduct in carrying out their activities is prima facie not attributable to the state.

However, where there is evidence that the state was using its ownership interest in or control of a corporation specifically in order to achieve a particular result, the conduct

---

[82] *Jan de Nul v Egypt* (n 76) para 166.

[83] ibid, para 170.

[84] *Tulip Real Estate Investment and Development Netherlands B.V. v Republic of Turkey*, ICSID Case No ARB/11/28 (10 March 2014), Award, para 292.

[85] *Gustav v Ghana* (n 77) para 198.

in question may be attributed to the state.[86] The degree of control which must be exercised by the state in order for the conduct of a person or entity to be attributable is 'effective control', as the ICJ outlined in *Nicaragua v United States of America*.[87] This is a very demanding standard as it requires not only a general direction or control of the state over the entity but also a specific control of the state over the particular act in question. Several investment tribunals confirmed that 'effective control' is the relevant test in interpreting Article 8 of the ILC Articles.[88]

The finding that an entity performs certain acts under the direction and control of the state within the meaning of ILC Article 8 is an issue of examining the evidence on record. In *EDF v Romania*, the evidence on record indicates that the Romanian Ministry of Transportation issued instructions and directions to two SOEs regarding the conduct these two companies should adopt in the exercise of their shareholder rights. Further, the evidence indicates that the Romanian state was using its ownership interest in or control of the two SOEs to achieve the particular result of bringing to an end their contractual arrangements with the foreign investor and the joint venture and to institute instead a system of auctions for commercial spaces at the Otopeni Airport.[89] In the Tribunal's view, such conduct fell within the meaning of the Commentary to Article 8 of the ILC Articles and was attributable to Romania.

In *Tulip v Turkey*, the majority of Emlak's voting shares and the board at all relevant times were controlled by TOKI, a state organ responsible for Turkey's public housing and operating. Accordingly, the Tribunal concluded that TOKI was capable of exerting a

---

[86] The ILC Draft Articles (n 79) 48.

[87] Case Concerning Military and Paramilitary Activities in and against Nicaragua (*Nicaragua v United States of America*), Merits, ICJ Judgement of 27 June 1986, para 115.

[88] *Jan de Nul v Egypt* (n 76), para 173; *Tulip v Turkey*, ICSID Case No ARB/11/28, Decision on Annulment (30 December 2015), para 189.

[89] *EDF v Romania* (n 76) paras 213.

degree of control over Emlak to implement elements of a particular state purpose. However, the tribunal stressed that:

> …the relevant enquiry remains whether Emlak was being directed, instructed or controlled by TOKI with respect to the *specific activity* of administering the Contract with Tulip JV in the sense of sovereign direction, instruction or control rather than the ordinary control exercised by a majority shareholder acting in the company's perceived commercial best interests.[90]

Looking at the evidentiary record, the Tribunal concluded that while Emlak was subject to TOKI's corporate and managerial control, Emlak's conduct with respect to the execution, maintenance and termination of the Contract was acting in what it perceived to be its commercial best interest. Due to an absence of proof that TOKI used its control of Emlak as a vehicle directed towards achieving a particular result in its sovereign interests, Emlak's conduct was not attributable to the state under Art 8 of the ILC Articles.[91]

Applying the Broches test and ILC Draft Articles to Chinese SOEs, several conclusions may be drawn. First, after three decades of extensive reforms, Chinese SOEs possess legal personality under the domestic law of China separate and distinct from that of the state. They are not part of the governmental structure, and their business activities are subject to the Chinese Civil Code, the capital market regulations and other private law instruments. Therefore, Chinese SOEs are not state organs, so their acts cannot be attributed to the Chinese Government according to ILC Article 4.

Second, Chinese SOEs are not exercising government authority when they make overseas investment. In *CSOB v Slovakia*, when evaluating whether CSOB's activities were an exercise of governmental authority, the tribunal focused only on the nature of the CSOB's activities. As discussed in the section above, the attribution analysis in investment arbitration has become more nuanced since *Maffezini v Spain*. Now it has become an integral part of analysis for tribunals to examine the link between the entity under inquiry and the home state, including ownership structure, chain of control, the nature, purpose,

---

[90] *Tulip v Turkey* (n 84) para 309.

[91] ibid, para 326.

and objectives of the entity. This approach coincides with the commentary to ILC Article 5 which suggests that multiple factors should be considered to decide on attribution. Nevertheless, like *CSOB v Slovakia*, investment tribunals still focus on the ultimate purpose of the Broches Test and ILC Article 5, ie, whether the state-owned entity exercised governmental authority *in the particular investment projects*. SOE activities cannot be attributed to the state if it did not exercise governmental authority in the specific situation which gives rise to the investment dispute. It is difficult to imagine how Chinese SOEs may exercise governmental authority in overseas acquisitions, given that they do not possess any governmental power in the first place. Indeed, in the new round of SOE reforms, it was stressed that the even the SASAC shall abstain from exercising the public administration function of the government and from intervening in the autonomy of management of enterprises.[92]

The focus on the nature of specific activities at issue explains why the tribunal followed the CSOB's approach in *BUCG v Yemen.* Although the tribunal accepted the respondent's description of the BUCG in the broad context of the PRC state-controlled economy, such as the BUCG is expected to advance China's national interest, and the BUCG's key management, operational and strategic decisions are supervised and monitored by the Chinese state, the tribunal found them largely irrelevant. This is because the issue is not the corporate framework of the state-owned enterprise, but whether it functions as an agent of the state or discharges a PRC governmental function in the fact specific context, namely, the construction of the Sana'a International Terminal project in Yemen.[93] The tribunal concluded that there was no evidence to establish that, in building

[92] The State Council, 'Several Opinions of the State Council on Reforming and Improving the State-owned Asset Management System', No 63 [2015] of the State Council.

[93] *BUCG v Yemen* (n 75) para 39.

an airport terminal in Yemen, the BUCG was discharging a PRC governmental function rather than a commercial function. [94]

Third, a successful rejection of Chinese SOEs' standing is more likely based on the first limb of the Broches test, ie, Article 8 of the ILC Articles. If there is evidence showing that the Chinese Government was using its ownership interest in or control of a SOE specifically in order to achieve a particular result, the investment in question may be attributed to the state and the SOE in question will not have standing to bring the arbitration.[95] However, in practice, it is unlikely to happen for three reasons. To begin with, Chinese SOEs, in particular central SOEs, are under the direction and control of the SASAC and therefore the Chinese state and the CCP. However, the ILC Commentary makes clear that the attribution under Article 8 is highly demanding and exceptional. It requires not only a general direction or control of the state over the entity but also a specific control of the state over the particular act in question.[96] Even if the CCP has tightened the political control of SOEs in the past few years, there is little evidence that the Chinese state has intervened into specific investment projects made by SOEs. Indeed, one of the objectives of the new round of SOE reforms is precisely to reduce governmental interference and make SOEs independent market entities.[97] Second, one fundamental transformation to redefine the Party-state's relationship to SOEs is not to see the role of the state as that of owner and regulator of SOEs, but a core investor.[98] In line with the shift in view from 'managing enterprises to managing capital', state-owned capital investment and operation companies are created to take equity stakes and exercise rights as

---

[94] ibid, para 40.

[95] *Gustav v Ghana* (n 77) para 198.

[96] *EDF v Romania* (n 76) para 200.

[97] *The Economist*, 'A Whimper, not a Bang: China's Plan to Reform its Troubled Firms Fails to Impress' (19 September 2015).

[98] H Chen and M Righmire, 'The Rise of the Investor State: State Capital in the Chinese Economy' (2020) 55 *Studies in Comparative International Development* 257, 258.

shareholders in SOEs, mixed-ownership and private firms. As an intermediary between SASAC and SOEs, SASAC would have to convey directives directly to state capital investment companies rather than directly to operating firms. Such a system is seen as putting the SASAC at arm's length and further separating the SOEs from the government agencies.[99]

Finally, whether Chinese SOE's acts which give rise to the investment dispute were performed under the direction and control of the Chinese state is an issue of examining the evidence on record. As a legal matter, the level of required control to support the attribution argument is difficult to prove with prevailing evidence in practice.[100] This is particularly true in view of the labyrinth of Chinese SOE regulation structure and various informal channels through which government influence may be exerted.

B. Weaponing National Security

For the purpose of managing national security risks originating from foreign investment, some states, such as the US, Australia and Canada, have imposed special national security scrutiny procedures on SOEs. Since the introduction of these special procedures is readily available in the existing literature, it is sufficient to summarise their key features here. First, the threshold to launch an investigation based on national security concerns is very low. For example, in the US, the CFIUS is required to conduct a full investigation of all foreign government-controlled transactions whether or not the initial review shows that these transactions pose a national security concern.[101] In Canada, the government subjects all

---

[99] The State Council, Implementation Opinions of the State Council on Advancing the Pilot Program of the Reform of State Capital Investment and Operation Companies, No 23[2018] of the State Council.

[100] *Tulip v Turkey* (n 84), Separate Opinion of Michael Evan Jaffe on the Questions of Attribution under Article 8, ILC Articles.

[101] F Wehrlé and J Pohl, 'Investment Policies Related to National Security – A Survey of Country Practices', OECD Working Papers on International Investment 2016/02, 25.

investment by SOEs (including even private investors assessed as being closely tied to or subject to direction from foreign governments) to enhanced national security scrutiny, regardless of the value or size of the investment.[102] In Australia, the Foreign Investment Review Board (FIRB) will launch an investigation into whenever a SOE acquires a direct interest (usually 10 per cent or more) in an Australian entity or business. [103]

Second, the key terms, including national security itself, are intentionally left undefined in national foreign investment laws. In addition, the legal test used to assess national security implications of a proposed SOE investment is ambiguous because it usually requires weighing and balancing a range of factors. It is not clear how these factors are assessed, which factors are more important and why, and how to draw a conclusion if different factors point to different inferences.[104] As a result, a host country retains almost unlimited discretion to prohibit the proposed investment or requires Chinese SOEs to undertake onerous commitments to alleviate any regulatory concerns that a host country might have.

Third, to challenge a national security decision in domestic courts is frequently fruitless either because such decisions are immune from judicial review or because domestic courts tend to defer to administrative agencies to make such decisions. For example, in September 2012, President Obama ordered the China-based Ralls Corp to divest four Oregon wind farms it had previously acquired from Innovative Renewable Energy LLC. Ralls Corp brought a suit against the US Government, including President Obama, in the first legal challenge to a CFIUS decision. The US Court of Appeals in July 2014 ruled allowing Ralls to obtain evidence on why its bid for Oregon wind farms was rejected. However, the ruling did not have a major impact on the actual decision made by

---

[102] The Minister of Innovation, Science and Industry, *Guidelines on the National Security Review of Investments* (24 March 2021).

[103] Australian Government, *Australia's Foreign Investment Policy* (1 January 2021) 7.

[104] M Du, 'The Regulation of Chinese State-owned Enterprises in National Foreign Investment Laws: A Comparative Analysis' (2016) 5 *Global Journal of Comparative Law* 118, 137.

CFIUS because the Court did not rule that the CFIUS and Obama had no power to block the Ralls Corp deal.[105]

The reference to international legal rules will not solve the problem either. The principle of sovereignty in international law gives states ample leeway to prevent foreign investors from taking over domestic companies. This freedom may be restricted through bilateral investment treaties (BITs). However, an overview of the BITs shows that they largely focus on the question of the extent to which cross-border investments are protected once they have been made, for example, against arbitrary expropriation.[106] Even though some recent BITs extend national treatment to the pre-entry phase of the investment, countries undertaking such commitments regularly include reservations and exemptions for the protection of national security.[107]

One may wonder whether intensified scrutiny of investments from SOEs on national security grounds is justified. First, the vague standard and lack of transparency in the national security review process may render the scrutiny of Chinese SOEs' investment a tool of economic protectionism.[108] Rather than addressing real regulatory concerns, unrestricted political interference based on political gamesmanship and irrational fears have resulted in a chilling effect on potential foreign SOE investors.[109] The botched attempt

---

[105] S Tiezzi, 'Chinese Company Wins Court Case against Obama', *The Diplomat* (17 July 2014).

[106] A Heinemann, 'Government Control of Cross-Border M&A: Legitimate Regulation or Protectionism' (2012) 15(3) *Journal of International Economic Law* 843, 855.

[107] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (New York and Geneva 2007) 142. For a distinction between then distinguishes between 'Limited Entry' BITs and 'Liberalisation' BITs, see ch 5, in this volume.

[108] S Lubman, 'China's State Capitalism: The Real World Implications', *The Wall Street Journal* (1 March 2012); P Rose, 'Sovereigns as Shareholders' (2008) 87 *North Carolina Law Review* 83, 117.

[109] Y Feng, 'We Wouldn't Transfer Title to the Devil: Consequences of the Congressional Politicization of Foreign Direct Investment on National Security Grounds' (2009) 42 *New York University Journal of International Law and Politics* 253, 255.

by CNOOC, a Chinese SOE, to acquire Unocal in 2005 was a typical example. With the benefit of hindsight, it is clear that the US had overreacted.[110] The main concern that CNOOC might divert Unocal's energy supplies exclusively to meet Chinese needs was not supported by any sensible facts. By 2005, Unocal was no longer a major player in the energy industry. In 2004, the year before the transaction, Unocal produced less than one per cent of the US natural gas consumption.[111] It possessed no refineries in the US and its most valuable assets were located primarily overseas, which was the primary reason why CNOOC found it so attractive in the first place. To assuage the national security concerns, CNOOC had announced its willingness to divest itself of Unocal's American holdings.[112] Even if CNOOC rerouted all Unocal's US production to China, which is economically penalising for CNOOC and its controller, it would not harm the US interest because US buyers could easily replace Unocal's miniscule production with imports from the international market, leaving net imports and US balance of payments in energy unchanged.[113]

Second, all the current national investment regulations seem to treat all Chinese SOEs in the same way. One may wonder whether such a legal criterion is not too crude. As discussed in section II above, Chinese SOEs are not created equal. Though by definition, all SOEs are controlled by the state, significant variations exist in their organisational structure, relations with the state, sectors in which they operate and management of SOEs. For example, the SASAC serves as a unitary holding company for

---

[110] JW Casselman, 'China's Latest 'Threat' to the United States: The Failed CNOOC-Unocal Merger and its Implications for Exon-Florio and CFIUS' (2007) 17 *Indiana International and Comparative Law Review* 155.

[111] DK Nanto et al., 'China and the CNOOC Bid for Unocal: Issues for Congress', CRS Report for Congress (2005) 9.

[112] CNOOC Ltd. Press Release, 'CNOOC Limited Proposes Merger with Unocal Offering USD $67 Per Unocal Share in Cash' (June 23, 2005).

[113] TH Moran, 'Foreign Acquisition and National Security: What are Genuine Threats? What are Implausible Worries', paper presented at OECD Global Forum on International Investment (December 2009) 5.

central SOEs (*yang qi*) that were formerly under the control of various government agencies. In 2017, the total assets and turnover of central enterprises reached RMB55 trillion, a 73.8 per cent increase over 2012, and RMB26.4 trillion, or 33 per cent of that year's national GDP.[114] In view of their importance to the national economy, central SOEs are a different beast from local SOEs as they are closer to the political centre. Similarly, though Chinese SOEs currently operate in many industries and sectors, the Chinese Government maintains control only in strategic fields through either sole ownership or an absolute controlling stake. By comparison, the state's role in other non-strategic sectors will be significantly smaller and the number of SOEs in these sectors will be drastically reduced. Precisely because of these differences, Chinese SOEs should be approached in a more nuanced manner. Variations concerning SOEs' distance from the political centre, the percentage and density of state ownership, the competitiveness and political saliency of the sectors in which they mainly operate, and even certain leadership characteristics inevitably cause SOEs' behavioural differences in cross-border investment and dispute resolution.[115]

V. Conclusion

This chapter concludes that, after three decades of reforms, Chinese SOEs no longer exercise any governmental functions. They have independent decision-making power, and they are run on a commercial basis. Still, there is no doubt that Chinese SOEs are an integral part of the Chinese Party-state, and they are under the direction and control of the Chinese Government. However, such general direction and control, in itself, cannot be a basis to deny a Chinese SOE from accessing ISDS as a claimant. Moreover, it is submitted that the national security screening procedures may be weaponised with Chinese SOEs as targets,

---

[114] Zhang (n 37) 57.

[115] J Li, 'State-owned Enterprises in the Current Regime of Investor- State Arbitration', in S Lalani and RP Lazo (eds), *The Role of the State in Investor- State Arbitration* 380 (Leiden, Brill, 2014) 380, 385.

and that a more nuanced mechanism differentiating different types of Chinese SOEs may be warranted.

As Howson pointed out, Chinese companies investing abroad represents a new phase of China's changing entanglement with foreign and international legal, commercial and governance norms. Both the Chinese Government and the Chinese SOEs were forced for the first time to play by internationally accepted rules not only during the whole investment phase but also with respect to internal corporate governance at the firms themselves.[116] In this sense, Chinese SOEs' cross-border investments have started a socialisation process bringing value to both China and the global economy. On the one hand, it is simply a bad policy choice, both economically and politically, to reject Chinese SOE investments not on legitimate grounds but under the influence of misinformed populism and protectionism. On the other hand, the recent spotlight on Chinese SOEs may serve as an external incentive for the Chinese Government to push forward its market-oriented SOE reforms. These reform measures will not only reduce suspicion and misunderstanding when Chinese SOEs make OFDI, but also help them become truly competitive global champions.

[116] NC Howson, 'China's Acquisitions Abroad- Global Ambitions, Domestic Effects' [2006] *Law Quadrangle Notes* 73, 74