SOVEREIGNS, SOCIALLY RESPONSIBLE INVESTING, AND THE ENFORCEMENT OF INTERNATIONAL LAW THROUGH PORTFOLIO INVESTMENT AND SHAREHOLDER ACTIVISM: THE THREE MODELS

SALAR GHAHRAMANI*

There are currently about 50,000 multinational enterprises ("MNEs"), which, along with 450,000 affiliates, employ more than 200 million people around the world.[1] The MNEs' transborder activities—their transfer of tangible or intangible assets and the transport of equipment and physical property for the purposes of plant building, manufacturing, and wealth creation for the MNEs in general—are foreign direct investment ("FDI") with significant human and environmental consequences.

Not surprisingly, then, the conversations surrounding corporate social responsibility ("CSR") in international investments often involve framing the discussions from the FDI lens, usually in three forms: (1) analyzing the existing instruments of international soft law that aim to address the respective roles of the state and MNEs in protecting and promoting human rights principles;[2] (2) considering the questions of universal jurisdiction and how national courts can deal with transnational corporate misconduct arising under either international customary law or torts and

* Assistant Professor of Business Law and International Law & Policy at the Pennsylvania State University—Abington and the Founding Co-Chair of the International Task Force on Sovereign Wealth Fund Research.

1 *Multinational Enterprises*, INT'L LAB. ORG., http://www.ilo.org/global/topics/employment-promotion/multinational-enterprises/lang--en/index.htm (last visited Mar. 4, 2014).

2 *See, e.g.*, Special Representative of the Sec'y Gen. on the Issue of Human Rights and Transnat'l Corps. and Other Bus. Enters, *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, ¶ 19, U.N. Doc. A/HRC/17/31 (Mar. 21, 2011) (by John Ruggie) (recommending that business enterprises conduct impact assessments and incorporate relevant findings into business practices in order to "prevent and mitigate adverse human rights impacts").

crimes;[3] and (3) examining the intersection of investment treaties, the host state's regulatory environment, and the MNEs' protections and obligations under the various legal regimes.[4]

This Article aims to add another dimension to the discussion: the consideration of the three models of sovereign-driven *portfolio* investment (in contrast to foreign investment) and how governments may pursue CSR and international law principles through shareholder activism.

1. PORTFOLIO INVESTMENT AND SHAREHOLDER ACTIVISM

Portfolio investment is contrasted with foreign investment in that the former is normally represented by "a movement of money for the purpose of buying shares in a company formed or functioning in another country"[5] as well as the purchase of other security instruments—bonds, for instance—through which companies can raise capital.[6] Another distinguishing factor between the two is the highly liquid nature of portfolio investments: compared to FDI, where the investor's assets generally constitute physical infrastructure that may not easily be bought and sold, a share or bond holder may utilize the capital markets with relative ease in order to dispose of the security instruments. As such, it may be argued that portfolio investors have little to no commitments to the host countries, since shares may be sold in a span of days—if not seconds.

Portfolio investors can be active or passive: they may or may not attempt to pressure the companies in which they hold shares to change their behavior. Activist shareholders use their power to impact the processes or the outcomes of a particular company or to do so at a larger scale and across several companies by

---

3 *See, e.g.*, Anthony J. Colangelo, *The Alien Tort Statute and the Law of Nations in* Kiobel *and Beyond*, 44 GEO. J. INT'L L. 1329 (2013) (advising courts to use international law to supply the "conduct-regulating rule under the ATS," the Alien Torts Statute).

4 *See, e.g.*, George K. Foster, *Investors, States, and Stakeholders: Power Asymmetries in International Investment and the Stabilizing Potential of Investment Treaties*, 17 LEWIS & CLARK L. REV. 361 (2013) (describing how investment treaties ought to be modified to enable local stakeholders to "protect their own human rights" without reliance on their governments).

5 M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 7 (2d ed. 2004).

6 *Id.*

symbolically targeting one or more firms.[7] They can submit proposals during shareholder meetings; write letters to fellow shareholders, firm management, or to the media; or cast votes that oppose the position of management in order to affect the firm's direction and trigger modifications in corporate governance.[8] These actions are considered "voice activism."[9] Another type of activism is "exit," where disgruntled investors punish the firm by selling their shares.[10]

The motivations behind activism are either financial—where shareholders put pressure on management to issue dividends or to enhance the company's monetary results through slashing non-performing units and decreasing executive pay—or social—where shareholders are motivated by ethical, human rights, or environmental issues.[11]

Social activism, along with socially responsible investing ("SRI"), has a long history among individuals and private institutional investors. Since at least the nineteenth century, certain shareholders aligned their investments with their religious views and refrained from buying shares in "sinful" entities that produced or sold alcohol, tobacco, or gambling-related services.[12] However, SRI-focused investments by sovereigns, the subject of the next Section, is a relatively recent phenomenon.

2. SOVEREIGNS, SRI, AND INTERNATIONAL LAW

This Section posits that there are three paradigms under which sovereigns—national and subnational political units—engage in SRI through portfolio investing: (1) Ethics-based Legislative Exclusion, (2) Nation-centric Legislative Exclusion, and (3) Extra-legislative Activism.

---

[7] Lori Verstegen Ryan & Marguerite Schneider, *The Antecedents of Institutional Investor Activism*, 27 ACAD. MGMT. REV. 554, 555 (2002).

[8] *Id.*

[9] Janet H. Marler & Christophe Faugère, *Shareholder Activism and Middle Management Equity Incentives*, 18 CORP. GOV.: INT'L REV. 313, 314–16 (2010).

[10] *Id.* at 314–16.

[11] William Q. Judge et al., *Antecedents of Shareholder Activism in Target Firms: Evidence from a Multi-Country Study*, 18 CORP. GOV.: INT'L REV. 258, 259 (2010).

[12] *See generally* Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 BUS. LAW. 681, 682–85 (2002).

2.1. Ethics-Based Legislative Exclusion: Norway's Sovereign Fund

The ethics-based exclusion model largely relies on exit activism in that a government-sponsored fund, through a process mandated by law, divests from certain companies and excludes them from its investment universe based on unethical or illegal corporate conduct.

This model is best demonstrated by Norway's Government Pension Fund-Global ("GPFG"), a sovereign wealth fund ("SWF"), whose activities have been analyzed extensively by legal scholars.[13]

SWFs—including GPFG—are distinguished from the pension funds discussed later in this Article in that SWFs are, by definition, government-owned investment vehicles *without* explicit fixed payment liabilities to pensioners.[14] However, some SWFs (GPFG included) are created to share wealth across generations or to function as contingency investment vehicles charged with addressing a polity's potential pension shortcomings in the future. (Other types of SWFs are used to protect government budgets from volatility in commodity prices, to obtain higher investment returns than traditional reserve holdings, or to fund infrastructure and socioeconomic projects.)

Historically, SWFs have been passive investors, but they possess a natural tendency for shareholder activism.[15] They are increasingly involved in the capital markets and invest in both traditional and nontraditional asset classes, utilizing a mixture of investment strategies.[16]

GPFG is the prime example of an SWF that has publicly engaged in both voice and exit social activism. The fund operates based on a series of legislature-imposed ethical norms and is

---

13 *See, e.g.*, Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 GEO. J. INT'L L. 425 (2010) (examining the Norwegian SWF in action and analyzing its investment effects).

14 INT'L WORKING GROUP OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GENERALLY ACCEPTED PRINCIPLES AND PRACTICES – "SANTIAGO PRINCIPLES" 3 (2008), *available at* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.

15 *See generally* Salar Ghahramani, *Sovereign Wealth Funds and Shareholder Activism: Applying the Ryan-Schneider Antecedents to Determine Policy Implications*, 13 CORP. GOV. 58 (2013).

16 *See* Salar Ghahramani, *Sovereign Wealth Funds, Transnational Law, and the New Paradigms of International Financial Relations*, 8 YALE J. INT'L AFF., no. 2, 2013 at 52, 52 (detailing some of the asset types in which SWFs invest).

monitored by the Council on Ethics, established by Royal Decree and charged with evaluating whether the fund's investments are consistent with the specific guidelines.[17] The Council serves in an advisory role to the Ministry of Finance, which controls the fund.

The legislative Ethics Guidelines require that GPFG's investment universe exclude companies that:

- produce weapons that violate fundamental humanitarian norms;
- make tobacco; or
- sell military material to those states whose government bonds GPFG is not permitted to purchase.[18] (Burma fell under this category until January 2014—at which point it was removed and replaced by North Korea, Syria, and Iran—and a Chinese seller of military trucks to the country was excluded from the fund's investments for this reason.)[19]

Additionally, on the advice of the Council on Ethics, the Ministry may exclude companies that may be responsible for:

- systematic human rights violations;
- violations of the rights of individuals in war or conflict;
- severe environmental damage;
- gross corruption; or

---

17 *Council on Ethics*, GOVERNMENT.NO, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council.html?id=434879 (last visited Mar. 4, 2014).

18 *Guidelines for the Observation and Exclusion of Companies from the Government Pension Fund Global's Investment Universe*, GOVERNMENT.NO, http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277 [hereinafter Ethical Guidelines].

19 Press Release, Norwegian Ministry of Fin., Supplier of Military Materials to Burma Excluded from Government Pension Fund—Global (Mar. 13, 2009), *available at* http://www.regjeringen.no/en/archive/Stoltenbergs-2nd-Government/Ministry-of-Finance/Nyheter-og-pressemeldinger/pressemeldinger/2009/supplier-of-military-materials-to-burma-.html?id=549152.

- other violations of fundamental ethical norms.[20]

Currently, sixty companies are on GPFG's exclusion list, including Singapore Technologies for its production of anti-personnel land mines; Raytheon for making cluster munitions; Boeing, Honeywell, and Lockheed Martin for nuclear arms production; Altria and Philip Morris for tobacco; Wal-Mart for human rights violations; Rio Tinto and Freeport McMoRan for severe environmental damage; Potash for serious violations of fundamental ethical norms; and Shikun & Binui for violating rights of individuals in war or conflict.[21]

If the Ministry of Finance has doubts as to whether a company's conduct renders it ineligible to remain in the fund's investment universe, it may choose to place the company in question under observation. As of the writing of this Article, Alstom, a French conglomerate specializing in energy and transport infrastructure, is on a four-year watch list of the Council on Ethics as per the Ministry of Finance's concerns regarding Alstom's "unacceptable risk of gross corruption in the company's operations."[22] (Initially, in 2010, the Council on Ethics had advised the Ministry of Finance that GPFG should divest its holdings from Alstom due to the widespread bribery allegations leveled against the company in several countries,[23] but the Ministry ultimately elected to place Alstom on the watch list due to the uncertain outcome of the ongoing legal proceedings against the company.)[24]

Essentially, the ethics-based legislative model, unlike the paradigm discussed next, is not state-centric in that the decision to exclude is largely based on a company's conduct or a product that

[20] Ethical Guidelines, *supra* note 18.

[21] *Companies Excluded from the Investment Universe*, GOVERNMENT.NO, http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/companies-excluded-from-the-investment-u.html?id=447122 (last updated Jan. 30, 2014).

[22] *Government Pension Fund Global: Company Placed on Observation List*, GOVERNMENT.NO, http://www.regjeringen.no/en/archive/Stoltenbergs-2nd-Government/Ministry-of-Finance/Nyheter-og-pressemeldinger/nyheter/2011/government-pension-fund-global-company-p.html?id=665635 (last visited Mar. 4, 2014) [hereinafter Observation List].

[23] COUNCIL ON ETHICS, TO THE MINISTRY OF FINANCE: RECOMMENDATION OF 1 DECEMBER 2010, *available at* http://www.regjeringen.no/pages/2588965/alstom_e_2010.pdf.

[24] Observation List, *supra* note 22.

it produces rather than where it operates or with which country it does business.

2.2. Nation-Centric Legislative Exclusion: The American State

Under the nation-centric model, the legislature mandates that the public pension funds under its jurisdiction refrain from investing in companies that do business with specific countries.

The model may be observed in numerous sub-federal units in the United States that have, in effect, engaged in transnational law-making and SRI through their state or local public pension systems. This form of exclusion can be traced back to the 1980s divestment regulations of the Apartheid era, when numerous local and state governments prohibited their public pension funds from investing in companies that had South African operations or had not agreed to the original Sullivan principles of non-segregation and equal and fair employment and pay.[25]

The American state continues to spearhead this model. For instance, a number of states have enacted laws prohibiting their public funds from investing in companies that do business with Sudan due the country's human rights violations and the genocide in Darfur. At times, the Sudan-related legislative declarations accompanying the statutory texts allude to international law. For example, the California statute that forbids the state's public employee retirement funds from investing in companies that have business operations in Sudan partially relies on the United Nations Convention of 1948 and the findings by the United Nations International Commission of Inquiry on Darfur to justify the state's divestment requirements.[26]

The same statute requires that the state's public funds become activist shareholders, compelling the funds to send written notices to the affected companies, requesting that the companies take substantial action within 90 days to reduce their Sudan exposure, and, if substantial progress is not shown by the companies, to utilize exit activism and fully divest from the entities.[27]

Additionally, a number of states have adopted specific policies

---

25 *See generally* Kevin P. Lewis, *Dealing with South Africa: The Constitutionality of State and Local Divestment Legislation*, 61 TUL. L. REV. 469 (1987).

26 CAL. GOV'T CODE § 7513.6 (Deering 2013).

27 CAL. GOV'T CODE § 7513.6(g) (Deering 2013).

on Cuba, Iran, and Syria and require their public pension funds to exercise exit activism and divest their holdings in companies that do business with one or more of these nations.[28] As an example, Florida requires its State Board of Administration to divest from Cuba and is "prohibited from investment in stocks, securities, or other obligations of . . . [a]ny institution or company domiciled in the United States, or foreign subsidiary of a company domiciled in the United States, doing business in or with Cuba, or with agencies or instrumentalities thereof . . . ."[29]

2.3. Extra-Legislative Activism: CalPERS

Under this model, government funds pursue SRI objectives beyond, or in the absence of, legislative mandates.

The model is utilized by the California Public Employees' Retirement System ("CalPERS"), a state agency with an investment portfolio value of over $270 billion,[30] the largest state pension fund in the United States and perhaps the most forceful in its utilization of shareholder activism.

CalPERS goes beyond what the state requires of it[31] and actively considers environmental, social, and governance factors in what it calls the ESG approach. Throughout the past decade, the fund has joined the Investor Network on Climate Risk, adopted a plan to reduce energy consumption in its real estate portfolio by twenty percent over a five-year period, and signed on to the United Nations-sponsored Principles for Responsible Investment ("PRI").[32]

The fund has also adopted the Global Sullivan Principles of Corporate Social Responsibility, the objectives of which are to

---

28 *See generally* Salar Ghahramani, *Divestment Laws, Fiduciary Duty, and Pension Fund Management: An Empirical Examination*, 56 INT'L J.L. & MGMT. 29 (2014).

29 FLA. STAT. § 215.471 (2013).

30 CAL. PUB. EMP. RET. SYS., FACTS AT A GLANCE (Feb. 2014), *available at* http://www.calpers.ca.gov/eip-docs/about/facts/facts-at-a-glance.pdf.

31 Currently, California law requires the state's pension funds to observe, engage, or divest from companies with operations in Iran, Northern Ireland, and Sudan, as well as businesses with Holocaust-related legacy. CAL. PUB. EMP. RET. SYS., TOWARDS SUSTAINABLE INVESTMENT: TAKING RESPONSIBILITY 28 (2012), *available at* http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/esg-report-2012.pdf [hereinafter TOWARDS SUSTAINABLE INVESTMENT].

32 *Id.* at 7.

support economic, social, and political justice, and has urged corporations to adhere to the human rights, labor, environmental, and anti-corruption principles of the United Nations Global Compact, a soft law regime based on a number of international instruments.[33]

Based on its ESG approach, the fund has used its proxy-voting rights to endorse social and environmental shareholder proposals[34] and has invested in biofuels, solar, wind and other alternative energy companies.[35] In 2010, the fund allocated $500 million to an environmental index fund that invests in approximately 380 global stocks that derive a significant portion of their revenues from environmentally-sound sectors.[36] CalPERS has also dedicated one percent of its total investments, which currently measure about $2.3 billion, to investments in forestlands in order to address climate change.[37]

In the past, CalPERS has taken into account the civil liberties and human rights records of various states in order to exclude entire countries from its investments. In 2002, for instance, the fund announced that it would sell its holdings in the Philippines, Thailand, Indonesia, and Malaysia because the countries did not meet its human rights standards,[38] and, until 2007, had a "Permissible Country List" that essentially prohibited equity investments in certain countries.[39] But, upon concluding that the approach adversely affected the fund's returns, CalPERS established the Emerging Equity Market Principles ("EEMP"), which set the basis for the fund's policies on social issues,[40] and

33 CAL. PUB. EMP. RET. SYS., GLOBAL PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE 17–18 (2011), http://www.calpers-governance.org/principles/home.

34 TOWARDS SUSTAINABLE INVESTMENT, *supra* note 31, at 12.

35 *Id. at* 21.

36 *Id.*

37 *Id.* at 22.

38 *CalPERS' New World View Hits Home in Asia*, L.A. TIMES, Feb. 21, 2002, http://articles.latimes.com/2002/feb/21/business/fi-wrap21.

39 TOWARDS SUSTAINABLE INVESTMENT, *supra* note 31, at 29.

40 *See generally* CAL. PUB. EMP. RET. SYS., STATEMENT OF INVESTMENT POLICIES FOR EMERGING EQUITY MARKET PRINCIPLES (2013), http://www.calpers.ca.gov/eip-docs/investments/policies/inv-asset-classes/equity/ext-equity/emerging-eqty-market-prinicples.pdf [hereinafter EEMP].

now excludes individual companies rather than countries.[41]

EEMP considers the following factors:

- *Political stability*, which the fund defines as "[p]rogress toward the development of basic democratic institutions and principles"[42] and consists of factors such as respect for civil liberties and human rights, the presence of a strong and independent judiciary and democratic accountability, and the absence of ethnic tensions, corruption, and religion and military in politics;[43]
- *Transparency* in politics, economic policy, and the financial markets as advanced by freedom of the press and lack of censorship and physical violations against the media;[44]
- *Productive labor practices* that include absence of harmful labor practices or use of child labor and compliance with the International Labor Organization Declaration on the Fundamental Principles and Rights at Work;[45]
- *Corporate social responsibility and sustainability*, which include factors such as environmental protection and compliance with the Global Sullivan Principles;[46]
- *Market regulation and liquidity*;[47]
- *Capital market openness*, as embedded in free market policies and legal protection for foreign investors;[48]
- *Proficiency and efficiency in the financial markets*;[49] and
- *Proper disclosure* on environmental, social, and corporate governance issues.[50]

To achieve its EEMP objectives, CalPERS has contracted an external advisory firm that analyzes the fund's investments in emerging economies and undertakes a three-step process that helps CalPERS make investment decisions. The steps include: (1) the analysis of all emerging market investments with a particular

---

[41] TOWARDS SUSTAINABLE INVESTMENT, *supra* note 31, at 29.

[42] EEMP, *supra* note 40, at 3.

[43] *Id.*

[44] *Id.*

[45] *Id.* at 4.

[46] *Id.*

[47] *Id.*

[48] *Id.* at 5.

[49] *Id.*

[50] *Id.*

focus on the companies' compliance with international labor standards and CSR principles; (2) rating of companies as "pass," "watch list," or "red flag;" and (3) excluding "red flag" companies from the fund's investment universe.[51] CalPERS claims that the EEMP and the above-noted processes have helped the fund positively impact CSR issues in the emerging markets.[52]

3. CONCLUSION

State-sponsored portfolio investors are often missing from the FDI-centered discussions on CSR in international investments. This Article has attempted to examine the methods by which the state's instrumentalities pursue international norms and CSR objectives as activist shareholders and how such examination may supplement our understanding of the various tools available in addressing state or corporate participation or complicity in breaches of international law and human rights principles and threats to sustainability and the environment. What this Article has purposely avoided is judging the merits of utilizing the financial markets as a governmental tool for advancing certain norms, an endeavor beyond the scope of this project but worth consideration.

---

51 TOWARDS SUSTAINABLE INVESTMENT, *supra* note 31, at 29.

52 *Id.*