

## *Preface*

International investment is an increasingly powerful force for economic growth and prosperity throughout the world. All countries, rich and poor, seek foreign capital and its associated technology and know-how as vital elements in their plans for national economic development. Accordingly, all governments have either explicitly or implicitly formulated policies about international investment and have incorporated them into their legal systems. At the same time, companies from both developed and developing countries are investing massive amounts of capital abroad in their search for markets, natural resources, production efficiencies, and knowledge. In connection with these efforts, investors and their legal counsel take great care in using a variety of legal devices to structure their investments in ways that will maximize investment returns and minimize investment risks.

While economic forces are the essential drivers of international investment, they are not the only factors that influence it. Legal rules and institutions also affect international investment flows. Law determines whether and how investments may be made in a particular country, the nature of the respective rights of investors and host country governments, the means by which governments and investors may adjust their legal relationships to changing circumstances, and the processes they may use to resolve their investment disputes.

The rules applicable to international investments are derived from three basic legal frameworks: (1) national laws, both of the host country and the investor's home country; (2) contracts, whether between investors and host governments or among investors; and (3) international law, consisting of applicable treaties, customs, and general legal principles developed by states. Any international investor must therefore understand the nature and complex interaction among these three legal frameworks—national, contractual, and international—in undertaking, managing and protecting a foreign investment. Thus, United Kingdom investors seeking to build a power plant in India to sell electricity to a state government's public utility must evaluate and use the Indian laws governing the ability of foreigners to enter the power sector, the state regulations concerning the production and sale of electricity to state power companies, the contract between the contemplated power company and the state corporation, and the international rules protecting investor rights embodied in a variety of sources, including treaties between India and the United Kingdom. For the UK investors, the economic success of the power project depends crucially on the content and application of the three frameworks. For the central government of India and the state government, the three frameworks are equally essential for securing and regulating a reliable and economical source of electricity so essential to their growth and development. In their operation, these frameworks are not isolated but interrelated. Thus, the content of the contractual framework is profoundly influenced by the applicable national law, and investor rights under international law are influenced by national legislation. For example, in the event of conflict with the Indian government, the ability of the UK investors to invoke treaty protection may require them first to avail themselves of remedies in the Indian courts, at least for a period of time.

This book examines the content of each of these three legal frameworks for international investment and explores how they influence the foreign investment process and the operation of international investment transactions, projects, and enterprises. The term "international investment law," so commonly used to describe the law applicable to foreign investments, contains an inherent ambiguity. It may refer either to the international law

governing investments or to all the law applicable to international investments. Thus, while many excellent books exist on the subject of “international investment law,” they focus primarily on the international law and thus tell only part of the legal story of foreign investment. Indeed, in their focus almost uniquely on the international law governing investment, one can say that such works tell only one-third of that story since they do not examine in depth the two other crucial legal frameworks—national laws and investment contracts. Consequently, they do not explain how host and home countries use their legal systems to encourage and regulate international investment, nor do they consider the various legal devices and techniques that investors and governments employ to structure investment projects and transactions. An understanding of both of these dimensions of the investment process is vital for lawyers, executives, and government officials working with foreign investment.

In taking a comprehensive view of the laws affecting foreign investment, this book is divided into five parts, each of which consists of three or more chapters. *Part I: International Investment and the Law*, after explaining the contemporary nature and significance of international investment, examines the theoretical and practical links between law and the investment process. It explores how and why law fosters or impedes investment and posits that the international investment process is influenced by the actions of three basic players: the host country, the investor, and the investor’s home country. It examines the interests and policies of each player and how those interests and policies influence the content and application of the laws of foreign investment. Part I concludes with an overview of the nature of the three principal legal frameworks for international investment resulting from the interplay of these interests.

*Part II: The National Legal Framework* explores the nature of a country’s national laws affecting foreign investment. It begins with a chapter examining the factors that influence national policies and laws on international investment, particularly governmental ideologies, popular attitudes, and accepted economic models of national development. Subsequent chapters explore state controls on the exit and entry of capital, national regulation of foreign investment, and the problem of legal and regulatory instability. Regardless of legal tradition and economic history, national regulatory systems are fundamentally influenced by two, often competing imperatives: the need to encourage the inflow and investment of foreign capital and the need to control that flow and its use once it has entered the country. The precise balance that the national legal framework strikes between these two imperatives varies from country to country and also changes over time.

Any foreign investment is basically a bargain between the foreign investor and the host country. Countries use their legal systems to maximize the perceived benefits and minimize the contemplated costs of that bargain. In doing so, all national regulatory frameworks must address four basic issues: (1) the nature of the foreign investment the country seeks or will accept; (2) the incentives that it is willing to grant to desired investments; (3) the regulatory controls to which desired investments will be subject; and (4) the governmental apparatus that will administer the foreign investment process. Part II considers each of these legal issues and their impact on foreign investments and investors. It then concludes with a consideration of the challenges of legal change and its impact on investors and governments.

In *Part III, The Contractual Framework*, the book explores the nature of the contractual framework for international investments, and the complex of rules that have been shaped by negotiated agreements between the parties. It begins by discussing the role of contracts in the investment process. Since any investment transaction is invariably the product of negotiation between the parties concerned and the host government, the following chapter

explains the process by which agreements are negotiated and the techniques employed by the foreign investors and governments to advance their respective interests in the process. Part III then examines in detail particular types of investment contracts employed in international investment, especially joint venture agreements, project finance arrangements, and international loans. A separate chapter is devoted to a special kind of contract that is part of many international investment transactions: political risk insurance. Since investment contracts are invariably long-term transactions subject to the vicissitudes of changing circumstances, Part III concludes with a chapter on contractual stability and renegotiation, subjects of vital concern for both investors and host governments.

*Part IV: The International Legal Framework* explores the international rules and institutions for investment to be found in the complex of treaties, customs, and general legal principles that have emerged to protect investment from certain types of injurious actions by host country governments. The international legal framework developed primarily because foreign investors and their home governments judged that the national and contractual legal frameworks in host countries did not afford foreign investments sufficient protection. This part of the book first explores the historical development of the international legal framework, then examines its contemporary elements and principles, and finally considers its effectiveness and the various ways these international rules are applied and investment disputes settled.

To conclude the volume, *Part V* considers how the three legal frameworks interact with each other.

I have worked in the field of the law of international investment for nearly forty years as teacher, scholar, legal consultant, and arbitrator. During that time, I have benefited from invaluable conversations with countless lawyers, economists, government officials, business executives, scholars, arbitrators, and international experts in many disciplines. They are too numerous to list here by name but I am deeply grateful to all of them for helping me understand this important area of law and its relationship to economic growth and development.

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## Contents

<i>Table of Cases</i>	xv
<i>Table of Legislation</i>	xviii
<i>Table of Agreements, Conventions, Rules, and Treaties</i>	xxi
<i>List of Abbreviations</i>	xxv

### PART I: INTERNATIONAL INVESTMENT AND THE LAW

<b>1. The Nature and Significance of International Investment</b>	3
1.1 The Meaning of Investment	3
1.2 The Forms of Investment	4
1.3 The Nature of International Investors	7
1.4 Investors and the Role of Return and Risk	12
1.5 The Nature of International Investment	13
1.6 Forms of International Investment	14
1.7 State and Investor Interests Shaping the Laws of International Investment	18
1.8 Investment and Trade: What's the Difference?	23
<b>2. The Relationship between Law and International Investment</b>	24
2.1 Introduction	24
2.2 Law Enhances or Diminishes the Predictability of Investment Transactions	25
2.3 Law Increases or Reduces Associated Transaction Costs	29
2.4 Law is an Instrument to Direct, Control, and Encourage International Capital Flows	31
2.5 Law Defines and Regulates Investment Rights, Responsibilities, and Relationships	32
2.6 Law is a Means to Resolve Investment Disputes	33
<b>3. Three Legal Frameworks for International Investment: National, Contractual, and International</b>	35
3.1 The Investment Frameworks in General	35
3.2 The National Legal Framework	35
3.3 The Contractual Framework	39
3.4 The International Legal Framework	42
3.5 The Interrelationships of the Three Legal Frameworks	47

### PART II: THE NATIONAL LEGAL FRAMEWORK

<b>4. Factors Shaping National Legal Frameworks for International Investment</b>	51
4.1 Introduction	51
4.2 Four Dominant Attitudes toward International Investment	52
4.3 National Economic Systems and Development Models	59

<b>5. National Regulation of the Exit and Entry of Capital</b>	<b>75</b>
5.1 Introduction	75
5.2 The Authority of States to Regulate International Capital Movements	76
5.3 Regulation of Capital Outflows	82
5.4 Regulation of Capital Inflows	87
<b>6. National Regulation of Foreign Investment</b>	<b>89</b>
6.1 National Foreign Investment Policy and Law	89
6.2 Regulation of Foreign Direct Investment	89
6.3 The Definition of Permitted Investments	92
6.4 Incentives and Guarantees Offered to Foreign Investment	99
6.5 Controls over Foreign Investment Operations	103
6.6 Administration of Direct Foreign Investment Regulations	106
6.7 Host Government Investment Approvals	109
6.8 Privatization of State Assets as a Means to Encourage Foreign Equity Investment	110
6.9 National Regulation of Foreign Portfolio Equity Investment	121
6.10 National Regulation of International Debt Investments	123
6.11 Debt-to-Equity Conversions	131
<b>7. The Challenges of Legal Change</b>	<b>137</b>
7.1 The Nature of Legal Change	137
7.2 The Forces for Legal Change	141
7.3 Investor Strategies for Coping with the Risk of Legal Change	144
PART III: THE CONTRACTUAL LEGAL FRAMEWORK	
<b>8. The Nature and Functions of the Contractual Framework for Investments</b>	<b>159</b>
8.1 In General	159
8.2 Investment Contracts as Legal Instruments	160
8.3 The Economic and Social Functions of Investment Contracts	167
<b>9. The Negotiation of International Investment Contracts</b>	<b>171</b>
9.1 The Role of Negotiation in the Investment Process	171
9.2 The Nature of the Negotiation Process	171
9.3 Barriers to Negotiating an International Investment	174
9.4 The Barrier of the Negotiating Environment	175
9.5 The Barrier of Foreign Laws and Governments	177
9.6 The Barrier of Ideological Differences	177
9.7 The Barrier of Foreign Organizations and Bureaucracies	178
9.8 The Barrier of Multiple Currencies	178
9.9 The Barrier of Political Instability and Sudden Change	179
9.10 The Barrier of Cultural Differences	179
9.11 Negotiating Investment Contracts with Foreign Governments	184
9.12 Negotiating Long-Term Investment Contracts	198
<b>10. The Nature and Content of International Investment Contracts</b>	<b>204</b>
10.1 Introduction	204
10.2 Wholly Owned Foreign Direct Investments	204
10.3 International Joint Ventures	205

<i>Contents</i>	<i>xiii</i>
10.4 International Joint Venture Contracts	209
10.5 The Content of International Joint Venture Agreements	213
10.6 International Investment in Infrastructure	219
10.7 A Case Study of Infrastructure Investment: The Dabhol Power Company in India	233
10.8 International Loan Contracts	239
<b>11. Political Risk Insurance</b>	<b>245</b>
11.1 Political Risk	245
11.2 Political Risk Insurance	246
11.3 National Governmental Programs	247
11.4 The United States Overseas Private Investment Corporation (OPIC)	249
11.5 Multilateral Political Risk Insurance Programs	265
11.6 The Multilateral Investment Guarantee Agency (MIGA)	266
11.7 Private Sources of Political Risk Insurance	272
<b>12. Contractual Stability, Instability, and Renegotiation</b>	<b>274</b>
12.1 The Challenge of Contractual Stability	274
12.2 Defining Renegotiation	276
12.3 Post-Contract Renegotiations	278
12.4 Intra-Contract Renegotiations	281
12.5 Extra-Contract Renegotiation	286
12.6 A Case of Extra-Contract Renegotiation: The Dabhol Power Project in India	288
12.7 Conclusion	301
PART IV: THE INTERNATIONAL LEGAL FRAMEWORK	
<b>13. The Foundations of the International Legal Framework for Investment</b>	<b>305</b>
13.1 In General	305
13.2 International Conventions	306
13.3 International Custom	307
13.4 General Principles of Law	308
13.5 Customary International Law and General Principles of Law Governing Investment	308
13.6 Customary International Law Concerning Expropriation and Breach of State Contracts	314
13.7 Challenges to the Capital-Exporting States' Position on International Investment Law	320
13.8 Perceived Deficiencies of International Investment Law	329
<b>14. The Treatification of International Investment Law</b>	<b>331</b>
14.1 Introduction	331
14.2 Historical Background of the Treatification Process	332
14.3 The Objectives of the Movement to Negotiate Investment Treaties	354
14.4 The Primary Objectives of Investment Treaties	355
14.5 Secondary Objectives of Investment Treaties	357
14.6 Long-Term Goals of Investment Treaties	359
14.7 The Treaty Negotiation Process	360
14.8 Conclusion	362

<b>15. The Nature and Content of Investment Treaties</b>	<b>364</b>
15.1 Introduction	364
15.2 Treaty Structure	364
15.3 Treaty Title and Statement of Purpose	364
15.4 Definitions and Scope of Application of Investment Treaties	365
15.5 Investment Promotion, Admission, and Establishment	377
15.6 General Standards of Treatment of Foreign Investment	383
15.7 Monetary Transfers	393
15.8 Expropriation and Dispossession	393
15.9 Operational and Other Conditions	396
15.10 Losses from Armed Conflict or Internal Disorder	396
15.11 The Consequences of Treaty Violations	396
15.12 Dispute Settlement	397
15.13 Treaty Exceptions, Amendments, and Terminations	398
15.14 Conclusion	400
<b>PART V: CONCLUSION</b>	
<b>16. The Interaction of the Three Legal Frameworks</b>	<b>405</b>
16.1 In General	405
16.2 The National Law–Contractual Framework Interaction	405
16.3 The National Law–International Law Interaction	407
16.4 The Contractual Framework–International Law Interaction	408
<i>Index</i>	411