

Jeswald W. Salacuse

THE THREE LAWS OF INTERNATIONAL INVESTMENT

*National, Contractual, and International
Frameworks for Foreign Capital*



OXFORD

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JESWALD W. SALACUSE

OXFORD
UNIVERSITY PRESS

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Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
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First Edition published in 2013

First published in paperback 2014

Impression: 1

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Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data

Data available

Library of Congress in Publication Data

Data available

ISBN 978-0-19-965456-7 (Hbk.)

ISBN 978-0-19-872737-8 (Pbk.)

Printed in Great Britain by
Lightning Source (UK) Ltd.

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*In Memory of William L. Salacuse,
Attorney & Counselor at Law*

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.

In writing this book, various persons have provided invaluable assistance for which I am grateful. In that regard, I especially want to thank Gaurav Tiwari, Cecelia Vogel, and Hyejin Park for their research help.

Jeswald W. Salacuse

Medford, Massachusetts
August 2012

Preface to the Paperback Edition of The Three Laws of International Investment

I am very pleased that Oxford University Press is publishing a paperback edition of *The Three Laws of International Investment: National, Contractual, and International Frameworks for Foreign Capital*. In writing the book, I naturally hoped to reach as many professionals as possible working in the field of international investment. But I was also especially concerned to provide university students, whether in law, business, or international relations, a comprehensive, yet compact and accessible text for undertaking serious study of the legal aspects of international investment, an increasingly important area of economic activity. It is my hope that this paperback edition will provide students with that desired access.

I have used this book as a basic text on the law of international investment both at Harvard Law School and the Fletcher School of Law and Diplomacy, Tufts University, with gratifying results. The syllabus for the course at Harvard Law School, *International Investment, Development and the Law*, which consists of forty-eight hours of instruction, may be found on the OUP web site at <http://ukcatalogue.oup.com/product/9780199654567.do>, while the syllabus for the course at the Fletcher School, *International Investment Law*, extending over twenty-six hours of instruction, may be found on the Fletcher School website at <http://fletcher.tufts.edu/>

I would also be pleased to receive and respond to readers' comments, questions and criticisms about the book.

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