CHAPTER 4

Practice of International Contract Law

§4.01 GENERAL

The vast majority of international business transactions are based on contracts. While contract issues are consequently discussed throughout all parts of this book, this chapter is meant to address general contract law issues from the point of view of cross-border transactions to provide a basis for the more detailed discussions in the subsequent chapters. It starts with a comparative introduction to basic contract law features followed by a section on pre-contractual documents and agreements and their practical implications. The main part of this chapter then addresses the usual structure and contents of contracts underlying cross-border business transactions. A final section on drafting issues completes this chapter.

It is the goal of the following sections to highlight the most important issues from the viewpoint of legal practice and to provide references which allow easy access to primary and secondary sources. Furthermore, throughout this chapter sample clauses are introduced and discussed. It is important that these sample clauses are for discussion only and should not be simply copied when drafting contracts. In contrast, contracts and other legal documents need to be drafted on the basis of the fact of each individual case and by taking into account the governing law.

§4.02 COMPARATIVE CONTRACT LAW

[A] Introduction

Legal comparativists have traditionally divided the world's legal systems into different legal traditions (also called: legal families), e.g., the Common Law tradition, the Civil Law tradition, religious legal traditions, the socialist legal tradition and so on. The concept of legal traditions has served many purposes. In particular, it has facilitated

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comparative studies by allowing representative comparisons.[1] The concept of legal traditions is, however, very problematic as evidenced by the broad disagreement on how specific legal traditions are to be identified and what the distinguishing features are. Furthermore, in times of globalization of the legal world harmonization and unification efforts take place at different levels and foreign law patterns being copied (transplanted) or at least considered for legislative purposes in many countries. Therefore, almost every legal system is nowadays to a certain extent 'mixed', i.e., incorporates elements from different legal traditions.[2] As this development is gaining further momentum the concept of legal traditions loses its justification.

Comparative work is of course important also from the viewpoint of legal practice. In particular, in the context of cross-border business transactions it is inevitable to consider foreign law and foreign legal concepts when structuring cross-border deals and drafting the supporting contractual documentation. Three of the most fundamental differences between contract law systems are briefly recalled in the following sections. Other more specific aspects are discussed from a comparative point of view in subsequent chapters.

[B] Offer, Acceptance and Consideration

It is nowadays broadly accepted that a contract requires offer and acceptance in relation to an agreement with sufficiently specific, i.e., enforceable, contents.[3] Details differ from jurisdiction to jurisdiction.[4] One of the key features distinguishing Common Law from Civil Law contract law systems is the Common Law doctrine of consideration. According to this doctrine a promise is only enforceable if it is made in a deed or if something is given in return in order to ensure reciprocity among the contract parties.[5] Consequently, a gift contract would not be enforceable unless it is made in the form of a deed.[6] The doctrine of consideration requires that something of some value must be given in return for a contractual promise that is not made in a deed. But, it is not necessary that such the value of such consideration is adequate or even matches the value of the promise.[7] In principle, even a nominal consideration suffices.[8] There is a large and very sophisticated body of case law on different aspects of the doctrine of consideration and library-filling numbers of books and articles discussing the doctrine from various points of view.

The doctrine of consideration is not applied under Civil Law and in other legal traditions.[9] However, in many of these jurisdictions rules are in place to 'ensure', in a similar way, the two main ideas underlying the concept of consideration, i.e.,

1. Örücü 2007, 169.
2. *Ibid.*, 177.
3. Farnsworth 2006, 915.
4. Compare, e.g., for the binding nature of offers Zweigert/Kötz 1998, 357-362.
5. Compare Farnsworth 2006, 208-210.
6. Zweigert/Kötz 1998, 390.
7. Farnsworth 2006, 909; Zweigert/Kötz 1998, 391.
8. Zweigert/Kötz 1998, 391.
9. Farnsworth 2006, 910.

reciprocity or the concept of a bargain.[10] For example, under German law only formal gift contracts are enforceable although once the gift is made the lack of form is not a valid reason to request the return.[11]

[C] Form

In modern jurisdictions, as a matter of principle, informality prevails in contract law. Normally, contracts are, therefore, not subject to special form requirements.[12] However, in all jurisdictions form requirements do exist in relation to special contract types,[13] e.g., gift contracts, contracts for the provision of security, contracts related to real estate or consumer credit contracts. Form requirements serve two main purposes. They ensure that there is documentary proof of contractual arrangements. They may also serve a warning function as the form requirement adds an additional hurdle which will normally remind the parties to (re)consider the agreement they are about to enter into and thus avoid any imprudent action.[14]

Form requirements can be established contractually or by way of law. They can refer to the whole agreement or just the declaration of intention of one party. And, they can require different form types, e.g., written form or notarial form relating to the recording of a statement, to the notarial confirmation of the identity of the person(s) who signed the contract or to the contract contents. The legal consequence of a failure to meet a form requirement may as well differ. It may render a contract void.[15] Alternatively, the lack of the required form could only mean that the agreement cannot be proven in court.[16] Or, the contract may be completely unenforceable.[17]

Finally, rules may vary in different jurisdictions in relation to the use of standard contract forms and standard contract clauses. Standard forms and standard clauses facilitate transactions as they are normally drawn up on the basis of past experience and previously developed wording, thus avoiding unnecessary work and potential sources of error.[18] It is, on the other hand, only natural that a party which uses pre-formulated standard contract forms or clauses will try to adopt wording that is to

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10. *Ibid.*, 909.
11. Articles 516-518 German Civil Code.
12. Zweigert/Kötz 1998, 366.
13. Compare *ibid.*
14. Farnsworth 2006, 914.
15. Compare Art. 125 German *Civil Code*, text available at http://www.gesetze-im-internet.de/englisch_bgb/.
16. Compare s. 1341 French *Code Civil*, text available at http://www.napoleon-series.org/research/government/c_code.html.
17. Compare § 2-201 US *Uniform Commercial Code*, text available at http://www.law.cornell.edu/ucc/ucc.table.html.
18. Farnsworth 2006, 911; Chuah 2013, 3-4 (4: 'customary practice in international commerce for parties to adopt commonly recognized standard terms').

its own advantage.[19] It is, therefore, widely acknowledged that the respective other party may need protection. The use of standard contracts and standard clauses is, therefore, normally subject to some kind of judicial control as to appropriateness and fairness. Many jurisdictions have developed statutory rules or case law for this purpose,[20] although in particular consumer protection rules may often not apply in relation to international business transactions.[21]

[D] Specific Performance

The question if and how contractual rights are enforceable is answered differently by different legal traditions. In Civil Law systems, contractual obligations must be fulfilled as a matter of principle and are, therefore, fully enforceable.[22] If a judgment debtor fails to perform as ordered by a court the judicial system provides for tools to coerce performance, e.g., through fines or – in extreme cases – imprisonment, or by way of allowing a third party to perform in place of the debtor who has to bear the costs. The situation may only differ where the obligation must be fulfilled by the debtor in person due to an agreement or the nature of the obligation.[23]

Common Law takes the same approach only in relation to money claims.[24] In contrast, it does, in principle, not acknowledge that non-monetary contractual obligations are enforceable. Instead non-performance will enable the creditor to claim for damages against the non-performing party.[25] Common Law allows claiming for 'specific performance' only in special situations, that is, where a particular obligation cannot be expressed in a money value.[26]

§4.03 E-CONTRACTS AND SMART CONTRACTS

[A] Introduction

As mentioned above,[27] the evolution of modern computer technology and the Internet over the last 20 years has opened up many new opportunities in the context of cross-border business transactions. At the same time these developments have created challenges and risks, including those from the legal point of view. This section discusses two contract law-related aspects in this context, namely the conclusion of contracts via the Internet as well as special legal features of so-called 'smart contracts'.

19. Chuah 2013, 4: '(A) distinction must be made between those that have been agreed to by parties of equal bargaining power and those imposed on persons on a "take it or leave it" basis.'
20. Compare Farnsworth 2006, 912.
21. Chuah 2013, 5.
22. Farnsworth 2006, 930; Zweigert/Kötz 1998, 472.
23. Zweigert/Kötz 1998, 472.
24. Farnsworth 2006, 931 ('substitutional relief').
25. Zweigert/Kötz 1998, 479.
26. *Ibid.*, 480.
27. Compare *supra* Ch.3, §3.04[B] [10].

[B] E-Contracts

The term e-contract (or: electronic contract) does not have a technical meaning. E-contracts are normally understood as contracts:

> 'formed in the course of e-commerce by the interaction of two or more individuals using electronic means, such as e-mail, the interaction of an individual with an electronic agent, such as a computer program, or the interaction of at least two electronic agents that are programmed to recognize the existence of a contract.'[28]

The increasing use of e-contracts has led to the question if and to what extent electronic communications meet the established requirements of contract law.[29] Major issues of concern in this regard are if special issues must be considered for e-contracts in relation to offer and acceptance, if the electronic form can meet any existing form requirements originally established for paper-based contracts[30] and if electronic signatures can serve the same purposes like signatures by hand. Furthermore, from a procedural point of view it must be decided if and how electronic documents are admissible as evidence.

Many countries have enacted laws or amended existing laws to address these and other issues related to e-contracts.[31] Often these legislative activities have been shaped after the United Nations Commission on International Trade Law (UNCITRAL) *Model Law on Electronic Commerce*,[32] originally adopted on 12 June 1996 and the UNCITRAL *Model Law on Electronic Signatures*,[33] adopted on 5 July 2001. Building upon these instruments UNCITRAL has prepared the *United Nations Convention on the Use of Electronic Communications in International Contracts* [34] (the Electronic Communications Convention), which was adopted by the UN General Assembly on 23 November 2005.

28. US Legal Inc.
29. Compare Bury 2016, 198.
30. Compare, e.g., Art. II 1. of the *Convention for the Recognition and Enforcement of Arbitral Awards* (the New York Convention), in force as of 7 Jun. 1959, Text available at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html according to which enforceability of arbitral awards requires a written arbitration agreement; also cf. *infra* Chapter 10, §10.07[C].
31. Also compare the *Directive (EC) 2000/31 of the European Parliament and Council of 8 June 2000 on Certain Legal Aspects of Information Society Services, in particular Electronic Commerce*, in the Internal Market ('Directive on electronic commerce'), text available http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32000L0031; cf. Svantesson 2012, 280–282.
32. Text available with the Guide to Enactment at https://www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf; also see the OECD *Guidelines for Consumer Protection in the Context of Electronic Commerce*, of 9 December 1999, text available at http://www.oecd.org/sti/consumer/oecdguidelinesforconsumerprotectioninthecontextofelectroniccommerce1999.htm; compare La Torre Jeker et al. 2006, 48–54.
33. Available with the Guide to Enactment at http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/2001Model_signatures.html; also compare e.g. the *Electronic Signatures in Global and National Commerce Act*, in force as US federal law since 1 October 2000, text available at https://www.gpo.gov/fdsys/pkg/PLAW-106publ229/pdf/PLAW-106publ229.pdf.
34. Text available with an Explanatory Note by UNCITRAL at http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/2005Convention.html.

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The Electronic Communications Convention is a state-of-the-art legal framework embodying prevailing concepts regarding electronic communications in the context of international contracts. It is the goal of the Electronic Communications Convention to ensure that e-contracts and other electronic communications are effective and enforceable in the same way as their paper-based counterparts. [35] Its scope of applicability covers electronic communications used when contracting across borders, i.e., the formation and performance of contracts via electronic communications between parties located in different Member States[36] unless the applicability is fully or partly excluded by the parties.[37] The Electronic Communications Convention is currently[38] in force only in seven countries, namely Congo, the Dominican Republic, Honduras, Montenegro, the Russian Federation, Singapore and Sri Lanka.[39] It may, however, also apply based on a valid choice by the parties to a contract.[40]

The Electronic Communications Convention makes it clear that a party is not required to use or accept electronic communications, but that a communication or a contract shall not be denied validity or enforceability only because of its electronic form.[41] Furthermore, the requirement of a written form is met by an electronic communication if the related information is accessible and usable for subsequent reference.[42] The Electronic Communications Convention further stipulates that electronic signatures meet the requirements of a paper-form signature provided that:

(a) a method is used to identify the party and to indicate that party's intention in respect of the information contained in the electronic communication; and
(b) the method is either:
  (i) as reliable as appropriate for the purpose for which the electronic communication was generated or communicated, in the light of all the circumstances, including any relevant agreement; or
  (ii) proven in fact to have fulfilled the functions described in subparagraph (a) above, by itself or together with further evidence.[43]

The Electronic Communications Convention also sets out in which cases an electronic communication equals an original of a communication or a contract.[44] Furthermore, it may be important to determine when a communication is 'dispatched'

35. UNCITRAL at http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/2005 Convention.html.
36. Article 1 para. 1. Electronic Communications Convention; for exclusions see Article 2.
37. Article 3 Electronic Communications Convention.
38. December 2012.
39. Compare UNCITRAL at http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2005Convention_status.html.
40. UNCITRAL at http://www.uncitral.org/uncitral/uncitral_texts/electronic_commerce/2005 Convention.html (last visited on 18 Dec. 2012).
41. Article 8 Electronic Communications Convention.
42. Article 9 para. 2. Electronic Communications Convention.
43. Article 9 para. 3. Electronic Communications Convention.
44. Article 9 para. 4 Electronic Communications Convention.

and received, e.g., to determine when an offer is made and if and when a contract is concluded. According to the Electronic Communications Convention an electronic communication is in principle dispatched when it leaves an information system and it is received when it becomes capable of being retrieved by the addressee.[45]

A proposal to conclude a contract via electronic communications which is not addressed to one or more specific parties qualifies as an invitation to make an offer unless there is a clear indication to the contrary.[46] Finally, input errors in an electronic communication exchanged with an automated message system can, subject to certain preconditions, be rectified by way of a withdrawal of the electronic communication in which the error was made.[47]

[C] Smart Contracts[48]

The concept of smart contracts has become a topical issue since the mid-1990s and has gained further momentum after the invention of digital currencies.[49] A smart contract entails

> 'a set of promises, specified in digital form, including protocols within which the parties perform on the other promises.'[50]

Smart contracts are therefore 'digital contracts' because their contents are set out in digital terms.[51] It is the main feature of smart contracts that they are self-executing and self-enforcing. The notion of self-execution and self-enforcing implies that the contract terms including the performance details and details regarding breach of contract consequences are digitalized, i.e. performance or remedies in case of non-performance or under-performance are not dependent on additional human action.[52] In other words, the digital programming of smart contracts defines conditions the fulfilment of which initiate automated consequences, such as the payment of the purchase price,[53] the issuance of certain documents, the delivery of goods or the payment of damages. Contract parties assign the decision-making upfront to a blockchain[54] system which will automatically execute these instructions upon fulfilment of the pre-defined

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45. Article 10 paras 1 and 2 Electronic Communications Convention.
46. Article 11 Electronic Communications Convention.
47. Article 13 Electronic Communications Convention.
48. Special thanks go to Jenny Chan and Xu Chang who have prepared of a draft version of this section.
49. Tapscott/Tapscott 2016, 102; Blockchain Technologies, 'Smart Contracts Explained'.
50. Szabo 1996, at 'Introduction'; cf. Tapscott/Tapscott 2016, 101; Blockchain Technologies, *ibid.*
51. Blockchain Technologies - Blockchain Technology Glossary, at 'Smart Contracts'.
52. Compare Tapscott/Tapscott 2016, 101.
53. Goh Eng Han 2016/17, 2.
54. The term 'blockchain' stands for 'a type of distributed ledger, comprised of unchangeable, digitally recorded data in packages called blocks (rather like collating them on to a single sheet of paper). Each block is then "chained" to the next block, using a cryptographic signature. This allows block chains to be used like a ledger, which can be shared and accessed by anyone with the appropriate permissions', Blockchain Technologies – Blockchain Technology Glossary, at 'Blockchain'; Goh Eng Han 2016/17, 1–2.

conditions.[55] The execution of smart contracts is consequently unstoppable, irreversible[56] and has therefore been called 'deterministic'.[57] Needless to say that smart contracts cannot only substitute traditional contracts in total. It is also possible to 'smarten' only particular contract parts of a contract, e.g. the payment of the purchase price.[58]

Furthermore, it has been suggested that smart contracts can be embedded

> 'into our physical property ... These embedded smart contracts would automatically grant access to the rightful owner of the property or guests, depending on the parameters of the contract.'[59]

Smart contracts appeal to a variety of transaction types.[60] Apart from the obvious example of sales contracts, smart contracts can, e.g., replace lawyers in managing escrow accounts.[61] In the context of debt financing[62]

> '[*a*] loan could be stored as ... smart contract ... and also with collateral ownership information. In an example where the loan is completed, [*the ownership of the property*] will be transferred [*to the borrower*]. Similarly, if a default occurs and the borrower misses a repayment, then a smart contract could automatically revoke ... his or her [*i.e. the borrower's*] access to the collateral.'[63]

In the area of intellectual property smart contracts provide obvious advantages for the automated calculation and allocation of royalty payments to artists and other parties.[64] What is nowadays standard for patent attorneys when internally managing their clients IP rights, i.e. the computer generated issuance of request letters, filing and renewal applications, payment of fees, etc., would under smart contracts be applied also in relation to other (contract) parties.

It has been claimed that the self-executing character of smart contracts leads to higher efficiency, helps to reduce transaction costs and improves the enforceability.[65] Because of the self-executing nature of smart contracts parties or their agents do no longer have to monitor performance or to act upon non-performance.[66] Moreover, the automated execution of smart contracts also ensures absolute accuracy and preciseness in terms of performance and remedial measures in case of non- or under-performance,[67] subject of course to accurate and precise digital predetermination. The

55. Compare Ou 2016.
56. Koulu 2016, 59.
57. Greenspan 2015, at 'Why private blockchains should not be eager to run code'.
58. Blockchain Technologies, at 'Smart Contracts Explained'.
59. Gord 2016, at 'Smart Property'.
60. Compare Ream/Yang/Schwatsky 2016, at 'Signals' and 'Smart Contract Use Cases'.
61. BBVA Research 2015, 5; for escrow accounts also cf. *infra* Ch.8, §8.15[C][2].
62. Compare *infra* Ch.8, §8.07.
63. Gee 2016, at 'Where else could you use a smart contract?'; cf. BBVA Research 2015, 5; for the use of digital currency, i.e. cryptocurrency, such as Ethereum and Bitcoin, cf. Blockchain Technologies - 'Cryptocurrencies Explained'; Dong et al. 2015, 7–9.
64. Ream/Yang/Schwatsky 2016, at 'Smart Contract Use Cases'.
65. Szabo 1996, at 'Some Basic Principles of Contract Design'.
66. Compare Gee 2016, at 'The middleman is gone; Szabo 1996, *ibid.*, for the increased 'observability' and 'verifiability' of performance and non-performance in the case of smart contracts.
67. Compare Goh Eng Han 2016/17, 2.

verifiability of smart contracts may on the one hand facilitate dispute settlement at least in 'low intensity disputes'.[68] On the other hand digital codes of smart contracts will have to be translated back into a human-readable form in order to be accessible for the dispute settlement process.[69] Finally, smart contracts reinforce the notion of '*pacta sunt servanda*' in that performance is on the one hand automated, i.e., unstoppable. Even if this leaves any room for non- or under-performance related consequences are predetermined thus making non-performance potentially unviable.[70]

The perceived advantages of smart contracts do of course at the same time also carry downsides. First, the legal profession generally lacks familiarity with smart contracts and related technical issues. Furthermore, accepted industry standards do not exist. The development of smart contract designs which cater to the specific needs of the involved parties is therefore a very challenging task.[71] At the same time very sophisticated legal advice will be needed due to the complexity of the issues involved. While legal innovation always requires the development of expertise and skills, in the case of smart contracts the degree of non-law related IT knowledge required to address the issues involved appropriately leads to very special challenges.

Second, as explained, it is the special feature of smart contracts that they are self-executing. Once put in action they are irreversible. In practice, however, it may be difficult to design smart contracts which adequately reflect the true intentions of the parties without the option to make adjustments at a later point of time.[72] In fact, the self-executing nature of smart contracts eliminates any flexibility of the parties to react to developments not appropriately addressed upfront in the digitalized contract terms. In other words, without any renegotiation function,[73] once the digital codes are entered, the terms of smart contracts are fixed and cannot be changed thus eliminating the option to respond to unforeseen developments. The problem cannot be addressed simply by adding a renegotiation function because in this case a smart contract would no longer be 'algorithmically deterministic'[74] and thus the self-executing nature of the contracts would be defeated. In other words, smart contracts are rigid in that they can only provide for automated action in relation to predetermined parameters. In contrast, anything outside these parameters cannot be addressed.[75]

Third, smart contracts are unable to record contractual obligations which are defined in an indeterminate manner. One may argue that this is only a spurious argument for contractual categories like 'reasonableness' and 'appropriateness', as the use of smart contracts will force the parties to avoid unclear terminology of this kind

68. Koulu 2016, 66; cf. Gee 2016, at 'See you in court!'.
69. Compare Szabo 1996, at 'Contracts Embedded in the World'.
70. *Ibid.*
71. Koulu 2016, 64: 'Reviewing a smart contract's code is difficult and time-consuming for a lawyer.'.
72. Lim/Saw/Sargeant 2016, at 'How does a smart contract compare to a dumb contract?'
73. Compare Gee 2016, at 'See you in court!'.
74. Lim/Saw/Sargeant 2016, at 'How does a smart contract compare to a dumb contract?'; cf. BBVA 2015, 5.
75. Compare BBVA 2015, *ibid.*

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and thus reduce the potential for disputes significantly. However, it appears doubtful if indeterminate terms can be completely avoided with the goal to make smart contracts 100% deterministic. In other words, while a perfect smart contract should not leave any room for interpretation, it is questionable if this vision is practical.

Fourth, another downside of smart contracts is the fact that the possibility to (self-)execute smart contracts is limited when performance requires additional acts which are outside the scope of what can be achieved digitally. One example is the legal requirement to register any property transfer with public authorities. Furthermore, smart contracts can only (self-)execute any decision if relevant information regarding the fulfilment of predetermined conditions is received digitally. This means that smart contracts must have access to external accounts or instructions must be given from external accounts.[76] Smart contracts are unable to proactively deal with ambiguities, check legal issues arising in the context of the execution[77] or 'quer[y] an external database and change [] its own state based on the outcome of the query.'[78]

Fifth, smart contracts are vulnerable to cyber-crimes as the example of the hacking of the Smart Contract platform in mid-2016 has demonstrated[79] which led to the theft of the equivalent of USD 72 million in digital currency.[80] *Vice versa*, smart contracts may be used for illegal activities such as tax evasion, money laundering and fraud and regulators need to consider how to address this risk.[81]

Attention has also been drawn to the fact that

> 'Blockchain requires a significant amount of computing power, which used to be taken care of by a central authority's servers and data centres. ... Furthermore, a common problem in blockchain implementations is ... they are often much slower than systems we have today. In the case of "smart contracts", the blockchain can only execute a contract after checking the entire database for the required information.'[82]

Sixth, many legal questions regarding smart contracts are still unclear. Discussions at the domestic and international law levels regarding the question if and how smart contracts fit into existing legal frameworks or whether special legislation is needed have just begun.[83]

> 'As blockchain-based applications like smart contracts are gaining ground, reactions from the legal system are required. These reactions are not limited to questions about how we regulate cryptocurrencies, or user communities advocating for them. There are subtler questions: for example, what does the irreversibility

76. Rikken 2017, at 'Smart contracts can operate fully autonomously'.
77. Lim/Saw/Sargeant 2016, at 'How does a smart contract compare to a dump contract?': 'Smart contracts operate without reference to any external legal framework ...'
78. Rikken 2017, at 'Smart contracts can operate fully autonomously'.
79. Baldwin 2016; cf. Goh Eng Han 2016/17, 3-4.
80. I.e. 'Cryptocurrency', cf. Blockchain Technologies - 'Cryptocurrency Explained'.
81. McMillan 2017, at 'Regulatory and policy settings'.
82. Goh Eng Han 2016/17, 3.
83. Compare from the viewpoint of digital currency Dong et al. 2015, 25.

> of blockchain transactions mean from the legal perspective? How do we provide such an infrastructure with effective redress mechanisms, or can we at all? What assumptions are we making within smart contracts, e.g. if we assume the parties to be equal, rational actors, is there room for taking imbalances in their power relations into consideration? ... Another issue relates to the possibilities provided by anonymity.'[84]

From the viewpoint of international business transactions it has been predicted that

> '[*i*]n the future the size [*of*] distribution of multinational companies will approach that of local business, giving rise to Multinational Small Business. Legal barriers are the most severe cost of doing business across many jurisdictions. Smart contracts can cut through this Gordian knot of jurisdictions.'[85]

In fact, the advantages of smart contracts as described above should on the one hand also apply to cross-border business transactions. And, the special features of smart contracts may offer practical benefits in particular in cross-border business transactions. For example, at least in theory they allow for perfectly simultaneous performance by the different contract parties.[86] This may be a major advantage in the cross-border context in light of the difficulty to monitor action taken by the parties across jurisdictions.

On the other hand the general challenges associated with the smart contracts as described above do of course also apply in the cross-border context. In addition, as in all cross-border transactions, the determination of the applicable law is of crucial importance. While this is true also for smart contracts, it must be considered again that law and legal practice governing different aspects of smart contracts are underdeveloped almost everywhere leading to even bigger disparities between different jurisdictions and thus even more potential for disputes.[87]

> 'The differences in laws across jurisdictions – including matters as basic as ownership laws – can be highly problematic, resulting incongruent rights and responsibilities, and confusion regarding the consequences if there is a contract violation.'[88]

As the call for comprehensive legislative action to address issues of smart contracts intensifies it has been suggested to develop standard rules in the form of international conventions or model contracts to remedy the situation.[89]

84. Koulu 2016, 67.
85. Szabo 1996, at 'Some Basic Principles of Contract Design'.
86. Compare Szabo 1996, at 'Contracts Embedded in the World'.
87. See for the suitability of the CISG to address issues of smart contracts, Gregory 1999, at 'The Need for a Convention on E-Contracts': The CISG '... does not apply readily to all aspects of electronic contracting ... such as the effect of errors, or whether a trading partner agreement will work.'
88. McMillan 2017, at 'Jurisdictional issues'.
89. Cf. Gregory 1999, at 'The Need for a Convention of E-Contracts'.

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Finally, due to their complex nature and the uncertainty surrounding related legal aspects smart contracts are for the time being the exception rather than the norm.[90] Currently, the FinTech industry is spearheading the development. However, other business sectors will follow, and lawyers and legislators will have to prepare for the challenges to come. In fact, the development of

> '[e]xpertise in smart contracts could be a big opportunity for law firms that want to lead innovation in contract law.'[91]

§4.04 PRE-CONTRACTUAL DOCUMENTS AND AGREEMENTS

[A] Introduction

The conclusion of contracts relating to international business transactions is often preceded by the signing of other (pre-contractual) documents and agreements. The most important types of these documents and agreements are described in this section. The names and titles used in the following for these documents and agreements are the most common ones. However, normally they are not technical terms. Courts and other dispute settlement bodies will, in any event, usually rely on the contents of a particular document or agreement rather than on the name or title of a document. For the drafting, interpretation and implementation of pre-contractual documents the focus, therefore, has to be on the substantial contents rather than on the form.

Documents and agreements signed during the pre-contractual stage may give the impression that they are signed with the intention of the parties to enter into a final agreement. Subject to the rules of the applicable law in each individual case, this may lead to the liability of any party being responsible if such final agreement will eventually not be concluded. To avoid this effect pre-contractual documents and agreements may provide for an express exclusion of such liability. Whether or not the risk of pre-contractual liability exists and whether this pre-contractual liability can be excluded contractually must be decided on the basis of the facts of each particular case in light of the applicable law.

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90. Goh Eng Han 2016/17, 4 ('unlikely to take the world by storm'); for the limitation of smart contracts to particular industry sectors see Ream/Yang/Schwartsky, at 'Smart Contract Use Cases'.
91. Tapscott/Tapscott 2016, 103.

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SAMPLE CLAUSE FOR DISCUSSION ONLY

Pre-contractual Document – Exclusion of Liability for Failure to Conclude Final Agreement

'The Parties are signing this ... [*pre-contractual document*] with a view to enter into ... [*final agreement*]. However, neither Party shall have any obligation to enter into such ... [*final agreement*]. Furthermore, neither Party shall be liable if such ... [*final agreement*] will not be concluded whether this is a result of either Party's action or failure to act or of any other reason. In particular, the signing of this ... [*pre-contractual document*] shall not create any obligation of either Party to enter into ... [*final agreement*].'

In larger transactions the parties may agree on a break-up fee (also called: 'break fee' or 'termination fee' or 'inducement fee') to be paid either by one party or by both parties in case that the parties cannot close or implement the deal.[92] The original idea of a break-up fee was to reimburse the respective other party for costs incurred. However, in modern practice the break-up fee may also serve the purpose to prevent parties to simply walk away from a deal.[93]

[B] Confidentiality Agreements

As the name suggests, Confidentiality Agreements (also called: 'CAs', 'non-disclosure agreements' or 'NDAs') are agreements which are concluded with the goal to oblige one or all the parties not to disclose certain information to third parties. The importance of confidentiality is, of course, not limited to the pre-contractual stage and confidentiality arrangements may consequently be an issue throughout the entire term of a cooperation project and beyond.

During the pre-contractual stage, Confidentiality Agreements usually aim at the non-disclosure of three different information items:

- confidential information disclosed by one or all of the parties during the pre-contractual stage, in particular during negotiations;
- the fact that the parties are negotiating;
- the fact that the parties have entered into the Confidentiality Agreement.

In most cases, the first item will be the most important one. In order to allow the other parties to assess the viability of a project during the pre-contractual stage, it will often be necessary to disclose sensitive information, e.g., of a technical or business nature. Confidential information derives its particular business value from the fact that

92. Hanke/Socher 2010, 1261; Luk 2016, 37.
93. Hanke/Socher, *ibid.*

it is not available to third parties. It is, therefore, essential for the sake of protecting the interests of the owner of the information to keep the information confidential during and after the pre-contractual stage whether a contract will finally be concluded or not. From the viewpoint of drafting technique, different ways exist to define information which shall be subject to the confidentiality obligation. While it is normally not practical for a contract to declare all information disclosed, e.g., during the negotiations by one party to the other, as confidential, confidential information can be expressly listed in the contract. Alternatively, the contract can require the parties to declare to the respective other party that (only) particular information items shall be subject to the non-disclosure obligation.

SAMPLE CLAUSE FOR DISCUSSION ONLY

Confidential Information – Definition

'"Confidential Information" shall mean any information disclosed in the written form [*in any form/irrespective of the medium*] by either Party to the other Party prior or during the Negotiations which is marked "CONFIDENTIAL" or accompanied by a written statement declaring that the information is "CONFIDENTIAL" and provided that the information would be regarded as confidential by a reasonable person.'

In addition to information related to the substance of the project, the parties may also have an interest in keeping confidential the fact that they are negotiating or that they have entered into the Confidentiality Agreement as this may affect relationships with customers, creditors, debtors, other business contacts or – in case of listed companies – share prices.

While it stands to reason that the obligation to treat confidential must be set out in clear terms with reference to the definition of those information items that are subject to the non-disclosure obligation, Confidentiality Agreements which fail to meet this requirement are, in practice, not uncommon.

The obligation to treat confidential is normally supplemented by the obligation to use information provided by the other party only for a specific purpose, such as the assessment of the viability of the transaction or the negotiations. Furthermore, often the obligations to return or destroy hard copies and files containing the confidential information and not to produce or keep any copies are often expressly set out in Confidentially Agreements.[94]

In practice, Confidentiality Agreements are often rather short. They may, however, also address issues like the contract language, notices and severability.[95] The International Chamber of Commerce (ICC) has published a *Model Confidentiality Agreement* and a Model Confidentiality Clause which can serve as the basis for drafting

94. Christou 2015, 83–85.
95. *Infra* §4.05.

purposes.[96] The usual contents of Confidentiality Agreements are as shown in the following chart:

CASE STUDY FOR DISCUSSION ONLY

Confidentiality Agreement – Contents

(1) Preamble/Recitals/Introduction[97]
(2) Parties[98]
(3) Obligation to treat confidential
- information provided by parties for the purpose of the negotiations/for the purpose of a business project
- existence of Confidentiality Agreement
- fact that parties negotiate

(4) Obligation to use confidential information only for purpose of the negotiations/of a business project
(5) Obligation to return/destroy hard copies/files provided and not to produce/keep any copies
(6) Liability for breach of Confidentiality Agreement
(7) Time limits
(8) Governing law[99]
(9) Dispute settlement[100]
(10) Place/Date[101]
(11) Signatures[102]

It may be particularly difficult to enforce Confidentiality Agreements in practice. It would be for the claimant to prove that the other party has leaked information in violation of the agreement, that the other party has used the confidential information contrary to the purpose of the agreement or that hard copies and files have been duplicated or not returned or destroyed as required under the Confidentiality Agreement. The provision of evidence in this regard may be difficult. Related risks have to be considered when making the decision to disclose information to the other side.

Finally, the detailed rules of the applicable law must be assessed carefully. For example, it must be assessed if contractual confidentiality obligations are subject to time limits or if the parties should impose time limits contractually.

96. Compare International Chamber of Commerce 2006.
97. Compare *infra* §4.05[E].
98. Compare *infra* §4.05[D].
99. Compare *supra* Ch.3, §3.04[B][6] and *infra* §4.05[M].
100. Compare *infra* §4.05[N], Ch.10, §10.09.
101. Compare *infra* §4.05[R].
102. Compare *infra* §4.05[R].

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[C] Exclusivity Agreements

During the pre-contractual stage, Exclusivity Agreements aim to prevent negotiations with third parties for a certain period of time in relation to the same subject matter. The purpose of Exclusivity Agreements is to guarantee permanent availability of the parties with an uninterrupted focus on the negotiations. This kind of 'stand still arrangement' also eliminates the possibility of 'bidding wars', that is, situations where parties use the discussions with other parties to improve their bargaining power.

Exclusivity Agreements are also common during other stages of cross-border cooperation projects. In particular, exclusivity is often agreed in the context of and distributorship arrangements when either the agent or the distributor are not meant to work for other principals or when the principal is not allowed to employ other agents or distributors or when both sides, principal and agent/distributor, are bound under the exclusivity arrangement.[103]

The structure of Exclusivity Agreements usually follows the structure of Confidentiality Agreements as set out above[104] with the obligation to treat confidential to be replaced with the obligation to cooperate exclusively.

SAMPLE CLAUSE FOR DISCUSSION ONLY
Exclusivity Agreement - Obligation to Negotiate Exclusively
'From ... *[date]* to ... *[date]* the Parties will negotiate exclusively with each other in relation to ... *[project name or description]* and any similar projects.'

In M&A transactions, cost coverage undertakings in Letters of Intent (LoIs)[105] or Memoranda of Understanding (MoUs)[106] are sometimes used as alternatives to Exclusivity Agreements. Cost coverage undertakings allow the vendor to continue negotiations with more than one interested party, if this party agrees to reimburse a 'preferred bidder' for any costs incurred during the negotiations in the case that a deal is not closed with this party.[107]

Unlike exclusivity agreements, so-called 'lock-in agreements' oblige the seller

> 'to continue negotiating the transaction in good faith with the buyer within a certain time limit. Lock-in agreements have been unanimously held to be unenforceable in *Walford v Miles* [1992] 2 AC 128 where it was held that an "agreement to negotiate" is like an "agreement to agree" which voids for uncertainty. This principle was followed in *Hyundai Engineering & Construction v Vigour* [2005] 1

103. Compare *infra* Ch.5, §5.12[B][4] and §5.12[C][2].
104. *Supra* §4.04[E].
105. *Infra* §4.04[D].
106. *Infra* §4.04[E].
107. Hanke/Socher 2010, 1261.

> HKC 579 (CA) for the rationale that in some cases part of the negotiating tactic may be to call off the negotiations hoping that better terms would be offered.'[108]

The enforceability of lock-in agreements must of course be assessed separately on the basis of the applicable law and against the background of the particular facts of each case.

[D] Letters of Intent

LoIs are pre-contractual documents with which one party expresses its intention to enter into a particular project.[109] LoIs are, in practice, often regarded as identical with MoUs.[110] However, traditionally a difference was made between LoIs and MoUs to the extent that LoIs are issued by one party whereas MoUs are issued by more than one party jointly. Again, in practice this difference does no longer have any significance.

LoIs are normally not supposed to be legally binding. In contrast, they set out preliminary terms to be discussed and negotiated further.[111] The main purpose of LoIs is that parties who have had initial talks without having been able to reach an agreement often wish to 'take something home'. LoIs seem to show that the negotiations have not been in vain. They summarize the results of the discussions with an emphasis on the parties' intention to close the deal. LoIs can also be helpful to obtain preliminary confirmation that financing will be made available, e.g., during the bidding process of an auctioned sale of a target company.[112]

The fact that LoIs are normally not intended to create legally binding obligations causes sometimes problems in practice. Depending on the applicable law, courts may assume binding force where the parties have adhered to a LoI for a considerable period of time. Furthermore, special attention must be given to the drafting of LoIs, i.e. wording must be chosen which excludes the possibility of any binding force where such binding force is in fact not intended.[113] In particular, where LoIs are signed without the involvement of lawyers the wording may sometimes not be as straight forward as assumed. Express statements to reinforce the non-binding nature of the LoI are therefore useful in this regard. Sometimes this non-binding intention is expressed by the phrase 'subject to contract'.[114] However, even clearer language may be preferable.

108. Luk 2016, 14; for the enforceability of so-called 'lock-in agreements' cf. *ibid.*
109. Compare *ibid.*, 1261.
110. *Infra* §4.04[E]; Gran 2008, 2010.
111. Fajans/Falk/Shapo 2015, 519; Hanke/Socher 2010, 1261.
112. Compare *infra* Ch.8, §8.06[C].
113. Compare Fajans/Falk/Shapo 2015, 519.
114. Compare Christou 2015, 49–50.

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SAMPLE CLAUSE FOR DISCUSSION ONLY

Letter of Intent – Confirmation of Non-binding Nature

'This Letter of Intent is signed for convenience only. This Letter of Intent is not legally binding upon and is not enforceable against either of the Parties.'

LoIs can, however, create moral obligations or have psychological effects as they reaffirm the issuing party's intention to proceed. And, even if a LoI is carefully drafted and in fact not legally binding it may still create at least some kind of *de facto* expectation. As a result, any deviation from the LoI contents, e.g., in subsequent negotiations may lead to justification needs. In particular, in Asia it is in practice often been difficult to reach agreement on terms different from those set out in LoIs. It can, therefore, be useful to limit the level of detail of LoI contents.

[E] Memoranda of Understanding

As already mentioned,[115] MoUs are often used synonymously with LoIs. It may have been the traditional understanding that MoUs are signed by two or more parties, whereas LoIs are issued by only one party.[116] Others regard MoUs as 'initial agreement on the general principles of the transaction' and in this regard as similar to, what is otherwise called, 'Heads of Agreement'.[117]

[F] Position Papers

Position Papers are non-legally binding summaries of negotiations.[118] The term 'Position Paper' is, however, not a generic term and also not often used in practice.

[G] Term Sheets

A Term Sheet is a list of issues in relation to which the parties have already achieved an agreement or in relation to which the parties intent to reach an agreement.[119] A Term Sheet is normally not supposed to be legally binding. As in the case of LoIs,[120] it must be assessed in each individual case if this corresponds with the real intentions of the parties and the contents of the Term Sheet must be drafted accordingly.

115. *Supra* §4.04[D].
116. Hanke/Socher 2010, 1261.
117. Christou 2015, 50.
118. Hanke/Socher 2010, 1261.
119. Compare *ibid.*, 1262.
120. *Supra* §4.04[E].

[H] Heads of Agreement

Heads of Agreements are normally, but not always, meant to be legally binding. They confirm contractually the issues in relation to which the parties intend to reach an agreement.[121] Heads of Agreements may even expressly oblige the parties to conclude the final agreement provided that the essentials of such final agreement are available or that the Heads sets a method how these essentials are to be determined, e.g., by a court, arbitrators or other independent third parties. In this regard, a Heads of Agreement (sometimes also called: 'Letter of Understanding'[122]) is an agreement to agree. Difficult legal questions can arise if the parties fail to conclude the final agreement. If this failure lies within the responsibility of one party, such party may be subject to (pre-contractual) liability under the governing law. The situation may be even more complicated where the obligation of the parties to conclude the final agreement has not been expressly set out in the Heads of Agreement. These and other difficulties should be avoided by way of meticulously drafted documents although it may in practice not always be possible to cover all eventualities at the time of the conclusion. An express statement confirming to what extent the parties want the Heads of Agreement to be legally binding can at least avoid some misunderstanding and reduce the potential for later disputes.

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[I] Instructions to Proceed

Parties sometimes agree on particular obligations during the pre-contractual stage. The legally binding document which sets out these obligations, but is normally not related to the contents of the contract under negotiation, is sometimes called Instructions to Proceed.[123]

[J] Combinations

Pre-contractual documents may be combinations of the above.[124] In practice, Confidentiality Agreements often contain clauses ensuring exclusivity. Furthermore, in many cases LoIs incorporate confidentiality and exclusivity arrangements. In these situations the wording of the LoIs will have to address the fact that parts of the LoIs, i.e., those on confidentiality and exclusivity, are legally binding whereas the rest is not. Furthermore, as a matter of good drafting practice a LoI which (also) establishes binding obligations should provide at least for stipulations on the applicable law[125] and dispute settlement.[126] The same is true, e.g., in relation to the wording of a LoI that

121. Hanke/Socher 2010, 1263.
122. Compare Fajans/Falk/Shapo 2015, 523.
123. Hanke/Socher 2010, 1262.
124. *Ibid.*, 1261.
125. Compare *infra* §4.05[M].
126. Compare *infra* §4.05[N] and Ch.10.

CHAPTER 7

Cross-Border Services

§7.01 GENERAL

Cross-border service arrangements are based on contracts normally relating to the supply of services: (i) from the territory of one country into the territory of another country, (ii) in the territory of one country to a service consumer of another country, (iii) by a service supplier of one country through commercial presence in the territory of another country, or (iv) by a service supplier of one country through the presence of natural persons in the territory of another country.[1]

Cross-border services are becoming increasingly important globally although the development has slowed down in recent years as a result of economic problems in China and Brazil and fluctuating exchange rates.[2] According to WTO statistics, in 2015 world exports of commercial services declined by 6% year on year to USD 4,754 billion.[3] In particular, growth rates in Europe, Russia, and Canada were down in double-digits year on year[4] while only the Middle East, China and Argentina showed positive growth rates of 5%, 2% and 1%, respectively.[5] This seems to confirm predictions made as early as in 2005 that the future may bring a relocation of service industries from developed to developing countries reflecting trends in the manufacturing industries over the past decades.[6] In 2015, 53% of the global volume in commercial services were generated by the 10 leading exporting countries, i.e., the US, the UK, China, Germany, France, the Netherlands, Japan, India, Singapore and Ireland.[7]

1. Compare GATS Articles 1, 2.
2. Compare WTO 2016, 16.
3. WTO 2016, 16, 91.
4. *Ibid.*
5. WTO 2016, 91.
6. Chow/Schoenbaum 2005, 17.
7. WTO 2016, 15, 96.

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Cross-border trade in services can take very different forms and relate to different industries. Cross-border trade in services can, e.g., entail:

- consultancy (e.g., tax, accounting, design, IT);
- legal services;
- training (show-how[8]);
- cultural performance;
- banking and finance;
- management;
- language services;
- security services;
- town, landscape and garden planning;
- architecture and construction;
- transport and logistics;
- medical services;
- travel services;
- communications;
- distributorship and agency;
- sports services;
- audio-visual services;
- R&D; and
- development, installation and maintenance (e.g., of IT systems).[9]

In practice, different service types are often combined. Due to the resulting diversity of cross-border service models and the fact that many services are nowadays provided online,[10] related legal issues can be rather complex. The following sections are aimed to give a broad overview. Certain contract types such as those related to finance[11] and transport[12] are covered in earlier chapters. Aspects of cross-border employment relationships will be addressed in the context of the discussion of legal aspects concerning cross-border investments.[13]

Finally, intermediaries can of course also be used in the context of trade in services. Whether a contract is:

> 'one where the defendant agreed merely as agent to arrange for services to be provided by others, in which case there is an implied term that he will use reasonable care and skill in selecting those other persons, or one where the defendant agreed to supply the services, in which case there is an implied term that

8. Döser 2001, 119; Easson 1999, 117.
9. Also cf. the list of services provided in the WTO's *Services Sectoral Classification List* of 10 Jul. 1991, text available online at http://www.wto.org/english/tratop_e/serv_e/mtn_gns_w_120_e.doc; Raworth 2005, 6–12; Miller/Oats 2016, 307.
10. Compare *supra* Ch.1, §1.04[B], Ch.3, §3.04[B][11] and Ch.4, §4.03.
11. *Supra* Ch.5, §5.07 and §5.08.
12. *Supra* Ch.5, §5.06.
13. *Infra* Ch.8, §8.09.

> he will as supplier of the services carry out the services with reasonable care and skill.'[14]

§7.02 DOMESTIC LAW AND TRADE IN SERVICES

Purely domestic as well as cross-border service arrangements are, first of all, subject to domestic contract law rules. It is for the applicable private international law rules[15] to determine the governing regime. Domestic law often establishes barriers to or imposes restrictions or prohibitions on cross-border service arrangements. These restrictions and prohibitions may take the form of nationality requirements, residency requirements or operational requirements, e.g., in the form of procedures that must be followed, restrictions on capital transfers or prohibitions for special types of services.[16] Domestic tax law may impose taxes on the provision of services[17] or profits made through the provision of services.[18] The reasons behind this kind of barriers, restrictions and prohibitions can range from public security or health concerns, purely statistical interests, the need to generate revenue to support government operations to blunt protectionism.[19]

The 'intangible' nature of cross-border services, as opposed, e.g., to the exchange of 'tangible' goods against money in the case of trade, leads to greater complexities when it comes to design legal regimes.[20] In addition, the specifics of particular service types may vary significantly. Consequently, domestic contract law often has to provide for rather different rules to cater for the variety of types of service contracts. More common service contract types may be subject to elaborate tailor-made regimes. In contrast, special rules may not be available for less common or more innovative contract types with the result that general contract law governs or that rules developed for other contract types have to be applied by analogy.

It is not surprising that the disparities of domestic rules governing different service contract types are mirrored by the differences of rules applied in different jurisdictions. This is in particular true as far as breach of contract rules and available remedies are concerned. To minimize the potential for disputes arising out of these differences, contractual arrangements governing the cross-border provision of services are normally rather comprehensive.[21]

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14. Bugden/Lamont-Black 2010, 1.
15. *Supra* Ch.3, §3.04[F].
16. Raworth 2005, 16–17.
17. In the form of indirect taxes, cf. *infra* Ch.9, §9.01[A].
18. In the form of direct taxes, cf. *infra* Ch.9, §9.01[A].
19. Also cf. *supra* Ch.5, §5.14.
20. Raworth 2005, 1: 'The essence of a service transaction, on the other hand, is the conferral of an intangible benefit ...'; cf. Chow/Schoenbaum 2015, 15 ('no package crossing a national boundary and a customs frontier').
21. Döser 2001, 120, 98; cf. *infra* §7.04.

§7.03 INTERNATIONAL LAW AND TRADE IN SERVICES

[A] Introduction

As already mentioned, domestic law often imposes barriers to and restrictions on cross-border services.[22] Unlike other areas where initiatives at the supranational level aim first of all at the harmonization of domestic rules in a particular area, the main goal of international initiatives related to cross-border services is the liberalization of trade in services. The focus is on ensuring market access, national treatment [23] and most-favoured-nation treatment[24] as well on guaranteeing the transparency of domestic law, its fair application and the availability of a review process.[25] The following sections summarize major international initiatives in this regard.

[B] GATS

The *General Agreement on Trade in Services* (GATS)[26] is probably the most prominent international treaty system addressing cross-border service issues. GATS forms part of the *Final Act Embodying the Uruguay Round of Multilateral Trade Negotiations* signed in Marrakesh on 15 April 1994 by ministers of the WTO founding states.[27] The *Final Act* and GATS have entered into force on 1 January 1995.[28]

GATS is divided into six parts: Part I determines the scope of applicability of GATS. Part II on 'General Obligations and Disciplines' establishes basic obligations of the GATS Member States, such as the obligation

- to provide most-favoured-nation treatment;[29]
- to meet transparency requirements, e.g., in relation to the publication of relevant laws and regulations as well as relevant data;[30]
- to administer restrictions imposed on trade in services in a 'reasonable, objective and impartial manner';[31]
- to establish a review system in relation to administrative decisions regarding trade in services;[32] and

22. Raworth 2005, 1.
23. The national treatment requirement obliges States 'not to discriminate between domestic and foreign services and service suppliers by treating foreign services and suppliers less favorably than like domestic services and suppliers', Wolfrum/Stoll/Feinäugle 2008, 397.
24. Most-favoured-nation treatment means that advantages granted by a state to a third state or person must be no less favourable than treatment granted by the granting state to a third state or to persons or things in the same relationship with that third state, Wolfrum/Stoll/Feinäugle 2008, 73.
25. Compare Raworth 2005, 12-27.
26. Text available online at https://www.wto.org/english/docs_e/legal_e/26-gats.pdf.
27. See WTO Texts (under 'General Agreement on Tariffs and Trade').
28. *Supra* Ch.3, §5.03[B].
29. Article II GATS.
30. Articles III and III *bis* GATS.
31. Article VI (1) GATS.
32. Article VI (2) GATS.

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- to meet requirements related to the recognition of qualifications for the purpose, e.g., of obtaining authorizations and licenses.[33]

However, GATS adopts a positive-list modality whereby the liberalization obligations only apply to the sectors listed, which themselves are subject to limitations and conditions inscribed'.[34] This means that it is for the GATS Member States to negotiate commitments amongst themselves.[35] In other words, Member States are free to decide which sectors they want to liberalize.[36]

Part III of GATS, titled 'Specific Commitments', addresses issues of market access and national treatment to which the Member States subscribe in so-called national schedules.[37] Part IV on 'Progressive Liberalization' calls for further rounds of negotiations and the development of national schedules to continue the process of service sector liberalization in the future.[38] Part V contains 'Institutional Provisions' on consultations between the Member States, dispute settlement and enforcement, the establishment, constitution and operation of a Council for Trade in Services, technical cooperation and the relationship with other international organizations. 'Final Provisions' are set out in Part VI. Annexes to GATS deal with exemptions from GATS obligations, the movement of natural persons supplying services under GATS, air transport services, financial services, negotiations on maritime transport services, telecommunications and negotiations of basic telecommunications. GATS is further supplemented by a number of instruments in the form of decisions and one understanding.[39]

[C] TiSA

Since March 2013, 23 WTO members, including the EU representing the 28 EU Member States, are negotiating the *Trade in Services Agreement* (TiSA). Together the negotiating parties account for 70% of the global trade in services.[40] It is the goal of the TiSA negotiations to liberalize the international services sector by

> 'improving rules in areas such as licensing, financial services, telecoms, e-commerce, maritime transport, and professionals moving abroad temporarily to provide services.'[41]

33. Article VI (4) GATS.
34. Roy/Marchetti/Lim 2007, 158; Roy/Marchetti/Lim 2008, 80.
35. Article XIX GATS; cf. Raworth 2005, 32.
36. Raworth 2005, 32.
37. WTO Part III.
38. WTO Part IV.
39. Texts available online at http://www.wto.org/english/tratop_e/serv_e/gatsintr_e.htm.
40. European Commission 2017.
41. *Ibid.*

TiSA is based on GATS and could eventually become part of the WTO/GATS regime.[42] All WTO members are free to join the negotiations. China's request to join the negotiations is currently[43] pending.[44]

The TiSA negotiations have been heavily criticized for being conducted in secret and for not being transparent.[45]

[D] OECD 'Sub-global' Instruments[46]

Certain instruments employed by the Organisation for Economic Co-operation and Development (OECD)[47] address issues related to trade in services.[48] These instruments only apply to the currently[49] 35 OECD Member States,[50] but have been opened up to non-OECD states since 2012.[51] The instruments are in particular the *Code of Liberalisation of Current Invisible Operations* in its latest version of 2016[52] and the *Code of Liberalisation of Capital Movements* in its latest version of the same year.[53] The *Code of Liberalisation of Capital Movements* has been under review by an Advisory Task Force 'with a view to strengthening it and ensuring its continued relevance'.[54] Both *Codes* create commitments for the governments of the OECD Member States to eliminate restrictions between each other in relation to capital movements including underlying services such as those relating to capital transfers, and in relation to 'invisible operations', i.e., the transfer of of intangible goods such as intellectual property rights and trade in services. Some of the major principles of the Codes are as follows:[55]

- With minor exceptions, OECD member countries may not introduce new barriers but are committed to furthering the ultimate goal of liberalization.
- The situation of Member States which decide to maintain certain restrictions on the free flow of capital and services will be examined periodically and explanations will be required.

42. *Ibid.*
43. July 2017.
44. European Commission 2017.
45. Compare Dayen 2015.
46. Raworth 2005, 13, 71–85.
47. *Supra* Ch.5, §5.03[A][3].
48. Compare Raworth 2005, 71–85.
49. July 2017.
50. See OECD at http://www.oecd.org/daf/inv/investment-policy/oecd-code-capital-movements-review.htm.
51. OECD at http://www.oecd.org/daf/inv/investment-policy/Codes-liberalisation-governance.pdf.
52. Text available online at https://www.oecd.org/pensions/private-pensions/InvisibleOperations_WebEnglish.pdf.
53. Text available online at https://www.oecd.org/daf/inv/investment-policy/CapitalMovements_WebEnglish.pdf.
54. OECD at http://www.oecd.org/daf/inv/investment-policy/oecd-code-capital-movements-review.htm.
55. OECD 2008 at http://www.oecd.org/dataoecd/21/23/38072327.pdf, 10–12.

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- The principle of non-discrimination demands that restrictions, if any, have to be applied in relation to everybody without exception.
- A transparency requirement obliges member countries to make information on capital movement and services available.

The *Codes* do not provide a mechanism to enforce further liberalization against any OECD Member State. However, 'member countries' commitment to the common goal of liberalization, together with the dynamics of the process and the spirit of cooperation are such that the number of reservations has sensibly declined over the years'.[56]

The *Codes* are supplemented by the *Declaration on International Investment and Multinational Enterprises* [57] which applies to Argentina, Brazil, Chile and the Slovak Republic. The *Declaration* (only) concerns the application of the national treatment principle to the provision of services by commercial presences.[58]

The *Codes* and the *Declaration* are to a large extent superseded by GATS.[59]

[E] Regional and Sector-Specific Systems

Many regional trade systems also provide for rules on services.[60] Examples are the Association of Southeast Asian Nations (ASEAN),[61] the North American Free Trade Agreement (NAFTA),[62] the Southern Common Market (MERCOSUR)[63] and the European Union (EU).[64] Furthermore, service sector-specific rules exist at the international level either integrated in global or regional system or as free-standing regimes.[65]

[F] Preferential Trade Agreements

It has been observed that the positive-list modality[66] has among other things so far prevented the GATS efforts to convincingly succeed in liberalizing service sectors

56. OECD 2008 https://www.oecd.org/daf/inv/investment-policy/38072327.pdf), 10; Raworth 2005, 84 ('peer review and persuasions rather than an adversarial dispute settlement procedure').
57. Latest version (2011) available online at http://webnet.oecd.org/OECDACTS/Instruments/ShowInstrumentView.aspx?InstrumentID=241&InstrumentPID=270&Lang=en&Book=False.
58. Raworth 2005, 76.
59. *Ibid.*, 75–76.
60. Compare *ibid.*, 87–184.
61. *Supra* Ch.5, §5.03[A][4]; Raworth 2005, 165–184.
62. *Supra* Ch.5, §5.03[A][6]; Raworth 2005, 87–115. Unlike GATS 'NAFTA is based on a negative-list scheduling modality: everything is liberalized, unless otherwise indicated through lists of reservations', Roy/Marchetti/Lim 2007, 158.
63. *Supra* Ch.5, §5.03[A][7]; Raworth 2005, 146–165.
64. *Supra* Ch.5, §5.03[A][8]; Raworth 2005, 115–146.
65. For international treaty systems in the area of transportation cf. *supra* Ch.5, §5.06[B][5], §5.06[C]–[G]; Raworth 2005, 423–450; for aspects of liberalization of trade in financial services, telecommunications and of the government procurement sector, *ibid.*, 185–298, 299–422, 451–506.
66. *Supra* §7.03[B].

globally.[67] In addition, in recent times many countries seem to prefer bilateral free trade agreements with commitments to liberalize services sectors over multilateral arrangements. This rather new phenomenon of 'regionalism in services trade'[68] has led to 'spectacular advances overall' in terms of service sector liberalization.[69]

[G] International Investment Agreements

International investment agreements, which are discussed in greater detail in Chapter 8,[70] are agreements between two or more States usually confirming the right of investors from one State to invest in the other and establishing the obligation of the host state to treat investors according to so-called minimum international standards.[71] Depending on the scope of applicability of a particular investment agreement, more precisely depending on the respective definition of 'investments',[72] trade in services could be covered either as one recognized form of investment or because certain services, such as capital transfers, are required to make investments possible. Details may vary and the applicability of each international investment agreement in relation to cross-border services must be assessed separately.

§7.04 CONTRACT PRACTICE

International service contracts are often rather comprehensive and detailed to address the idiosyncrasies of available service patterns.[73] As in other contract types, the description of the scope of a service contract is particularly important. Special attention must also be given amongst others to tax law aspects as the provision of services over a certain period of time may qualify as permanent establishment thus triggering tax duties under the applicable domestic tax law.[74]

67. *Supra* §7.03[B].
68. Roy/Marchetti/Lim 2008, 79.
69. *Ibid.*, 81.
70. *Infra* Ch.8, §8.02[B][2].
71. *Ibid.*
72. Compare Ho 2010, 633–647.
73. Compare *supra* §7.02.
74. Döser 2001, 121; for the tax law concept of 'permanent establishment' cf. *infra* Ch.9, §9.01.

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CHAPTER 8
Cross-Border Investments

§8.01 GENERAL

[A] Introduction

Cross-border business transactions can be divided into two categories, i.e., investment and non-investment related transactions. The main differences as well as the fundamental advantages and disadvantages of these two categories have been described in an earlier chapter.[1] In short, unlike non-investment related transactions cross-border investments allow for the possibility to establish long-term and stable market positions in foreign markets. This may in turn facilitate the marketing of brands, the development of closer and more integrated relationships with customers, suppliers and other business partners as well as the protection of intellectual property rights and know-how.[2] Compared with non-investment cross-border business projects, investment projects do normally require more time, manpower and capital. While this may lead to the possibility of better returns, losses are potentially higher if an investment project becomes distressed.[3]

In very broad terms, cross-border investment implies the establishment of a new or the acquisition of an already existing business abroad including all steps to support such establishment or acquisition.[4] As will be discussed in detail in subsequent sections, cross-border investments can be implemented via very different legal forms from the establishment of a representative office, branch or subsidiary[5] abroad to the

1. *Supra* Ch.1, §1.02.
2. *Ibid.*
3. *Ibid.*
4. Compare OECD 1999, 7–8.
5. *Infra* §8.04[C].

cross-border acquisition of an existing business entity by way of share deal, asset deal or through alternative options.[6]

There are many reasons for the decision to invest abroad all of which are normally guided by the ultimate goal to maximize the investors overall profits. Traditionally overseas investments have often been a further step in an enterprise's globalization strategy which may have started with the establishment of trade relations with overseas partners to explore and develop a foreign market 'from within'. The ultimate stage of the implementation of a company's globalization strategy will then be that business operations take place where the overall conditions are the best or where this is required by market needs irrespective of the nationality or home country of any investor.[7]

Investments overseas can, however, also be motivated by more specific reasons, e.g., the fact that production costs in the target country are low or other operation conditions are beneficial, that imports into the target country are not viable due to trade barriers or that exports from a host country may be eligible to benefit from free trade arrangements.[8]

In relation to each investment project, a number of issues need to be considered which are often predetermining for any of the subsequent steps.

Checklist: Cross-Border Investments[9]

- Type and Scope of Business/Investment Rationale
- Host Country/Location in Host Country
- Planned Type and Scope of Business Allowed/Restricted in Host Country?[10]
- Investment Vehicle[11]
  - 100% subsidiary
  - Joint venture with local or foreign partner (majority or minority shareholding, voting power arrangements, change of control options, etc.)
  - Representative office
  - Branch
  - ...
- Legal Form and Organizational Structure of Investment Vehicle[12]
- Investment Mode[13]

6. *Infra* §8.04[B].
7. Wolff 2011, 131.
8. Compare Folsom et al. 2015, 914–915.
9. For a checklist in the context of US law to be used after the parties to an acquisition project have in principle agreed to proceed, see Kury 1980–81; also cf. Stack 2011, 243–244.
10. Compare *infra* §8.13[C].
11. Compare *infra* §8.04[C].
12. Compare *infra* §8.04[D].
13. Compare *infra* §8.04[B].

  - Greenfield investment
  - Share deal
  - Asset deal
  - Merger
  - Alternatives
- Onshore/Offshore Holding Structure?[14]
- Partner (if any)
  - Local/foreign?
  - Legal form
  - Shareholders and other stakeholders
  - Market position
  - Standing
  - Contacts
  - Sovereign immunity/waiver of sovereign immunity of state parties
  - ...
- Pre-closing Requirements under Investor Home State/Host State Law[15]
  - Approval
  - Registration
  - Documentation
  - (Sector-specific) Licensing
  - ...
- Capital Contribution
  - Cash
  - In-kind
  - Time frame for contribution
  - Early repatriation possible?
- Necessity of External Financing[16]
  - Equity
  - Senior debt
  - Mezzanine options
- Term and Timing[17]
  - Pre-closing stage (due diligence, decision making, negotiations, signing, closing)
  - Start-up stage
  - Operation stage
  - End (phase out, exit, termination, liquidation)
- Costs
  - Establishment
  - Start-up
  - Operation
  - End (phase out, exit, termination, liquidation)

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14. Compare *infra* §8.04[E].
15. Compare *infra* §8.13[C].
16. Compare *infra* §8.07.
17. Compare *infra* §8.06.

- Currency Control[18]
  - Currency supply
  - Convertibility/Exchange rate
  - Transfer (and re-transfer) of capital, profits, additional funds
  - Restrictions on use of offshore bank accounts[19]
- Insurance[20]
- Human Resources[21]
  - Local staff and workers
  - Expatriates
- Technology Transfer[22]
- Raw Materials, Finished and Semi-finished Products Needed?
  - Type
  - Supplier
  - Logistics
  - Costs
- Infrastructure
- Sales and Marketing
  - Products (sales channels, estimated numbers, etc.)
  - Services (use of intermediaries, costs, target group, estimated turnover, etc.)[23]
- Environmental Issues[24]
- Tax[25]
- Anti-trust Clearance Required?[26]
- National Security Clearance Required?[27]
- Availability of Investment Incentives
  - Tax holidays
  - Political risk insurance[28]
  - Relief regarding procedural requirements

  ...
- Governing Law[29]
- Dispute Settlement[30]

18. Compare *infra* §8.07[E].
19. Folsom et al. 2015, 997.
20. Compare *supra* Ch.5, §5.11[C]-[D] and §8.03.
21. Compare *infra* §8.09.
22. Compare *supra* Ch.6.
23. Compare *supra* Ch.7.
24. Compare e.g for China Wolff 2015, 55.
25. Compare *infra* Ch.9, §9.03.
26. Compare *infra* §8.10[B].
27. Compare *infra* §8.13[D].
28. Compare *infra* §8.03.
29. Compare *supra* Ch.3, §3.04[B]; *infra* §8.02[C][2].
30. Compare *infra* Ch.10.

- External Advisors?
- Post-closing Considerations[31]
  - Re-structuring
  - Integration (workforce, IT-systems, supply and sales structures, marketing, etc.)

  ...

This chapter addresses topical issues related to cross-border investment projects from a legal point of view. It is, however, not concerned with portfolio investments, i.e., domestic or overseas passive investments without the intention to control or to participate in the management of the investee entity or entities. Furthermore, the environment against the backdrop of which cross-border investments are conducted is of course not static, but rather in a state of constant change caused by developments on different fronts. The different sections below highlight these new developments wherever deemed to be appropriate.

One of the major developments of this kind in recent years which may have substantial impact on cross-border investment projects is the emergence of the digital economy in all its different facets. On the one hand, digital industry sectors have gained great importance over the past two decades thus creating lots of new investment options and needs.[32] On the other hand, digitalization also brings massive changes to traditional cross-border investment patterns as it implies that foreign markets can be reached easier and with much less investment in terms of capital and manpower.[33] Digitalization allows for easy, instant and permanent cross-border communication and information exchanges between parties located in different countries thus creating new options to address management and governance issues. This can potentially enable investors to reduce their operations in a target country including the deployment of high-level management personnel.[34] It may even allow enterprises to avoid a physical presence overseas altogether as digital structures facilitate the control of independent local partners on the ground or allow direct interaction with end-customers.[35]

Digitalization therefore encourages the development of new business models[36] and creates lots of new opportunities. At the same time, these new developments also carry risks for the international community, for countries and regions as well for private enterprises. Amongst others digitalization increases the reliance on (functioning) technology, it creates new security risks[37] and it accelerates movements within markets with the possibility of very abrupt and unexpected changes. All players in the cross-border investment arena have to be aware of these chances and risks, and they have to respond accordingly last but not least at the legal level. Different sections of this chapter and of previous and subsequent chapters consequently draw attention to

31. Compare *infra* §8.06[E].
32. UNCTAD 2017, 159.
33. UNCTAD 2017, 162, 164.
34. Compare *ibid.*
35. *Ibid.*, 164.
36. Cf., *ibid.*, 175.
37. *Ibid.*, 164.

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related features. At the same time it must be kept in mind that in many areas the effects of digitalization have only just started and commonly accepted patterns and practices have not yet manifested themselves.[38]

This chapter is structured as follows: The first section provides general information on the development of the global investment arena to set the scene for the detailed discussion of legal topics. Then, the sources of investment law as well as conflict of investment laws issues will be explored followed by a section on structuring issues. A special section is dedicated to private equity investments. The subsequent sections then explore the different stages of cross-border investment projects with a special focus on the due diligence exercise. The financing of investments projects as well as sections on employment issues and merger control are other important topics to be discussed in the subsequent sections. Not all cross-border business projects develop as expected and it is for this reason that sections on restructuring, dissolution and cross-border insolvency have to conclude the discussion of substantive law topics relating to cross-border investments. The last part of this chapter is dedicated to specific questions of investment contract practice.[39]

[B] Cross-Border Investments in Numbers

[1] Overall Developments

According to UNCTAD's World Investment Report 2009, global foreign direct investment (FDI) had reached a historic high of United States Dollars (USD) 1,979 billion in 2007 followed – as a result of the global financial crisis – by a dramatic year-on-year decline of 14% in 2008[40] and by another 37% decline in 2009.[41] In 2010, global FDI inflows increased by only 5% and were still 15% below the pre-crisis level.[42] Despite the emerging EURO crisis, FDI flows then grew by 16% year on year in 2011 to USD 1,524 billion.[43] For 2015 UNCTAD reported a strong FDI recovery of 38% compared with 2014 reaching USD 1,760 billion and thus the highest level since the global financial crisis.[44] This was mainly a result of increased cross-border M&A activity which rose from USD 421 billion in 2014 to USD 721 billion.[45] The 2015 value of announced greenfield investments was USD 766 billion.[46] However, UNCTAD also noted that the recovery 'lacked productive impact'.[47]

38. Compare, however, the comprehensive analysis largely from the economic and policy point of view by UNCTAD 2017, 156–217.
39. Compare Easson 1999, 2.
40. UNCTAD 2009, xix.
41. UNCTAD 2010, xvii.
42. UNCTAD 2011, x.
43. UNCTAD 2012, 2.
44. UNCTAD 2016, x. UNCTAD, *ibid.*, ascribes a major portion of the FDI volume to TNC re-organizations without which the increase of global FDI flows would (only) be at 15%.
45. UNCTAD 2016, 4.
46. *Ibid.*
47. UNCTAD 2016, 3.

UNCTAD has anticipated that FDI developments will not differ much in the short term from the global FDI picture of 2015

> 'with less than half of all [*multinational enterprises* =[48]] MNEs anticipating FDI increases to 2018. However, there are differences across sectors and between economic groupings. Executives from developing and transition economies are more optimistic than those at MNEs headquartered in developed countries; and not unexpectedly, given the decline in commodity prices, MNEs from the primary sector are more pessimistic than those in the manufacturing and, especially, services sector.'[49]

The year 2016 then saw a decrease of global FDI flows by 2% to USD 1,746 billion.[50] However, the overall outlook is mildly positive as indicated by a 35% year-on-year increase of announced M&As during the first four months of 2017.[51] UNCTAD has predicted 'a moderate rise of investment flows' in 2018 to USD 1,850 billion. It is interesting to note that this would still be below the pre-crisis level of 2007.[52]

> '2015 about two thirds of global stock was concentrated in the services sector, in line with its share in the world economy. Manufacturing and the primary sector accounted for 26 per cent and 6 per cent respectively. The long-term shift toward services has plateaued since the outbreak of the global financial crisis.'[53]

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Investment Glossary: Foreign Direct Investment (FDI)

The definition of FDI varies. According to the OECD:

> 'Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.'[54]

In international investment treaties 'direct investment':

> 'often refers to the chain of ownership. Thus, a Dutch treaty might require that a protected investment be held by a Dutch entity without intermediate holding companies.'[55]

48. Text in brackets added by the author.
49. UNCTAD 2013, 24.
50. UNCTAD 2017, 10.
51. *Ibid.*, 5.
52. UNCTAD 2017, 3.
53. UNCTAD 2017, 21.
54. OECD FDI Definition, 234.
55. Wells 2010, 48; also cf. the definition of 'investor' under Art. 8.1 of the EU-Canada *Comprehensive Economic and Trade Agreement (CETA)*, text available at http://ec.europa.eu/trade/

In this regard international investment treaties often adopt a broad 'asset-based definition' covering:

> 'every kind of asset of a foreign investor in a host country, suggesting that any economic value is covered by the agreement.'[56]

Other international investment treaties have used an 'enterprise-based definition' of investments limiting their scope of applicability to foreign investments in enterprises rather than in any kind of asset.[57]

In other contexts the term direct investment has been used to describe a particular investment mode, i.e., greenfield investments[58] as opposed to investments via the M&A[59] route.[60] Finally, sometimes the term direct investment signifies investments except for those made through stock markets.[61]

[2] *Target Countries and Regions*

Initially the last decade saw a shift of in- and outbound investment flows from developed countries to developing and transition economies which in 2010 absorbed more than half of the global FDI inflows. [62] In the same year, only one-third of the global M&A deals were conducted in developing and transition industries.[63] In 2015 FDI flows to developed economies then rose to USD 962 billion which was almost twice of the 2014 value thus marking 55% of the value of the total of global FDI flows as compared with 41% in 2014. In 2016 developed countries FDI recorded another increase of FDI inflows by 5% year on year to USD 1,000 billion taking up 59% of the global FDI inflows.[64] In contrast, in the same year FDI inflows to developing countries were down by 14% compared with 2015 reaching only USD 646 billion.[65] For 2017 UNCTAD expects FDI inbound FDI flows to developed countries to remain steady. In contrast, inflows to developing countries may increase by 10%.[66]

policy/in-focus/ceta/ceta-chapter-by-chapter/, which aims at excluding 'letterbox companies' companies from being protected under CETA by requiring 'substantial business activities in the territory'.

56. Chaisse 2011, 218.
57. *Ibid.*, 218.
58. Compare *infra* §8.04[B][1].
59. Compare *infra* §8.04[B][2]-[3].
60. Wolff 2011, 132.
61. Compare *ibid.*, 132.
62. UNCTAD 2011, xii, 4.
63. *Ibid.*, 10.
64. UNCTAD 2017, 10.
65. *Ibid.*, 11.
66. *Ibid.*, 3.

In 2015 developing Asia had remained the largest FDI recipient region in the world.[67]

> 'A primary catalyst of decreasing inflows in developing and transition economies was the continued decline in commodity prices, especially for crude oil and for metals and minerals. The precipitous fall in oil prices that occurred in the second half of 2014 weighed heavily on FDI flows to oil-exporting countries in Africa, South America and transition economies.'[68]

Mainland China[69] had become the second most-in-demand FDI target country in 2010.[70] In 2011, China even passed the US to become the most important target country for transnational corporations (TNCs) direct investments.[71] Then, in 2015 China's inbound FDI flows had slowed down and China (only) took the third place following the US and Hong Kong.[72] The picture was similar in 2016 with the US having remained the most popular FDI destination with USD 391 billion in inflows and China coming third with USD 134 billion in inflows.[73] In the same year the UK had advanced to become the second most popular FDI target country attracting USD 254 billion of inflows.[74]

2011 had seen an almost dramatic increase of India's inbound investment volume by 31%.[75] The development did, however, not continue at the same rate. As a result of the slow growth in all emerging markets in 2015 India (only) recorded a 'relatively stable' development and was the 10th most popular FDI target country in terms of inbound investment volume.[76] In 2016 India moved one rank up with an inbound investment volume of USD 44 billion.[77] According to UNCTAD this trend may continue and India may soon become one of the top FDI destinations probably even taking the number 3 spot following the US and China. The UK, Germany, Japan, Brazil, Mexico, Indonesia Malaysia are also expected to be among the top target countries for foreign inbound FDI in the years to come.[78]

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67. UNCTAD 2016, x, 4.
68. *Ibid.*, 5.
69. Not including the Hong Kong SAR, the Macau SAR and Taiwan.
70. UNCTAD 2011, 4.
71. UNCTAD 2012, 22.
72. UNCTAD 2016, 3. Hong Kong's large volume of inbound FDI in 2014 was the result of the restructuring of two large conglomerates.
73. According to Tang 2017, A5, with reference to the PRC Ministry of Commerce China recorded FDI inflows worth USD126 billion in 2016.
74. UNCTAD 2017, 11.
75. UNCTAD 2011, 4.
76. UNCTAD 2016, 5.
77. UNCTAD 2017, 12. Also cf. Tang 2017, A5, according to whom India's FDI inflows were up by 8% to USD60 billion in the fiscal year ending March 2017.
78. UNCTAD 2016, 28.

The top 10 target countries/regions of inbound investments in 2016 were:[79]

(1) US
(2) UK
(3) China
(4) Hong Kong
(5) Netherlands
(6) Singapore
(7) Brazil
(8) Australia
(9) India
(10) Russian Federation

Some countries and regions with currently relatively high FDI volumes may see rather drastic reductions of their inbound investment volumes. Examples could be Hong Kong, Singapore, Belgium, Canada, Ireland, Luxembourg and the Netherlands. In contrast, the importance, e.g., of the Philippines and Myanmar as potential FDI target countries may increase significantly in the years to come.[80] In fact, in 2016 both Hong Kong and Singapore dropped one place from 3rd to 4th and from 5th to 6th place respectively, while Brazil was one up at 7th place. In the same year Australia improved significantly to 10th place from 16th place.[81]

The year-on-year increase of outbound investments from developing and transition economies was 27% in 2011[82] and had thus 'lost some momentum' compared with previous years.[83] In 2015 outbound investments from developed countries increased by 33% compared with one year earlier to USD 1,100 billion. However, this was still 40% below the level prior to the global financial crisis of 2008–2009.[84] Outbound investments from transition and developing economies continued to slow down across the board. For example, outbound investments from developing Asia were down by 17% to USD 332 billion in 2015 with Hong Kong standing out with a decline of 56%.[85] In the same year only some developing economies managed to increase their outbound investment volume. Examples are China (from USD 123 billion to USD 128 billion), Kuwait (from USD 10.5 billion to USD 15.4 billion) and Thailand (from USD 4.4 billion to USD 7.8 billion).[86]

79. UNCTAD 2017, 12; cf. *supra* Ch.1, §1.03.
80. UNCTAD 206, 27–28.
81. UNCTAD 2017, 12, Figure I.11.
82. UNCTAD 2016, 4.
83. *Ibid.*, 5.
84. *Ibid.*, 6.
85. *Ibid.*, 7.
86. *Ibid.*

In 2015 developed countries increased their portion of the global outbound FDI volume from 61% in 2014 to 72%.[87] In particular, outbound investments from European countries seemed to reverse the downward trend of the past four years and became a 'major driver of this surge'.[88] However, in 2016 outbound investments from developed countries were down again by 11% to 1,000 billion taking up 72% of the total value of global outbound investments. In the same year outbound investments from developing economies and transition economies dropped by only 1% and 22% respectively.[89]

The top 10 outbound investing countries/regions in 2016 were:[90]

(1) US
(2) China
(3) Netherlands
(4) Japan
(5) Canada
(6) Hong Kong
(7) France
(8) Ireland
(9) Spain
(10) Germany

Considering various factors UNCTAD has predicted in 2016[91] and reconfirmed its assessment in 2017[92] that the top investing economies in the years up to 2018 will be China, the US, the UK, Germany, France, India, the Netherlands, Japan, Canada, Spain and Italy.[93] Emerging economies with increasing outbound investment activities are the UAE, South Korea and Turkey.[94]

From a private investor's point of view, a large variety of reasons must be considered when determining where to invest with the main factors of course being strategic considerations relating to the business potential of a particular investment project. A number of organizations and institutions conduct studies in relation to different factors that may help during the decision-making process. Two of these initiatives shall be introduced in the following paragraphs.

First, Global Competitiveness Reports have been published annually by the World Economic Forum since 2005. The Reports are based on the Global Competitiveness Index which is meant to be a comprehensive tool

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87. *Ibid.*
88. *Ibid.*
89. UNCTAD 2017, 13.
90. *Ibid.*, 14; Ch.1, §1.03.
91. UNCTAD 2016, 27.
92. UNCTAD 2017, 8.
93. UNCTAD 2016, 27.
94. UNCTAD 2017, 8.

'that measures the microeconomic and macroeconomic foundations of national competitiveness ... as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the level of prosperity that can be earned by an economy. The productivity level also determines the rates of return obtained by investments in an economy, which in turn are the fundamental drivers of its growth rates. In other words, a more competitive economy is one that is likely to sustain growth.'[95]

2016-17 Global Competitiveness Report

– Selected Country Rankings –

(1) Switzerland	(15) Canada
(2) Singapore	...
(3) US	(28) China
(4) Netherlands	...
(5) Germany	(39) India
(6) Sweden	...
(7) UK	(43) Russian Federation
(8) Japan	...
(9) Hong Kong	(137) Mauritania
...	(138) Yemen

Source: 2016-17 Global Competitiveness Report, World Economic Forum, Switzerland, xiii.

Second, the Index of Economic Freedom is published annually by the Heritage Foundation. The Index is based on 12 components of economic freedom grouped into four broad categories or pillars of economic freedom:

1. Rule of Law (property rights, government integrity, judicial effectiveness);
2. Government Size (government spending, tax burden, fiscal health);
3. Regulatory Efficiency (business freedom, labour freedom, monetary freedom); and
4. Open Markets (trade freedom, investment freedom, financial freedom).[96]

95. World Economic Forum, 4.
96. Compare Miller/Kim 2017.

2017 Index of Economic Freedom

– Selected Country Rankings –

(1) Hong Kong	...	(110) Moldova
(2) Singapore	(12) United Kingdom	(111) China
(3) New Zealand	...	(112) Sri Lanka
(4) Switzerland	(17) United States	...
(5) Australia	...	(142) Ethiopia
(6) Estonia	(34) Botswana	(143) India
(7) Canada	...	...
(8) United Arab Emirates	(40) Japan	(178) Cuba
(9) Ireland	...	(179) Venezuela
(10) Chile	(61) Kuwait	(180) North Korea

Not ranked: Iraq, Libya, Liechtenstein, Somalia, Syria, Yemen.

Source: Miller/Kim 2017.

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[3] *Transnational Corporations, State-Owned Enterprises and Sovereign Wealth Funds*

Cross-border investments lead to the creation of TNCs.[97] UNCTAD has defined TNCs as:

'incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent company is defined as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital stake. ... A foreign affiliate is an incorporated or unincorporated enterprise in which an investor that is a resident in another country, owns a stake that permits a lasting interest in the management of that enterprise.'[98]

Already in 2007 about 79,000 TNCs existed worldwide with 790,000 affiliates.[99] In 2011, UNCTAD observed that:

'TNC's production worldwide generated value-added of approximately $16 trillion in 2010, about a quarter of global GDP. Foreign affiliates of TNC's accounted for more than 10 per cent of global GDP and one-third of world exports.'[100]

This trend continued in 2011 when TNC sales rose 9% year on year reaching a record of USD 28 trillion. Value added reached USD 7 trillion marking 10% of the global GDP. TNC affiliates accounted for 69 million jobs globally in 2011.[101] The number increased

97. Also called transnational enterprises (TNEs) or multinational enterprises/multinational companies (MNEs/MNCs), cf. Easson 1999, 3.
98. UNCTAD 2008, 249.
99. *Ibid.*, xvi; also cf. Easson 1999, 3.
100. UNCTAD 2011, x.
101. UNCTAD 2012, 23.

to 75 million jobs in 2014[102] and 79.5 million in 2015.[103] In line with the general outbound investment trends in 2016, Nine TNCs from developing and transition economies ranked among the top 100 TNC worldwide.[104] According to the World Economic Forum in 2017 'fewer than 10% of the world's public companies account for more than 80% of all profits'.[105] The increasing power of TNCs has led to concerns which have become one of the main themes of the anti-globalization movement.

Cross-border investments are not only conducted by privately owned entities. In contrast, state or state-sponsored cross-border investments have gained increasing importance in recent years. According to UNCTAD approximately 1,500 state-owned TNCs with more than 86,000 foreign affiliates globally existed in 2016.[106] While they made up only about 1.5% of all TNCs, 15 of the top 100 non-financial TNCs and 44 of the top 100 financial TNCs were state-owned.[107] Also, between 2010 and 2016 state-owned TNCs accounted for more than 9% of the value of globally announced greenfield projects.[108] About one-third of the 25 largest state-owned TNCs are from developing countries, in particular four are from China.[109]

Mirroring the increasing importance of global investments by state-owned TNCs is the rise of sovereign wealth funds (SWFs) as cross-border investors. SWFs are state-owned or state-sponsored entities established to invest state funds globally with the long-term goal to maximize a state's wealth.[110] At the end of 2009, UNCTAD had identified more than 80 SWFs holding assets with an estimated value of USD 5,900 billion while many countries were in the process of or considering establishing additional SWFs.[111] SWFs were particularly affected by the global financial crisis. As a result, the 2010 FDI by SWFs declined to USD 10 billion in 2010 from USD 26.5 billion in 2009.[112] While at the end of 2011 SWFs had nearly USD 5,000 billion in assets under management only 5% of these assets were in the form of FDI.[113] According to UNCTAD more than 100 SWFs existed in 2014, [114] of which more than 40 were newly established since 2004.[115] In 2014 SWFs were holding assets worth about 10% of the total global asset value.[116]

The importance of SWFs as cross-border investors has increased constantly over the past two decades and an end of this trend is not in sight.[117]

102. UNCTAD 2015, 18.
103. UNCTAD 2016, 9.
104. UNCTAD 2017, 28.
105. World Economic Forum 2017.
106. UNCTAD 2017, 30.
107. *Ibid.*
108. UNCTAD 2017, 37.
109. *Ibid.*, 32.
110. Compare UNCTAD 2011, 14; UNCTAD 2010, 13.
111. UNCTAD 2011, 14.
112. *Ibid.*, 14.
113. UNCTAD 2012, 13.
114. Sovereign Wealth Fund Institute 2016 - What is a SWF.
115. *Ibid.*
116. UNCTAD 2015, 15.
117. *Ibid.*, 13.

Top 10 SWFs according to Assets under Management

	Assets in USD billion	*Year of Inception*
Government Pension Fund – Global, Norway	922.11	1990
Abu Dhabi Investment Authority, UAE	828	1976
China Investment Corporation, China	813.8	2007
Kuwait Investment Authority	524	1953
SAMA Foreign Holdings, Saudi Arabia	514	1952
Hong Kong Monetary Authority Investment Portfolio	456.6	1993
SAFE Investment Company, China	441	1997
Government of Singapore Investment Corporation, Singapore	359	1981
Qatar, Investment Authority, Qatar	320	2005
National Social Security Fund, China	295	2000

Source: Sovereign Wealth Fund Institute 2017.

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Global investments by state-owned TNCs and SWFs have been a topic of considerable discussion and criticism. First of all, the pure size of TNCs and SWFs makes them very powerful new players thus affecting the interplay between established market forces. Furthermore, investments which are ultimately supported by foreign governments may lead to national security concerns in target states and regions.[118] From the viewpoint of their private competitors, SOEs and SWFs benefit from state sponsorships which may offer them unfair competitive advantages.[119] The potential lack of democratic governance and transparency are additional points of concern.[120]

> 'Some sovereign wealth funds are not as transparent as others. For example, one sovereign wealth fund may disclose their investment holdings in a periodic basis, while another fund keeps them private. Since 2008, sovereign wealth funds have taken strides to be more transparent, hoping to dispel fears of protectionism.'[121]

118. UNCTAD 2011, x; UNCTAD 2012, 14; Sornarajah 2010, 68.
119. Compare UNCTAD 2011, x.
120. Compare *ibid.*, x; UNCTAD 2010, 94 with reference to the 'Generally Accepted Principles and Practices' (Santiago Principles) agreed by the International Working Group of Sovereign Wealth Funds representing 23 countries with SWFs.
121. Sovereign Wealth Fund Institute 2016 – What is a SWF?