

**WOLLO UNIVERSITY
SCHOOL OF LAW**

LAW OF INVESTMENT POWER POINT

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Unit One: Definition and Nature of Investment

1. Definition of investment

- The term investment may mean different things in different disciplines and contexts .
- ❖ The very known investment **lawyers Fisher and Jordan** define investment as “commitment of funds made in the expectation of some positive rate of return.”

Elements

- ✓ Commitment of funds
 - ✓ The commitment is made with the expectation **some positive rate of return (this positive rate of return is a profit).....**some times carries risks.
 - ✓ If the person failed to expect profit (positive rate of return) it will not be considered as investment....
 - ✓ Proper management is essential
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From the legal point of view; “every kind of asset includes movables, immovable, right in rems , shares, IP, good will, reputation.

- ❖ Not only funds in the form of money but also includes good will (reputation)
- ❖ BITs “any kind of assets and any direct or indirect contribution in cash, in kind or in service which is invested (re-invested) in any sector of economic activities considered as investment”
- ❖ BITs, specifically includes movable, immovable, right in rems (mortgage, pledge, usufruct), shares, bonds, copy rights, good will, trade names, contract to exploit natural resources.
- ❖ An outlay of money or capital for profit

Nature of investment law

- Law of investment, in general is a branch of law consists of set of rules that regulate investment
- International law on FI or national law on investment
- International law a set of rule that governs international investment and international laws on FI
- International law to resolve a problem which are

arises between host countries(capital importing countries) and home countries(capital exporting countries)

- Does investment law part of public or private law domain?

○ National investment law

- Investment is a commercial (trade) (business activity) and business activities are governed by commercial code/law of the country and the commercial law cuts across both the **law of obligation** and **the law of property**.
- Investment activities are governed by commercial law and commercial law developed through practice by merchants and the state 'received' it into a legal system
- Investment law is under the public law...dealing with the relation between investor (individual) and the gov't
- So, it is a public law
- Commercial code is a public law by its nature b.c the gov't regulates the transaction of Inv't as a commercial activity
- Therefore investment law has both private and public law aspects

Investment law regulates investment in general and particularly:-

1. **Admission and establishment of inv't**
 - The entry of FI in a host country
 - The state may restrict inv't in certain sectors of the economy
 - Requirements to establish enterprise to undertake inv't activities and the forms of enterprises
2. **National treatment (NT):-** to treat foreign investors in the same manner like national/ domestic investors
 - Mostly provided by BITs / national laws
3. **Environmental issues** :- today, it is realized that economic activities are closely linked to the protection of the env't and inv't treaties have begun to include provision addressing

env't protection

4. **Labor issues**:- promotion of employment of host country's nationals. See Art.22 of the proc. No 1180/2020, the law requires that "foreigners be replaced by Ethiopian with in limited period of time"
- ❑ Investment treaties may provide for minimum standards as to wages and working labour conditions. It may also address the rights of workers to organize labour union.
5. **Guarantees**:-Inv't law provides guarantees to investors and International investment Law is aimed at Guaranteeing to Foreign Investors from **nationalization** and **expropriation**

Definition of investment and investor (Art. 2(1) of Pro.No.1180/2020)

- Under Art.2(1) of the proclamation investment defined as “**expenditure of capital in cash or in kind or in both by investor to establish a new enterprise or to acquire, in whole or in part or to expand or upgrade an existing enterprise.**

1. Expenditure of capital,

- ✓ One, to have an investment there must be an expenditure of capital and according to Art 2(3) of the proclamation, **capital** means
- ✓ Local or foreign currency, negotiable instruments, machinery or equipment, buildings, working capital, property rights, patent rights or other tangible or intangible business assets.
- A. Local or foreign currency, which are represented by a notes
.....money is a capital, and expenditure of money is investmentso long as other elements of the definition of investment fulfilled



B. Negotiable instruments considered as capital

- NI: Art.715 of the commercial code as a document, which incorporating a right and transferable by **delivery**
 - NI a written document which is made (created in favor of some other person and transferred by delivery.
 - One can promise, order to give capital through the document and the one who holds the document assumed as if he has a good(better) title
 - **NI are documents which are serving as a capital by substituting the note form money and also the law consider NI as capital**
 - ❑ So what is important for investment in relation to NI is, it is possible for a person to contribute a NI instead of contributing the goods(money) to the enterprises
- C. Machinery or equipments, buildings...since they have **economic value** and help the enterprise in the making of profit
- D. Business assets (**trade mark, trade name, good will**)also considered as a capital since again they have an **economic value** and they help a lot an enterprise on the making of profit



2. Investors

- Art. 2(4), defines the term as “**a person who invest in Ethiopia**... can be a local (foreign) citizen
- ❑ The **place of the investment** and if the place of the investment is Ethiopia the law never wonder as to the citizen of the person
- ✓ **For some socio-economic purposes the investors can be domestic investors and foreign investors**

Domestic Investor

- Art 2(5) of the proclamation define domestic investors
 1. Ethiopian **national**
 2. An Enterprise incorporated in Ethiopia and wholly owned by Ethiopian National;
 3. The Government; a Public Enterprise; A cooperative society
 4. A Foreign National or Foreign Enterprise treated as domestic investor as per the relevant law or international treaty ratified by Ethiopia;
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Foreign Investor (Art.2(6))

1. A foreigner or
2. An enterprise in which a foreign national has an ownership stake or
3. An Enterprise incorporated outside of Ethiopia by any investor or
4. An Enterprise established jointly by any of the investors specified under Sub-article (6) paragraphs (a), (b) or (c) of this Article; or
5. An Ethiopian permanently residing abroad ... preferring treatment as a Foreign investor;

3. Enterprise

Art. 2(2) an undertaking established for the purpose of **gaining of profit** considered as investment, but if the enterprise is established other than profit making, such entity is not considered as investment

4. Expansion and upgrading Art.2(8)

- ❑ It must be at least **50%** of the production or service rendering capacity of an existing enterprise in **volume** or
- ❑ An increase **in variety**, by at least **100%**, by introducing a new production or service rendering in line of an existing enterprise or increment by both

3. Elements of investment

❖ 3 Factors that are considered as elements of investment (2RT)

1. Reward

2. Risk

3. Time

1. **Reward**: - the intention to gain profit (the return is known as a **reward** for the investment)

2. **Risk**(estimation about the **degree of happening of loss**): - No profit

- ❑ The chance that the expected profit may not materialized
- ❑ When the actual out come of investment is less than the expected out come
- ❑ Risk and return are inseparable
- ❑ Return is an expected income from investment(it represent benefit) + return is depend on the risk involved in the investment.}
- ❑ **Both risk and return are measurable elements**

3. **Time**

- Investment could not materialized with in a very short period of time
- Conducting research as to the market till installation of materials it needs time
- By its nature is of a **long term** process(is the result of a series decision)

❖ Investment is both Art and Science. How?

4. Economic PP of investment

Investment is science and there are **fundamental pp** applicable to inv't (**7 Eco.PPs**)

1. **Safety of investment:** inv't needs safety since the investors invests money and time [adequate protection should exist as to losses of capital] and maximum profit as possible)

□ Investing in the form of shares relatively safe

2. **Liquidity:** it shows the flexibility of investment... liquid if they can **convert to cash** through sell so whenever the investor need arise



3. Tax implication: as per the income tax procln. every person having income shall pay income tax. Business organizations shall pay 30% of their income as a tax.

4. Profit: element of investment and economic PP

5. Inflation: erodes the value of money invested, money is incapable for buying something and the real value will decrease and the capital will not have power that it was at the time of investment and therefore the investor might be forced to increase

the capital

6. **Gov't control:** Government controls certain economic sectors

and some time it affects the investment. E.g. Areas only reserved for state (electric power, postal service and airtransport)

7. **Legality:** Investor is required to invest on areas that are allowed by law

❑ Investors allowed to go in line with the laws and to fulfill the requirements of laws like **license**

❖ **Saving is an essential pre-requisite for investment! (Discuss the relation between Saving, Investment, Inflation and Unemployment rate)???????**

TYPES OF INVESTMENT

- ❖ Foreign (international) and local (domestic) investment(based on the identity of investor)....identity of investor would attract several legal consequences
- ❖ **Foreign investment divided in to 2**
 1. FDI (Foreign direct investment)
 2. Portfolio investment
- 1. FDI: - If the investor directly and physically control the assets that are made in the host country including **recruit of staff directly and personally**
- ❑ The investment has to be made for along term(made to acquire lasting interests) to be consider as FDI... by taking in to account the intention of the investor plus the amount of investment are indication in relation to the lasting period of the investment and
- ❑ The **sectors...** some sectors could not be accomplished within short period of time. So they will be regard as FDI. +E.g. inv't on factories.

- ❖ In FDI investor has got double protection one is from the host country and the diplomatic protection of home state (international law). Why?

2. Portfolio investment

- ❑ Is a movement of money for the purpose of buying shares in a company formed or functioning in another country
- ❑ There is a divorce between management and control of the company and the share ownership in it
- ❑ Unlike the FDI there is no a physical presence of a person rather there is **a simple movement of money**
- ❑ According to Art. 12(3) of the proclamation no. 769/2012 portfolio investments should obtain an approval from the Ministry of Trade to purchase share in Ethiopia enterprise and to be considered as investor

FACTORS THAT AFFECT THE DIRECTION OF FDI

- FDI came to the host state with high skilled man power, capital and technology the host state has do a lot at least **legislatively to attract FDI**
- There are also economic factors that determine FDI

1. **Market seeking** :- If the FI get a large market in the host state for their production and service they are simply attracted by the host state
 2. **Resource/Asset seeking**:-Investors require resources (assets) for production and it will positively attracted on areas where resources(assets) available.
 3. **Efficiency seeking**:-Investors will undertake investment where the production is efficient in terms of cost
- In addition to the above main factors Economist have developed different **theories** to explain the factors that affect the direction of FI
- I. **Transportation cost**, sometimes it become unprofitable to enterprises to ship some products a long distance with a high amount of money and because of transportation cost the enterprise might opt to undertake FDI rather than exporting products with a high amount of money to other countries
e.g. Cement
- ✓ (But, transportation costs have little impact on the attraction of FDI on some electronic components since they earn little money)

2. **Market imperfection (Internalization theory)**(hindrance of market from working perfectly):- if there is impediments to the free flow of products between nation or if there are inhibit(hinder) market from working perfectly investors opt for FDI
3. **Competition strategy** : - FDI flows are a reflection of strategic competition b.n enterprise in the global market and to same product e.g. Fuji and Kodak may invest as FDI in a country with the intention of not allowing each other to take the advantage of FDI plus to ensure that the other competition not gain a dominant position in the foreign market.
4. **The product life cycle**: - Here one pioneer enterprise in the home market may undertake FDI to **produce production if the labor costs are lower to produce** products in that foreign market. When demand in that country will support the local production and they invest in low-cost locations.
5. **Location - specific advantages** : - It is related to the location of the host state
 - Advantages that arise from using local natural resources and know-how that helps the investor to produce

E.g. A country where oil as a natural resource is abundant, where there is low-cost highly skilled labour.



Factors that attracts FI

- ✓ Foreign investors are encouraged by several factors to invest abroad PULLING AND PUSHING FACTORS
- 1. **Pulling factors**, are factors that attract the investors towards developing countries to investment and
- 2, **Pushing factors**, are factors that is found in the home state of the investor that repel the investor from that country (b.c of unfavorable conditions...) Thus, push factors have the force to push the investor to opt for a favourable condition to invest in



■ Pulling factors

1. **Market pulling factors**, Investors need market for their production and large market that are emerging in developing countries will be more attractive for Foreign investors, e.g. Ethiopia is member of COMESA
2. **Resource**, it means in relation to **natural** and **human** resources and if the host state has abundant and huge natural and human resource
3. **Policy frame works**, it means liberalized economic policies attract FDI and **political and economic stability** also the other factors which attract FDI.
4. The existence of **relevant clusters** also another factor to attract FDI, it means the existence of some inputs from other enterprise in the same country facilitate a space of feeding each other and it plays a lot to attract FDI.
5. **Lax environmental laws**(less strict) E.g. Developing countries



- Push factors,

1. **Market push factors, if the market is less,** in their home market they investors may wish to go out to find market.
2. **Increase in production costs,** it includes increase in production costs, increase in labor costs , Scarcity of resources and inflationary pressures area crucial factor that pushes investors.
3. **Home country business conditions,** if the competition in the home country is stiff, the investor may need to move into a foreign market.