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PROMOTION AND PROTECTION OF INVESTMENT BILL 2013

Submission to the Department of Trade and Industry

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Submission by the South African Institute of International Affairs

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1. Background

In recent years South Africa's approach to regulating the protection of foreign investments and investors has moved sharply into the spotlight. The debate has played out around the future of bilateral investment treaties (BITs), and has become increasingly heated; pitting the European Union (EU) and some of its member states, particularly Germany, against the South African government. The debate was precipitated by the latter's decision to terminate or not to renew BITs, affecting a number of EU member states. Until very recently there was no framework to replace the protections afforded by those BITs, but that changed on 1 November 2013, when the South African government released the Promotion and Protection of Investment Bill (Investment Bill), allowing a three month window for public comments.

This submission responds to the call for public comments on the bill. We contextualise this, briefly, in a review of the positions of key actors in the exchange, namely EU investors and the South African government, as we understand them. This background is critical to framing our subsequent analysis of the bill itself. That analysis is then rooted in broader concerns over South Africa's evident need to attract foreign direct investment (FDI) in order to address its pressing socio-economic problems. Our critique of the various provisions in the bill are put forward with this concern in mind.

2. Government Review of Investment Policy

Placing the current bill in context of the BITs and review of investment policy in South Africa, it is important to note, in the first instance, that the texts of the BITs signed by South Africa in the 1990s were generally the same and based on a model developed in the late 1950s/early 1960s with an aim to protect companies from developed countries expanding their investments in developing countries. The Department of Trade and Industry (the dti) initiated a review of BITs in 2008, in part in response to a number of disputes lodged against the South African Government by foreign investors. There were also shifts in the debate at a global level about the protection of investors, particularly focused on international dispute settlement mechanisms. It is widely agreed by many other countries (including some developed ones like Australia) that the traditional BIT model is flawed and in need of revision.

Following the review, the South African government decided not to renew existing BITs and to develop a new legislative framework that would apply to all investors. First, they argue that the BITs in question afford foreign investors more rights in the South African market than domestic investors, since the latter do not have recourse to international arbitration panels when they feel their rights have been transgressed. Second, they argue that those international panels are problematic in that they tend to rule in favour of corporate interests at the expense of host nation policy space. Related to this, the South African government's BEE policies were challenged in the International Centre for the Settlement of Investment Disputes (ICSID) by a group of Italian investors; a case that was ultimately settled out of court. Since BEE is a core redress policy in a country still characterised by deep inequalities bequeathed by apartheid, it is easy to see why this case caused deep concern in government. Furthermore, the dti argues that the South African Constitution provides sufficient protection against arbitrary expropriation to all investors, and that these protections can be adequately enforced through the South African legal system. They also note that other significant countries have similar concerns, notably Brazil which has not implemented its BITs; India which is reviewing theirs; and Australia which eschewed investor-state dispute settlement in its free trade agreement with the United States. Finally, they note that a number of countries operate investment-screening agencies such as the United States, Canada and Australia.

3. Foreign Investors' Concerns

As widely reported in the media, foreign government concerns over the cancellation of South Africa's BITs centre on the implications for the legal rights of their companies in the possible event of expropriation by the South African authorities. Under the BITs in question, generally negotiated in the 1990s, investors from the affected states have recourse to international dispute settlement via arbitration panels under the jurisdiction of ICSID. Many foreign investors around the world favour such panels since they remove disputes from the host nation's political and legal systems, offering the prospect of a neutral, or more favourable, hearing.

This is a consequential matter for foreign investors in South Africa. Notwithstanding the country's transition to democracy in 1994, in our experience some foreign investors retain concerns about the country's long-term political stability. They point north, to Zimbabwe, where widespread land invasions and expropriation characterise that country's land reform process. They also point to South Africa's domestic politics. Prominent within this was the debate that raged within the governing tripartite alliance[1], but particularly the ANC, between 2009 and 2012, over nationalisation as a policy instrument. That debate coincided with the government's decision to revoke BITs, sparking suspicions amongst foreign investors that the revocation was a prelude to widespread expropriation, in the manner of Zimbabwe's land reform process. Third, and in the same timeframe, the South African government intervened in Walmart's planned acquisition of Massmart, the outcome of which was that Walmart was legally obliged to set up a fund to promote local procurement. During the course of the legal proceedings, centering on the competition authorities and revolving around 'public interest' concerns, key government ministers and members of Parliament made the case for establishing an investment screening agency that would be empowered to review incoming FDI against certain criteria. This argument reinforced a more general drift towards inward-looking trade and industrial policies, underpinned by the policy of black economic empowerment with its emphasis on increasing black ownership and management control in the economy, and moves to beneficiate natural resources in the country potentially using access to minerals licenses as a policy tool. In the minds of some foreign investors these policies are the thin-edge of an expropriation wedge. The South African government, and particularly the dti which is the authority responsible for regulating investment, does not see the matter the same way as is explained in the section above.

4. The Investment Bill

In order to understand the contents of the Investment Bill and its implications for foreign investors should it be enacted in its current form, it is necessary to explore the relationship between South African domestic law and international law. South Africa has one of the most celebrated constitutions in the world. The South African Constitution provides that when it is being interpreted courts **must consider international law (39(1)(b)).** This means that South African courts shall always defer to international law when necessary. Foreign investment regulation is by its nature and evolution regulated on the international plane. Very few areas enjoy such an elevated regulatory regime. Therefore, the Investment Bill differs from other domestic statutes in that it will always be

[1] The African National Congress (ANC); Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP).

deconstructed using an international investment law lens. Of particular importance in this regard are customary international law principles pertaining to expropriation, fair and equitable treatment, minimum standard of treatment, denial of justice, among others. This means that South African courts when interpreting the Constitution and any legislation having a bearing on international law must consider these principles.

The general texture of the Investment Bill reflects a government that is in need of expansive regulatory space for its transformation agenda, industrial policy and the progressive realisation of socio-economic rights. The Bill achieves this goal. However, when analysing the specifics of an investment agreement there are key provisions or pillars which have to be borne in mind. These provisions relate, inter alia, to expropriation, compensation, national treatment, rights of establishment, and dispute settlement. In other words, it is not sufficient to assert key national prerogatives; the way they are framed also has to be consistent with domestic and international laws, as explained above. Consequently, in the following sections we use these international law principles to interrogate the substantive provisions in the Investment Bill.

Preamble

Preambular language is important in a legal instrument as tribunals or courts can defer to it when interpreting the legislation. The preamble of the Investment Bill tries to balance the need for investment and the state's developmental objectives as enshrined in the Constitution. This has always been the government's desire considering that it entered into some BITs before the advent of the Constitution. There was therefore a need to 'constitutionalise' investment regulation, so to speak. This has been happening in other spheres of regulatory space such as labour, health, competition etc. What makes investment peculiar is that it had hitherto been regulated by international law.

One notable feature of the preambular language is its assertion of the principle of 'public interest'. This principle has generally been widely interpreted and there is substantial disagreement within the legal community in South Africa on what constitutes 'public interest'. Since the definition is so elusive, and this principle features centrally in the Bill, we recommend that the government offer a statutory definition in the final legislation. This will give foreign investors a sense of certainty and transparency, as opposed to the current framing which could lend itself to arbitrary actions.

Definitions

Investment

The definition of investment in the Bill is quite good by international standards. This is because it includes what a lay person would understand as investment but most importantly it also includes contractual rights; in other words a breach of contract would constitute an expropriation of investment. This is a progressive definition codifying the Salini test,[2] a celebrated test in international investment law. The definition therefore excludes speculative investments. Overall, the South African government shows that it is open to many kinds of investments by providing a very broad definition. However, the government would be advised to distinguish between investments made by private persons and state owned enterprises. This would cater for investments by

[2] The Salini test was devised in an arbitral decision and has become widely accepted in international investment law policy and practice. It simply provides that for an activity to be deemed an investment it should be adding economic value to the host state's economy.

sovereign wealth funds and, for example, Chinese state owned enterprises, in which the strategic interests of home states may come into play. This might not be an issue now but could become problematic in future. It also points towards the importance of definining 'national security', which currently is not specified in the Bill.

Interpretation Clause

This is a very important clause. It provides that the Act has to be interpreted with regard to the Constitution (which is supreme law). It must also be interpreted in accordance with international law which is consistent with the Constitution. This means that if there is any aspect of international law which is deemed not to be consistent with the Constitution then international law cannot be applied. This is where the AgriSA case[3] comes into play. In AgriSA, a case concerning indirect expropriation, a principle of international law was ruled to be not part of South African law by the Constitutional Court.[4]

In addition, the Bill states that it should be interpreted in line with customary international law **consistent** with the Constitution. The implication is is that there can be customary international law that is not consistent with the Constitution. Ideally customary international law should be read in to any piece of domestic regulation including the Investment Bill. Trying to qualify, limit or subject customary international law to the Constitution is problematic. Considering that most customary international investment law principles will run counter to this Bill, then South Africa might find itself with a statute that does not apply international law principles. Such a statute can be challenged at international courts for denial of justice.

Interestingly (section 2(d)) of the Bill provides that it must be interpreted in accordance with any agreement that South Africa is a party to or will become a party to. This is probably meant to also cater for future BITs which might include exhaustion of local remedies. This makes the interpretive provisions self-contradictory as all international investment agreements are interpreted within the confines of customary international law. In other words, customary international law is read in to any international investment agreement. An example of such is the principle of indirect expropriation which the Constitutional Court ruled in AgriSA to be not part of South African investment law. While that case fell under the radar to a certain extent, if the claimants had been foreign investors they could have approached an international forum like the SADC Tribunal or even the International Court of Justice and argued denial of justice. In this regard, it is important that the government consider aligning these aspects of the Bill with international investment law.

[3] See AgriSA v Minister of Minerals and Energy 2013 ZACC 9.

[4] The Court in this case made a distinction between deprivation and expropriation. Usually in international investment law that kind of distinction is only academic. More problematic, is the court's finding to the effect that for expropriation to occur, the state should have benefited. However, in most cases of regulatory takings, the state derives no pecuniary benefit. Customary international law does not require the state to benefit to make a finding of expropriation. The Constitutional Court finding in AgriSA is therefore flawed and for it to find its way into the Investment Bill raises concerns.

Screening of Investments

Sections 5 and 6

Every country by virtue of the principle of sovereignty has a right to accept or deny aliens entering into its territory. The same principle can also be rightly extended to the regulation of foreign investment entry as an adaptation of immigration law and policy. Section 5(2) codifies this principle by denying the right of establishment. It needs to be read in conjunction with section 6. Section 6(1) introduces a national treatment obligation for the South African government (more on this below), but 6(4) conditions the obligation on an 'examination'. Clearly this constitutes the 'screening' requirement highlighted by the Walmart case.

Regarding the right to establishment, rather than impose a blanket prohibition it would be more investor friendly, and therefore more in keeping with the sub-title of the bill (Promotion of Investment) if the government were to establish a negative list proscribing right to establishment in designated sectors. Obvious sectors that come to mind are the armaments industry, or telecommunications, and other 'dual use' technology sectors. In other words the presumption should be that FDI is generally beneficial and therefore to be promoted, but in certain cases particularly those bearing on national security, closer scrutiny is required. Then the 'public interest' review could be reserved for exceptional cases, rather than as currently framed whereby the Bill appears to license government to screen all incoming investment.

Regarding the screening process, the procedural dimensions of the examination are not explained in the Bill. In particular, it is not clear who would conduct the examination, particularly which state institution(s). Nor is it clear which investments would be screened: all incoming FDI; only potential investments that are of concern to the South African government; or investments that take place subsequent to the enactment of the Bill? Screening will involve a lot of administrative regulation, so more elaborate provisions would be useful for both foreign investors and regulators. South Africa has one of the best administrative justice frameworks in the world. The Investment Bill must therefore be made more compliant with the Promotion of Administrative Justice Act. In addition, the screening agency could have a built in dispute resolution aspect to give foreign investors more confidence in the system.

The following sub-sections then specify very broad criteria against which the investment will be examined: 'the effect of the foreign investment on the republic'; 'the sector the investment is in'; 'the aim of any measure relating to foreign investment'; and 'other factors relating to the foreign investor or the foreign investment in relation to the measure concerned'. These tests give some insight into the intentions of the drafters but, as the old saying goes, they are so broad that one could drive a bus through them. Clearly the framers of these provisions intended to leave wide scope for government discretion. This approach could however fuel concerns over the South African government's intentions rather than to ally any fears.

Overall, it will be more prudent if the government could consider more elaboration of the factors to be used in screening and the composition of the body that will be tasked with it. Furthermore, the government needs to clearly specify thresholds that would trigger screening investigations. These could be specified numerically, for example investments exceeding a certain transaction value. And/or they could be specified in terms of policy grounds. Drawing on international experience, using 'public interest' as the main criteria for screening inward investments is far too wide in scope. Most international jurisdictions adopt a narrower, national security definition.

National Treatment

This principle provides that foreign investments must be treated similarly to local investments. The question in international investment law and policy has always been what if the host country is subjecting its investors to a standard that falls short of international standards? Some have countered this by averring that investors must reconcile themselves to the possibility that they might be treated adversely. However, the voluntary assumption of risk does not apply in customary international law. There is a principle in international investment law referred to as the international minimum standard of treatment or fair and equitable treatment. This is used to limit or contextualize national treatment.

There is usually confusion between national treatment in international trade and that in the international investment sphere. The former is generally easy to configure and apply while the latter is more nuanced and easier to violate. The likeness principle has always been difficult to understand in trade as in investment. Maybe the case by case analysis envisaged in section 6(4) is borne out of this realization. The attempt in the Bill to flesh out factors which will be used in determining national treatment is accordingly to be welcomed.

Security of Investment (section 7)

International law requires states to provide security to investors' property. Section 7(1) therefore seeks to codify that. However, it deviates from international investment law standards in that the security to be provided is subjectively described. It states that the security should be determined by '**available resources and capacity'**. This insinuates that if the resources are not sufficient, then the state will not be liable. This is an important provision when a situation arises where civil disobedience threatens the security of investors' property. We therefore advise the government to adopt clearer drafting in this regard.

Section 7(2) could be read as contradicting the interpretation clause because it states that compensation in case of security breach shall be determined in accordance with domestic, international and international customary law. This is in contrast to the interpretation clause which places constitutional law over customary international law. What entails appropriate compensation is one of the vaguest issues in investment law. Appropriate compensation is subjective and in light of the Constitutional Court judgment on AgriSA and other socio economic rights cases, this kind of compensation might be deemed to be what the state can afford. Inherently, courts will be more lenient to the state considering its budget.

Expropriation Clause

This is probably the most important proviso in any investment instrument. It is even more important in South Africa where proprietary rights occupy a politically contested terrain. Section 8(1) codifies customary international law insofar as it provides that expropriation is lawful if pursued for a public purpose or interest. The Bill then derogates from customary international law in the level of compensation. It provides that compensation must be just and equitable. This standard is in line with the South African Constitution, as devised by Calvin Calvo, an Argentinean diplomat and jurist. Simply put this means that it is compensation which the state can afford. This is quite subjective. And what is fair and equitable is a minefield of legal interpretation.

The best standard of compensation, which now occupies customary international law status, is the one devised by Cordell Hull. This states that compensation must be prompt, adequate and effective.

This is a kind of compensation that accords with rules of natural justice in that it is aimed at wiping out all the consequences of the expropriation (restitution). The Calvo (South African) standard of compensation is state centric; the Hull formula is investor or proprietary centric. The issue of compensation is not settled in theory in international investment law, but in practice arbitration tribunals and most BITs use market value. Efforts are underway in the international investment arena to find a middle ground. South Africa could therefore be more creative in the context of the Investment Bill and devise a middle path compensatory standard which would be acceptable to both government and investors.

Section 8(2) raises some challenges of both form and content. This is because it has a positive list of conduct which it deems not to be expropriatory. It is important to note that the list is not exhaustive.

a) This subsection provides that concerted action having an adverse effect on the value of an investment is not expropriation. This is difficult to reconcile with customary international law. In customary international law this kind of action is referred to as creeping, constructive, indirect expropriation etc.
b) In this proviso, the Bill wrongly states that a measure aimed at protecting or pursuing public policy is not expropriation. In customary international law, the objective of the measure is irrelevant. It is only important in distinguishing between lawful and unlawful expropriation. This distinction is mostly academic as both can be compensated.
c) This provision suffers from the same handicap. As long as the deprivation of the intellectual property rights results in the diminution of value then there is expropriation. It could be lawful or unlawful and is compensable either way.
d) This particular provision makes state ownership of the acquired property as a condition sine qua non for an expropriation. It codifies a problematic principle established in AgriSa v Minister of Minerals and Energy (discussed above).

The foregoing provision gives government too much arbitrary power to regulate and therefore threatens the certainty for investors. This provision should therefore be brought in line with prevailing international investment standards in order to provide foreign investors with a degree of confidence.

A reading of Section 8(1), which sets the standard of compensation, together with Section 8(4) outlining the valuation formula, reveals a conflict between the two. There is a level of creative drafting which results in constructive ambiguity. Investors are left with an uncertain situation should the two provisions need to be invoked. Specifically, the valuation formula accords with the Hull standard of compensation while the compensation standard is concomitant with the Calvo doctrine. In practice it will create problems for tribunals to reconcile the two.

Regulatory Space

Section 10

This part of the Bill seeks to outline all the most important aspects of the government agenda within which it seeks regulatory space. It is an exposition of aspects of South Africa's industrial and economic policy within which it aspires to harness FDI for sustainable development. The policies which have to be linked to FDI or investments will generally prove to be burdensome. The experience of having justiciable socio-economic rights under the South African Constitution has illustrated the challenges. Any effort to try and impose these rights as performance requirements for foreign investors is likely not to assist in promoting FDI.

Dispute Resolution

Section 11

This provision appears to reflect diverse views among the drafters of the Bill. It subjects investment disputes to local tribunals, however there is no applicable hierarchy. Nonetheless, in line with international trends, it introduces alternative dispute resolution (ADR) as a way of dealing with investment disputes. South Africa has an impeccable culture of ADR honed in the labour field and recently in company law and this aspect is to be welcomed. Yet the fact that this provision mentions international arbitration under the Arbitration Act of 1965 is peculiar. This is quite an outdated statute which was drafted to codify the New York Convention on the Enforcement of Foreign Arbitral Awards. Since its enactment its use has mainly been confined to commercial arbitration. Its express inclusion here could be a sign that South Africa is contemplating entering into international investment contracts with individual investors instead of BITs. These contracts have an advantage for government in that they are regulated by commercial contract law despite having an arbitration clause. However these kinds of contracts usually apply to natural resource extraction e.g. mining, forestry etc. It is hard to imagine that they could apply to mergers and acquisitions and other such investment types.

We would have expected this provision to provide that if an investor has failed to find redress in local courts, they may approach international tribunals based on an international agreement etc. This would allow for any future new generation BITs which South Africa might enter into to provide for an exhaustion of local remedies. This is presumably the intention behind the drafting of the Model BIT, that has yet to be released but which was one of the outcomes of the review of investment policy. It would be useful to be able to consider the revised Investment Bill in tandem with the Model BIT so as to ensure a coherent overall approach to the promotion and protection of investment in South Africa as well as with regards to outward South African FDI.

5. Concluding Observations

Overall, we conclude that the drafting of the Promotion and Protection of Investment Bill provides South Africa with a good opportunity to reconfirm its commitment to protecting foreign investment in line with both domestic priorities as well as international obligations. We are of the view that the current draft does not yet do that and requires amendment in a number of areas, such as the clauses related to expropriation and dispute settlement.