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Process Matters: South Africa's Experience Exiting its BITs

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Abstract

This paper examines South Africa's policy decision to review and exit its Bilateral Investment Treaties (BITs). Drawing on interviews with government officials and business representatives, public documents and secondary literature, it scrutinises the process that South Africa went through in reviewing its investment policies, its decision to terminate its BITs and to enact new domestic legislation for investor protection. The paper illustrates that the decision of the South African government to change its policies on investment was triggered by a concern that BITs and the international system of investor-state arbitration inhibits the ability of governments to enact legislation and regulatory measures aimed at promoting public policy objectives. While the review undertaken by South Africa may have its shortcomings, which the paper highlights, it has been lauded as a thorough and critical approach through which it has sought to build its internal capacity on the topic of investment. Documenting this fascinating process provides valuable insights into the drivers of investment policy reform and useful lessons for other developing counties who may wish to embark on a similar exercise.

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1. Introduction: Accounting for South Africa's policy change

South Africa's government has long acknowledged that foreign direct investment (FDI) can act as a driver for economic development. The significance of FDI for stimulating growth was particularly emphasized in South Africa's Growth, Employment and Redistribution Strategy in 1996 and has been reiterated in official statements since then.[2] As private investment has been restricted by South Africa's low saving rates, FDI is viewed as essential to address the saving deficiency and promote economic growth.[3] However, in what would seem as a counterintuitive move, the South African government began terminating its bilateral investment treaties (BITs) in 2012, after a three-year review process. Why?

This paper examines in detail the policy choices of the South African government. Drawing on interviews with government officials and business representatives, public documents and secondary literature it scrutinises the process that South Africa went through in reviewing its investment policies, its decision to terminate its BITs and to enact new domestic legislation for investor protection. More precisely, it examines how it is that South Africa entered into BITs that conflicted in important ways with its constitution; the factors that triggered the government's decision to review its investment policies; the process that the government pursued in order to terminate its BITs and to enact new domestic legislation; the reactions of foreign investors and governments; and the counter-reaction of the South African government. Documenting this fascinating process provides valuable insights into the drivers of investment policy reform and useful lessons for other developing counties who may wish to embark on a similar exercise.

Investment polices in South Africa

Despite South Africa's sustained record of macroeconomic prudence since the beginning of the post-apartheid era and its development into a leading capital importer and exporter in Africa, inclusive economic growth has continued to elude the country. Former President Thabo Mbeki, during his 2003 State of the Nation address, described South Africa as having a prevailing 'dual economy'[4], which is comparable in several respects to an industrialized economy but in many others resembles a developing one.[5] A more detailed account provided by a report on South Africa's inward FDI policy elaborates: 'South Africa's sound regulatory and legislative environment for investment, its sophisticated business sector and globally competitive financial markets are juxtaposed against pervasive poverty and high income inequality.'[6]

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[2] Arvantis, A. (2005). Foreign Direct Investment in South Africa: Why Has It Been So Low?. In: M. Nowak and L. Ricci, ed., *Post-apartheid South Africa: the first ten years*, Washington, D.C.: International Monetary Fund.
[3] Avantis, A. (2005) ibid
[4] The existence of a "dual economy and society" in South Africa was first mooted by President Thabo Mbeki during his 2003 State of the Nation address, available at: http://www.info.gov.za/speeches/2003/03021412521001.htm.
[5] Wöcke, A. and Sing, L. (2013). Inward FDI in South Africa and its Policy Context, New York: Vale Columbia Center on Sustainable International Investment.
[6] Wöcke, A. and Sing, L. (2013) ibid

One of the ways the South African government decided to address this dilemma was by deciding to shift their inward FDI strategy from the currently adopted "freedom of investment model" to an "investment for sustainable development model" (ISD).[7] The main difference between them being that the former assumes that all investment is good and promotes economic development, whereas the latter stipulates that regulations are required to balance the incentives used to attract FDI with the need to ensure that these investments positively contribute to South Africa's sustainable development objectives.[8]

Shifting to the ISD approach entailed scrutinizing South Africa's investment policies, including its bilateral investment treaties (BITs). As most bilateral investment treaties were reaching their termination dates, the Minister of Trade and Industry Rob Davies saw the review as an opportune moment to develop a new framework that would aim "to achieve an appropriate balance between the rights and obligations of investors and the need to provide adequate protection of foreign investors, while insuring that Constitutional obligations are upheld and that the government retains the policy space to regulate in the public interest".[9]

The review was concluded in 2010 and was very critical of BITs. It stated that the country's BITs extend far into the policy sphere and are incompatible with the constitution and domestic legislation. In addition, the BITs also allowed for legal challenges to regulatory changes, which the government regarded as public interest.[10] Furthermore, as part of the review, the DTI was mandated to balance openness to FDI with regulations to safeguard the government's sovereign right to pursue their policy objectives.

Based on the recommendations made by the cabinet, from 2013 South Africa proceeded to legally terminate[11] its expiring BITs and to restructure its investment policy framework to ensure that South Africa's broader social and economic priorities are not undermined.[12] To this end, South Africa's government released the draft Promotion and Protection of Investment Bill (PPIB) for public comments in November 2013. The PPIB was presented as part of an overhaul of the regulatory framework for foreign investment in South Africa.[13] This overhaul saw the government terminate its BITs with Belgium, Luxembourg, Spain, Germany and Switzerland, indicate that it will terminate its remaining BITs with European countries, and discuss termination with other, non-European countries.[14] The PPIB replaces these bilateral treaties with domestic legislation that stipulates the rights and obligations of the government, and of all investors, both local and foreign.

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[7] UNCTAD, (2012). *Shift African investment towards industry, South African Minister recommends.* (online): http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=292&Sitemap_x0020_Taxonomy=UNCTAD%20 Home
[8] UNCTAD (2012) ibid
[9] UNCTAD (2012) ibid
[10] Lang, J. (2013). Bilateral Investment Treaties – a shield or a sword?. [online] Bowman Gilfillan Africa Group. Available at: http://www.bowman.co.za/FileBrowser/ArticleDocuments/South-African-Government-Canceling-Bilateral-Investment-Treaties.pdf
[11] A treaty can be terminated unilaterally or by mutual consent. The Vienna Convention allows parties to terminate their agreements by mutual consent at any time. Rules for unilateral treaty termination are typically set out in the BIT itself.
[12] Lang, J. (2013) see note 10
[13] Woolfrey, S. (2014). *South Africa's Promotion and Protection of Investment Bill - tralac*. [online] Tralac.org. Available at: http://www.tralac.org/discussions/article/5345-south-africa-s-promotion-and-protection-of-investment-bill.html
[14] Woolfrey, S. (2014). ibid

South Africa's decision to exit from BITs is not unique. As a result of the growing dissatisfaction with the perceived imbalance of costs and benefits provided by BITs[15], several developing countries have been working towards exiting BITs. In 2008, Ecuador and Venezuela started to terminate BITs with other countries, and in 2012 Bolivia terminated its BIT with the US.[16] Now countries like Indonesia and India are exploring their options.

What differentiates South Africa's experience from that of other developing countries that have exited their BITs is the fact that the South African Department of Trade and Industry (DTI) had carried out a three-year review of South Africa's investment policy regime before terminating any agreements. Very few governments have engaged in this sort of public review of governmental policy regarding the treatment of inward investment.[17]

The response to the government's attempts to overhaul South Africa's investment regime has been mixed. Critics argued that by terminating its BITs, South Africa took a step away from being an 'investor friendly' jurisdiction.[18] European governments, with whom South Africa had many of its BITs, were particularly critical. European officials signalled their disappointment at the government's decision to cancel the BITs instead of seeking to renegotiate the treaties, and suggested that it could have a negative effect on investor confidence.[19] Criticism also came from local and foreign business groups. The South African Chamber of Commerce and Industry and representatives of the European business community claimed the new bill offered foreign investors a lower standard of protection than that provided for under South Africa's BITs.

Others, notably legal and economic experts, praised the government for its decision to review and exit its BITs. These included David Schneiderman, an internationally renowned professor of law, and Martin Khor, head of the South Centre, an intergovernmental organization of developing countries. Critics argued that BITs do not sufficiently promote sustainable development and may constrain a states' ability to regulate in the public interest.[20] Leading economist Joseph Stiglitz applauded the government for 'taking the lead' amongst the developing world in seeking to rebalance the rights and responsibilities of states and investors.[21]

The long-term effects of this new policy cannot yet be judged. It is too early to tell whether the South African government met their objectives, or equally, if the new policy will impact foreign investment flows. However, important lessons can be drawn from the experience so far.

The remainder of this paper is structured as follows: Section two examines how it is that the South African government entered into BIT obligations that conflicted with its constitution in

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[15] Including the legal costs, potential for massive damages, and the 'chill' on domestic regulatory space
[16] Johnson, L. and Sachs, L. (2014). Trends in International Investment Agreements, 2011-2012: A Review of Trends and New Approaches. In: A. Bjorklund, ed., 1st ed.
[17] Klaaren, J. and Schneiderman, D. (2009). *SA s Bilateral Investment Treaty Policy Framework Review*. Working Paper. Johannesburg: Wits Law School, Mandela Institute.
[18] Steenkamp, T. (2014). *South Africa's New Bilateral Investment Treaty Policy: A Reasonable Response to a Flawed Regime?* Master of Laws. The University of British Columbia. <https://circle.ubc.ca/handle/2429/49945>
[19] Woolfrey, S. (2013) see note 13
[20] Steenkamp, T. (2014) see note 18
[21] Stiglitz, J. (2013). *South Africa Breaks Out*. [online] Project Syndicate. Available at: https://www.project-syndicate.org/commentary/joseph-e--stiglitz-on-the-dangers-of-bilateral-investment-agreement

important ways and examines the triggers that led the government to embark on a thorough review its investment policies. Section three looks in detail at the process by which the South African government terminated its BIT obligations and enacted new domestic legislation. Section four examines the response of foreign investors and governments, and section five looks at the government's response to investor criticisms. The paper concludes by distilling the key lessons that other countries can learn from South Africa's experience.

2. Why did South Africa enter into BITs it later deemed unfavourable?

When South African officials began signing BITs in the 1990s they failed to assess the implications of certain provisions of these treaties and were unaware of their potential impact on their future policies. Poulsen (2011) argues that the combination of bureaucratic conditions and lack of expertise and coordination led South African officials to ignore the risks of BITs and overestimate their benefits.[22] Poulsen's research further reveals that BITs were signed simply because they were available and ready to adopt. The government did not undertake a careful consideration of costs and benefits of the treaties compared to alternative investment promotion instruments. Consequently, the implications of entering into these investment treaties were brushed aside and did not receive scrutiny until the South African government found itself on the receiving end of a first serious claim in 2007 the *Piero Foresti v. Republic of South Africa* case.[23] This case concerned the broad-based black economic empowerment (BBE) provisions of the Minerals and Petroleum Resources Development Act of 2002 (MPRDA).[24]

South Africa first entered into a BIT with the UK in 1994. Although the new post-Apartheid South African government signed it in 1994, the BIT was actually presented to the outgoing government a year earlier. The UK government at the time was said to be wary of the new government of South Africa, fearing they would not protect their existing investments and would nationalize or expropriate the property of its investors.[25] Accordingly, they acted swiftly by presenting their draft model BIT to the outgoing government, which simply accepted the draft model BIT without any negotiation from when it was presented in 1992/93.[26] The proposed text was based on a 'standard' OECD model.[27] The main features of the agreement was that it stipulated that foreign investors and their investments had to be treated fairly and equitably, there should be no discrimination or expropriation, contracts should be upheld, there should be no capital restrictions, and disputes could be adjudicated through international investor-state arbitration.[28]

At the time, such agreements were widely considered harmless, and many developing countries entered into them. However a close analysis of the terms of the UK-South Africa BIT and South Africa's constitution reveals substantial incompatibility and, in hindsight, it is quite striking that this was overlooked. For instance, the national treatment clause in the BIT contained no explicit provision allowing the state a right to give local firms preferential treatment. This clause directly contradicted the new constitution, which was being developed when the BIT was signed, and, which included affirmative measures to redress the historical

[22] Poulsen, L. (2011). *Sacrificing sovereignty by chance: investment treaties, developing countries, and bounded rationality*. PhD Thesis. The London School of Economics and Political Science (LSE).
[23] Poulsen, L. (2011) ibid
[24] See Piero Foresti, et al. v. Republic of S. Afr., ICSID Case No. ARB(AF)/07/1
[25] Williams, R. (2009). The Third Annual Forum of Developing Country Investment Negotiators Nothing Sacred: Developing Countries and the Future of International Investment Treaties [online] International Institute for Sustainable Development. Available at: http://www.iisd.org/pdf/2011/developing_countries_and_the_future_of_IIAs.pdf
[26] Williams, R. (2009) ibid
[27] UNCTAD; *International Investment Instruments: A Compendium, vol.III* (Geneva: UNCTAD, 1996).
[28] Poulsen, L. (2011) see note 22

injustices faced by the black population.[29] Once the constitution was completed other contradictions appeared. The BIT did not make a distinction between expropriation and deprivation, implying that deprivation was tantamount to expropriation and would result in compensation. In contrast, the constitution clearly stipulated that deprivation would not require compensation if the measures were pursuant to law and not arbitrary.

Another aspect was the calculation of compensation, which in the constitution included taking public interest into account and allowing for less than market compensations. This would be considered in cases where it was, for instance, proven that the land was acquired during the apartheid era. However, the relevant clause in the BITs would not allow any deviation from market value. Finally, with respect to international arbitration, South Africa had no reason to be sceptical as in the early 1990s there were few, if any, cases to make anyone treat arbitration as the serious threat it constitutes today.[30]

The contradictions between the BITs and South Africa's constitution were all overlooked. Strikingly, after the president signed the BIT in 1994, the officials did not voice any concerns to the parliamentary committee. Instead they asserted that the BIT with the UK did not contain any substantive obligations that would be placed on South Africa.[31] Moreover, the BIT between South Africa and the UK was adopted by South Africa as a draft model and used as the basis for concluding 46 further BITs (although only 23 of these entered into force).[32]

Why precisely did this happen? How is it that South African government officials entered into such agreements? Again, Poulsen's field research attributes this to weak organization, uninformed and poorly coordinated workforce of government officials dealing with these issues. The bureaucrats charged with negotiating the treaties were not lawyers and had little legal and technical expertise in international law.[33] Furthermore, this was the first treaty where South Africa allowed investor-state arbitration over a wide range of regulatory issues, which gave foreign investors access to a dispute settlement forum and enforcement mechanisms not available to local South African investors.[34] The impression that the treaty did not have any implications and its provisions corresponded completely to South African law meant there was no reason for parliamentarians to investigate its importance for investors.[35] Politicians also did not question the scale of the legal guarantees granted to foreign investors.[36]

The lack of oversight resulted in treaties being signed in many cases for diplomatic reasons, ignoring the real commitments they entailed. Few records exist to explain why South Africa took the approach it did towards entering into BITs in the 1990s, but a draft cabinet memorandum from 1994, which appears to contain no legal or economic analysis of the risks associated with BITs, indicates that: 16 countries had requested the conclusion of BITs with South Africa; the DTI was convinced that such agreements would create an investor friendly

[29] Poulsen, L. (2011) see note 22
[30] Poulsen, L. (2011) see note 22
[31] Williams, R. (2009) see note 25
[32] http://investmentpolicyhub.unctad.org/IIA/CountryBits/195#iiaInnerMenu
[33] Poulsen, L. (2011) see note 22
[34] Poulsen, L. (2011) see note 22
[35] Poulsen, L. (2011) see note 22
[36] Poulsen, L. (2011) see note 22

environment; and that the aspects covered by BITs can be viewed as 'basic investor rights'.[37]

In an interview, a senior official at the DTI explained that the implications of South Africa's first BITs were not analysed properly when they were signed. He observes: "We had signed on BITs without proper analysis, the more the merrier, part of the global trend of signing BITs without understanding the implications."[38] Only over time did the DTI officials begin to realize what the implications would be: the shortcomings in the legal text, in the specific provisions and in the international arbitration process.[39]

What triggered the policy change?

South African officials argue that in the late 1990s they became aware of the challenges posed by these investment treaties. The signals came from observing the fractious debate in the OECD over a multilateral investment agreement.[40] South Africa was also a participant in the discussions in the WTO that sought to include investment, as one of the Singapore Issues (trade and investment) in the Doha Round negotiations.[41] The spike in international investment arbitrations that followed the financial crisis in 2001 made them aware of how BITs can pose serious risks to government policy.[42] Indeed, when Randall Williams took over as South Africa's BIT negotiator in 2001 he was 'quite horrified' to read the content of the BITs, which 'places all the obligations on the host state and gives all the rights to the investors.'[43]

Although there were concerns in the late 1990s and early 2000s, it was only when the first claim hit in 2007 that the South African government began to change its policy. The proximate trigger of the BIT review was the realization that South Africa's most comprehensive and far reaching social policy since apartheid its BBE scheme, was conflicting with its obligations under BITs.[44] BBE policy was designed to redress inequalities in the political, social and economic spheres of South Africa.[45]

The conflict between BBE and BIT obligations became evident in the wake of a 2007 claim by several Italian citizens and a Luxembourg corporation filed a claim under the Belgium-Luxembourg BIT generally referred to as the 'Foresti Case'. The claimants charged that the 2004 Mineral and Petroleum Resources Development Act (MPRDA)[46] amounted to the

[37] Department of Trade and Industry (2009). *Bilateral Investment Treaty Policy Framework Review. Government Position Paper to Cabinet*. Pretoria:
[38] Carim, X. (2014). Director-General for International Trade and Economic Development at the Department of Trade and Industry, Republic of South Africa. Personal Interview. 22 July 2014
[39] Carim, X.(2014). ibid
[40] Carim, X. (2012) Speech at the WTO Public forum 2012 "Investment Provisions and Agreements: What is the Right 21st Century Approach?" Session.
[41] Carim, X. (2012) ibid
[42] Carim, X. (2012) ibid
[43] Williams, R. (2009) see note 25
[44] Yazbek, N. (2010) Bilateral investment treaties: the foreclosure of domestic policy space, South African Journal of International Affairs, 17:1, 103-120 http://dx.doi.org/10.1080/10220461003763874
[45] Department of Trade and Industry, online: DTI <https://www.thedti.gov.za/economic empowerment/bee.jsp>
[46] Part of the BBE Scheme and particularly South Africa's efforts to increase participation by historically disadvantaged South Africans in the mining industry)

expropriation their mineral rights.[47] The Act required mining companies to transfer 26% of their shares to historically disadvantaged South Africans. The claimants argued that these measures were expropriatory and contradicted certain obligations in the BITs signed by South Africa.[48] The government responded defending its obligation to promote equality under both international human rights law and the South African Constitution, and arguing that the mining policy was aimed at realizing its human rights obligations.[49] The case was ultimately settled on the merits in 2010, with the tribunal only required to make an award on costs.[50]

The 'Foresti Case' made it clear to the South African authorities that the ability of the state to regulate its domestic public policy objectives were under serious threat from the BIT obligations in general and international investment arbitration in particular. In the wake of the settlement, South Africa initiated a review of its investment policy regime.[51]

While the 'Foresti Case' triggered the review, it is important to acknowledge a wider trend in international policy circles that bolstered the position of the South African government. As public statements by South Africa's Trade Minister reveal, the government justified their decision to update their investment protection regime as being consistent with global trends. Many countries are seeking to address the faults in the treaties and in investor-state arbitration processes.[52]

Indeed debates over the merits of international investment treaties extend to the developed countries too, as evident in the debate going on within the EU with regards to investor-state dispute settlement provisions under the Transatlantic Trade and Investment Partnership Agreement (TTIP). Furthermore, multilateral dialogues on investment treaties have intensified in UNCTAD, which has developed a set of principles, and guidelines that seek to embed sustainable development objectives into investment treaties.[53] While it is likely that South Africa would have undertaken its review process even without these wider developments, they provided the government with additional justification.

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[47] IISD, (2012). *Investment Treaty News*. online: http://www.iisd.org/itn/2012/10/30/news-in-brief-9/
[48] Piero Foresti, Laura de Carli and others v Republic of South Africa (ICSID Case No ARB(AF)/07/1) Award, 3 August 2010, online: ICSID, <www. icsidworldbank.org> [Foresti et al v South Africa].
[49] Steenkamp, T. (2014) see note 18
[50] Peterson, L. (2010) "South Africa mining arbitration ends with a whimper, as terms of discontinuance are set down in award", online: Investment Arbitration Reporter <http://www.iareporter.com/articles/20100818_6>.
[51] Steenkamp, T. (2014) see note 18; IISD, (2012) see note 47
[52] Remarks by Dr Rob Davies at the Centre for Conflict Studies Public Dialogue on "South Africa, Africa and International Investment Agreements" Cape Town, 17 February 2014 http://www.tralac.org/news/article/5481-south-africa-africa-and-international-investment-agreements.html
[53] Remarks by Dr Rob Davies ibid

3. How did South Africa go about terminating its BITs?

The government's decision to review its approach to BITs mirrors BIT revisions and updating processes in other countries, including the United States, Canada and Australia. South Africa's review process coincided with the general disenchantment with the international investment agreements regime[54] and hence such an exercise could potentially be replicated by many other developing countries.

The South African government embarked on a systematic review of its investment policies in 2007 and this entailed looking at both the macro and microenvironment surrounding BITs. The macro-policy research conducted under this project sought to determine the policy and strategy considerations that motivate BITs, to assess the gains to South Africa from entering such agreements.[55] The micro-environment study scrutinized the legal obligations under existing BITs and evaluated the changes that would be needed for the government to safeguard its own policy objectives.[56]

More than a hundred stakeholders participated in the review from business, labour, government, local and international institutions, with a view to informing and updating the executive on the legal implications and impact of BITs on South Africa's developmental agenda.[57]

Participation in the review was through detailed interviews at management level with the various sector desks at the Department of Trade and Industry (DTI), which had led BIT negotiations, and other relevant stakeholders. Interviewees were requested to provide an indication of their working methodology and in particular, what policies and/or strategies had led them to include the negotiation of a particular BIT in their work plans. The objective of the review was to establish the reasons why the government had failed to pursue joined-up-policy. This ultimately led to the conflict between national policies and its BIT obligations, and drew out lessons for cross-governmental policy integration, encouraging departments to be on the same wavelength, informed and working towards the same objectives. The review did not seek to provide an economic analysis of the investment policy that South Africa needs to follow to maximize economic growth.

The policy framework review process included three drafts, the first of which was an initial policy document based on research collected through interviewing the bilateral units in the international trade division who directly worked with BITs.[58] This also included an internal government workshop bringing policy makers together to discuss the results and receive feedback. Subsequently, encompassing this feedback, a second draft of the policy paper was published online as well as in the newspapers for public comment. This only yielded limited public participation and feedback, so a public workshop was held, which attended by a wide range of stakeholders including academics, NGOs, business representatives,

[54] Langalanga, A. (2014). » *South Africa's Foreign Investment Regulation: A revisit*. [online] Blogaila.com. Available at: http://blogaila.com/2013/12/05/south-africas-foreign-investment-regulation-a-revisit-by-azwimpheleli-langalanga/
[55] Department of Trade and Industry (2009). see note 37
[56] Williams, R. (2009) see note 25
[57] http://govza.gcis.gov.za/node/598331http://govza.gcis.gov.za/node/598331
[58] Williams, R. (2009) see note 25

lawyers, labour unions and civil society.[59] The feedback received from this event was integrated in the third draft that was sent to the cabinet.

The review was concluded in 2010. The headline finding of the macro-review was that there is no correlation between a bilateral treaty with a particular country and the flow of foreign direct investment (FDI) from that country. In fact, some of South Africa's main investors came from countries they did not sign BITs with, for example the United States. As a senior DTI official explains, large investments come in from non-treaty partners, including the United States, India, Malaysia, and Brazil. As he explains, "… we could not see any clear unambiguous evidence that the treaties themselves encourage investment, which was also part of the calculation in weighing the possible benefits of the treaties compared to the risk."[60]

Perhaps more importantly, the review reaffirmed that adequate policy space is important for developing countries, and that BITs, as they are currently being drafted, extend too far into this 'policy space, imposing damaging binding investment rules with far-reaching consequences for sustainable development.'[61] It further concluded that BITs allowed for legal challenges to public interest regulation. The DTI therefore recommended that South Africa restructure its policy framework to ensure that broader social and economic priorities are not undermined.[62] The review's conclusion was that a new overarching investment policy strategy was needed to span all of South Africa's investment-related policy efforts.[63]

The South African cabinet made a series of landmark decisions on the basis of the review and these were presented by the DTI to parliament. The core decisions were to:[64]

(i) develop an investment legislation to codify BIT provisions into domestic law;
(ii) terminate first generation BITs after offering the partners the possibility to renegotiate;
(iii) develop a South African Model BIT as basis for any new agreement;
(iv) establish an inter-ministerial committee to oversee the process.

Termination of BITs and new domestic legislation

In the wake of the cabinet decisions, the South African government began terminating old BITs, a process that was led by the Department of International Relations and Cooperation.

Between 2011 and 2014, South Africa gave notice to terminate three of its most important bilateral investment treaties: those with Germany, Switzerland and the Netherlands. These three treaties were given priority as they were subject to automatic renewal clauses and,

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59 Williams, R. (2009) see note 25
60 Carim, X. (2014). See note 38
61 Department of Trade and Industry (2009). see note 37
62 Lang, J. (2013) see note 10
63 Maupin, J. and Langford, M. (2009). Bilateral Investment Treaty Policy Framework Review Government Position Paper. Legal Resources Centre and The Centre for Applied Legal Studies.
64 Republic of South Africa, Department of Trade and Industry, Update on the Review of Bilateral Investment Treaties in South Africa, (Pretoria: Report to Cabinet, 15 February 2013) online: South African Foreign Policy Initiative, <http://www.safpi.org /sites/ default/files/ publications/dti_review_of_bits_ppc_20130215.pdf>.

therefore, would have been extended had they not been terminated in time. The German and Swiss treaties contain a twelve-month notice period with a run-off protection for existing protected investments of 20 years, whereas the Netherlands treaty has a six-month notice period with a 15-year run-off period.[65] The South African government is discussing other European and non-European BITs that do not have automatic renewal clauses and have reached their termination dates with the respective partner countries.[66] In other cases, as a senior official notes, treaties were negotiated but never came into force, “now we are quite happy that they didn't because it would have complicated matters further for us.” [67]

Following this instruction by cabinet, in 2011 the National Treasury issued a paper advocating a more coherent policy framework and surveillance mechanism to regulate financial flows emanating from complex mergers and acquisitions.[68]

In tandem, the government drafted a Promotion and Protection of Investment Bill (PPIB) which was intended to provide investors with a domestic law that would protect their investments and in effect replace the BITs it was terminating. Interviews with senior officials reveal that the government had a strong conviction that South Africa’s domestic law would be able to provide adequate guarantees to all investors, their investment and returns on investment.[69] The PPIB was the product of an inter-ministerial work group commissioned to devise an investment protection act. At the time of writing (December 2014) the PPIB is a draft law and the government is still processing all the submissions and comments they have received from the different stakeholders.

The draft bill aligns national treatment, expropriation, compensation and transfer of funds with South Africa’s constitutional principles. In the draft bill, the national treatment standard (which prohibits discrimination by a state vis-à-vis foreign investors/investments as compared to how domestic investors/investments are treated) is subject to exceptions in respect of measures to redress inequalities as stated in the South African constitution and to uphold rights guaranteed in the constitution.[70] These exceptions allow the government to address its social and economic inequalities through measures like the BBE, without violating the national treatment standard.[71]

There are also differences between expropriation and compensation clauses in the draft bill and those found in most BITs. Whereas most expropriation clauses in BITs do not differentiate between direct and indirect expropriation, the issue of indirect and creeping expropriation is addressed in the draft bill. The draft bill differentiates between deprivation and expropriation as defined in Article 25 of the South African constitution, and clarifies that incidental adverse impact on the economic value of the investment does not constitute

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[65] Kolver, L. (2013). *SA proceeds with termination of bilateral investment treaties*. [online] Engineering News. Available at: http://www.engineeringnews.co.za/article/sa-proceeds-with-termination-of-bilateral-investment-treaties-2013-10-21
[66] Kolver, L. (2013). ibid
[67] Carim, X. (2014). See note 38
[68] Kolver, L. (2013). See note 66
[69] De Gama, M. and De Gama, R. (2013). *» South Africa’s approach to the implementation of its Investment Policy Framework by Mustaqeem De Gama & Rafia De Gama**. [online] Blogaila.com. Available at: http://blogaila.com/2013/12/05/south-africas-approach-to-the-implementation-of-its-investment-policy-framework-by-mustaqeem-de-gama-rafia-de-gama/
[70] De Gama, M. (2014) Director of Legal, Trade and Investment in the Department of Trade and Industry. Republic of South Africa. Personal Interview. 24 July 2014
[71] De Gama, M. (2014) ibid

expropriation.[72] Secondly, whereas BITs typically call for prompt adequate and effective compensation and stipulate that market value is the only reference for determining compensation for expropriation, the PPIB in line with Article 25 of the constitution provides for just and equitable compensation. Effectively, the major change is that market value is not an end point. In the cases where the expropriation was proven to the court to be done in light of legitimate objectives of public interest, a lower than market value compensation can be determined at the discretion of the court.

Finally, it is noteworthy that the bill excludes two provisions provided for in most BITs: (i) the principle of Fair and Equitable treatment (FET) was left out as it was deemed to be too widely framed and subject to controversial interpretation; and (ii) international arbitration limiting investors seeking arbitration to access domestic courts and any competent tribunal that may have jurisdiction to hear matters related to an investment.[73]

[72] De Gama, M. (2014). » *South Africa's Promotion and Protection of Investment Bill: A Brief Outline* [online] Blogaila.com. Available at: http://blogaila.com/2014/06/13/south-africas-promotion-and-protection-of-investment-bill-a-brief-outline-by-muhammad-mustaqeem-de-gama/
[73] De Gama, M. (2014) ibid

4. How have foreign investors reacted?

The government's decision to terminate all expiring BITs was met with discontent by the international investment community. The EU is South Africa's largest trading partner and source of FDI, and it was particularly vocal.[74] European investors, together with many other international investors, asserted that the domestic law, embodied in the draft PPIB was not a viable alternative to the terminated BITs. Moreover, the termination of BITs in the absence of a clear and robust domestic legal framework created an atmosphere of uncertainty in terms of what kind of investment protection would be provided instead.

Interestingly, the EU and European investors did not question the decision of the government to embark on a review of its investment policies. However, serious concerns were raised about how the review had been undertaken and many investors challenged the contents of the draft PPIB. According to Axel de La Maisonneuve, the Head of Economic, Trade section of the EU Delegation in South Africa: "this was the sovereign right of the government to take policy steps of this nature.... South Africa is entitled to believe at a certain stage that BITs have done their time and that they need to modernize the framework. For us that is not the problem, its not a matter of content or substance, it is a matter of how it was handled and how it should be handled in the future to ensure investors remain confident that they can invest in South Africa safely."[75]

While most foreign investors raised objections, some were sympathetic to the South African government's situation. Well-known lawyer Peter Leon[76], argues: "I have to say I do have sympathy with the government here, I do think they signed these BITs under ignorance and pressure from the UK…the South African government should have obtained advice about what they were signing from international investment lawyers. They did so under pressure on the basis that this would open a veritable Pandora's box for a whole flood of investments."[77]

Foreign investor concerns about the BIT termination process

Interviews with European government representatives and foreign investors reveal three main concerns with the BIT termination process: (i) that South Africa could not afford to take such a move considering the negative implications it would have on the existing investment climate issues they were facing; (ii) the lack of communication/consultation and simply notifying the parties before terminating the treaties; and (iii) the lack of an alternative available at the time of termination and the uncertainty it created.

Several interviewees heavily criticized the government's decision to terminate BITs on the grounds that this would negatively impact foreign investment flows. Pietman Roos, Senior

[74] Steyn, P. (2014). *Investments In South Africa - Private Equity | Werksmans Attorneys*. [online] Werksmans Attorneys. Available at: http://www.werksmans.com/legal-briefs-view/new-promotion-protection-investment-bill-assessment-implications-local-foreign-investors-south-africa/

[75] Pougin de La Maisonneuve, A. (2014). Head of Economic, Trade section of the EU Delegation in South Africa. Personal Interview. 5 August 2014

[76] Peter Leon acted as co-counsel to Italian investors in an arbitration against the South African government instituted under the auspices of the International Centre for Settlement of Investment Disputes (Foresti and Others v Republic of South Africa

[77] Leon, P. (2014). Partner at Webber Wentzel. Personal Interview. 30 July 2014

Policy Advisor at the South African Chamber of Commerce and Industry[78] explains that the investment bill was met with cynicism and pessimism among many investors. He interpreted the bill in the broader policy context in South Africa, in which he argued there is a trend towards too much government intervention in health and safety regulation, black empowerment, and business regulation. The bill is seen as part of a larger, ideologically-driven bid by government to play a larger role in regulating private sector. Roos states that he doesn't expect the current bill to pass and if it does there will be a fight. He further asserted, "the bill sent a negative signal, which is that the government is always putting into place legislations to ease the process of expropriation."[79]

A representative of an association of German investors shared a similar perspective, asserting that the move came at a time at which 'South Africa is increasingly testing the confidence of the international business community.'[80] The unstable political situation, made visible through discussions on the nationalization of certain industries as well as the strikes in the mining and automotive sectors have created an unfavourable atmosphere for the country.[81] An official from the EU delegation shared this sentiment, asserting that some of the measures taken in the new bill were not consistent with South Africa's need to attract investment. He argued that FDI inflows to South Africa are relatively low compared to other emerging economies like Chile, Turkey and South Korea.[82]

Markus Schrader, the Head of Economic Cooperation and Development at the Embassy of Switzerland, similarly emphasized that the government was not in a position to take such measures, considering South Africa's relatively low ranking in reports like *Doing Business*.[83] If the government is striving to attract investment, he said they are "shooting themselves in the foot" by deciding to exit these treaties. He stressed the argument that though some countries have high FDI rates without BITs, this does not apply to South Africa, as it is one thing not to sign a BIT in the first place and another to cancel existing treaties without providing alternatives. [84]

A series of criticisms concerned the process of BIT termination. According to Leon, international investment lawyer, some aspects of the government's actions were surprising. In particular, the government failed to follow the recommendations made by its own cabinet decision to offer a new model BIT and negotiate with main investment partners rather than simply decide to exit.[85] EU official, De La Maisonneuve, also emphasized that it was the handling of the termination and not whether it was expected that was most disappointing.[86] It was unforeseen that the termination would be unilateral. This contradicted with the nature of

[78] SACCI is the country's largest business organization, with a membership of close to 20 000 businesses, from the largest corporations in South Africa to sector-specific business associations. It has almost 50 constituent chambers.
[79] Roos, P. (2014). Senior Policy Advisor at the South African Chamber of Commerce and Industry. Personal Interview.25 July 2014
[80] Southern Africa Initiative of German Business (SAFRI),(2014). South Africa: New Legal Framework for Direct Investments. [online]: http://www.safri.de/upload/SAFRI_BIT_Factsheet_13032014_ENG_1413.pdf
[81] SAFRI, (2014) ibid
[82] Pougin de La Maisonneuve, A. (2014) see note 76
[83] Schrader, M. (2014) Head of Economic Cooperation and Development at the Embassy of Switzerland in South Africa. Personal Interview. 6 August 2014
[84] Schrader, M. (2014) ibid
[85] Leon, P. (2014) see note 78
[86] Pougin de La Maisonneuve ,A. (2014) see note 76

bilateral treaties.[87] The result he stressed was not only a diplomatic concern but also damage to investor confidence.[88]

A major concern was that BITs were terminated before the PPIB became domestic law. Matthias Boddenberg, the Executive Director of the South African-German Chamber of Commerce and Industry,[89] stated that they had known since 2011 that the government intended to review the BITs (not only German BITs) that were concluded in the 1990s. What surprised them was that the termination of the BITs was conveyed before an alternative for protection of investments was finalized. The termination came three months before the proposal for the protection and promotion of foreign investment. The lack of coordination and consultation conveyed a message to investors that South Africa only wanted FDI on their own terms.[90]

Despite also echoing the concern that the handling of the process and notification could have been done better, several interviewees noted that the government had been transparent and had reached out to investors for their inputs into the draft bill. Schrader acknowledged that the government did consult the different entities before issuing the draft bill and Leon also commended the government for their transparency in sharing the drafts of the review over the three-year period.[91]

Foreign investor concerns about the draft PPIB

As noted above, the PPIB introduces some changes to investor protection principles under BITs in order to bring greater coherence between the rights accorded to investors and government policies. From a foreign investor's perspective, domestic legislation is not equivalent to a bilateral treaty; legislation inherently offers less protection.[92] The EU business community notes that the bill has been described as an attempt to equalize standards of treatment among all groups of investors in South Africa, as well as the stated right and duty of government to regulate in the public interest.[93] However, the EU business community does not believe the bill presents an adequate replacement of the investment protection regime.[94]

Foreign investors have raised specific concerns with the draft bill. First, the PPIB does not provide a guarantee of Fair and Equitable Treatment (FET), with the implication that domestic law can change in ways that disadvantages investors. Second, the legal protection of investments under the PPIB only covers direct expropriation. No claim for compensation exists for measures having an equivalent effect to expropriation – contrary to the BIT. Third, in contrast to the BIT, compensation payments in cases of expropriations can be below market value, as the basis for any decision is the general provision of fair and equitable

[87] Pougin de La Maisonneuve, A. (2014) see note 76
[88] Pougin de La Maisonneuve, A. (2014) see note 76
[89] SAGCC represents one of the largest groups of direct foreign investments into South Africa, by virtue of its members comprising predominantly German businesses of varying size and complexity, ranging from well-known multinational corporate businesses to small and medium sized enterprises ("SMEs").
[90] Boddenberg, Matthias. Executive Director of the South African-German Chamber of Commerce and Industry. Personal Interview. 21 July 2014
[91] Schrader, M (2014) see note 84 and Leon, P. (2014) see note 78
[92] Lang, J. (2013) see note 10
[93] Submission by EU-SA Business Links, (2014) The Promotion and Protection of Investment Bill 2013
[94] Submission by EU-SA Business Links. (2014). ibid

compensation, which reflects the consideration of both public interests and the interests of the parties concerned, and not just the market value. Fourth, also in contrast to the BIT, the PPIB does not provide recourse to international arbitral tribunals.

Interviews provided an opportunity to further probe investor concerns. Investment lawyer, Peter Leon stressed that the interpretation of what does not constitute expropriation in the PPIB is very worrying, as it gives the government a great deal of room to bring about expropriation for regulatory or other reasons which would not constitute an expropriation under the bill.[95] He further elaborates that this is of particular concern when observed in the context of the decision of the constitution court in AgriSA case[96]. While he was not involved in the case, he followed it closely and found the decision on behalf of the majority in that case lead by Chief Justice Mogoeng deeply troubling because, according to Leon, "what it basically says is that if you are not involved in the physical taking of property but transferring this property into some form of amorphous state custodianship that does not constitute an expropriation."[97] While he understands why the court reached that decision for policy reasons, he doesn't approve of its approach. Leon believes that as a result of that decision it is now open to the government to cloak all sorts of regulatory measures under the notion of some sort of custodianship and not be found to have brought about expropriation.[98]

With regards to FET, Leon agrees that Investor State Dispute Settlement (ISDS) is in need of reform, but argues that a better alternative solution to removing the FET clause all together from the bill would have been amending the FET clause or adopting the NAFTA model whereby they would define what would be considered as FET and what wouldn't.[99] Finally, with regards to arbitration, Leon viewed the domestic arbitration option as unacceptable, referring to the AgriSA case as an example of how politics can influence domestic verdicts.[100]

De La Maisonneuve, representative of the EU, believes that in removing provisions like access to international arbitration, South Africa took the wrong approach. He argues that when there is an international system with loopholes, a more constructive approach would be to try and improve it. He noted that while international arbitration is criticized by some voices within the EU, these criticisms are voiced as part of a debate at OECD, UNICTRAL and World Bank to improve the system to make it more transparent, equitable and fair, which he argues is the right approach.[101] He further elaborates that he doesn't think South Africa can afford such a move, as "realistically foreign companies do not necessarily feel comfortable to pour millions in a country where the law governing the process is one they are not familiar with."[102]

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[95] Leon, P. (2014) see note 78
[96] AgriSA won its claim for expropriation against the government in the high court, but this decision was reversed in the Supreme Court of Appeal. Justice Malcolm Wallis, in a meticulously researched judgment (see this column of July 27 2012), held that no expropriation had taken place. AgriSA had argued that the 1991 Act recognized a common-law contractual-rights system, with rights held by private parties such as AgriSA. When the new Act replaced this system, it expropriated AgriSA's contractual rights and thus should have triggered compensation. After carefully reviewing a history spanning more than 100 years, Judge Wallis held that the core mineral rights had always belonged to the state and hence no rights had been expropriated.
[97] Leon, P. (2014) see note 78
[98] Leon, P. (2014) see note 78
[99] Leon, P. (2014) see note 78
[100] Leon, P. (2014) see note 78
[101] Pougin de La Maisonneuve ,A. (2014) see note 76
[102] Pougin de La Maisonneuve ,A. (2014) see note 76

When asked if he thought it was too late for a common ground to be reached or an amicable solution to be found, de La Maisonneuve responded: “I think in terms of perception, and perception is key for investors, the damage has been done. Now we are trying to reduce the damage as much as possible and in that respect having an operational clause on ISDS would be necessary in the new regulation.”[103] He underlined that the loopholes in the first draft of the PPIB need to be addressed and the relations with the EU need to be fixed, which is why they have invited the South African authorities formally to a dialogue on this issue.

[103] Pougin de La Maisonneuve ,A. (2014) see note 76

5. How has the government responded to investor concerns?

Interviews with leading policy-makers in the South African government shed light on the government's rationale for terminating BITs and the ways in which it has responded to criticism from investors.

The government firmly rejects the assertion that the new legal framework embodied in the PPIB will not offer investors adequate protection. Xavier Carim, the Director-General for International Trade and Economic Development at the DTI, and lead official for BITs, describes the legal framework in place as one that is underpinned by the constitution and firmly entrenches private property rights and protects against expropriation.[104]

The response of foreign investors and European officials to the government's decision to review and exit the treaties is, from Carim's perspective, disproportionate. In his 20-year career at the DTI he explained that no investor had made an explicit link between and investment and the existence of an investment treaty. Crucially, he was not aware of any instance where an investor had refused to invest in South Africa because there was no treaty signed between their country and South Africa. Interestingly, foreign governments appeared to care more about the existence of a treaty than foreign investors, because they consider these treaties to be part of their policy framework. For this reason, many of the objections to BIT terminations came from foreign governments rather than the investors themselves. He therefore concluded that "this makes it difficult to distinguish whether it was really an investor concern in the first place. Our assessment was that it has not been an investor concern, but once governments start to raise it, the investors start to pick up on it."[105]

There is evidence that investment was not impeded by the termination of BITs. For instance just around the time of the termination with the BIT with Germany, South Africa received a substantial increase in investments by Mercedes Benz.[106] Similarly, in July 2014 the Dutch minister visited South Africa with a delegation of potential investors even through South Africa had terminated its BIT with the Netherlands in the previous year.[107] From the government's perspective this underscores the fact that the presence or absence of a BIT does not affect foreign investment. Investors invest in South Africa because they can see economic opportunities and they're comfortable with the legal framework.[108]

This said, the government does acknowledge the impact of wider policy trends on foreign investment. As Carim explains, investors have raised concerns about a general trend of policy developments that they feel negatively affect investor confidence. This includes the Marikana strikes, rise in electricity costs, and currency volatility. From the investor perspective, the termination of BITs is therefore part of a wider and more general concern,

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[104] Carim, X.(2014). see note 38
[105] Carim, X. (2014) see note 38
[106] Steyn, L. (2013). *Mercedes-Benz to invest a further R3-billion in SA*. [online] The M&G Online. Available at: http://mg.co.za/article/2013-10-16-mercedes-benz-to-invest-a-further-r3-billion-in-south-africa
[107] Minister for Foreign Trade & Development Cooperation, H.E. Ms. Lilianne Ploumen, visited South Africa on 7 and 8 July 2014 | Netherlands Embassy in Pretoria, South Africa.(online): http://southafrica.nlembassy.org/news/2014/july-2014/minister-for-foreign-trade--development-cooperation-h.e.-ms.-lilianne-ploumen-visited-south-africa-on-7-and-8-july-2014.html
[108] Carim, X.(2014) see note 38

and it is difficult for the government to decipher the relative weight of each of these factors in investors' decisions.

Government response to criticism of BIT Termination

The South African government refutes the assertion by investors that the process of terminating the BITs was abrupt and unilateral. During interviews, senior officials explained that the review started in 2007 and the government began to informally approach their European counterparts in 2008-9 when it became clear that the current treaties had serious shortcomings.[109] At the time South Africa participated with the EU in the G8+G5 process and informally raised the possibility of renegotiation of treaties with individual representatives of the countries present. According to the South African officials, representatives from these partner countries made it very clear that the agreements were 'basic' in content and that any renegotiation would be to take further measures (to liberalize).[110] EU countries were also made aware of South Africa's intention to renegotiate or terminate BITs during UNCTAD conferences in Doha and Geneva in 2012 and 2013, during public statements by senior officials and the lead Minister.[111]

During interviews, senior officials explained that the government had made extensive efforts to solicit input from stakeholders. At the very early phases of the review they invited public comment and organized public forums where the government's approach to BITs and the initial findings of the review were discussed.[112] They also held meetings outside of South Africa, at UNCTAD and the South Centre. The government received written submissions from a range of stakeholders including governments, think tanks and NGOs. On these grounds, senior government officials argue that it is implausible for anyone to claim that they were not aware of the review process.[113]

Moreover, in 2010 the South African government published the key findings of the review and the cabinet decisions, which set out the measures South Africa was planning to take. Mustaqeem De Gama, the Director of Legal, Trade and Investment in DTI explained that the government only started taking concrete steps to terminate specific BITs towards the end of 2012, a full two to three years after the issue was brought to the public domain. "During that period we had several consultations and specifically the EU delegation, we had full on discussion regarding the rationale. We took criticisms on board and addressed them while striving to make our clauses consistent with the constitution and existing legal framework."[114]

Government officials strongly disputed the charge that they did not consult their relevant counterparties or attempt renegotiation before embarking on termination. During interviews, they defended their decisions by explaining that the timing was not entirely up to them. The Lisbon Treaty was due to come into force at the point when the South African government sought to renegotiate BITs with individual European member states. Under the Lisbon Treaty

[109] Carim, X. (2014) see note 38
[110] Carim, X. (2014) see note 38
[111] Carim, X. (2014) see note 38
[112] De Gama, M. (2014) see note 71
[113] De Gama, M. (2014) see note 71
[114] De Gama, M. (2014) see note 71

competencies for investment moved from the member states to the European Commission. It was therefore unclear who the South African government could approach to discuss the possibility of new agreements as the EU was in flux. This lead to a very unsatisfactory situation for South Africa. The South African government waited for two years and took the decision to terminate[115] - some of the BITs were reaching the automatic renewal date that would extend the treaty for another 10-15 years (South Africa is allowed in the provisions of the BITs to terminate such treaties[116]).

As De Gama, the government's senior legal advisor, states, "It is unfair criticism to say we didn't consult. We waited two years and it only became clear that EU member states had limited capacity to negotiate their agreements and hence it was too late for us."[117] Another senior official explained that the South African government met with EU representatives a year before the termination took place to explain the options that the South African government was considering.[118]

Indeed, the South African government is not opposed to the negotiation of new BITs. The Trade Minister recently revealed that they were close to finalizing a draft model BIT that would be in line with a new Model BIT adopted by the 15 countries of the Southern African Development Community (SADC).[119] Indeed, South Africa was actively engaged with the International Institute for Sustainable Development (IISD) in developing the SADC model BIT that was completed by 2012 and adopted in 2013. De Gama similarly stressed that South Africa would be open to sign new BITs but instead of signing with countries to cover all investments they would sign with individual investors if needed to address legitimate investor concerns.[120]

When challenged on the timing of the terminations and the legal vacuum that resulted, government officials are more conciliatory. When asked to reflect on the shortcomings of the review process, De Gama acknowledged that there had been a gap between the termination of the BITs and the existence of an investment act that would regulate foreign investments, which was unfortunate. He explained that they had originally envisaged a gap of only one year between the initial decision to terminate the first BIT and the enactment of domestic legislation. For this reason, they had anticipated that the domestic legislation would have been in place when the first BIT formally ended. In addition, he noted that the legal vacuum, such as it was, only applied to new investments, as the BITs clearly state that all the investments that took place under the BIT would remain covered for a long period of time.[121]

Government officials are similarly defensive about the claim of foreign investors that the BITs were terminated to pave the way for contentious bills in areas like land ownership and foreign security. During interviews, government officials strongly rejected the assertion that there is any link between the current policy environment and the BIT termination process. One senior official explained that the foreign security bill was a completely separate process, unrelated to the BIT termination. Another noted that the policies deemed contentious by investors were

[115] De Gama, M. (2014) see note 71
[116] De Gama, M. and De Gama, R. (2013) see note 70
[117] De Gama, M. (2014) see note 71
[118] Carim, Xavier (2014) see note 38
[119] Remarks by Rob Davies (2014) see note 52
[120] De Gama, M. (2014) see note 71
[121] De Gama, M. (2014) see note 71

initiated before there was any decision to terminate BITs. Moreover, he argues that it is widely known that the law was fixed for current investments as they would continue to be protected by the agreement after it was terminated so they were never really under threat from any government action or change in policy.[122]

This said, government officials were of the strong opinion that South Africa must be able to articulate a law that addresses its security issues in a way it sees fit. In the view of de Gama, the right to regulate in the public interest and on issues like security is ultimately something each country should make an assessment on.[123]

Government response to criticism of the draft PPIB

The South African government strongly defends its approach to safeguarding investors through domestic legislation. The government's position on the PPIB is that it is not doing away with foreign investor protections but is rather making changes to the way in which those protections are safeguarded.[124] According to De Gama, the draft PPIB clarifies the international investment law concepts of national treatment, expropriation, compensation and transfer of funds in line with South Africa's constitutional principles. The PPIB also seeks to achieve several balances, including the rights and obligations of investors, to provide adequate protection to foreign investors, to ensure that South Africa's constitutional obligations are upheld, and that government retains the policy space to regulate in the public interest.[125]

The main function of the PPIB was to ensure they maintained the strong robust investment protection regime for investors in the constitution but also framed certain provisions in the BITs in line with South Africa's conditions.[126] One of the objectives of the PPIB was also to codify these standards into domestic law so foreign investors feel confident that when they do invest in South Africa that they have certain minimum rights and guarantees but subject to a balance between rights and obligations.[127] The right for the government to regulate was a key driver of the whole process.

During interviews, senior officials discussed the government's position on the specific concerns raised by investors on the contents of the PPIB and its shortcomings when compared to the BITs.

With regards to the FET standard, De Gama explained that there is no mention of the international investment law principle of FET in the PPIB because this concept is too widely framed, and subject to various controversies. He further argues that the South African law already provides sufficient guarantees for substantive and procedural due process.[128] Indeed, the South African government is reviewing other international agreements that contain similar provisions. The Finance and Investment Protocol (FIP) in Annex 1 of the

[122] De Gama, M. (2014) see note 71
[123] De Gama, M. (2014) see note 71
[124] Lang, J (2013) see note 10
[125] De Gama, M. (2014) see note73
[126] Carim, X. (2014) see note 38
[127] Carim, X. (2014) see note 38
[128] De Gama, M. (2014) see note 71

SADC agreement is particular cause for concern as it contains similar provisions to those that triggered the government's review and termination process (notably on FET and arbitration). The Ministry obtained a mandate from the SADC member states in 2013 to amend that annex.[129]

On the definition of expropriation De Gama stated that this has been a longstanding government concern, and for many years the government has had a draft expropriation bill which sought to ensure that Article 25(3) of the South African Constitution (which allows for less than market value compensation in certain cases[130]) was reflected in South Africa's 'international obligations', which currently stipulate market value for any taking that the government makes regardless of the circumstances and history of acquisition and property use.[131] The PPIB is an improvement on the draft expropriation bill as the term is defined more clearly with specific reference to the Constitution and it sets out certain public good measures (e.g. environment or health) that would not be considered expropriation and therefore not require compensation.[132]

Government officials argue that key cases like Foresti and AgriSA have been inaccurately interpreted by investors as proof that the government was seeking to expand its expropriation activities.[133] For instance in the Foresti case, De Gama asserts that what is commonly underreported is the fact "that not only were the company's existing rights renewed but also many of the new applications for new rights were also granted under the new system set up by the mining legislation. Consequently, as a result the claimant abandoned the case."[134] Whereas in the AgriSA case vs. Minister of Energy, "the highest court in the land found that where government essentially enacts a measure and does not require ownership of right/property it does not constitute expropriation, that is in line with some multinational arbitral that we have seen in the last 10-15 years. Ultimately it is a progressive interpretation."[135]

De Gama did acknowledge however that the way the expropriation clause was drafted in the bill might have given investors the wrong signal by keeping the list of exceptions for what constitutes expropriation open ended.[136] He stressed that the revised draft would keep the first section, which is that expropriation can only occur for 'public purposes, under due process of law, on a non-discriminatory basis' but would remove the open-ended list of exceptions. This formulation is consistent with Article 25 of the South African constitution.

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[129] De Gama, M. (2014) see note 71
[130] Article 25 (3): The amount of the compensation and the time and manner of payment must be just and equitable, reflecting an equitable balance between the public interest and the interests of those affected, having regard to all relevant circumstances, including:

(a) the current use of the property;
(b) the history of the acquisition and use of the property;
(c) the market value of the property;
(d) the extent of direct state investment and subsidy in the acquisition and beneficial capital improvement of the property; and
(e) the purpose of the expropriation.

[131] De Gama, M. (2014) see note 73
[132] Carim, X. (2014) see note 38
[133] De Gama, M (2014) see note 71
[134] De Gama, M. (2014) see note 71
[135] De Gama, M. (2014) see note 71
[136] De Gama, M. (2014) see note 71

Regarding compensation concerns, De Gama states, “it is interesting that people say this. I would dare to say that the last 20 years 99.9% of all the expropriation cases facing domestic or foreign investors, market value compensation was provided.”[137] However, he explains that from the government’s perspective, the history of acquisition has to be taken into account in determining the value of the compensation to ensure this is in line with the constitution. The PPIB now addresses such circumstances and allows for considering less than market value compensation.[138] Moreover, extensive analysis of the South African case law reveals that the judiciary takes market value as a baseline for any interaction, and whoever argues that compensation should be less than market value has the heavy burden of having to prove it.[139]

Turning to the question of arbitration, De Gama argued that it is difficult to draw a direct comparison between international arbitration and domestic legal systems. As he notes, there are widespread concerns with respect to the current structure of international investment arbitration, particularly with the undue level of influence of a select group of private arbitration firms over decisions.[140] Hence, he claims you find there is a revolving door, this concern that the same people are always involved: “To make things worse in some of the due diligence you find that many of these arbitrators have links with businesses, when all these concerns are combined you find arbitration as private and confidential system and you have no scrutiny whatsoever when public money is concerned.”[141] South African officials also note that the cost of arbitration is escalating and the length of international arbitrations has increased. As a result, arbitration is no longer short, effective and less costly than domestic legal proceedings.

For these reasons, the South African government has very little confidence in the international investment arbitration system, perceiving it to be broken and needing to be fixed. According to De Gama, the government has been seeking reform on the international stage including by constructively engaging at the OECD and at the UNICTRAL. The government does not intend to remove itself from the international arbitration system as a whole: if there is serious reform and a more credible and transparent system is in place, the South African government will reconsider international arbitration.[142]

The government is confident that the domestic legal process is sufficiently robust to protect investors. De Gama refuses the notion that the South African government is incapable of handling the legal obligations, as they have a strong constitution and a solid legal framework. He concedes that deficiencies still exist, but most issues are settled relatively promptly. He refers to the World Bank *Doing Business* Report where he considers South Africa’s ranking as high in the area of legal due processes and property rights (ranked 46 in enforcing contracts in 2014). South Africa is also in working on empowering its domestic courts and enabling them as per the recommendations by the cabinet.

Again, international policy debate has served to reinforce the government’s position. As senior officials note, negotiations between the EU and US under the auspices of TTIP have

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[137] De Gama, M. (2014) see note 71
[138] De Gama, M. (2014) see note 71
[139] De Gama, M. (2014) see note 71
[140] De Gama, M. (2014) see note 71
[141] De Gama, M. (2014) see note 71
[142] De Gama, M. (2014) see note 71

resulted in a high level of public debate about the merits and demerits of international investment agreements. Ironically, many of the concerns that South Africa raised in discussions with the EU prior to terminating several EU BITS were raised by some of the EU member states during the TTIP negotiations. These concerns were promoted when it became clear how wide the mandate of the European Commission would be and it became public that there were at least nine or ten cases against EU countries brought by American investors and which challenge the right to regulate.[143] De Gama referred particularly to Germany's experiences in the Vattenfall case, which deals with a policy decision to move away from a particular type of energy system to a more sustainable and safer one.[144]

De Gama argues that the calls for ISDS to be watered down or excluded from the TTIP aren't that different from the South African demands, because in both instances it is about preserving legitimate public spaces for public policy. He concludes: "at the end of the day we have this process to really indicate that we are serious about investor rights but also about the right to regulate…. Making these requirements means we are more serious about sustainable growth and not that we are against more investment."[145]

[143] De Gama, M. (2014) see note 71
[144] De Gama, M. (2014) see note 71
[145] De Gama, M. (2014) see note 71

6. Conclusion and recommendations

This paper has reviewed South Africa's decision to review its investment policies, to terminate several of its BITs, and to use domestic legislation as the primary mechanism for protecting foreign investors. Foreign investors have raised serious concerns about the impact of these decisions on the attractiveness of South Africa as an investment destination, suggesting that the termination of BITs is part of a wider government policy to unduly intervene in the activities of foreign investors.

It is worth noting that despite these concerns, South Africa's investment regime for FDI is an open one by international comparison.[146] In fact, the level of openness is comparable with the OECD country average and well above that of other emerging market economies as measured by the OECD FDI Regulatory Restrictiveness Index.[147] Furthermore, where restrictions do exist, they are not unusual among OECD adherents as these are recognized in the Codes and are necessary for specific sectors to function optimally.[148]

The decision of the South African government to change its policies on investment was triggered by a concern that BITs and the international system of investor-state arbitration inhibits the ability of governments to enact legislation and regulatory measures aimed at promoting public policy objectives.[149] The review undertaken by the South African government is laudable. While it had some shortcomings, it was, in the words of a recent report by leading South African think-tanks, a thorough, frank, and critical approach, as South Africa sought to build 'its own internal capacity and policy coherence on the topic of investment, taking the protection and promotion of human rights and sustainable development as the point of departure for all future policymaking.'[150] It enabled the South African authorities to develop a clear idea of the nature and size of the reform required to balance the rights of investors with the public interest. It was important that South Africa adopted a transparent and interactive strategy throughout the review process engaging the international community and not only the local public.

Given the growing concern about the desirability of key elements of BITs, other countries may well seek to undertake a similar review process. The South African experience provides valuable lessons.

In following the recommendations of the review and the cabinet decision, the South African government was well within its rights to terminate the BITs that had reached their end date. International law recognizes the right of partners to terminate such treaties as per the Vienna Convention on the Law of Treaties, under Article 54, and all the BITs signed by South Africa contain specific provisions for the procedures of termination. Moreover, the termination of the BITs did not result in a radical change in the level of protection of current investors, as the survival clauses in the BITs mean that the same terms of the treaty will be applied for 10-20

[146] Mashigo, K. (2014). Self-assessment of South Africa's investment regime in relation to the OECD Codes of Liberalization and the principle of National Treatment. OECD-South Africa Investment Policy Dialogue. (online): http://www.oecd.org/daf/inv/investment-policy/South-Africa-Investment-Regime.pdf
[147] Mashigo, K. (2014) ibid
[148] Mashigo, K. (2014) ibid
[149] Woolfrey, S. (2013) see note 13
[150] Maupin, J. and Langford, M. (2009) see note 64

years after termination.[151]

With regards to the termination process, the two areas where the South African government could have performed better are the communication of the termination of BITs, and the timing of the draft bill. The government had completed all the necessary prerequisites for revising their agreements by providing a thorough review, which illustrated why they needed to address the BITs, and throughout the review process they consistently communicated and consulted with the different stakeholders. However, by not communicating with their partners before termination and simply notifying them with their intention to terminate (which was perfectly legal), the authorities provided grounds for a claim by the investors that South Africa were not willing to discuss or negotiate a more balanced agreement and that it was simply an 'ideological decision'.

South Africa would have been in a stronger position if it had communicated its conclusions to its counterparts before terminating, especially considering that most of their decisions were based on sovereign rights to bring their agreements in line with their constitution. Accordingly, if their counterparts had refused to negotiate these clauses as they intimated in informal meetings with South African officials and as their reaction to the new bill clearly indicates, it would have strengthened South Africa's claim that they were left with little choice but to pursue the route they have taken.

Another critical issue was the delay in issuing the PPIB and the uncertainty it created when it was announced that the BITs would be terminated. This uncertainty created a negative atmosphere, which was worsened by the criticism being waged by the investor community. Considering South Africa could not afford to delay the termination due to the renewal clauses in the BITs signed, this situation could have been avoided with better planning and timing of the process during the three year long review to ensure there was no legal vacuum for investors at any point.

The process of drafting the PPIB also provides some useful lessons. The objective of the draft PPIB is laudable. As noted by the South African Institute for International Affairs (SAIIA), a leading research institute, 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 realization of socio-economic rights. The Bill achieves this goal.[152] The government has also made its position clear on specific contentious issues, explaining that it will not enter into any negotiations to revise inter alia, FET, allowing indirect expropriation, and the exclusion of resource to international arbitration.

However, there are a few areas in which unclear wording and or lack of definitions in the draft PPIB have created uncertainties among the investment community. These could have been avoided and, indeed, can be remedied in the final draft of the bill. Three issues stand out. First, the qualification for applying the national treatment standard only in 'like circumstance' is unclear. The condition of like circumstance is meant to determine whether the foreign investor and the domestic investor are in a comparable setting before judging

[151] De Gama, M. (2014) See note 71
[152] Economic Diplomacy Programme (2014). South Africa's Draft Promotion and Protection of Investment Bill: Submission by the South African Institute of International Affairs. Johannesburg: South African Institute of International Affairs.

whether the foreign investor is entitled to expect the same treatment provided to the domestic investor. While some investors acknowledge that in order to determine the scope of equal treatment, the circumstances under which the investments are made have to be evaluated,[153] there should be further elaboration on which criteria is used in such an evaluation.

Second, clarification is needed on the extent to which the government can provide physical protection for foreign investments and when the government would be liable, as the current wording of the provision does not clearly define when the government is liable and when it is not.

Third, the expropriation clause could be amended to stay in line with the constitution by keeping the first clause of the provision but by removing the open ended list of exceptions, thus making it more acceptable to investors.

South Africa's experience in revamping its investment regime is far from complete. Ultimately, the success or failure of this experiment will rest on whether the South African government is able to achieve the targeted inclusive economic growth through its new investment regime coupled with its adopted economic and social policies.

To this end, the review highlighted areas of institutional weakness that the government would need to address in order to deliver on its ambitious aims. As a recent report by leading South African think tanks noted, the government needs to invest further in strengthening its institutions in two ways in order to deliver. First, the review highlighted the lack of coordination between various government departments, which characterized the government's investment policymaking efforts and led to the conflict between the obligations in BITs and key domestic policies.[154] To take forward its investment policies in a more coherent way than in the past, it is vital that government develops a well-structured method for streamlining and coordinating the efforts of the various government departments.[155] Second, the review drew attention to the crucial role of continuous strategic planning, evaluation, and monitoring for the success of any overarching investment policy.[156] The government needs to invest to ensure its lead government departments and the central organizing structure are fully equipped to lead the implementation of the new policy.[157]

[153] Submission of The South African –German Chamber of Commerce and Industry to the Department of Trade and Industry of the Republic of South Africa in respect of the Promotion and Protection Bill, Published on 1 November 2013.
[154]Maupin, J. and Langford, M. (2009) see note 64
[155] Maupin, J. and Langford, M. (2009) see note 64
[156] Maupin, J. and Langford, M. (2009) see note 64
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