Reforming the Investment Regime: A View from South Africa

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19 May 2016
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Background

- SA provides and will continue to provide robust investor protection.
- South African has systematically strengthened its investment protection regime since 1994.
- When SA undertook democratic transition in 1994, some foreign investors were unclear about the future direction of economic policy.
- In the immediate post apartheid era (1994-1998), South Africa concluded 15 BITs mainly with European countries.
- Good faith attempt to assure investors that their investments were secure under the new democratically-elected government.
- BITs also seen as signal confirming South Africa’s re-entry to international community after apartheid isolation.
South Africa’s Review Process
• Soon aware of challenges posed by investment treaties (OECD MAI, WTO, spike in legal challenges following 2001 global financial crisis)

• Two challenges to SA: under Swiss BIT in 2004 and Italian/Belgo-Lux BITs in 2006). Threats of others

• All this prompted BITs Review 2007-2010. Key findings:

• Proponents argue BITs attract FDI and offer protection to foreign investors in jurisdictions where legal regime is weak or biased against foreigners.

• This premise does not hold in SA: Constitution (NT, expropriation with compensation); Companies, Competition Acts; IPR; Administrative Justice.

• Protection consistent with high international standard (WTO obligations & OECD standards)

• No clear relationship between BITs and increased FDI inflows (various studies)

• South Africa receives no FDI from many countries with whom we have a BIT, receives FDI from countries without BITs (USA, Japan, India)
• Serious deficiencies in first generation BITs arising from the lack of precision/ambiguity in the core legal provisions:

  ➢ Broad definitions of investor/investment can cover any asset (goodwill, holiday home);
  ➢ Most favoured nation allows ‘importing’ provisions from other treaties;
  ➢ Expropriation and fair and equitable treatment provisions may be defined as any measure that impacts on the use of property that deprives investor of expected economic benefit;
  ➢ Agreements and arbitration tend to favour narrow commercial interests over national / public interests
  ➢ Agreements tend to bypass domestic court system

• BITs thus clear way for foreign (not domestic) investors to challenge almost any measure deemed to undermine their ‘expectation’ of profit
• Can pose serious risk to legitimate policy making in the public interest
Deficiencies in treaties are accompanied by shortcomings in the functioning of the international investment arbitration ‘regime’:

- Fragmented system without common standards
- Divergent legal interpretations of identical or similar provisions and differences in assessment of the merits of cases involving the same facts.
- Inconsistent interpretations lead to uncertainty about the meaning of key treaty obligations compounding problems of unpredictability of treaties
- Recurring episodes of inconsistent awards
- No appeal mechanism to rectify incorrect awards or ensure consistency
- Whether arbitration process by three individuals, appointed on an *ad hoc* basis, possess sufficient legitimacy to assess acts of State on particularly on sensitive public policy issues
- Undermines the domestic legal system and can pose challenge to democratic decision making
• Growing number of cases: first in 1987, growing cumulatively to 50 by 2000, and 514 by 2012
• 62 claims in 2012: the highest number in any one year to date
• Two-thirds of claims brought against developing country governments
• 75% of the awards in favour of investors
• Unprecedented amounts of compensation claimed and amounts awarded.
• Arbitration costs: average over US$8 million per investor-state dispute, exceeding US$30 million in some cases
• 40 known claims at the end of 2012 were above US$1 bn, the highest amounting to US$114 bn against the Russian Federation, US$50 bn claim against Peru and US$31 bn against Venezuela
• Other multi-billion dollar claims include Algeria; Argentina, Austria, Belgium, Cyprus, Ecuador, Egypt, India, Kazakhstan, Nigeria, Pakistan, Romania, Slovakia, Turkey, Ukraine and Uzbekistan;
Similar reviews undertaken in Australia, Brazil, Canada, Norway, USA, Sweden, and more recently EU and India

Widespread amendments, re-interpretation of BITs clauses - US, Canada.

Brazil, Ecuador, Indonesia, Venezuela have embarked on termination processes

New approaches to investment treaty emerging to mitigate risk of earlier agreements through precise drafting of provisions & balancing rights & obligations

New approach pays more attention to provisions that support inclusive growth and sustainable development (SD) objectives.

Recognise that FDI can make a positive contribution to SD, but that the benefits to the host country are not automatic

Secures right of governments to regulate in the public interest (environment and public health, for example)
Cabinet Decision
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Key outcomes of the Review:

• July 2010 Decision that work be undertaken to modernise SA’s investment protection legal framework

• Relationship between BITs and FDI is ambiguous, at best.

• BITs and international arbitration pose unacceptably high risks & limitations to governments legitimate and sovereign right to regulate in the public interest

• Strengthen/clarify national legal framework for investor protection, in line with SA Constitution and drawing on international experience

• Update BITs and ensure alignment with national legislation, the Constitution, and developments in international investment treaty-making
Cabinet Decision: 5 Core Elements / 2

(1) Refrain from entering into BITs in future, unless there are compelling economic and political reasons;

(2) Terminate first generation BITs and offer partners possibility to renegotiate;

(3) Develop New Investment Act to codify and clarify typical BIT-provisions into domestic law, and strengthen investor protection;

(4) Develop new Model BIT as basis for (re-)negotiation; and

(5) Establish an Inter-Ministerial Committee (IMC) to oversee process (DTI, NT, DIRCO, EDD, DAFF).
BIT Terminations
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BITs Statistics:
49 BITs signed
22 BITs ratified and entered into force
14 Terminated

• Partners informed as from May 2011.
• Notifications and termination processes underway & taking place indiscriminately
• Not calculated to harm a particular region
• Protection remains for 10-15 years (‘survival clause’)
Protection of Investment Act, No 22 of 2015
Process

- PIA was subject to a rigorous consultation process with Government and stakeholders, inclusive of an expansive public comment period and consultations with the Govt, Labour and Business constituencies (NEDLAC)

- June 2015 Cabinet endorsed the Bill;
- July 2015 State Law Advisor certification of the Bill;
- End July 2015 Introduced into Parliament;
- Sept 2015 Public hearings commenced;
- Dec 2015 President assented the Bill
Key Elements

• PIA developed to mitigate against the risk presented by BITs, ensure development of legislation protecting all investment, ensure alignment with the Constitution
• Key elements of PIA:
  ➢ Updates, modernises and strengthens investor protection in SA;
  ➢ Remains open to FDI (no new restrictions);
  ➢ Provides security and protection to all foreign investors (non-discrimination);
  ➢ Appropriate balance between rights/obligations of investors and government; and
  ➢ Preserves right to regulate in the public interest.
  ➢ Incorporates relevant BITs-type provisions into national legislation ensuring consistency with Constitution and law
Definition

• The definition of “investment” adopts an enterprise-based approach which is one of the models proposed in the SADC Model BIT

• The assets of the enterprise (shares, debentures, other ownership instruments, movable and immovable property, IP rights) are also included in the investment.

• For the purpose of this Act, an investment is—
  – any lawful enterprise established, acquired or expanded by an investor in accordance with the laws of the Republic,
  – committing resources of economic value over a reasonable period of time, in anticipation of profit;
  – the holding or acquisition of shares, debentures or other ownership instruments of such an enterprise
Interpretation of the Act

- This Act must be interpreted and applied in a manner that is consistent with—
  - its purposes as contemplated by section 4;
  - the Constitution, including—
    - the interpretation of the Bill of Rights contemplated in section 39 of the Constitution;
    - customary international law contemplated in section 232 of the Constitution; and
    - international law contemplated in section 233 of the Constitution;
  - any relevant convention or international agreement to which the Republic is or becomes a party.
Establishment

- States maintain the right to make regulations governing admission of investment
- Act provides for post-establishment rights - investment is subject to national legislation
Fair & Equitable Treatment (FET)

- Provision normally found in BITs.
- Meant to protect an investor against a denial of justice and arbitrary and abusive treatment.
- Treatment is not fair and equitable if:
  - Investors are denied justice in criminal, civil, or administrative proceedings;
  - if fundamental principles of due process are neglected;
  - if investors are abused (including coercion, duress, or harassment);
  - principles of effective transparency are disregarded.
- In PIA, this principle is covered in the Fair Administrative Treatment Provision.
FET / 2

- Government must ensure administrative, legislative and judicial processes do not operate in a manner that is arbitrary or that denies administrative and procedural justice in accordance with the Constitution and applicable legislation.
- Guarantees right to be given written reasons and administrative review of the decision consistent with section 33 of the Constitution and applicable legislation.
- Access to government-held information consistent with section 32 of the Constitution and applicable legislation.
- Subject to section 13(4), investors must, in respect of their investments, have the right to have disputes resolved in a fair manner.
Most Favored Nation

- The MFN principle is normally found in BITs, however the MFN principle is not covered in the PIA since domestic legislation provides for equal treatment.
- The purpose of a MFN clause is to ensure that any favourable treatment that is given to a foreign investor is extended to any third investor.
  - The Act moves away from the concept of nationality and treats all investors in a similar manner irrespective of their nationality.
  - Given the objectives of the Act, such a clause would be redundant since any advantage given to an investor under the Act is automatically extended to all investors irrespective of their nationality.
National Treatment

• **Purpose:** grants an investor the right to be treated no less favourably than SA investors so long as their investments are “in like circumstances”

• Limitations imposed on the concept of national treatment are legitimate and entirely in line with international legislative and treaty practice

• Factors to be considered include:
  – effect of the foreign investment; sector that the foreign investments are in; aim of any measure relating to foreign investments; effect on third persons and the local community; effect on employment; and direct and indirect effect on the environment
Physical Security of Investment

• **Purpose:** This provision refers to government’s obligation to provide “physical” security to investments covered by the Act.

• Customary international law requires a state to provide a level of protection to the assets of aliens and the Act emphasises the Republic must accord foreign investors and their investments a level of security as may be generally provide to domestic investors, subject to available resources and capacity.

• In the modern era this refers to so called police powers to provide protection against unlawful interference with such rights.
Legal Protection of Investment

- **Purpose**: reference to S 25 of the Constitution
- Section 25 provides that an investment may not be expropriated except in accordance with the Constitution and in terms of a law of general application for public purposes or in the public interest, under due process of law, against just and equitable compensation effected in a timely manner.
- Initially the Act contained norms addressing expropriation, however the “Expropriation Bill” deals with these matters and as a result the PIA defers to the more specific legislation.
Transfer of funds

- **Purpose:** provide repatriation of funds by investors

- A foreign investor may, in respect of an investment, repatriate funds subject to taxation and other applicable legislation.
Right to Regulate

• **Purpose**: Preserve Government’s right to regulate in the public interest

• Measures may be necessary to redress historical, social and economic inequalities & uphold rights guaranteed in the Constitution

• SA experience includes:
  – challenges by investors against measures directed at affirmative action,
  – corrective measures to address injustices of the past e.g. Broad based black economic empowerment legislation,
  – challenges by mining companies against developmental aspects of the MPRDA,
  – public health measures to address access to critical medicines.
Dispute Resolution

• **PIA provides for:**
  – alternative dispute resolution mechanism – mediation and outlines a clear process to be followed;
  – Access to Courts in SA;
  – After exhaustion of domestic remedies – Government may consent to State-State arbitration;
  – Consideration will be subject to fair administrative process as set out in Section 6 of the PIA.

• PIA provides for exhaustion of domestic remedies prior to international arbitration
Model BIT

• BIT negotiating template is finalised
• Aligned to:
  – PIA
  – Constitution
• To be presented to Inter-Ministerial Committee (IMC) during 2016