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GENERAL NOTICE

NOTICE 961 OF 2009

the dti
Department
Trade and Industry
REPUBLIC OF SOUTH AFRICA

The Department of Trade & Industry (**the dti**) has initiated a review of Bilateral Investment Treaties (a.k.a Reciprocal Promotion and Protection of Investment Agreements) entered into by the Republic of South Africa since 1994 to date.

The objective of the review is to make recommendations to Cabinet in respect of the policy and legal considerations which will impact on any future decisions taken by the executive in respect of the protection and promotion of investments, both from an inward and outward foreign direct investment perspective.

After extensive consultation with governmental stakeholders, **the dti** has developed a draft policy review document which it is now seeks comment on from the general public.

In order to access the document and comment thereon, please refer to **the dti** website at **www.thedti.gov.za**. For further enquiries and/or hard copies of the document, please contact the official mentioned below.

Please note that all comments must be received in writing by no later than **24 July 2009** and must be submitted to:

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BILATERAL INVESTMENT TREATY POLICY FRAMEWORK REVIEW

Executive Summary of

Government Position Paper

Department of Trade and Industry

77 Meintjies Street

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Pretoria

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EXECUTIVE SUMMARY

This paper attempts to consolidate and reflect the work of a Department of Trade and Industry (DTI) Task Team mandated to review Bilateral Investment Treaties (BITs) entered into by the Republic of South Africa to date. This review was partly necessitated by various arbitral proceedings initiated against the Republic of South Africa (RSA) and the need to conduct a comprehensive risk assessment. Prior to 1994, the RSA had no history of negotiating BITs and the risks posed by such treaties were not fully appreciated at that time. The Executive had not been fully apprised of all the possible consequences of BITs. While it was understood that the democratically elected government of the time had to demonstrate that the RSA was an investment friendly destination, the impact of BITs on future policies were not critically evaluated. As a result the Executive entered into agreements that were heavily stacked in favour of investors without the necessary safeguards to preserve flexibility in a number of critical policy areas. In reviewing the *travaux préparatoires* of the various BITs entered into at the time, it became apparent that the inexperience of negotiators at that time and the lack of knowledge about investment law in general resulted in agreements that were not in the long term interest of the RSA. To a large extent, the review seeks to correct this misalignment and to place before the Executive the true facts inherent to commitments undertaken by the RSA under BITs whilst at the same time updating the RSA's BIT regime as is being contemplated by many developed as well as developing countries whose history and experience of BITs is similar to that of the RSA.

This review consists of two parts, a macro - and micro policy framework analysis. The dual analysis alluded to above was necessitated by the fact that very little policy work had been done in this area. This review does not intend to provide an economic analysis of the investment policy that the RSA needs to

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follow in order to maximize growth. It merely flags this as an issue that would need to be examined in the near future. The linkages on a policy level between industrial development, trade and investment is also flagged, a deeper analysis of these linkages also falls beyond the scope of this analysis.

The macro-policy research seeks to determine the policy and strategy considerations that are applied in respect of the initiation of BITs. This process was undertaken by means of detailed interviews at management level with the various sector desks at the International Trade and Economic Development division (ITED) of the DTI and other relevant stakeholders. The outcome of these interviews seem to suggest that the RSA's investment approach to both inward and outward Foreign Direct Investment (FDI) has not been informed by a holistic policy perspective but rather a patchwork of general policy considerations. Thus, it is not argued that no policy exists, merely that the formal legal basis for FDI policy is scattered across various line function departments that do not always coordinate policy interventions. It is proposed that the legal basis for both inward and outward FDI be placed on a more secure footing by developing an overarching policy on FDI with more direct mechanisms for cooperation. A much closer link must be established between investment promotion activities, industrial policy and trade policy. The legal basis for an FDI policy is not fully captured in the terms of reference of the BIT Task Team, hence the recommendation that this issue be dealt with in a separate process.

Reference is made to various policy documents that line function government departments use to inform their work. The RSA's economic relations during the last decade have been defined by the very influential *Global Economic Strategy* which formed the backbone of the RSA's regional and bilateral relations with key trading partners. The DTI has been in the process of updating this document to better reflect the changing world order and the need for the RSA to reposition itself

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in such a dispensation. To the extent that this process is yet to be completed, the BIT Task Team can merely recommend that the emerging trade policy fully account for coordination between industrial planning on the one hand, and investment policy and promotion on the other.

The RSA has also emerged as a capital exporter into the African continent and beyond. RSA companies have established a footprint on the continent, a foray that has been fully endorsed and encouraged by government. In the SADC region the *Protocol on Finance and Investment* (FIP) creates a framework for investment in the SADC region. This instrument seems only to cater for inward FDI and does not cater for intra-SADC investment. There seems to be little or no integration between the FIP and investment protection and promotion policies followed by the RSA. Given the sizable intra-Africa investments made by RSA companies, the RSA ought to assess how best such investments by its citizens may be safeguarded. Already the issue of diplomatic protection has been raised in the context where no BIT was in place to protect such interests. Different considerations apply in situations where either inward or outward FDI is contemplated. This raises some difficult questions with relation to the appropriate model for investment protection since clearly different needs may be articulated by RSA companies that invest in the African continent or elsewhere and investment entering the RSA. Many countries, particularly developing countries who seek to promote sustainable development, have an investment law which regulates issues pertaining to sectoral interventions, incentives and the role of Investment Promotion Agencies. Clear policy guidelines must inform approaches to both inward and outward investment.

The micro policy analysis seeks to develop a policy framework for future engagement of investment issues and to assess the impact of obligations

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undertaken in BITs on the RSA. A legal analysis of various provisions found in BITs has also been undertaken. Though most BITs follow a similar basic structure, nuances in language may result in very different legal consequences. This review takes place against the backdrop of a rapidly changing investment law environment. It is therefore important to gauge such changes against an emerging body of international practice. Policy recommendations are made with regard to the emerging legal trends and issues that have come to dominate investment treaties.

The analysis compares 11 standard clauses to be found in BITs concluded by the RSA. Typical clauses include issues such as the scope of an investment; the definition of an 'investment'; who qualifies as an 'investor'; geographic application; duration and termination; standards of treatment (including national treatment and MFN treatment); expropriation; transfer of funds and dispute resolution.

Investment law is an emerging discipline and in the words of a leading scholar should be approached with extreme caution. Few areas of international law excite as much controversy as the law relating to foreign investment. Much of the discipline as it exists today was created by developed (capital exporting) countries that sought to protect investments made by their citizens. The recipients of FDI, mostly developing countries, opposed notions set forth by developed countries as may be apparent from the Calvo doctrine. This doctrine has its origin in South America and emphasizes that the responsibility of governments towards foreigners cannot be greater than that which such governments have towards their own citizens. It explicitly rejects the notion of a so-called 'international minimum standard' as a standard applicable to the treatment of foreigners, including foreign investors. However, developing countries also started to compete with each other for investment and entered into

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BITs containing rules on investment protection. The treaties created jurisdiction in arbitral tribunals at the unilateral instance of a foreign investor. This in turn led to an articulation by such tribunals of principles which confirmed and extended notions that favoured the treatment of foreign investment in accordance with 'external' standards. In the broader scheme of things it restrained governmental interference with such investments. The real debate is to what extent host states should be allowed to regulate foreign investment.

The interplay of various economic, political and historical factors shaped and continues to shape the development of international law on foreign investments. Traditionally investments by metropolitan powers were protected by virtue of their dominant military position (a result of colonialism), gun-boat diplomacy was sufficient to ensure that both trade and investment were protected. In parts of the world where such a colonial relationship did not exist, the genesis of state responsibility may be found. The United States is the progenitor of the doctrine on state liability for injury to aliens and their property. The United States sought to externalize the norms that governed aliens and their property and it argued for an international minimum standard in accordance with which aliens should be treated. Foreign investors were entitled to compensation in accordance with the hallowed formula devised by Cordell Hull that compensation should be 'prompt, adequate and effective'.

There is agreement that international law does not prohibit the expropriation of alien property. Disagreement, however, exists as to the conditions that must be fulfilled to prevent it from becoming unlawful. It seems clear that pronouncements by Secretary of State Hull in 1938, that compensation must be 'prompt, adequate, and effective', is no longer accepted by international law. Today the standard of 'appropriate' compensation seems to enjoy the greatest support and has been approved in several arbitral awards. This debate has also

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played out in the RSA since BITs call for the traditional standard of compensation, while the Constitution of the RSA mandates a lesser standard.

Investment agreements contain obligations specifying the treatment that the contracting parties are required to provide to the investment once it has been established. In many instances it has been contended that an international minimum standard exists. Apart from the rule relating to compensation for expropriation and the settlement of such issues through a tribunal that sits outside the host state, there does not seem to be any guidance as to what the content of the standard is. The existence of a minimum international customary law standard has long been disputed. Such standards impact on the ability of governments to prefer its own nationals on grounds of past discrimination or on the basis of economic considerations. Greater balance must be injected into relationships governed by BITs.

Investment dispute settlement has now embarked on a course that effectively assigns arbitral panels an active role in implementation and interpretation of BITs. Investors have become aware of the attractive *status quo* under the global investment regime – literally hundreds of long-ignored investment treaties offer investors access to an investor-state dispute settlement mechanism, allowing them to take their disputes directly to international arbitration – leapfrogging domestic legal systems (and thus, any safeguards designed to protect important public goods). Some investors are using bilateral investment treaties to challenge treatment of foreign investments in various sensitive areas, including water and sewage provision, oil and gas exploitation and mining concessions. Major law firms are using BITs as the tool of choice for challenging host state regulation of public services. Solutions to the issues of dispute settlement are available. They include greater transparency; selection of arbitrators in a neutral manner rather than by the parties; proper deference to domestic dispute settlement procedures;

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clear separation of the functions of arbitrator and advocate; and the introduction of an appellate process. Most of these changes by now appear inescapable.

Existing international investment agreements are based on a 50-year-old model that remains focused on the interests of investors from developed countries. Major issues of concern for developing countries are not being addressed in the BIT negotiating processes. BITs extend far into developing countries' policy space, imposing damaging binding investment rules with far-reaching consequences for sustainable development. New investment rules in BITs prevent developing country governments from requiring foreign companies to transfer technology, train local workers, or source inputs locally. Under such conditions, investment fails to encourage or enhance sustainable development. There are many who question whether BITs in fact attract FDI at all. Various countries are reviewing their BIT regimes, so the RSA is not alone in the process. Whilst a revised BIT will go a long way in resolving critical problems which the RSA now faces, it will not, however, be a panacea for all other FDI problems. These problems can only be tackled by proper policy integration, co-ordination and implementation.

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