BALANCING THE PROTECTION OF FOREIGN DIRECT INVESTMENT AND THE RIGHT TO REGULATE FOR PUBLIC BENEFIT IN SOUTH AFRICA

MINI-DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT FOR THE REQUIREMENTS OF THE DEGREE OF MASTER'S OF LAW IN (INTERNATIONAL TRADE AND INVESTMENT LAW IN AFRICA)

INTERNATIONAL DEVELOPMENT LAW UNIT, FACULTY OF LAW, CENTRE FOR HUMAN RIGHTS, UNIVERISTY OF PRETORIA

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DECLARATION

I declare that this Mini-Dissertation which is hereby submitted for the award of Masters' of law (LL.M) in International Trade and Investment Law in Africa at International Development Law Unit, Centre for Human Rights, Faculty of Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institution. Other works referred to are accordingly acknowledged.

Mmiselo Freedom Qumba

DEDICATION

This work is dedicated to my family. To my friends, Dr Ngodwana, Dr Sangqu, Vuyolwethu, Siminikiwe and Lwazi who supported me financially throughout my master's programme.

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I owe special gratitude to Jesus who always gives me strength and ability beyond my natural ability and my family for being an encouragement to me.
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Thank you all , God bless

List of acronyms

BEE	Black Economic Empowerment
BIPA	Bilateral Investment Promotion Agreement
BITs	Bilateral Investment Treaties
EU	European Union
FET	Fair and Equitable Treatment
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
IISD	International Institute for Sustainable Development
ICSID	International Center for the Settlement of Investment Disputes
IMF	International Monetary Fund
MAI	Multilateral Agreement on Investment
MFN	Most Favoured Nation Treatment
MPRDA	Mineral Petroleum Resources Development Act
PIA	Promotion of Investment Act

RSA	Republic of South Africa
RTAs	Regional Trade Agreements
SADC	Southern African Development Community
SAIIA	South African Institute of International Affairs
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development.
WTO	World Trade Organisation

Directory of cases

ACD v *Hungary*

Agric SA v Minister of Minerals and Energy

Bisset v Buffalo city Municipality,

Campel and another V Republic of Zimbabwe

Factory at Chorzow , Germany V Poland

L.F.H and Pauline Neer (USA) v United Mexican states, General claims Commission

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List of Instruments and Treaties

Agreement between the Government of the United Kingdom of Great Kingdom and Northern Ireland and Government of the Republic of South Africa for the Promotion and Protection of Investments

Agreement on encouragement and reciprocal Protection of investments between the Republic of South Africa and the Kingdom of Netherlands

Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965, entered into force in 1959
Energy Charter Treaty entered into force 1998

Southern African Development Community Protocol on Finance and Investment of 2006

Southern African Development Community Model Bilateral Investment Treaty Template completed in June 2012

United Declaration of Human Rights(UDHR) of 1948

The Constitution the Republic of South Africa, Act 108 of 1996

The Companies Act No 71 of 2008

Financial Markets Act No 19 of 2012

Protection of Investment Act 22 of 2015

Promotion and Protection of Investment Bill of 2015

Mineral and Petroleum Resources Development Amendment Act No 49 of 2008

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Chapter 1 Introduction

1.1 Background to the research

Foreign investment involves the transfer of tangible or intangible assets from one country into another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets.[1] In the case of Salini,[2] investment was defined to include substantial commitment, duration of performance, regularity of profit and return, assumption of risks and significance for the host state's development. Foreign Direct Investment (FDI) has also been defined as an investment where an investor based in one country acquires an asset in another country with the intention to manage that asset.[3] Since states reserve the exclusive right to define and decide what constitutes foreign investment in their economies, the above definitions can only be illustrative and subject to specific definitions that states have advanced in their bilateral investment treaties (BITs), regional trade agreements or within an investor-state investment agreement.[4]

In deciding where to invest, foreign investors take into account the regulatory environment in the potential host state as well as the ability to make profits. Hence, for the host state to attract foreign investors, it needs to have a conducive environment, ensure fair treatment of investors and offer guarantees against expropriation.[5] Therefore, the host state and the home state sign BITs with the aim of ensuring that foreign investors and their investments are protected in the host country's territory, thereby giving foreign investors, through the treaty, substantive and procedural rights that will encourage them to invest in the host state. So, BITs are supposed to intensify the economic

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[1] M Sornarajah *The International Law on Foreign Investment* (2010) 7.

[2] *Salini Costrutiorri SpA & Italstrade SpA v Kingdom of Morocco*, ICSID Case ARB/OO/4.

[3] D Wallace & D Bailey 'The Inevitability of National Treatment of Foreign Direct Investment with Increasingly Few and Narrow Exceptions' (1998) *Cornell International Law Journal* 27-28.

[4] ND Valentine *The International Law on Foreign Investments and Host Economies* (2011) 16.

[5] A Reinisch *Standards of Investment Protection* (2008) 34.

relations between the two countries involved, protect investments, boost the transfer of technology and capital inflows, and facilitate the economic development of the host state.[6]

The South African Government has long acknowledged that FDI is a driver of economic growth. After 1994, the South African government entered into many BITs, with the aim of attracting investment and boosting the economy. The first BIT that South Africa entered into was with the United Kingdom (UK). It was concluded by the then outgoing Government of the Republic of South Africa in 1994. The importance of FDI was emphasized in South Africa's Growth, Employment and Redistribution Strategy and other official documents and policy statements.[7] The fear was that the new incoming government was going to expropriate properties of foreign investors without paying adequate compensation, so the UK government deemed it necessary to conclude a BIT with the outgoing South African Government so as to ensure the protection of its investments in South Africa. [8]

1.2 Problem statement

One of the challenges currently facing South Africa is how to put in place a friendly investment climate to attract foreign investors into the most critical sectors of its economy to boost growth and create jobs. However, there have been concerns that the BITs offered more protection for foreign investors than that offered by the Protection of Investment Act,[9] and that they encroached more into the South African policy space to regulate for public benefit. So the Government of South Africa began to scrutinize its existing BITs so as to ensure that there is adequate policy space

[6] Reinisch (n 5 above) 10.

[7] M Mossallam 'Process Matters : South Africa's Experience Exiting its BITs' GEG Working Paper 2015/97 http://www.globaleconomicgovernance.org/sites/geg/files/GEG%20WP_97%20Process%20matters%20-%20South%20Africas%20experience%20exiting%20its%20BITs%20Mohammad%20Mossallam.pdf (accessed 23 November 2015) 23.

[8] Mossallam (n 7 above) 7.

[9] Protection of Investment Act 22 of 2015

for the Government to pursue legitimate purposes. In many instances, it appeared that BITs were concluded without deep reflection about what they meant for the country.[10]

In 2010, the Government of South Africa undertook a three-year review of its BITs. The purpose was to assess the level of protection offered to foreign investors as well as the risks and the benefits of BITs. The observation was that the current investment regime mainly focused on narrow issues of economic interests while placing matters of national interest in unpredictable international arbitration that undermined the constitutionality of the state and its space to make domestic policy.

The dilemma the South African government is now facing is how to balance its need for FDI, while preserving its policy space to pursue empowerment measures and policies. The exercise by the South African Government of its sovereign right to regulate in the national interest could cause severe economic damage to the interest of foreign investors, but failure to exercise its regulatory powers would compromise the effectiveness of the country. As a result, South Africa's reaction to what it perceives as unfairness in the international investment system of BITs will result in a conflict between the sovereignty of the country to regulate in the national interest and the duty to provide compensation in cases where there has been regulatory direct or indirect expropriation.

It is in light of the above scenario that this study will interrogate the inconsistencies and incompatibility of the Protection of Investment Act against the standard of protection in international investment law found in customary international law, the SADC Protocol on Finance and Investment, and the SADC Model BIT.

1.3 Research questions

The main question that will be addressed in this study is: does the Protection of Investment Act offer adequate protection to foreign investors.? In answering this question, the following sub-questions will be examined:

[10] L Peterson 'South African's Bilateral Investment Treaties, Implications For Development and Human Rights' (2006) http://www.saiia.org.za/images/upload/Peterson%202006%20-%20SA%20BITS%20and%20human%20rights.pdf (accessed 24 March 2016) 9.

1. What are the standards of protection under customary international investment law and what were the critical features of South Africa's former regulatory investment regime?

2. What is the nature of South Africa's regulatory power and rationale for its new investment regime?

3. In light of the information provided in response to questions 1 and 2, does the Protection of Investment Act offer adequate protection to foreign investors?

1.4 Thesis statement

This mini thesis argues that whilst the Protection of Investment Act may generally be regarded as a legislative mechanism to regulate for the public benefit, it does not strike a careful balance between the rights of the foreign investor and the host state. This mini thesis also argues that though the South African judicial system may be generally considered robust and independent, foreign investors may not have faith in the judicial system, particularly on issues regarding the constitutional mandate to address the imbalances of the past, as the concept of indirect expropriation is not mentioned in the Protection of Investment Act and in the Constitution.

1.5 Significance of the study

The objective of this study is to propose a careful balance between the protection of foreign investors and the right of a host country to regulate for public benefit. The critical focus is on whether the new Protection of Investment Act departs from the international trends and, if so, does it contribute to the setting of new international standards to be followed by developing countries, particularly those in the process of terminating their BITs. The study is relevant to the South African Government, as it has recently passed controversial investment legislation. It is important to academics and researchers as it will build on what has been written and provide new insights into achieving an equitable framework.

It is also important for policymakers, as it will contribute to the current knowledge on investment regulatory frameworks and can serve as a mechanism to ensure that South Africa remains attractive for foreign investments. Further, it is important to other developing countries that may wish to

follow South Africa's lead in terminating their BITs and adopting a new investment regime. It will contribute to the debate surrounding the new Protection of Investment Act by ensuring a proper balance between the formulation and implementation of effective investment law for national interests and in ensuring that South Africa offers adequate protection to foreign investors.

The study will contribute to the current ongoing debate that BITs fail to address the balance of rights and responsibilities of investors as they offer numerous international legal rights for investors without corresponding obligations on them. This study will respond to the criticism that Protection of Investment Act offers more protection to the host country and less protection to foreign investors.

1.6 Research methodology

The research will be based on the qualitative approach, which will consist of desk- and library-based research. It will rely on both published and unpublished material. The sources will include but not be limited to various international legislation, judicial decisions and journals. The research will rely extensively on internet sources and papers from relevant institutions and stakeholders. The primary sources that will be used include the Protection of Investment Act and the Constitution of the Republic of South Africa (the Constitution). The secondary sources will be academic writings such as books and journals. The research will entail the analysis of relevant provisions of the Protection of Investment Act and comparison with international standards of treatment as entrenched in customary international law on protection of foreign investors.

1.7 Literature review

Foreign investment has been regarded as a great driver of economic growth in many countries in the world. Many authors, government publications and publications of international institutions have discussed the issue of whether inward flows of FDI have any impact on a country's economic development. There is huge debate that South Africa's introduction of a new legal framework is a step away from being investor friendly at a time when the country is on the brink of a recession and needs to attract FDI into the most important sectors of its economy.

Investment attracted pursuant to BITs can be good for the host state, as it could boost its economy. Foreign investors have confidence to invest as a result of the guarantees offered under the BIT. The Protection of Investment Act offers less protection to foreign investors than that offered by BITs. The introduction of the new Protection of Investment Act and cancellation of BITs by the South African Government may be considered as retrograde steps that will adversely affect investor confidence.

On the other hand, the South African government has been praised for leading the way by many developing countries in seeking to re-balance the rights and obligations of states and investors. Many developing countries are working towards exiting BITs because there is imbalance in the costs and benefits offered by BITs. The researcher seeks to find an answer between two opposing views. The study will primarily focus on the need to achieve an appropriate balance between foreign investment protection and the constitutional obligation to regulate in the public interest.

Sornarajah[11] argues that all bilateral investment treaties constrain sovereignty. He adds that investment treaties constrain sovereign rights of control over the intrusive process of foreign investment, which takes place entirely within the territory of the host state. To this extent the erosion of sovereignty in such treaties is considerable. Johnson[12] is of the opinion that limiting the state's room to regulate is an essential component of reducing investor risk and thereby promoting foreign investment. He adds that, in accordance with existing BITs, investors have the right to enforce a treaty's provisions through international arbitration in order to promote maximal protection for investors which facilitates greater inflows of FDI.

Muchlinski[13] contends that, though the reduction of government intervention in economic policy making is seen as essential to the efficient operation of the international investment, the International Institute for Sustainable Development (IISD) Model agreement reinforces the need

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[11] n 1 above, 265.

[12] A Johnson'Rethinking Bilateral Investment Treaties in Sub-Saharan Africa'(2010) 59 *Emory Law Journal* 26.

[13] P Muchlinski 'Regulating Multinationals: Foreign Investment, Development and Balance of Corporate and Homes Country Rights and Responsibility in a Globalizing World' in 3 (2011)http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199793624.001.0001/acprof-9780199793624-chapter-001003 (accessed 23 march 2016).

of the home state to require civil litigation before its own courts before recourse to international arbitration by investors. He also argues that the IISD Model agreements offers a useful, though by no means uncontroversial, step forward. He further argues that this step would be consistent with the call in the Doha Declaration for an investment framework that reflects in a balanced manner the interests of the home and host state countries.

Trackman[14] is of the opinion that, though the conflict between state and investor interests appears significant, these interests are often compatible. Sovereign states are interested not only in regulating FDI on public policy grounds, but also in avoiding the flight of investor capital from states whose regulatory regimes are considered by investors to be unclear, arbitrary or capricious. Investors are interested not only in protecting their rights, but also in establishing long-term investment relationships including relationships with the host state. Accommodating the equitable treatment of FDI and other public interest requires careful balancing.

Sacerdoti, Acconti, Vallenti and De Luca[15] argue that the conflict under consideration here is between the investor's quest for stability and the host country's sovereign power to legislate. The investors need stability in order to plan their business. The host state needs flexibility in policy-making in order to meet its societal demands and, where necessary, adapt to changing circumstances. The fair and equitable standard is best suited to meet both concerns. The point here is to strike a balance. The authors quoted the case of *Parkerings-Compagniet AS* v.*Repulic of Lithuania* where it was said that, 'a state has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of stabilization clauses or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that law will evolve over time. What is prohibited however is for state to act unfairly, unreasonable or inequitable in the exercise of its legislative power.'

[14] L Trackman 'Foreign Direct Investment Hazard or Opportunity? (2009) 41 George Washington International Law reivew 19.

[15] G Sacerdoti *et al General Interests of Host States in International Investment Law* (2014) 79.

On the other hand, Lall and Narula[16] raise an issue that most developing countries have removed restrictions on FDI inflows, but this has allowed foreign investors to exploit existing capabilities more freely. Thus, the need to strike a balance between foreign investors' interest and the host state's right to regulate for public benefit.

Adeleke[17] foresees the potential imbalance with the Protection of Investment Act when it comes to interpretation of the Constitution and recognised international standards. He argues that much has been said about South Africa's decision to opt out of BITs but the Protection of Investment Act is not entirely isolated from the international law. Like all South African laws, the interpretation of the Protection of Investment Act must be consistent with the Constitution, which mandates the consideration of international law. International investment protection standards sometimes differ from the objectives of the Constitution to address socio-economic inequalities. He quotes *Agric SA* v *Minister of Minerals and Energy,*[18] where the court found that deprivation of rights in the Mineral and Petroleum Resources Development Amendment Act 49 of 2008 (MPRDA) was not arbitrary as a result of the objectives of MPRDA to facilitate equitable access to South Africa mineral resources.

The court suggested that acquisition of property must always occur for expropriation to be effected, which differs from recognised international practices, where indirect expropriation without acquisition of property is recognised. The court acknowledged the social context of South Africa and decided not to over-emphasise private property rights at the expense of the state's social responsibilities. The position taken by the court is consistent with the meaning of expropriation as adopted by the Protection of Investment Act and raises question about the balancing mechanism that South African courts will employ where there are clashes between the interpretation of the constitution and recognised international standards. The Protection of Investment Act will be tested in line with the above argument to see which scholarly view is logical and more persuasive.

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[16] S Lall & R Narula 'Foreign Direct Investment and its Role in Economic Development: Do we need a new agenda?' (2004) 16 *The European Journal of Development Research* 15.

[17] F Adeleke 'Benchmarking South Africa's foreign direct investment policy' (2015) http://www.saiia.org.za/policy-insights/benchmarking-south-africas-foreign-direct-investment-policy (accessed 23 March 2016).

[18] *Agric SA v Minister of Minerals and Energy* 2013 4 SA 1 (CC)

While the views expressed by the above authors sound reasonable, there are further challenges which have not yet been fully addressed, if at all. In South Africa, the challenge is now how sovereign power to legislate and regulate to address the injustices of the past will be implemented in a manner that does not amount to indirect expropriation from the investor's perspective. This challenge is the major focus of this study.

1.8 Outline of chapters.

The study consists of five chapters: the introductory chapter, a definition of the research methodology, guiding research questions, and objectives and significance of the study literature review.

Chapter 2 focusses on the standard of protection under customary international law and an overview of the past regulatory regime.

Chapter 3 focusses on the power of the state to regulate and the concept of indirect expropriation, the conflict that exists between the BITs and right of the state to regulate and the reasons for cancellation of BITs. It also looks at the rationale for the introduction of the new investment regime.

Chapter 4 covers the analysis of the Protection of Investment Act; it examines the consistency of the Protection of Investment Act with the customary international investment standards of protection for foreign investors and protection of foreign investor's investments at the international and regional level.

Chapter 5 covers summary of the findings and conclusions, and makes recommendations that could be implemented in South Africa.

Chapter 2 Customary International Law Principles and Overview of the Former Regulatory Investment Regime in South Africa

2.1 Introduction

This chapter explains customary international law principles on foreign direct investment. It seeks to explain the relationship between customary international law and the protection of foreign investors. The underlying principles of customary international law on foreign investment will be examined and the nature and scope of these principles will be assessed. In view of the fact that there is no multilateral investment agreement, this chapter attempts to explain the fundamental principles of customary international law and consider the legality and the extent of protection afforded to foreign investors under the Protection of Investment Act.[19]

Customary international law affords protection to foreign investors for a number of reasons. According to Gazzini, "There are virtually no BITs between developed countries, secondly, the customary international law is not only important as a legal basis on investment but as applicable law before international investment tribunal and municipal tribunals."[20] Foreign investment was protected under the principles of customary international law before the signing of BITs by nations. Customary international law is not created by the decisions of a tribunal but rather through the general and consistent practice followed by states from a sense of legal obligation.[21] "Customary international law operates above all laws and is derived from the practices of the states. This means that domestic measures or statutes cannot be used to derogate from duties imposed by these standards.''[22] International investment law principles such as non-discrimination, prohibition against expropriation, and payment of just, prompt and adequate compensation in cases of

[19] Protection of Investment Act 22 of 2015

[20] T Gazzini 'Role of Customary International Law in the Field of Foreign Investment' (2007) 8*The Journal of World Investment &Trade* 56.

[21] CP Matthew 'An International Common Law of Investor Rights' (2006)25 *University of Pennsylvania Journal of International Law* 66.

[22] A Langalanga 'Imagining South Africa's Investment Regulatory Regime in a Global Context ' (2014) South African Institute of International Affairs Occasional Papers http://www.saiia.org.za/occasional-papers/848-imagining-south-africa-s-foreign-investment-regulatory-regime-in-a-global-context/file (accessed 19 March 2016).

expropriation and having a general minimum standard of treatment of foreign investors have gained the status of customary international law.[23] This chapter will explain these customary international investment law principles as they are core to the protection of foreign investors.

The protection of foreign investors under customary international law was clearly explained in case of *L.F.H.Neer and Pauline Neer (USA) v United Mexican states*,[24] which was decided in 1927. There, it was stated that "it is of the opinion of the commission had to go little further and to hold that the propriety of government act should be put to the test of international standards, and second that the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty or to an insufficient government action so far short of international standard that every reasonable and impartial tribunal would readily recognise its insufficiency." It is safe to conclude from this ruling that customary international law standards exist independently of standards from the international investment treaties and international investment contracts.

Therefore, the focus of this chapter is to explain and examine the content of the standards of treatment of investors (aliens) under customary international law and to look at the overview of the previous investment regime in South Africa.

2.2 Customary international law principles governing FDI

As previously noted, the legal foundation for the protection of foreign direct investment is rooted in customary international law.[25] The protection of foreign direct investment finds expression in the notion of "state responsibility." The doctrine of state responsibility describes the situation where injury sustained by a foreign national as a result of actions of citizens of the host state is attributed to that host state and the home state of the injured person initiates a claim on its behalf.[26]

[23] Langlanga (n 22 above) 12.

[24] *L.F.H.Neer and Pauline Neer (USA) v United Mexican States,* Reports of international Arbitral Awards (15october 1926) 21.

[25] Gazzini (n 20 above) 3.

[26]The Centre For International Environmental Law Issue Brief (2003) 'International Law on Investment : The Minimum Standard of Treatment' http://www.ejiltalk.org/international-minimum-standard/ (accessed 23 March 2016).

The aim of protection under the customary international law principles is to ensure the protection of aliens against non-commercial risks, such as discrimination and expropriation.[27]

The idea is that foreign investors should be afforded the same level of treatment and protection as the local investors. Basically these principles are non-discrimination, prohibition against expropriation except for public purpose and, if adequate, prompt and effective compensation, due process and minimum standard of treatment of aliens.[28]

2.2.1 Prohibition against expropriation

The lawfulness of expropriation does not absolve a state from paying compensation. The criteria to establish the lawfulness of an expropriation are: non-discrimination, public purpose, due process and compensation. Payment of compensation is not dependent on whether the expropriation was lawful or unlawful but rather on whether or not the expropriation occurred.[29]

It has been argued that an investor is entitled to full compensation,when there is a finding by an arbitral tribunal that expropriation has taken place rather than if the expropriation was unlawful or not. If there was no expropriation, then the investors would not receive any compensation.[30] Investment law prohibits both direct and indirect expropriation.[31] A direct expropriation is an outright seizure of a foreign investor's property and indirect expropriation can either be a regulatory expropriation or creeping expropriation.[32]

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[27] FJ Nicholson 'The Protection of Foreign Property under Customary International Law'(1965) 3 *American Journal of International Law* 33-34

[28] Energy Charter Treaty art 13 provides that "investment of investors of contracting party in the area of any contracting shall not be nationalised, expropriated or subjected to a measure or measures having effect equivalent to nationalisation or expropriation except where such measures complies with the rules of customary international law in this matter (public purpose, due process, non-discrimination and compensation)".

[29] Organisation for Economic Co-operation and Development (OECD) '"Indirect Expropriation" and the "Right to Regulate'' in International Investment Law' OECD Working Papers on International Investment (2004) http://dx.doi.org/10.1787/780155872321 (accessed 28 January 2016).

[30] PD Iskoff 'Defining the Scope of Indirect Expropriation for International Investments' (2013)3 *Global Business Law Review* 53.

[31] OECD (n 29 above) 3.

[32] Gazzini (n 20 above) 2.

The difference between lawful and unlawful expropriation lies in the degree to which investors have to be compensated when the existence of expropriation has been established.[33] It has been said that, in cases of unlawful expropriation, the principle laid down by *Factory at Chorzow, Germany v Poland ICJ*[34] is apposite. There, the permanent court of justice said that "the reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if the act had not been committed. Restitution in kind, or if this is not possible payment of a sum corresponding to the value which restitution in kind would bear, the award, if need be, of damages for loss is sustained which would not be covered by restitution in kind or payment in place of it. Such are principles which should serve to determine the amount of compensation for an act contrary to international law".

It is submitted that compensation for unlawful expropriation must be such that the investor's position is returned to the status quo ante.

Direct expropriation

Direct expropriation amounts to the actual taking of property by a host government through direct means, including the loss of all, or almost all, useful control of a property. The definition is clear and without controversy. A clear example of direct expropriation occurred in *Campell and Another v Republic of Zimbabwe*,[35] where government policies permitted the taking over of white-owned lands without compensation being paid to them by black farmers. The Southern African Development Community (SADC) tribunal held that the expropriation by the Zimbabwean government was discriminatory against the applicant on the basis of race and constituted direct expropriation.

[33] U Kriebaum 'Regulatory Takings, Balancing the Interest of Investor and the State'(2007) 8 *The Journal of World Investment &Trade* 21.

[34] *Factory at Chorzow, Germany v Poland* ICJ (28 June 1923)(1923) Oxford Reports on International Law 23

[35] *Mike Campell(plt)(ltd) and other v Republic of Zimbabwe* (2007) SADCT (28 November 2008).

Indirect expropriation

Indirect expropriation means the indirect taking of property of the investor by a governmental measure, whether administrative or legislative, that has the effect of substantially depriving the investor of its property.[36] This has happened in South Africa where the matter (*Piero Foresti, Laura de Carli & Others v The Republic of South Africa*) was taken to the International Centre for Settlement of Investment Disputes (ICSID) for arbitration.[37] In this case,[38] the BEE policy was challenged as an indirect expropriation by Luxemburg investors who alleged that, by granting 26 percent of the company's shares to previously disadvantaged South Africans, MPRDA resulted in the substantial deprivation of their property.

Creeping expropriation

The third type of expropriation is a kind of indirect expropriation. It involves the use of a series of governmental measures to reduce the economic value of an investment. Individual measures on their own may not amount to creeping expropriation, but a cumulative impact of the measures may do so.[39]

Regulatory expropriation

For a government measure to constitute a regulatory expropriation, the measure should be discriminatory and would require the payment of compensation. Regulatory expropriation is also another form of indirect expropriation. The impact on the economic value of the property of the investor must be sufficient to be deemed expropriation.[40]

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[36] *Piero Foresti, Laura de Carli & Others v The Republic of South Africa* ICSID Case ARB(AF)/07/01,30 August 2010.

[37] n 36 above.

[38] As above.

[39] P Surbedi *International Investment Law: Reconciling Policy and Principle* (2012) 354.

[40] Surbedi (n 39 above) 77.

2.2.2 Non-discrimination

The principle of non-discrimination has two facets to it. One of the principles has its origin in the *Calvo* doctrine which required that the aliens and their property be treated the same as the nationals of the host state. The other is founded on the concept of state responsibility. According to this doctrine, customary international law requires that there should be a minimum standard of treatment to aliens and any departure from this standard is not allowed.[41] The principle of non-discrimination states that properties of foreign investors should not be subject to discriminatory legislation.[42]

This means that each country is under the obligation to give foreign nationals in the host state the benefit of the same laws, the same administration, the same protection and the same redress to injuries which it gives to its own citizens.[43] Nationals and foreign nationals must be affected in the same way by legislation authorising seizure of property. The confiscation of property on racial grounds has been condemned as a violation of international law.[44] It has been argued that any taking that is racially motivated, without justification, amounts to discrimination and violates the customary international law principle of non- discrimination.[45]

However, the contrary view is that "customary international law does not require any host state country to guarantee non-discriminatory treatment to foreign investors wishing to establish their activities in its territory or even to those already established.''[46] Surbedi argues that strict application of the principle of equality before the law would mean that foreign investors should be subjected to national courts and laws of the host state as applicable to domestic investors. Therefore, there is no rule under customary international law which prohibits discrimination

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[41] Surbedi (n 39 above) 78.

[42] F Dawson & B Weston, '"Prompt, Adequate and Effective'' A Universal Standard of Compensation?' http://ir.lawnet.fordham.edu/flr/vol30/iss4/4 (accessed 15 February 2016)

[43] Dawson & Weston (n 42 above) 19.

[44] Nicholson (n 27 above) 397.

[45] As above.

[46] V Mosoti 'Non-discrimination and its possible WTO framework agreement on investment, reflections on the scope and policy space for the development of poor economies' (2003) 4 The Journal of World Investment & Trade 643.

between foreign investors and local investors.[47] Differentiation is not prohibited by the non-discrimination principle but differentiation must be based on reasonable grounds.[48] Despite the contrary views, it is, however, without doubt that the principle of non-discrimination is a universally accepted standard and has attained the status of customary international law.[49]

2.2.3 Public purpose

The host country has a prerogative to determine what is in the public purpose. As noted by the United Nations Conference on Trade and Development (UNCTAD), usually a host country's determination of what is in its public interest is accepted.[50] Once the determination has been made that there is substantial deprivation of property, then the focus shifts to ascertain whether the measure was for public purpose. The tribunal decided in the *Methane corporation vs United States of America* US Court of Appeal case: "As a matter of general international law, a non-discriminatory regulation for public purpose, which is enacted with due process and which affects a foreign investor or an investment is not deemed expropriatory and compensable, unless specific commitments have been made by the government to the then putative foreign investor contemplating investment that the government would refrain from enacting such regulation."[51]

It is submitted that this case not only requires that the expropriation should be for public purpose, but that it should also incorporate other elements such as the non-discriminatory nature of the measure and the following of due process. Put differently, satisfying the public purpose requirement is not sufficient on its own to justify a non-compensable expropriation. The regulation must also satisfy other requirements.

Another decision that specifically deals with public purpose requirement is the *Saluka Investment B v Czech Republic*, where the United Nations Commission on International Trade Law

[47] Surbedi (n 39 above) 354.

[48] R Klager *Fair and Equitable Treatment in International Investment Law* (2011) 4.

[49] Dawson & Weston (n 42 above) 16-17.

[50] United Nations Conference on Trade and Development (UNCTAD) 'Taking of Property' UNCTAD series on issues in International Investment Agreements (2000) 435-436.

[51] *Methane corporation v United States of America 231 US 215*(1999).

(UNCITRAL) held that " it is now established international law that states are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at general welfare."[52] It is submitted that this decision explicitly excludes the payment of compensation in cases of expropriation is for public purpose and also other elements are satisfied, including the non - discriminatory nature of the regulation, which must have been enacted *bona fide*.

From the rulings, a conclusion can be drawn that, although a government measure may result in a substantial deprivation of a foreign investor's property, the government may be exempted from the payment of compensation if the regulation was non-discriminatory, enacted bona fide following the due process of law and with a public purpose in mind.

2.2.4 Compensation on expropriation

Compensation is triggered when there has been a violation of an international legal norm, such as when expropriation is not for a public purpose, is discriminatory and violates international law principles.[53] The standard of compensation was best expressed by Cordell Hull when he stated that, "under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision of prompt, adequate and effective payment."[54] This rule is one that is often utilised to test the lawfulness of expropriation and, where the requirements have not been met, the conclusion can only be that the taking of property constituted confiscation. An expropriation is lawful when it is not discriminatory and is for a public purpose. Where expropriation cannot satisfy the relevant requirements, prompt, adequate and effective compensation has to be provided.[55]

[52] *Saluka Investment B v Czech Republic* 17 (1976) UNCITRAL(17 March 2006)

[53] OECD (n 29 above)

[54] Dawson& Weston (n 42 above) 19.

[55] Nicholson (n 27 above) 14.

The question is not whether compensation should be paid by the state that has violated the legal norm: rather, the proper focus of legal analysis is about the timing, the amount and the form of payment in cases of expropriation by the state.[56] Hull describes the taking of property without compensation as confiscation. It is a confiscation of property even when compensation will be paid in the future. Hull argues that if host states were allowed to take the property of foreign investors and pay when they deem fit and according to their economic conditions, then the safeguard provided by the well-established principles of international law would be illusory. Host state governments would be at liberty to take property beyond their affordability and the foreign investors would be left without legal recourse.[57]

The prompt, adequate and effective standard of compensation is not without controversy. The capital-importing countries are of the view that national treatment is sufficient to grant protection to foreign investors; in effect, declaring that a foreign investor that is aggrieved should approach the national courts for redress. In the view of capital-importing countries, this does not amount to a serious impediment to customary international law. However, the view of capital exporting countries has prevailed since the pre-1945 world order, hence the prompt, adequate and effective standard of compensation still applies to arbitral decisions today.[58]

2.2.5 Due process

The due process requirement is often referred to as the benchmark to test the legality of expropriation. It is uncertain whether the due process standard is a standard of customary international law. Due process in this case is usually understood as the determination of the amount of compensation after the expropriation has taken place. Expropriation without due process of law means that there has been violation of the equality principle, no fair hearing and contravention of the principles of natural justice recognised generally by the principal legal systems of the world.[59]

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[56] Klager (n 48 above) 31.

[57] Surbedi (n 39 above) 16.

[58] JD Aspremont ‘International Customary Investment Law-a Story of a Paradox’(2011)59.

[59] Aspremont (n 58 above).

The due process requirement was clearly expressed in the decision of the tribunal in *ACD V Hungary* heard by the International Centre for Settlement of Investment Disputes (ICSID).[60] It was held that "some legal mechanisms, such as reasonable advance notice, a fair hearing and unbiased and impartial adjudication to assess the actions in dispute, are expected to be readily available and accessible to the investor to make such legal procedure meaningful. In general, the legal procedure must be of a nature to grant an affected investor a reasonable chance within a reasonable time to claim its legitimate rights and have its claim heard."

2.2.6 Minimum standard of protection

The customary international law minimum standard of treatment of nationals from others states refers to all customary international law principles that protect the economic rights and interests of aliens.[61] It is clear that the minimum standard of treatment is a standard of customary international law, and, like other standards of customary international law, states have a common understanding of what legal obligations emanate from it. Derogation from this standard is not permitted. Further, it is submitted that, based on its definition, the minimum standard of treatment imposes more stringent requirements, as it encapsulates all other customary international law principles.

This view is fortified by a working paper of the Organisation for Economic Co-operation and Development (OECD),[62] where it is stated that the "international minimum standard of treatment is a norm of customary international law which governs the treatment of aliens by providing for a minimum set of principles which states, regardless of their domestic legislation and practises, must respect when dealing with foreign nationals and their property." In essence this working paper says that a state cannot hide behind its national legislation or domestic laws to deny the minimum standard of treatment to foreign investors. States have a legal obligation not to subject foreign investors and their property to a standard below the minimum standard of treatment required by

[60] *ACD v Hungary* ICSID Case ARB 103 116 Award (accessed 2 October 2006).

[61] Aspremont (n 58 above) 13.

[62] Organisation for Economic Co-operation and Development (OECD) 'Fair and Equitable Treatment Standard in International Investment Law' (2004) Directorate for Financial and Enterprise Affairs, Working Papers http://dx.doi.org/10.1787/675702255435 (accessed 4 February 2016).

customary international law. Put differently, it must not be a standard below the minimum standard of reasonableness.

It has been argued that the state is required under the principle to have reasonable measures in place to ensure protection of foreign investors' properties against threats which are specifically aimed at them or their property.[63] The state must show that it has exercised due diligence and taken all preventative measures to protect the property of the investors within its borders.[64] Surbedi argues that a state is also responsible if it fails to provide the national remedies for injuries suffered whether caused by a private person or the state.[65]

2.3 Overview of the South African's former investment regime

Before examining South Africa's regulatory power and Protection of Investment Act, it is important to briefly highlight how investment was regulated through the BITs it was a party to considering that some of them are still in force. As previously noted, before the conclusion of BITs, investment was regulated by customary international law which had fewer obligations than BITs. The obligations imposed by BITs are more stringent than those under the principles of customary international law.[66] The obligations included the requirement for the host state to submit to international investment arbitration disputes arising between a foreign investor and the host state or state to state dispute. The BITs provided greater protection to foreign investors.[67]

The standard of protection in BITs are found in the definition of investment, national treatment, most favoured nation status, expropriation, dispute resolution and transfer of funds. For the purpose of this discussion the United Kindgom and South African BIT will be used as an illustration of the standard of treatment of foreign investors found typically in BITs.

[63] Surbedi (n 39 above) 66.

[64] Surbedi (n 39 above) 77.

[65] n 39 above 78.

[66] A Jose 'A BIT on Custom, British institute of international and comparative law' (2009) www.biicl.org/files/5716_alvarez_06-05-11_biicl.pdf (accessed 23 March 2016).

[67] Peterson (n 10 above) 8.

2.3.1 Definition of investment

In the UK-SA BIT, investment is defined as every kind of asset and, in particular, though not exclusively, includes: (1) movable property and immovable property and any other property right such as mortgage, lien or pledges; (2) shares in and stock debentures of a company and any other form of participation in an company; (3) claims to money or to any performance under contract having financial value; (4) intellectual property right, good will, technical competences and know-how; and (5) business concessions conferred by law, or under contract, including concessions to search for, cultivate, extract or exploit natural resources. The definition concludes by stating that investment includes all investments whether made before and after the date of entry into force of this agreement.

This definition of investment is not subject to domestic laws. This takes away South Africa's regulatory power and means that investments are still protected even if they are against South African law. The definition is too wide, as it refers to *every kind of asset,* which is then followed by a non-exhaustive list of investments which include foreign direct investment, intellectual property rights, right to performance in terms of the contract having a financial value and right to money. The definition also includes business concessions that must be conferred by law to extract and exploit natural resources.

According to Sornarajah,[68] this means that business concessions to extract and exploit mineral resources cannot later be withdrawn without violation of the law and that means greater protection to foreign investors. The last part of the definition of investment has a retrospective effect on the application of the investment agreement. As previously noted, the first BIT was presented to the then outgoing government with the fear that the new South African government might expropriate the investments of the United Kingdom. Clearly the intention was to bring the new government to international investment arbitration in case of expropriation.

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[68] Sornarajah (n 1 above) 79.

2.3.2 Most Favoured Nation and National Treatment

The reason why foreign investors seek protection under the Most Favoured Nation (MFN) principle is to avoid discrimination against them as compared to investors of other countries. The main aim of the Most Favoured Nation principle is to ensure a conducive and equally competitive environment to investors and third countries.[69] For example, the National Treatment and MFN provision in the SA-Netherlands BIT provides that "each contracting party shall accord to such investments treatment which in any cases shall not be less favourable than that which it accords to investments of its own investors or to investments of investors of any third state whichever is more favourable to the investor concerned. In order to ascertain what is discrimination one has to make a comparison of the treatment of investors of the nationals and foreign investors that are similarly situated or are in the like circumstances.[70]

As discussed by Surbedi, the objective of the national treatment is to prohibit favourable treatment or discrimination of investors on the basis of nationality. The phrase 'like circumstances' is often the subject of much controversy. What are like circumstances and what are not like circumstances? This is often a matter of great controversy, but clearly only those investments in like circumstances will enjoy protection under the national treatment standard.[71] As discussed by Adam, in case of South Africa, affirmative action measures might be construed by foreign investors as a breach of the national treatment obligation found in the BITs, though such affirmative action arguably has significance for historically disadvantaged South Africans.[72]

2.3.3 Full protection and security

In terms of the UK-SA BIT, the nationals or companies of each contracting party shall at all times enjoy full protection and security in the territory of the other contracting party, and neither contracting party shall in any way impair by unreasonable or discriminatory measures the

[69] As above.

[70] Surbedi (n 39 above) 70.

[71] Surbedi (n 39 above) 98.

[72] Peterson (n 10 above) 15.

management, maintenance, use, enjoyment or disposal of investments in its territory of nationals or companies of the other contracting party.

This standard of full protection and security is unreasonable and unfair as it requires that *at all times* the full protection and security must be guaranteed. This makes the standard absolute and places a heavy burden on the host state. Each contracting party shall observe any obligations it may have entered into with regard to investments of natural or legal persons of the other contracting party. The full protection and security provision has been interpreted to mean that the host state must have exercised due diligence and taken all reasonable measures to protect the investments of the other party. The host state must prove that it has taken all reasonable precautions. The standard essentially applies when there has been civil strife and physical violence. However, according to Peterson, the full protection and security standard is not, in practice, absolute.[73]

In 2003, the first known international arbitration case against South Africa was initiated under the Swiss-RSA investment treaty.[74] During the apartheid period, a Swiss investor had acquired a private game lodge and farm in north-eastern South Africa. The investor made improvements to the property. However, the property was plagued by vandalism, theft and poaching. Following the alleged total destruction of the property in the late 1990s, the claimant took the South African government to international arbitration under treaty. The tribunal rendered an award and the South African Government was found to have breached its obligation to protect and secure the Swiss investor.

2.3.4 Fair and equitable treatment

The concept of fair and equitable treatment is highly rooted in customary international law principles and it is one of the most important principles in investment law. In neither case law nor literature is there a precise definition of what constitutes fair and equitable treatment spawning

[73] n 10 above, 15.

[74] L Peterson 'Swiss Investor prevailed in 2003 in confidential BIT arbitration over South Africa land dispute' http://www.iareporter.com/articles/swiss-investor-prevailed-in-2003-in-confidential-bit-arbitration-over-south-africa-land-dispute (accessed 16 August 2015).

great controversy and interest. The fair and equitable treatment standard has been the basis of most complaints against host governments by investors and the subject of many decisions by tribunals.[75] The UK-SA BIT states that "the investment of nationals or companies of each contracting party shall at all times be accorded fair and equitable treatment." As discussed by Reinisch, fair and equitable treatment is the most flexible standard, and its normative content is being constantly expanded to include new elements. Because of its flexibility, it is the most invoked standard in arbitration cases before tribunals.[76]

Surbedi argues that the problem with this principle is that it is often subject to multiple interpretations and is difficult to define in concrete terms. However, the principle provides the basic level of protection based on fairness and equity.[77] Under international law, the first case to deal with fair and equitable treatment is that of *Neer*,[78] where it was held that, for the treatment of aliens to constitute an international delinquency, it should amount to an outrage, to bad faith, to wilful neglect of duty or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would recognise its insufficiency.[79] Surbedi sums up fair and equitable treatment as being concerned mainly with the denial of justice in the criminal, civil and administrative justice of the host state.[80] It has been said that fair and equitable treatment in simple terms prohibits the host state from treating the foreign investors in a manner that falls short of international minimum standards that are accorded to all other foreign investors in the host state.[81]

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[75] Surbedi (n 39 above) 62.

[76] Reinisch (n 5 above) 40.

[77] Surbedi (n 39 above) 63.

[78] n 24 above.

[79] As above.

[80] n 39 above, 66.

[81] Langalanga (n 22 above) 11.

2.3.5 Prohibition against expropriation

The main reason why countries enter into BITs is to protect the investments of their natural or legal persons against expropriation by the host state.[82] As explained above, direct expropriation is quite rare and is defined as the outright seizure of an investment or the property of the foreign investor.[83] Indirect expropriation has been described by Reinisch as the slow and incremental infringement on one or more of the ownership rights of a foreign investor that diminishes the value of investment. The legal title to property remains vested in the foreign investor but the investor's right to use the property is diminished as a result of the interference by the host state.[84]

As explained by Adam, as a rule the South African BITs guarantee foreign investors that their investments cannot be expropriated without compensation. They prohibit nationalisation and government measures having an equivalent effect.[85] As noted by Schneiderman, the Canada-SA BIT places a much more onerous burden on the host state concerning the prohibition against nationalisation and expropriation than the text found in South Africa's constitution.[86]

2.3.6 Settlement of disputes between an investor and a host state

The UK-SA BIT requires that a dispute between an investor and the host state should be submitted to international arbitration at either the ICSID or the Court of Arbitration of the International Chamber of Commerce. It is indisputable that, in the UK-SA BIT, UK investors are placed in a better position than the South African investors in so far as it offers foreign investors the ability to avoid local courts, which is not an option open to the latter. [87]

Adam argues that the process provided under South Africa's BITs offers foreign investors and companies the ability to dispense with the South African judiciary and its legal system and to

[82] Langalanga (n 22 above) 10.

[83] As above.

[84] n 5 above 151.

[85] Quoted in Peterson (n 10 above) 22.

[86] As above.

[87] Peterson (n 10 above) 22.

request an international tribunal to resolve any investment dispute. International investment tribunals offer more advantages to foreign investors than domestic courts. First, the process of arbitration is not open to the public view.[88] The applicable law will be international law including investment treaties, and that means measures that may be consistent with the domestic legal order such as BEE and the host country's constitutional order may be subjected to high scrutiny by international tribunals. Moreover, in cases where there is conflict between the international law and domestic law, the former will prevail to the extent of inconsistency.[89]

2.3.7 Repatriation of funds

The main motivation for a foreign investor to choose a country for its investment and in seeking to do business in the host country is to make profits and distribute the said profits to the shareholders of the company in the home country or wherever they may be residing, hence the need to repatriate funds. The free transfer of funds is also critical for foreign investors for other purposes such as servicing an external loan, paying licence fees, purchasing raw materials and machinery for production and payment for other services. The repatriation of profits will be frustrated if prevented by the host country.[90]

The UK-SA BIT provides that "each contracting party shall in respect of its investment guarantee to nationals and companies of other contracting party the unrestricted transfer of their investments and returns." This provision makes it an absolute requirement to permit the transfer of investments or profits to the home country. According to Sornarajah, such an absolute obligation may be unrealistic, as there could be currency shortfalls in the host state resulting in restrictions on the transfer of investment or funds. He contends that such a provision is included in BITs as parties are complacent that such problems would not exist.[91]

[88] Quoted in Peterson (n 10 above) 22.

[89] Peterson (n 10 above).

[90] Reinisch (n 5 above) 152.

[91] n 1 above, 79.

2.4 Conclusion

It is safe to conclude that, even in the absence of BITs, foreign investors are still protected by customary international law principles and entitled to compensation by virtue of the application of customary international law principles. Although the scope and content of the conditions under which foreign investment may be expropriated is subject to much controversy, it is clear is that expropriation is permissible under customary international law. It is apparent from the discussion that the rule of the thumb is that, for expropriation to be lawful, it must be non- discriminatory and for a public purpose, due process must be followed, and the payment of compensation must be made.

As discussed in this chapter, developing countries have challenged and debated the binding nature of some principles of customary international law, resulting in customary international law principles losing their legitimacy and their universal application. However, an interesting trend is the conclusion of BITs and regional trade agreements with investment chapters. Because of this, BITs have been encroaching more into the domestic policy space of host states and requiring more favourable treatment to be granted to foreign investors. They fail to take into account the development objectives of host countries and their interests in attracting foreign investment.

As seen from the case of South Africa, BITs pose several risks to host states, including the possibility of being taken to international arbitration for perceived breaches of obligations under them. They undermine the sovereign right of countries to take measures to achieve specific goals which may be socially and politically necessary, as in the case of South Africa seeking to address the situation of historically disadvantaged South Africans. It is important for investment agreements to strike a careful balance between the rights of foreign investors and the right of host states to regulate in the national interest. An agreement which results in a win-win for investors and host countries would be optimal and facilitate greater inflows of foreign investment.

host countries would be optimal and facilitate greater inflows of foreign investment.

Chapter 3 Nature of Regulatory Power of the Host State and Protection Of Foreign Investment in South Africa

3.1 Introduction

This chapter explains the regulatory power of host state (South Africa) under international investment law, the evolution of the South African investment regime and the rationale for the termination of BITs. Particular focus will be given to Section 25 of the South African Constitution[92] and the conflict that exists between the host state regulatory power and the BITs to which South Africa is a party. The purpose of this chapter is to make a claim that has been made by international authorities that international law has failed to provide guidance on what measures constitute indirect expropriation. This chapter argues that South Africa should clearly delineate the scope of its regulatory power if it is to remain attractive to foreign investors and not be seen as indirectly expropriating foreign investors' properties through the operation of its historical mandate to address imbalances of the past.

As previously noted, expropriation has long been recognised under customary international law as long the following conditions are satisfied: (i) it is for public purpose; (ii) there is no discrimination (iii); due process is followed; and (iv) there is provision of prompt, adequate and effective compensation to investors.[93] It has not been easy to determine whether a government measure is for a legitimate public purpose. It is a fundamental principle of international law to respect the private property of foreign investors.[94] This chapter posits that the private property of foreign investors should be protected against indirect expropriation when the state exercises its regulatory power.

[92] The Constitution of the Republic of South Africa Act 108 of 1996.

[93] Nicholson (n 27 above) 8.

[94] As above.

The forceful taking of the property of the foreign investors is easily identified as direct expropriation[95]. Put differently, it is an open and deliberate government action to seize outright the property of foreign investors. The focus of this chapter will be on indirect investment as it is not clearly identified under the law or in the literature.

3.2 Host state's right to regulatory power

Regulatory power is the ability of the host state to adopt policies and laws to achieve a variety of policy objectives.[96] The right to regulate denotes the legal right exceptionally permitting the host state to regulate in derogation of international commitments it has undertaken by means of an investment agreement without incurring a duty to compensate. The right of the state to control foreign investment within its territory is firmly recognised under customary international law. It stems from the sovereign right of a state and permanent sovereignty of the state over its natural resources. [97] The principle of permanent sovereignty means that host countries are responsible for economic intervention and regulation of their economies.[98]

The sovereignty of a state is subject to international law.[99] The right to regulate signifies the freedom to engage in political, economic, legislative and other activities as the state deems necessary. The legal approaches to the treatment of foreign direct investment is largely dependent on the national interest, its history and the developmental goals of each individual country[100]. Sornarajah argues that, given that foreign investment takes place within a host state, it is the prerogative of that host state to control the investment as it pleases and foreign investors have to

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[95] AP Newcombe 'Regulatory Expropriation, Investment Protection and International law : when is government regulation expropriatory and when should compensation be paid ?' Unpublished ML thesis, University of Toronto, 1999 http://www.italaw.com/documents/RegulatoryExpropriation.pdf (accessed:23 march 2016).

[96] P Ranjan 'India's international investment agreements and India's regulatory power as the host nation' Unpublished PhD thesis, Kings College, London, 2012 https://kclpure.kcl.ac.uk/portal/en/theses/indias-international-investment-agreements-and-indias-regulatory-power-as-a-host-nation(87c1da95-433a-4b84-b652-48b645837dee).html (accessed 14 February 2016).

[97] Langalanga (n 22 above) 9.

[98] OG Bolivar 'Sovereignty v. investment protection: back to Calvo?' (2009) http://icsidreview.oxfordjournals.org/content/24/2/464.extract (accessed 21 January 2016).

[99] Klager (n 48 above) 155.

[100] Klager (n 48 above) 155.

operate within the framework of the host state regulatory power.[101] It has been argued that the host state has a right to regulate as long as the exercise of the state's regulatory power is within the confines of the law, and that foreign investors by investing in the host state assume the risk of having their investment subjected to the regulatory burden of the host state.[102] Each country has its own approach to the regulation of foreign investments depending on its history.[103] The trend is that developing countries tend to proclaim sovereignty over their natural resources in order to gain control over them and reduce dependency on foreign enterprises.[104] However, when a state signs a BIT and other international investment agreements, it arguably agrees to surrender part of its sovereignty.[105]

3.3 Conflict between international protection of investments and host state regulatory power

It has been argued that a clear conflict exists between the protection of investment and the regulatory power of the state. Some states tend to deny the existence of expropriation by resorting to regulatory measures in order to absolve themselves from the obligation to pay compensation as a consequence of expropriation.[106] The controversy is further aggravated by the fact that states seem to expropriate not because of some emergency situation, but because of nationalistic feelings. Through these actions, incalculable damage is done to the property of the foreign investor or the investor's ability to make profits is severely affected and sometimes completely obstructed.[107] However, constraining state sovereignty severely would compromise the ability of the state to

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[101] n 1 above 115.

[102] Klager (n 48 above) 166.

[103] As above.

[104] Klager (n 48 above)155.

[105] Reinisch (n 5 above) 115.

[106] N Al-Adba 'The limitation of state sovereignty in Hosting foreign investments And the role of investor-state Arbitration to rebalance The Investment Relationship' Unpublished PhD thesis, University of Manchester, 2014 https://www.escholar.manchester.ac.uk/uk-ac-man-scw:227876(accessed 20 April 2016) .

[107] Al-Adba (n 106 above).

regulate for the public benefit.[108] There is no denying that, in terms of both doctrine and arbitral decisions rendered to date, a state regulation can give rise to indirect expropriation.[109]

Historically, resistance to expanded rights of foreign investors has come from developing countries. There has been the fear of exploitation of multinational corporations supported by their governments.[110] The interests of the parties do not always coincide. Whereas foreign investors are interested in profit-making and market extension, the state usually sees foreign investment as an opportunity to boost its economy, create jobs and enhance the living standards of its people. The state also has an interest in exercising its sovereignty within its borders including regulating the business activities of investors.[111] As explained above, the right to regulate is an inalienable right of the host state arising from the exercise of its sovereignty within its borders.[112] Mosssalam suggests that BITs fail to address the balance of interests by offering solid legal protection to foreign investors without imposing corresponding responsibilities on them.[113]

The consequence of too much protection for foreign investors and the neglect of development goals by BITs is that foreign investors and their investments may intrude upon the domestic interest and marginalise local investors, despite their potential to boost the economy and build the needed infrastructure for the host state.[114] The formulation and application of BITs reflect the political and economic imbalances of the parties involved.[115] The best example which illustrates the conflict between BITs and a host state's right to regulate is when a foreign investor challenged South Africa's Minerals and Petroleum Resources Development Act (MPRDA) on the ground that it amounted to indirect expropriation, even though the legislation was in conformity with the constitution of the country aimed at addressing the imbalances of the past and thereby empowering

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[108] Reinisch (n 5 above) 153.

[109] As above.

[110] As above.

[111] As above

[112] As above.

[113] Mossalam(n7 above)

[114] L Trackman 'Foreign direct investment hazard or opportunity?' (2009-2010) 14 *George Washington lnternational Law Review* 12.

[115] Trackman(n 114 above) 13

black people to take part in the mining sector.[116] In a number of arbitral decisions, the actions of the South African Government have been found to be in conflict with BITs to which it was a party. Notwithstanding the severe economic crisis which has gripped Argentina for the past two decades, it was held it could not suspend its treaty obligations.[117]

There have been concerns about the mandate of international investment tribunals and uncertainty in the interpretation of the provisions of BITs.[118] The best illustrative example of interpretative uncertainty is *Occidental Exploration v Republic of Ecuador*,[119] where "the concept of like circumstances" in the national treatment principle was interpreted broadly to cover exporters of products other than oil which was the subject of the dispute. It would have seemed logical to compare a foreign company engaged in the oil business with a domestic oil company rather than all exporters including flower exporters.

The fair and equitable treatment in BITs has been the subject of many disputes between foreign investors and host states. This concept is very elastic and has been interpreted differently by arbitrators. Given the indeterminacy of the fair and equitable standard, it cannot constitute a legal norm because it fails to give clear guidance on which conduct is prohibited.[120] Confidence in the international arbitration system is also low because of the perception of conflict of interest. Arbitrators sometimes act as counsels before international investment tribunals. The absence of an appellate mechanism to review decisions of arbitrators has also contributed to the lack of

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[116] *Foresti* (n 36 above) award 36.

[117] Organisation for Economic Co-operation and Development (OECD) 'Essential security interests under international investment law' (2002) https://www.oecd.org/**investment**/international**investmentagreement**s/40243411.pdf (accessed 23 March 2016).

[118] 'Public Statement on International Investment Regime' http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/ (accessed 22 January 2016)

[119] *Occidental Exploration v. Republic of Ecuador* LCIA Case N3462, 1 July 2014.

[120] United Nations Conference on Trade and Development (UNCTAD) 'Fair and Equitable Treatment' UNCTAD Series on Issues in International Investment Agreements II http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf (accessed 22 February 2016) 134.

confidence in the current system. It is against this background that there have been suggestions for the creation of an international investment court.[121]

3.4 Right to regulate and indirect expropriation

As previously noted, the right to regulate is an inalienable right which comes with the sovereignty of a state. The issue which needs to be considered is whether a government regulatory measure could amount to an indirect expropriation and therefore be unlawful either under customary international law or a BIT.[122] While some states would insist that there should not be any restriction on the exercise of their regulatory powers, this may not be upheld by international tribunals if they are convinced that the essential requirements were not fulfilled by the host state that had expropriated the property of a foreign investor.[123] In this context, Sornarajah's view[124] that when a foreign investor enters another country for investment it places itself under the regulatory framework of the host country is debateable. It is submitted that, while a foreign investor is subject to all legitimate laws and regulations of the host state, it cannot be assumed that it consents to abuse by a host state of its regulatory powers.

In *Saluka investments B.V.v The Czech Republic* [125], the tribunal noted that international law has yet to identify in a comprehensively and definitive fashion precisely what regulations are permissible as falling within a state's regulatory power. Surbedi contends that the major challenge here is to distinguish between a legitimate exercise of governmental discretion that interferes with the enjoyment of foreign-owned property and a regulatory taking that amounts to expropriation requiring compensation.[126] However, Surbedi maintains that a measure must be discriminatory in order for such a measure to constitute a regulatory expropriation. The test is that foreign investors and national investors should be engaged in the same business under the same circumstances in

[121] C Rogers 'The Politics of International investment Arbitrators' http://law.scu.edu/wp-content/uploads/investment/Rogers-The-Politics-of-International-Investment-Arbitrators-Santa-Clara2.pdf (accessed 21 March 2016).

[122] Reinisch (n 5 above) 155.

[123] As above.

[124] n 1 above, 45.

[125] *Saluka investments(* n52 above).

[126] Surbedi (n 39 above) 64.

order for discrimination to exist.[127] Uncertainty is not eliminated by the operation of law of a particular country because the regulation is not universally shared but depends on the scope of the regulatory power of that particular government.[128] Expropriation should also not be based on the grounds of belonging to a certain nationality, ethnicity or on racial grounds, as this would be considered discriminatory. [129]

There can be no doubt that a measure may be for a legitimate government purpose, but the issue is whether such a measure amounts to expropriation in the international law context.[130] It is generally accepted that a state can exercise its right to sovereignty and regulate for the public interest, but what is contentious is the extent to which a country can regulate and what amounts to justifiable regulation for the public benefit in a host state without indirectly expropriating a foreign investor's property.[131] The core issue is the scope of the regulatory power of the host state.

Higgins argues that compensation is generally not payable for regulatory measures that substantially decrease the value of the property, provided the right to use, enjoy, manage and control property are left substantially intact.[132] Under international law, the host must have substantially interfered with the private property of an investor to justify expropriation. Indirect expropriation occurs when the regulation has an effect of depriving an asset of its economic value.

The criteria to be used to determine what could amount to an uncompensated expropriation was clearly stated in the *Saluka* case,[133] where it was held that "an uncompensated taking of the sort referred to shall not be considered unlawful provided that: (a) it is not a clear and violation of the law of the state concerned; (b) it is not an unreasonable departure from the principles of justice recognised by the principal legal systems of the world; (c) it is not an abuse of powers for the purpose of depriving an alien of his property. The purpose of these exceptions is not to weaken the

[127] Surbedi (n 39 above) 67.

[128] As above.

[129] As above.

[130] Sornarajah (n 1 above) 115.

[131] Surbedi (n 39 above) 66.

[132] As above.

[133] *Saluka* (n 126 above), Award13.

principle of an uncompensated expropriation but they serve as a reminder to the legislator or arbitrator that the exercise of power by the host state is not absolute.[134] It is submitted that without these exceptions the host state could abuse its regulatory power.

The host state can abuse its regulatory power when it exercises its right in a manner that would prevent another state from exercising its rights. The focus is on the intended purpose of the right rather than only the existence of the right.[135] OECD has stated that there must be clear and convincing evidence, as well as serious consequences in order to establish the abuse of rights.[136] In terms of international Human Rights law, no person may be deprived of his or her property in an arbitrary manner. The Universal Declaration of Human Rights of 1948 states that: (i) everyone has a right to own property alone as well as in association with others; (ii) no one shall be arbitrarily deprived of his property. An arbitrary action is: (i) an action by the government which is not authorised by law; (ii) it is an action that has been taken for an improper purpose; (iii) for irrelevant circumstances; and (iv) the action must be clearly unreasonable.[137] Reinisch argues that, in order to be able to convince arbitrators that the government measure in question is indeed arbitrary or unreasonable, the claimant must demonstrate it to be 'shocking' or at least 'surprising' without the respondent being able to rebut this effect. He also argues that arbitrariness is a wilful disregard of due process of law, an act which shocks or surprises a sense of judicial propriety.[138] An unreasonable measure would be a measure that would discriminate based on the investor's skin colour or racial background. It has also been argued that, contrary to some suggestions in terms of the modern law of investment, there is no general exception to the rule that any measure that has the expropriatory effect must be compensated. This was clearly seen in a case dealing with

[134] As above.

[135] OECD (n 117 above) 77.

[136] As above.

[137] Office of the High Commission for Human Rights (OHCHR) 'The Core International Human Rights Treaties' (2006) http://www.ohchr.org/Documents/Publications/CoreInternationalHumanRightsTreaties_en.pdf (accessed 23 march 2016)

[138] Reinisch (n 5 above) 59

environmental measures, where it was held that no matter how beneficial and laudable a measure may be in the society, the responsibility to pay compensation remains.[139]

3.5 Right to regulate and the South African approach to investment

The right to regulate assumes more significance in a country like South Africa given the apartheid policies pursued by the previous government. Discrimination on the basis of racial background was the norm. To redress the historical imbalances, the current Government has been urged to do more as far as land is concerned. It is felt that the current 'willing seller, willing buyer approach' is not very effective and that radical measures are needed to ensure equitable distribution of land. With such calls coupled with the decision to terminate its BITs and the passing of a highly controversial investment legislation, [140] it is understandable that foreign investors are worried. There is concern that their investments would be subject to indirect expropriation under the guise of the exercise of regulatory power to address the historical imbalances and achieve the developmental goals of the new government.[141] The notion of public purpose has not been subject to much scrutiny, as the assumption is that every host state or government activity is for public purpose, leaving the concept of public purpose vulnerable to abuse.

The regulatory power of South Africa like any other country is informed by its unique history and its fundamental policies that are aimed at addressing the historical imbalances. During the apartheid era, South African businesses were isolated and could not be internationalised. South Africa was under sanctions in this period and many investors divested their holdings in the country with the exception of a few industries such as textiles and clothing and automobile industries.[142] The sanctions affected the financial services industry as well as trade in general. In the mid1980s, the country was effectively cut off from international markets.[143] In the 1990s, there was broad

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[139] As above.

[140] Protection of Investment Act (n 19 above).

[141] Langalanga (n 22 above) 1.

[142] As above.

[143] A Arvanitis, 'Foreign Direct Investment in South Africa: Why Has It Been So Low?' https://www.imf.org/external/pubs/nft/2006/**soafrica**/eng/pasoafr/sach5.pdf (accessed 23 March 2016).

support for the "Washington consensus" [144] and most countries were eager to attract foreign investment. A significant number of BITs were signed in this period with due protection clauses for properties of foreign investors.[145] The need to ensure protection of foreign investments was guaranteed through a number of provisions, including those permitting investors to submit disputes to international arbitration under the auspices of ICSID or other arbitration institutions.

As consequence, FDI began to expand exponentially in the early 1990s. Host countries benefitted from foreign investment through the transfer of skills, know-how and technology. Developing countries were able to get access to regional and global markets through being affiliates of foreign investors or entering into joint ventures with multinational enterprises.[146] South Africa, like many developing countries, particularly African countries, had to depend heavily on foreign direct investment for its economic growth due to the lack of technical know-how and limited capital formation.[147] As previously noted, the Government of South Africa in its South Africa's Growth, Employment and Redistribution Strategy of 1996 and other official documents has long recognised the importance of foreign direct investment as a driver for economic growth[148]. It has been argued by some commentators that FDI does not guarantee economic growth in developing countries. However, the preponderance of views seems to indicate that FDI, depending on how it is regulated, the manner of its use and the particular circumstances of the host country, can promote growth.[149]

The quest for foreign direct investment and the need to integrate South Africa into global markets in the early 1990s led South Africa into signing several BITs. These BITs made no mention of equitable access to the country's natural resources or the need for land reform. The protection afforded to foreign investors under the BITs superseded every form of protection under domestic

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[144] Sornarajah (n 1 above) 49.

[145] Sornarajah (n 1 above) 50.

[146] X Sun 'Foreign Direct Investment and Economic Development: What Do the States Need To Do?' (2002) Prepared by the Foreign Investment Advisory Service for the Capacity Development Workshops and Global Forum on Reinventing Government on Globalization, Role of the State and Enabling Environment http://unpan1.un.org/intradoc/groups/public/documents/UN/UNPAN006348.pdf (accessed 22 March 2016).

[147] Mosallam (n 7 above) 1.

[148] As above.

[149]Organisation for Economic Co-operation and Development (OECD) 'Foreign Direct Investment for Development' (2002) https://www.oecd.org/investment/investmentfordevelopment/1959815.pdf (accessed 24 March 2016).

law. These were backed by an investor-state dispute settlement system which allowed foreign investors to initiate disputes before international arbitral tribunals. Most importantly, the BITs contained provisions to discourage expropriation. [150] As noted by Peterson, "as these treaties are seen to reach well behind the border and apply to sensitive economic sectors and government measures, there is a need for governments to scrutinise their treaties so as to ensure that they provide adequate safeguard for the exercise of legitimate government purpose. In many instances the treaties appear to have been drafted with insufficient forethought and without many safeguards, exceptions and limitations."[151] This is indeed the case with South Africa, when it started signing BITs.

South Africa signed its first BIT with the United Kingdom and later with EU countries without appreciating the constraints that these would have on the power of the state to regulate for the public benefit.[152] As previously mentioned, the BITs made no mention of equitable distribution of wealth in South Africa. Article 5 of the UK- SA BIT dealing with expropriation provides as follows: "Investment of a national or companies of either party, shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation in the territory of contracting party except for public purpose relating to the internal needs of that party on a non- discriminatory basis against prompt, adequate and effective compensation. Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or the impending expropriation became public knowledge whichever is the earlier shall be made without delay, be effectively realisable and be freely transferable"[153]

[150] L Peterson & R Garland 'Bilateral investment treaties and land reform in South Africa' (2010) Rights & Democracy http://www.peacepalacelibrary.nl/ebooks/files/334103282.pdf (accessed 25 March 2016).

[151] L Peterson 'South African's Bilateral investment treaties, implications for development and human rights' (2006) Dialog on Globalization Occasional Papers 26 http://www.saiia.org.za/images/upload/Peterson%202006%20-%20SA%20BITS%20and%20human%20rights.pdf (accessed 24 March 2016).

[152] P Leon 'Creeping expropriation: an African perspective' (Year of Publication) Volume/Issue *Journal of Energy and Natural Resources Law* http://www.polity.org.za/article/creeping-expropriation-of-mining-investments-an-african-perspective-2009-11-19 (accessed 24 March 2016).

[153] South Africa – United Kingdom Bilateral Investment Treaty http://investmentpolicyhub.unctad.org/Download/TreatyFile/2280 (accessed 24 March 2016).

3.5.1 Black Economic Empowerment policy and regulatory expropriation

Black economic empowerment (BEE) has been defined as an initiative that is driven by the need to deracialise the mainstream economy by providing black people with an opportunity to own and manage economic resources.[154] The purpose of BEE is to create equal exposure by both black and white races; it is to deracialise the economy and to address the imbalances of the past, to redress the economic legacy of apartheid, increase black ownership in priority sectors such as mining and the economy in general, to increase the number of black people in executive and senior management and increase ownership of land and productive assets by black people.[155] BEE has been severely criticised for hindering foreign direct investment and bringing back the issue of race by encouraging the re-racialisation of the political economy. It is credited for promoting the growth of a small but politically connected 'empowerment' elite.[156]

The significance of BEE lies in the history of South Africa as a country. Although apartheid has been abolished, its effects continue to linger on. South Africa has the most unequal income distribution in the world, primarily because of the apartheid system. Race and colour still determine the economic and social structure of the society. [157] Apartheid resulted in extreme oppression in which basic human rights of a certain class of people were denied. Black entrepreneurs were denied economic opportunities and managerial skills were granted mostly to white people. Apartheid has been described as the institutional disempowerment of black people.[158]

There have been significant efforts to transform the legacy of apartheid in South Africa through BEE measures. This has been done through sector-specific measures, affirmative action measures

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[154] 'Black Economic Empowerment' https://www.nelsonmandela.org/omalley/cis/omalley/OMalleyWeb/03lv03445/04lv04206/05lv04220/06lv04221/07lv04222.htm (accessed 21 March 2016).

[155] As above.

[156] As above.

[157] CT Malakwane 'Economic and Social Effects of Unemployment in South Africa' Unpublished MT thesis, Tshwane University of Technology, 2012 http://www.kga.org.za/wp/wp-content/uploads/2016/01/Economic-and-social-effects-of-unemployment-in-south-africa.pdf (accessed 24 March 2016).

[158] Black Economic Empowerment Commission, Report https://www.westerncape.gov.za/text/2004/5/beecomreport.pdf (accessed 25 March 2016).

and preferences on procurements.[159] It is submitted that while they may be justified taking into account the legacy of apartheid, BEE measures are discriminatory as they are based on racial preferences. This preference is clearly evident in the MPDRA[160] dealing with the transformation of the mineral industry. Section 100 of the MPDRA states that, "to ensure the attainment of Government objectives of redressing historical, social and economic inequalities as stated in the constitution, the minister must within six months from the date from which this Act takes effect develop a broad based social economic charter that will set the framework targets and time table for effecting the entry of historically disadvantaged South Africans into the mining industry and allow such South Africans to benefit from the exploitation of mining and mineral resources."[161]

In order for a measure to amount to regulatory expropriation, it must be discriminatory. Under the BEE policy, preference is given to black people and therefore it is discriminatory. The confiscation of property on racial grounds has been deemed to be inconsistent with international law.[162] It has been stated that such discrimination is based on an unreasonable distinction.[163] As has been noted,[164] the fact remains that BEE falls within the regulatory power of South Africa and its underlying reason is not universally shared. As such, it cannot be considered as a derogation from international law principles. The issue is whether the legitimate exercise by South Africa of its regulatory power amounts to confiscation of property. Put differently, is the BEE policy within the ambit of justifiable and reasonable discrimination from a foreign investor's perspective? There is a clear and direct conflict of interest between what international law would require and the BEE policy.

Peterson and Garland discuss the fact that, from the early stages, there were complaints surrounding certain aspects of the BEE policy. The view of foreign investors was that certain

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[159] 'South Africa's Economic Transformation: A Strategy for Broad-Based Black Economic Empowerment' https://www.thedti.gov.za/economic_empowerment/**bee**-strategy.pdf (accessed 23 March 2016).

[160] Minerals and Petroleum Resources Development Act (MPRDA) 28 of 2002.

[161] MPRDA (n 161 above) sect 100.

[162] Peterson (n 10 above) 6.

[163] CH Schreuer 'Protection against arbitrary or discriminatory measures'(2007)17.

[164] Langanga (n 22 above) 8.

provisions of the BEE may run counter to South Africa's obligations under its BITs.[165] The Mineral and Petroleum MPRDA converts existing mining rights into "new order'' mining rights. The main criticism of the MPRDA is the directive to transfer mining assets to black ownership. Under MPRDA, 26% of mining assets are to be transferred to black owners over the next decade.[166] The *Foresti* case arose because of this provision. Peterson mentions that, outside the mining realm, BEE measures, including employment equity, mandatory divestments, and other policy tools, may give rise to threats of international law suits under existing BITs.[167]

3.5.2 Investment protection and regulatory power of the state in the Foresti case

In 2004, South Africa enacted legislation aimed at furthering the objectives of the Black Economic Empowerment (BEE) scheme in the mineral and petroleum resources sectors, but the legislation was not well received by foreign investors.[168] The objections related to the requirements of the BEE policy, particularly as regards the issuance of shares to historically disadvantaged South Africans (HDSAs). All mineral rights were to be under the custodian of the state.[169] Investors were to be licensed only when they met certain criteria, including commitment to uphold the BEE policy. Some Italian investors were dissatisfied with the requirements of the new legislation. The view of the Italian Government was that the MPRDA had "a significant and deleterious effect on Italian investors' investments in the South African mining industry." Italy warned that the Act "might produce a breach" of the Italy-South Africa BIT.[170] In particular, Italy warned that the Act's "social upliftment objectives" and its preference of ownership by HDSAs could be deemed breaches of "just and fair" and non-discriminatory treatment for Italian nationals." They protested mainly because the legislation would have impacted significantly on their stone industry.[171]

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165 Peterson & Garland(n 151 above)1.

166 As above.

167 As above.

168 Leon (n153 above) 8.

169 As above.

170 Peterson & Garland (n 151 above) 7.

171 As above.

As previously noted, the best example to illustrate the conflict between investment protection and the right of a host state power to regulate is the case of *Piero Foresti, Laura de Carli & others v The Republic of South Africa.*[172] The South African Government had concluded a mining charter following talks with the South African National Union of Mine Workers and the South African Mineral Development Association. The intention was that historically disadvantaged South Africans would have greater ownership of the country's mining assets. They had to be given 26% ownership of the mining assets by 2014 and 40% of managerial positions by 2009. The relevant stakeholders would meet after five years to discuss steps to be taken to achieve these targets.

The concept of expropriation found application in this case. South Africa had entered into BITs with Luxembourg and Italy which gave protection to foreign investors against (i) direct expropriation; (ii) indirect expropriation; (iii) measures having an effect equivalent to expropriation; and (iv) measures limiting, whether permanently or temporarily, investor's rights of ownership, possession, control or enjoyment of the investment. The claimants also argued that for an expropriation to be lawful certain conditions must be fulfilled as found in both BITs: (1) the expropriation must be for public purpose or in the national interest; (2) it must be a non-discriminatory expropriation; (3) it must be subject to 'Immediate, full and effective compensation or prompt, adequate and effective compensation; and (4) the expropriation must be undertaken under due process of law.

The claimant argued that there had been an expropriation of their shares in the company through the operation of the BEE equity divestiture programme given effect by the mining charter and MPRDA. The claimants argued that the requirement that they cede 26% of the shares to the historically disadvantaged people amounted to a direct or indirect expropriation of the shares belonging to the foreign investors. They further alleged that the expropriation was unlawful on the following grounds: (i)failure to pay compensation; (ii) lack of due process; and (iii) discrimination.

[172] *Foresti* (n 36 above) 17.

3.6 Approach to balancing the conflicting interests between the protection of investors and the host state regulatory power

3.6.1 Sole effect doctrine

In the sole effect doctrine, the focus is solely on the "effect'' of the regulatory measure on foreign investment when determining indirect expropriation. Many tribunals have followed the sole effect doctrine, which is seen as favoring the right of a host state to regulate.[173] If the effect of a measure should reach a certain threshold, a finding of expropriation is inevitable. A threshold is reached when the property of the foreign investor is rendered valueless by a governmental measure.[174]

3.6.2 The purpose interest

International tribunals go beyond traditional private commercial interests only when deciding cases of expropriation, but take the right to regulate into consideration as something inherent in the sovereignty of states.[175] The test looks into the purpose of the measure but the question is:[176] what is the required extent of interference with a foreign investor's property for the interference to amount to indirect expropriation?

3.6.3 Proportionality test

This test requires that there must be a reasonable relationship between the weight imposed on the foreign investor and the aim sought to be achieved by the regulation.[177] The test will weigh and balance purpose with effect, and hence arguably appears attractive to solve the conundrum between expropriation and regulation. It has been argued that the proportionality test helps to

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[173] B Mostafa 'The sole effects doctrine: police powers and indirect expropriation under international law' (2008) 12 *Australian International Law Journal* http://www.austlii.edu.au/au/journals/AUIntLawJl/2008/12.pdf (accessed 21 May 2016).

[174] Mostafa(n 173 above) 13.

[175] *Campell* (n 35 above)12.

[176] Mostafa (n 173 above)13.

[177] OECD (n 149 above) 13.

achieve the balance between the right of the investor in the affected property and the public interest.[178]

3.7 Rationale for the introduction of the new investment regime in South Africa

FDI has played a considerable role in the economy of South Africa. Despite South Africa's rich natural resources, FDI inflows have remained relatively low compared to other emerging economies.[179] The decision to conclude BITs was motivated by the desire of the Government to attract FDI into the critical sectors of its economy. It is therefore ironic that South Africa has started to terminate some of its BITs with some European countries.[180] It would appear that instead of its foreign investment regime being regulated by BITs, it wants domestic laws to take on such a role.[181]

Regulation of FDI is a much debated area of the law mainly because it touches on subjects of significant importance such as economic growth and national sovereignty.[182] It has been suggested that this debate is fueled by the absence of a multilateral investment agreement on investment. In the intervening period, there have been a number of investment disputes involving developing countries.[183] Like many developing economies, FDI is important for South Africa's economic growth especially in areas where there are shortages of entrepreneurial skills, effective management skills, transfer of technology and job creation. Notwithstanding the clear benefits of FDI, the South African Government has taken the decision that its BITs have not assisted the developmental goals of the country.[184]

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[178] As above.

[179] Arvanitis (n 144 above) 11.

[180] Mosallam (n 7 above)1.

[181] As above.

[182] World Trade Organization (WTO) News 'Trade and Foreign Direct Investment' 9 October 1996 https://www.wto.org/english/news_e/pres96_e/pr057_e.htm (accessed 29 May 2016).

[183] Mossallam (n 7 above) 1.

[184] W Tang 'China and Africa: Expanding Ties in an Evolving Global Context' Investing in Africa Forum, March 2015 http://www.worldbank.org/content/dam/Worldbank/Event/Africa/Investing%20in%20Africa%20Forum/2015/invest

BITs tend to focus on issues such as expropriation, compensation and repatriation of profits. No explicit clear reference is made to the transformation agenda and empowerment policies such as BEE all of which are clearly stated in the Constitution of the Republic of South Africa.[185] These policies were designed to address the imbalances of the past and to provide preferential treatment to black employees and business owners. Effective implementation of these policies will fall foul of the provisions in BITs, hence the decision by the South African Government to terminate the BITs to which it is a party.[186]

On the other hand, BITs enhance the confidence of foreign investors and encourage them to invest in countries such as South Africa. Their termination by the South African Government coupled with the new Investment Act might dissuade foreign investors from investing in the country.[187] The reaction of many developing countries has been to develop their own BIT templates which take into account the development goals of the countries involved.[188] In addition, studies have shown that there is no concrete evidence to suggest that signing of BITs guarantees the increase of FDI inflows.[189] The question that remains unanswered is: what is the position of South African firms that have investments outside of the country, particularly in other African countries? Currently, there is no evidence or cases where South Africa has invoked provisions in a BIT against other countries, but it has been suggested that it would be necessary for them to have recourse to the investor-state mechanism available in the BITs, where appropriate.[190]

ing-in-africa-forum-china-and-africa-expanding-economic-ties-in-an-evolving-global-context.pdf (accessed 23 March 2016).

[185] Mosallam (n 7 above) 1.

[186] Langanga (n 22 above) 2.

[187] Peterson & Garland (n 151 above) 6.

[188] The United States and Canada have negotiated the templates.

[189] E Neumayer & L Spess 'Do bilateral investment treaties increase foreign direct investment to developing countries?' (2005) 33(10) *World Development http://eprints.lse.ac.uk/627/1/World_Dev_(BITs).pdf* (accessed 23 March 2016).

[190] N Joubert 'New Protection of Investment Act - The implications for foreign investors' 2016 http://www.caveatlegal.com/new-protection-of-investment-act-the-implications-for-foreign.(accessed 29 April 2016).

3.8 Conclusion

In conclusion, this chapter has explained the significance of the customary international law principle of sovereignty and the need for the host country to exercise its prerogative within its territory by virtue of sovereignty. Particular emphasis is placed on the host country to act within the parameters of the law when exercising its sovereignty. It has shown the difficulty in distinguishing legitimate government exercise of its regulatory power and the concept of indirect expropriation. Moreover, it has discussed the need for South Africa to pursue its BEE measures in a manner that does not amount to a substantial interference with foreign investments. Proportionality has been suggested as a test to be used to achieve the balance between the host state regulatory power and the need to respect foreign investors' property. Lastly, it argues that the reason for termination of BITs is clearly that they are unconstitutional and reflect a deep imbalance between the protection of investment and the right of the host state to regulate for public benefit.

Chapter 4 Key Provisions for Protection of Foreign Investors in The Protection Of Investment Act 22 of 2015

4.1 The Protection of Investment Act

4.1.1 Introduction

The Investment Act will come into force on a date determined by the President pursuant to a proclamation in the Government gazette. The Act represents a significant change in South Africa's investment regime. This change was necessitated by the challenge of the Black Economic Empowerment (BEE) policy in the *Foresti* case as discussed above.[191] In response to the ruling in that case, the Department of Trade and Industry in 2010 indicated its intention to codify its BITs into a single piece of legislation and review the BITs to which South Africa was a party.[192]

The decision to terminate the BITs was not well received by European countries such as Belgium, Denmark, Luxembourg, Switzerland, Spain and Netherlands which have substantial investments in South Africa. They were not consulted by South Africa before the decision was taken by the government, whose view is that BITs and international arbitration pose a serious risk to its legitimate and sovereign right to regulate for the public benefit and undermines the country's constitution.[193]

The main attraction of BITs to investors is the fact that there is international investment arbitration under the auspices of the World Bank and other arbitration bodies outside the jurisdiction of domestic courts. Moreover, the arbitrators tend to be experts in investment disputes, whereas there is no guarantee of the level of expertise at the domestic level. It is recalled that efforts to negotiate a multilateral investment framework failed due to different interests and opposing standards on

[191] n 36 above, 18.

[192] Department of Trade and Industry (DTI) 'The promotion and protection of investment bill' https://www.thedti.gov.za/gazzettes/Promotion_Protection_Investment_Bill.pdf (accessed 21 March 2016).

[193] Joubert (n 191 above) 9.

how foreign investors should be treated.[194] The new Protection of Investment Act confirms the investor's right to use any available legal avenue in the South African legal system to enforce its rights and only access state-state international arbitration after the exhaustion of local remedies.[195]

The South African government has responded to criticisms of the new Investment Act that it would offer less protection to foreign investors as it does not include provisions such as fair and equitable treatment, indirect expropriation and investor-state dispute settlement system by stating that its actions are consistent with the global trends.[196] It has also stated that BITs unduly limit a host state's regulatory power and could potentially subject it to multi-million rands' claim before international tribunals. It further states that, when read together with customary international law principles, the Investment Act provides adequate protection to foreign investors.[197]

4.1.2 Definition of investment

According to Section 2(a) of the Act,[198] investment means 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 profits. This definition subjects foreign investment to the laws of South Africa. In effect, it gives South Africa the power to refuse the protection of investment that is in contravention of South African Constitution. It emphasises that the enterprise must be lawful. Section 2(b) extends the definition to portfolio investment, as it includes the acquisition of shares.

Section 2(c) extends the definition further by providing that investment means the holding, acquisition or merger by such an enterprise with another enterprise outside the Republic to the extent that such holding, acquisition or merger with another enterprise outside the Republic, has

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[194] L Peterson 'The MAI and the politics of failure: Who killed the dog?' **Institute for International Economics** https://piie.com/publications/chapters_preview/91/2iie2725 (accessed 23 May 2016).

[195] Joubert (n 191 above) 8

[196] 'DTI defends investment bill' *iafrica.com* 25 January 2016 http://business.iafrica.com/news/1018577.html (accessed 29April 2016).

[197] DTI (n196 above) 1.

[198] Protection of Investment Act (n 19 above)

an effect contemplated by paragraphs(a) and (b). Section2 (c) is quite significant as mergers are subjected to South African law as opposed to the law of their state of incorporation.

Section 2 of the Act states that, for the purpose of the definition of an investment, an enterprise may possess assets such as: (a) shares as defined by the Companies Act of 2008 (Act 71 of 2008), stocks, debentures, securities as defined in the Financial Markets Act of 2012 (Act 19 of 2012) or other equity instruments of enterprises or other enterprises. The amendments or changes to these South African statutes and their regulations may cause greater uncertainty and too much subjectivity, which may be viewed by foreign investor as an abuse of the state regulatory power. The content of the Protection of Investment Act could be manipulated by simply changing the laws and regulations.

An enterprise is defined broadly to include intangible assets including, in subsection (f), copyrights, know how, good will or intellectual property rights, such as patents, trademarks, industrial designs and trade names, to the extent that they are recognised under the law of South Africa. South Africa enjoys an absolute control over intellectual property rights and their protection is dependent on recognition under South African law. In that regard, subsection (f) expressly states that such rights will be protected *to the extent that they are recognised under South African law.* Subsection (g) also lists returns such as profits, dividends, royalties or income yielded by an investment; and subsection (h) lists rights or concessions conferred by law or under contract, including licences to cultivate, extract or exploit natural resources. The licences, rights and concessions to exploit natural resources are also subjected to South African law.

4.1.3 National Treatment

National treatment has been defined as a principle whereby a host country extends to foreign investors treatment no less favourable than that accorded to national investors in like circumstances. In this way, the national treatment standard seeks to ensure a degree of competitive equality between national and foreign investors.[199] The rationale behind national treatment is that foreign investors should not be treated in a discriminatory manner and unfairly based on the

[199] Surbedi (n 39 above) 71.

grounds of their nationality.[200] Section 8(1) of the Protection of Investment Act[201] states that foreign investors and their investments must not be treated less favourably than South African investors in like circumstances. This means that the level of treatment accorded to foreign investors shall be equal to the treatment of nationals in similar situations. This also means that, after establishment in a country, no quotas or local purchase requirements may be imposed on foreign investors. Foreign investors have to enjoy the same benefits as the nationals of the host state.[202]

The inclusion of the national treatment standard means that discrimination between foreign investors and nationals on economic grounds cannot be justified.[203] The South African Protection of Investment Act, however, uses the term 'like circumstances', which, according to Sornorajah limits the effect of the national treatment requirement. He argues that, if this is a ground for discrimination, then the granting of national treatment would become pointless as because of the size and global integration of multinational companies, they cannot be compared with a national investor who may be small and only be based in one nation. As such, it would be difficult to satisfy the requirement of 'like circumstances.'[204]

It is submitted that the concept of like circumstances creates a form of screening test for South Africa to discriminate against investors that are not in like circumstances with domestic investors.

The importance of the national treatment principle is recognised in an UNCTAD report.[205] It is stated that the principle aims to eliminate distortions, to enhance the efficient operation of both the economy of host and home countries of the investors and to facilitate co-operation and integration of global economies.

As discussed above, it is commonly known that, due to the history of apartheid, South Africa's Black Economic Empowerment programme is tied to the developmental objectives of the country.

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[200] Adeleke (n 17 above) 3.

[201] Protection of Investment Act (n 19 above).

[202] Sornarajah (n 1 above) 201.

[203] As above.

[204] As above.

[205] UNCTAD (n 120 above).

The idea is that historically disadvantaged South Africans will be led out of poverty through the implementation of the empowerment policy. As such, all facets of South Africa's legal regime are affected by the empowerment legislation which, on the face of it, is discriminatory and could potentially be inconsistent with the principle of non-discrimination,[206] as preference is given to nationals with a certain skin colour over foreign investors. This view is buttressed by section 8(4) of the Protection of Investment Act[207] which requires that the benefits of any preference or privilege from law or measure meant to achieve equality in South Africa, protect and advance persons that were historically disadvantaged by unfair discrimination on the basis of race. The word preference is explicitly stated in the Act. It would therefore seem that the violation of national treatment is deliberate and intentional on the part of South Africa.

4.1.4 Legal protection of investments

In terms of the Act, reference is made to the Constitution of the Republic of South Africa,[208] as follows:[209] "Investors have the right to property in terms of section 25 of the constitution." The South African constitution, specifically section 25, highlights contradictions and substantial incompatibility with the UK-SA BIT[210]. The preamble to the Constitution states that it was adopted "recognising the injustices of the past.'' Section 25 states that "no one may be deprived of property except in terms of law of general application and no law may permit arbitrary deprivation of property."[211] It has been argued that the deprivation of property in terms of the constitution depends on the extent of interference with the enjoyment, use or exploitation and that substantial interference beyond the normal restriction on property use or enjoyment found in an open and democratic society would constitute deprivation."[212]

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[206] Peterson (n 10 above) 7.

[207] n 19 above.

[208] n 92 above.

[209] Protection of Investment Act (n 19 above).

[210] UK-SA BITs.

[211] Section25(1).

[212]MKontwana V Nelson Mandela Metropolitan Municipality, Bisset V Buffalo City Municipality; Transfer Rights Action Campaign V Mec, local Government and Housing, Gauteng, 2005(1) SA 530 (CC).

According to Section 25[213] of the Constitution, there are two grounds for the deprivation of poverty. The first is that deprivation of property may only occur pursuant to a law of general application. Arbitrary deprivations are prohibited. The intention appears to have been a desire to create regulatory space for the government to exercise its power. Secondly, expropriation of property may only occur by law of general application, for public purpose and in the public interest and subject to the payment of compensation to the affected owner.[214] It is clear from the wording of the Constitution that deprivation of property that is not arbitrary and, in terms of the law, of general application would require no compensation on the part of host state. However, in cases where expropriation has occurred, the constitution guarantees the payment of compensation to those who have been affected by such expropriation but it must also be in terms of law of general application.

It is important to note that the Constitution does not distinguish between direct and indirect expropriation. However, from the wording of the Constitution and by implication, it would appear that it only covers direct expropriation, which is the outright seizure of an investor's property, which is completely prohibited. The Constitution requires that expropriation be authorised by a law of general application. As previously noted, indirect expropriation occurs through the operation of a law or a government regulation and constitutes a substantial interference with an investor's property.

It is therefore safe to conclude that the Constitution of the Republic of South Africa does not prohibit indirect expropriation, as there is no mention of it or an indication that substantial interference with an investor's property is not allowed. This opens the door for the government to indirectly expropriate the property of investors under the veil of exercising its regulatory power. This also means that the state can exercise its regulatory power without limitation. It is submitted that the lack of prohibition of indirect expropriation creates a substantial imbalance between the protection offered by South Africa to foreign investors and the right of the host state to regulate for public benefit.

[213] Section 25(1) Act 108 of 1996.

[214] Section 25(2).

It is important to take into account the fact that the primary objective of investment treaties, including BITs still in force in South Africa, is to ensure compensation is provided in cases of expropriation, whether directly or indirectly. A crucial public interest consideration in South Africa will be relevant in determining the amount of compensation to be paid to foreign investors. Section 25(4) of the Constitution provides that "public interest includes the nation's commitment to land reform and the reforms to bring about equitable access to all South African natural resources." This shows that the prompt, adequate and effective customary international law standard does not apply in South Africa. The Constitution provides that compensation must be "just and equitable", reflecting an equitable balance between the public interest and the interest of those affected.[215] It has been noted that there is little jurisprudence with regard to the amount of compensation to be paid in matters where the property of a foreign investor has been expropriated, but there is a general consensus that less than the market value compensation may be awarded to foreign investors when consideration is given to the constitutional mandate of public interest, for example, when land acquisition is intended to address racial imbalances..[216]

The constitution states that, "in order to promote the achievement of equality, which includes the full and equal enjoyment of all rights and freedoms in the Bill of rights, to take legislative and other measures designed to protect and advance persons or categories of persons disadvantaged by unfair discrimination".[217]

The main challenge facing the government of South Africa today is to establish criteria that would permit the country to draw the line between regulatory measures not requiring compensation and expropriation.[218] It is well established in international law that not every regulatory interference with property rights has negative effects or amounts to expropriation requiring compensation.[219] To question the exercise of the state sovereignty would make the exercise of the state functions

[215] The Constitution (n 92 above) sec 25(3).

[216] Peterson(185 above) 10.

[217] The Constitution (n 92 above) sec 9(2).

[218] Reinisch (n 122 above) 13.

[219] As above.

impossible.[220] However, the doctrine and arbitral decisions support the view that regulation can amount to expropriation and the state's exercise of its sovereignty may place economic burden on foreign investors and subject them to the power of the state without granting them any compensation. The effect of a government measure is the determining factor whether a government action amounts to indirect expropriation. This is known as the 'sole effect doctrine'. According to this doctrine, if the interference exceeds a certain degree of intensity, expropriation will result.[221]

4.1.5 Physical security of property

In terms of the Protection of Investment Act,[222] foreign investors are not guaranteed a standard of protection higher or above what is accorded to domestic investors. This shows the need to achieve the balance of treatment as intended by the Act. The Act says that "the Republic must accord foreign investors and their investments a level of physical security as may be generally provided to domestic investors."[223] From the wording of the heading of section 9, it is clear that the state intended to change the full protection and security position granted in BITs[224] by only mentioning the physical security of property. The legislature's intention probably was to avoid a situation where the meaning of full protection and security would be extended to cover regulatory and legal protection.[225]

The position taken by South Africa indicates that the standard of full protection and security which previously existed and still exists in the BITs that are still in force is not absolute[226]. In terms of section 9 of the Investment Act, a reference is made to the minimum standard of protection as found in customary international law and this shows that the standard of protection that exists in BITs is more burdensome on the host state, as it goes beyond protection under customary international law. The traditional understanding of full protection and security, based on customary

[220] As above.

[221] Mostafa(n211above)13

[222]Act 25 of 2015.

[223] Section 9.

[224] Most the of South African BITs contained full protection and security clause" standard.

[225] Surbedi (n 39 above) 14.

[226] Reinisch (n 5 above) 112.

international law, is limited to protection based on physical injury and not maintaining and ensuring stability in the legal and commercial environment. It would thus appear that South Africa based its physical protection on the minimum standard of customary law, thereby adopting the less burdensome position.

It is important to note that in section 9 the level of physical protection and security of investors is dependent on the availability of resources and capacity. This means that the protection of investors is not guaranteed at all times but depends on the availability of resources and capacity.

The position taken by South Africa in this regard is highly defensive especially in cases where the property of a foreign investor would be violated and be subjected to threats. The South African government would raise a defence that, at the time of the violence or attack of the investor's property, it did not have the necessary resources and capacity to provide protection. Therefore, the government's failure to provide security would be justified in terms of the Act by reason of lack of necessary resources and capacity. However, under a BIT or any international investment agreement, the host government has the burden to prove that it had exercised due diligence and reasonable precaution had been taken at all times in order to protect the property of a foreign investor.[227] Foreign investors enjoy full protection at all times without conditions such as available resources and capacity attached to that protection.[228]

Therefore, the undisputed scope of application of the full protection and security even under the BITs has always been a protection against violence and use of force[229] and that protection has never been subjected to the availability of resources and capacity. What has been disputed, however, is the extension of the scope of this standard to business regulation. It was stated in the case of *Pse G v Turkey*[230] that measures that lead to the failure to ensure a stable and predictable business environment, notably normative changes, arbitrary modification of the regulatory framework violating legitimate expectations, inconsistent administrative acts and continuing

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[227] Surbedi (n 39 above) 133.

[228] SA-UK BIT (n 154 above).

[229] *Saluka* (n 126 above) 16.

[230] *PSEG Global Inc. and Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi v Republic of Turkey* ICSID Case No ARB/02/5.

legislative changes are under the obligation of according fair and equitable treatment and not in connection with the standard of full protection and security.

It would seem that South Africa wanted to clarify its position on what it intended to protect, which is only strife and violence subject to available resources. The intention of the legislature may be to avoid the extension of the meaning of protection to business stability or legislative changes by limiting the protection only to physical protection.[231]

4.1.6 Transfer of funds

In terms of Section 11 of the Protection of Investment Act, the transfer of funds is not unrestricted, unlike the previous regime where unrestricted transfer of funds was guaranteed in BITs. The Act does not make it an absolute requirement to transfer funds. It subjects the transfer of funds to other applicable legislation. As previously noted, foreign investors require the possibility to transfer funds for a number of reasons. Without such a guarantee, they will be reluctant to invest in a country. It is submitted that the Act does not provide certainty to foreign investors insofar as the repatriation of profits is concerned as the Act subjects the repatriation of funds to other applicable legislation and taxation. This gives a clear message to foreign investors that they may not be able to transfer funds out of South Africa whenever they want.

4.1.7 Dispute resolution

The Protection of Investment Act requires that disputes be resolved through mediation. A mediator shall be appointed by the government and foreign investor by agreement or in case where the Department is a party to the dispute, the mediator shall be appointed by the Judge President of the High Court. It would seem therefore that the aim of the legislature was to provide for a method of dispute resolution that was friendly, preserved relationships and was non-litigious. The Act also stipulates a timeframe within which the processes of mediation should be carried out so as to avoid inordinate delays.

[231] Sornarajah (n 1 above) 117.

A foreign investor is also required to approach a competent court or independent tribunal where it alleges a breach of investment protection contained in the Act. As discussed by Sornarajah, foreign investors, justifiably so in many instances, often do not have confidence in the impartiality of the judiciary of the host state. They prefer to have disputes resolved before a neutral tribunal in order to secure impartial justice. This is the reason why BITs generally permit the investor to refer an investment dispute to international arbitration.

However, from the government's perspective, a referral to an international investment tribunal would be costly and subject government policies to scrutiny by a third party thereby undermining its sovereignty and regulatory power. In this regard, the South African government is proud of its impartial and robust judiciary guaranteed by the Constitution. The Act, therefore, ensures that foreign investors can expect fair administrative and procedural justice that is not arbitrary. The crucial question is; would the South African courts be seen as impartial when there is an allegation of indirect expropriation by an investor?

Reference to international arbitration by an investor is removed from the Act. This is due to the inherent weaknesses within the system of international arbitration. As discussed by Da Gama, international arbitration is no longer a quick, effective and less costly method of dispute resolution. Government measures are heavily scrutinised in international arbitration and, in case of South Africa as seen from the *Foresti* case, government measures such as BEE and other affirmative action measures are likely to be construed as constituting indirect expropriation and therefore compensable.

4.1.8 Right to regulate in the Protection of Investment Act

Section 12 of the Act provides for the right to regulate. It states that the government may take measures aimed at addressing historical, social and economic inequalities and injustices. It further states that the government may take measures that are aimed at upholding the values and principles espoused in the Constitution, measures fostering economic growth, measures upholding the rights

guaranteed in the Constitution and measures aimed at achieving the progressive realisation of socio-economic rights.[232]

Regulation has been described as a sovereign duty, a legitimate response to market failures or the democratic expression of collective preferences. It has also been described as a basic attribute of sovereignty under international law. The question is: should host states not be held accountable for their regulatory conduct? This question is so relevant because the wording of section 12 of the Act suggests that an indirect expropriation may occur as long as it is for any of the reasons mentioned in the section. The Act in its current form has been criticised for placing SA's interests and policies above those of foreign investors. Too much emphasis on regulation underscores the lack of balance in the protection of investment and the host state's regulatory power. The provision brings back the challenge in investment law and policy, which is to find an acceptable balance between the right of states to regulate and the need to protect investors.

4.2 Regulation of foreign direct investment

4.2.1 Regulation of FDI at multilateral level

Attempts to create a multilateral investment framework have failed to yield any results. The last attempt was made by the Organisation for Economic Co-operation and Development(OECD) in 1998, but negotiations were abandoned as the parties had diametrically opposed views on a number of issues.[233] The proposed Multilateral Agreement on Investment (MAI) was intended to liberalise investment and ensure its effective regulation, guarantee investment protection and have an efficient dispute settlement mechanism. Common grounds could not be found on several negotiating issues.[234]

The first reason for the opposition related to the membership of the OECD. It was composed of 'like minded' developed countries, hence much emphasis was put on the interest of capital

[232] Protection of Investment Act (n 19 above)

[233] P Sol 'Linkages in international investment regulation: The antinomies of the draft multilateral agreement on investment' (2009) 19 *International Investment Law Journal* 266.

[234] Sol (n 235 above) 4.

exporting countries. It was short on development goals and the interests of developed countries and least developing countries were not given proper consideration. It was perceived that there was no balance of rights and obligations as far as multinational corporation entities were concerned. It appeared that emphasis was given to protecting foreign investors and granting them rights that were not available to domestic investors.[235]

Second, there appeared to be conflict of interest with negotiations taking place under the auspices of the OECD, which is composed mostly of capital exporting countries. It was thought that the OECD was not the appropriate forum for a multilateral agreement and that the WTO or the United Nations would have been a more appropriate forum where the interests of all parties would be duly considered. The difference between developed and developing countries became very clear at the Seattle Ministerial Conference in 1998 and subsequently at the Doha Ministerial Conference in 2001, where there was no consensus on launching negotiations on investment. Developing countries were concerned that the would be an imbalance in the rights and obligations of foreign investors *vis-a-vis* host state and domestic investors.[236]

4.2.2 Regulation of foreign direct investment at regional level

Regional trade agreements can be powerful tools to attract foreign investment. In the African context, many countries have liberalised their investment regimes and offered incentives to investors to invest in their countries. This trend increased in the early 1990s.[237]

In 2012, the Southern African countries developed a non-binding Model BIT as a guide for future negotiations of BITs. The model contained development goals with a view to striking a balance between the rights and obligations of foreign investors and the right of host states to regulate in the public interests. The model was intended for member countries to adopt in their own BITs or

[235] Sol (n 235 above) 5.

[236] L Granato 'The international regime on investment : a problematic status quo:an uncertain future' www.iadb.org/document.cfm?id=35249575 (accessed 23 March 2016).

[237] S Woolfrey 'SADC Model Bilateral Investment Treaty Template: Towards a new standard of investor protection in South Africa' www.tralac.org/.../6771-the-**sadc-model-bilateral-investment-treaty-template-towards** (accessed 25 March 2016).

for future negotiations of their BITs. The model BIT was developed in line with the overall goal of the SADC Protocol on Finance and Investment to promote the harmonisation of SADC member states' investment policies and laws. The drafting committee of the model BITs consisted of representatives from Mauritius, Namibia, South Africa and Zimbabwe.[238]

The Model BIT[239] includes provisions on fair and equitable treatment and expropriation but these are left out in the Protection of Investment Act of South Africa. The payment of compensation is based on the fair market value of the investment and subject to a reasonable period of time. Under the Protection of Investment Act, compensation for expropriation as found in Section 25 of the Constitution seems to suggest less than market value and there is no mention of the time within which compensation is to be effected. Whereas indirect expropriation is explicitly mentioned in the SADC Model BIT, there is no recognition of the concept of indirect expropriation under the South African law.

Unlike the Protection of Investment Act, the protection and security of foreign investors is not subject to available means and capacity under the SADC Model BIT. There are a number of conditions such as notice of intent to arbitrate, exhaustion of local remedies, choice to arbitrate under the agreement or another forum and written consent to arbitrate, but the model permits submission to international arbitration, which is not permitted under the Protection of Investment Act. Given that none of the SADC member states is a developed country, there was a lot of emphasis on the right of the host state to regulate and the need for balance to be struck on the rights and obligations of foreign investors.

Regarding the Protection of Investment Act, it has been said that the Act is inherently incompatible with the SADC protocol on Finance and Investment[240] (and modern international investment law as whole), and that it is also inconsistent with several specific provisions which South Africa played a prominent role in developing. This is so particularly in respect of the Act's provisions on

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[238] As above.

[239]Woolfrey Southern Africa Development Community (SADC) 'SADC Model BIT Template with Commentary' http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf (accessed 22 June 2016).

[240] Southern African Development Community (SADC) 'SADC Protocol on Finance and Investment' www.sadc.int/files/4213/5332/6872/Protocol_on_Finance__Investment2006.pdf (accessed 21 March 2016).

qualifications for protection, regulation, expropriation, as well as dispute settlement.[241] The inconsistence with the SADC Protocol is due to the fact that, the Protection of Investment Act prohibits the investor-state dispute in the international domain. This inconsistency needs to be remedied, as it leaves South African government open to challenges of its domestic policies.

4.2.3 Consistency of the Protection of Investment Act with customary international law

The Protection of Investment Act is not completely isolated from customary international law. Like other South African statutes, the Protection of Investment Act must comply with the Constitution which mandates the consideration of international law.[242] In the Protection of Investment Act, the national treatment principle and transfer of funds obligation are, as seen from the above discussion, aligned with the Constitution of the Republic of South Africa. On the concept of expropriation, reference is made to section 25 of the Constitution. The standard of compensation in the Constitution is "just and fair" compensation, which is subjected to certain qualifications. Therefore, compensation in cases of expropriation as espoused by the Act is less than the market value. The critical question therefore is whether the provisions of the Protection of Investment Act constitute a violation of customary international law.

As previously noted, the prompt, adequate and effective principle of compensation as a standard of customary international law is not without controversy. It has been discussed that the rules governing expropriation in customary international law have always been among the contested issues.[243] Because of the controversy associated with the concept of prompt, adequate and effective compensation, it cannot be said to have the universal recognition among states required so as to constitute customary international law. It is submitted that, due to controversy surrounding this principle, the South African domestic legislation, particularly section 25 of the Constitution, cannot represent a violation of standards of customary international law.

[241] Department of Trade and Industry (DTI) 'Summary of Submissions for the Promotion and Protection of Investment Bill' https://www.thedti.gov.za/parliament/2015/Summar_Matrix.pdf (accessed 22 March 2016).

[242] Adeleke (n 17 above) 15.

[243] Peterson(n 10 above) 19.

As discussed by Mosallam,[244] the BITs which codified prompt, adequate and effective compensation customary international principles into binding agreements call for the market value of compensation as an immediate payment after the finding that expropriation has occurred. On the contrary, the Protection of Investment Act in line with section 25 of the Constitution provides for just and equitable compensation. Effectively the Act does not provide for market value compensation.

In the Protection of Investment Act, discrimination is prohibited by a state vis-a-vis foreign investors/investments as compared to how domestic investors are to be treated, but this is subject to exceptions in respect of measures designed to address inequalities as stated in the South African Constitution and to uphold rights guaranteed therein. The purpose behind these exceptions is to cater for national policies such as BEE and affirmative action measures without violating the national treatment standard.

4.2.4 Arguments in favour of the South African Protection of Investment Act

Protagonists of the new Protection of Investment Act argue that it embodies the international investment law concepts of national treatment, expropriation, compensation and transfer of funds in line with the Constitution.[245] The Act seeks to ensure that constitutional obligations are upheld, South Africa retains its sovereign power and strikes a balance between the rights and obligations of investors. The right of the government to exercise its regulatory power is the key motivator for the enactment of the legislation. The main aim of the Act is to ensure that there is robust protection for investors and that the foreign investment law reflects conditions in South Africa.[246] It basically amends certain provisions in the BITs in line with South Africa's constitution.

It has been argued, with regard to the FET standard, that there is no mention of this standard in the Act because its content is indeterminate and has been the subject of varying interpretations by international tribunals. It is further claimed that South Africa already has sufficient administrative

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[244] n 7 above, 17.

[245] Mosallam (n 7 above) 17.

[246] Protection of Investment Act (n 19 above)

processes and does provide adequate protection in terms of due process. From the government's perspective, South Africa has a strong constitution which ensures that just and fair administrative processes are followed.[247] In other words, both substantive and procedural due process are respected within the Republic of South Africa. The Act has also lined up the value of compensation to be provided to foreign investors with Section 25 of the Constitution[248] so as to ensure that there is no disparity in the treatment of domestic and foreign investors.

The intention is to provide compensation that is less than the market value for the expropriated property of the investors. In the following quotation, Da Gama justifies the position of South African Government: "I would dare to say in the last 20 years, in 99.9% of all expropriation cases facing domestic or foreign investors, market value compensation was provided." The government wants to ensure that the history of acquisition is taken into account in determining the value of the compensation in line with the Constitution[249].

The South African government has no confidence in the international arbitration system. It has been alleged that the decisions of the international investment tribunals are heavily influenced by private firms and multinational corporations. In conducting due diligence, there have been findings that some international investment arbitrators have business connections with foreign investors and that international investment arbitration is no longer cost effective as a result of inordinate delays. There is no appellate mechanism which prevents host states from fully seeking redress. The international arbitration system is not equipped to deal with domestic policy issues in the disputes and as such the arbitrators are likely to render decisions which would upset the delicate balance that the Investment Act seeks to achieve.[250]

It has also been argued that BITs have resulted in state regulatory capture, hence the need for a much more balanced investment regime. Policies such as the BEE and Constitutional obligations are not reflected in the BITs and this has made the South African Government unwilling to

[247] Mossallam (n 7 above).

[248] The Constitution (n 92 above).

[249] Quoted in Mossallam (n 7 above) 17.

[250] As above.

implement its regulatory policies for fear of being hauled before international investment tribunals. Put differently, BITs have resulted in South Africa not being able to pursue its development objectives in accordance with the BEE policy as mandated by the Constitution. It might not have been foreseen at the time of entering into BITs that they would result in the capture of the state's regulatory space.[251]

It is widely acknowledged that foreign direct investment must have development impacts, including enhancing domestic productive capacity. Retaining a country's sovereignty and its economic autonomy are important in ensuring the realisation of its development goals. In short, while it is indisputable that foreign direct investment increases the country's economic growth and boosts its development economically, a host country cannot reap such benefits if account is not taken of its domestic needs. It is argued that BITs lock in countries and inadvertently make them surrender control. The trigger for the new investment regime in South Africa was the feeling that BITs and international investment arbitration inhibited the ability of the country to regulate for the public benefit. Too many rights were given to foreign investors without any corresponding obligations.[252] It is for these reasons that the South African government does not have confidence in the international arbitration system.

4.2.5 Crucial arguments against the Protection of Investment Act

It has been argued that the new Investment Act is inadequate to provide sufficient protection and security to foreign investors. Foreign investors will always prefer disputes to be settled by international tribunals, whereas host countries will have a preference for the settlement of disputes before domestic courts. The Investment Act is likely to lead to uncertainty as numerous laws are linked to it. Any confusion in the regulatory regime would result in foreign investors staying away from the country which could affect economic growth and development of the country. Under the previous BIT regime, the parties had to agree to any amendments to their investment relationship. Given that they will no longer be consulted, foreign investors may avoid investing in South Africa

[251] Adeleke (n 17 above) 9.

[252] As above.

mainly because of the uncertainty in the investment regime.[253] South Africa can change the regulatory regime by amending one of the laws linked to the Investment Act.

One of the leading research institutions in South Africa (SAIIA) has argued that South Africa has not yet established its reputation in the international community and that the adoption of the Investment Act will do nothing to enhance its credibility with foreign investors. By contrast, the signing of BITs and abiding by their terms would enhance its credibility and facilitate greater investment inflows into the country. As noted by Guzman, the country's reputation has a positive value, as that would be seen favourably by the community of nations. Being a co-operative member of the international community is what South Africa aspires to.

A country that enters into BITs can reap benefits from them, such as increasing its credibility and reputation in the community of nations. Thus far, the reaction of the international community to South Africa's decision to terminate its BITs has overall been negative, especially among capital exporting nations. By not renewing its BITs upon expiration, South Africa has incurred reputational costs which are akin to breach of international law. The non-renewal of these BITs has cast doubts about South Africa's commitment to international law.[254]

Although South African courts are regarded as independent, there is still uncertainty among foreign investors who question whether South African judges have the experience in handling complex investment disputes. Furthermore, it is not clear how they will interpret the provisions of the Investment Act when read in light with the other provisions that seek to right the wrongs of the past. The requirement that mediators and arbitrators must be of South African nationality has also raised doubts about how fair the process would be.[255] The investors may be concerned about issues of costs, independence and quality of the South African judiciary. According to the Protection of Investment Act, the international investment arbitration has been replaced by the South African

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[253] Woolfrey (n 239 above) 18.

[254] Tang(n 185 above) 19 .

[255] A Farish, 'Protection of Investment Act-Balancing Act between Policies and Investments' (May 2016) *De Rebus* 26-27.

judiciary in cases of investor-state dispute. This is worrisome from the investor's perspective due to the drop in the ranking on enforcement of contract in South Africa.[256]

In the 2016 World Bank Group Flagship Report on Doing Business in South Africa ,[257] South Africa is ranked 119 out of 189 economies on the ease of doing business, with the average costs of resolving court disputes at 33.20 percent of the value of the claim. This raises the question of the efficiency of resolving commercial disputes in South African courts. Furthermore, the contracts enforcement disputes in South Africa takes about 600 days.

The issue of state-state international arbitration also has its challenges. First, the Promotion of Investment Act says that consent is required from the government. Second, the requirement is exhaustion of local remedies in terms of the Act. The challenge being whether the bureaucracy will make it easy and timely for the consent to be obtained by foreign investors.[258]

There have been negative reactions by the international community, particularly the European Union's Regional Chamber of Commerce and Industry, arguing that foreign investors will be hesitant to invest in South Africa because of the inadequate protection given to them and their investments. Capital is now very mobile and investors are likely to invest in countries where they have confidence in the investment regime

4.3 Conclusion

In this chapter, it has been discussed that the Protection of Investment Act represents a significant change in the South African investment climate. The South African government, despite having been in receipt of substantial investment from the EU Countries, has since 2010 decided to terminate its BITs. This is believed to have been motivated by *Foresti* case, in which the BEE policy was challenged.

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[256] M Masamba 'This Africa Global Perspective' 2016 http://www.thisisafricaonline.com/ (accessed 27 May 2016).

[257] World Bank Group *Doing Business in South Africa* (2016) 82.

[258] As above.

Definition of investment is subjected to many different South African laws, which could pose a risk to foreign investors if the host country (SA) unilaterally revokes some of its laws. The Act does not mention the Fair and Equitable Treatment principle because of its interpretative uncertainty. The principle of National Treatment and MFN is subject to certain qualifications such as like circumstances and inclusion of the domestic policy space. Reference is made to section 25 of the Constitution on issues of expropriation. The arbitrary deprivation of property is prohibited and compensation upon finding of expropriation is to be 'just and equitable'. The compensation in cases of expropriation may not be a market value. Physical security of property is subject to available resources and capacity. The investor-state arbitration at ICSID is prohibited and the full repatriation of funds is not guaranteed, which could frustrate the expectation of foreign investors.

In light of the clear conflict of interest between the South African government's developmental goals and the former BITs regulation, this chapter has explained that this problem comes from the conflict of interest between the developed and developing countries on how investment should be regulated. The failure of the developed and developing countries to agree on the Multilateral Investment Agreement to regulate international investment is a clear indication of the two opposing interest of regulatory space required by the developing countries. The foreign investors' interest is to maximise profits, most of which comes from the developed country. The chapter also demonstrated the inconsistency of Protection of Investment Act with both the SADC Model BIT and the SADC Protocol on Finance and Investment and the potential danger of law suits.

Chapter 5 Final Conclusion

This chapter is a combination of the findings in the entire mini-dissertation: final conclusions are drawn and recommendations are given.

5.1 Introduction

The study has shown that one of the challenges currently facing South Africa is how to put in place a friendly investment climate to attract foreign investors into the most critical sectors of its economy to boosts growth and create jobs. It has also shown that BITs have resulted in South Africa not being able to pursue its development objectives in accordance with the BEE policy as mandated by the Constitution of the RSA. The country might not have foreseen at the time of entering into BITs that they would result in the capture of its regulatory space. Therefore, a dilemma that the South African government is now facing is how to balance its need for FDI, while preserving its policy space to pursue empowerment measures and policies

5.2 Summary of findings

Chapter 2 covered customary international law principles and provided an overview of the former regulatory investment regime in South Africa. Customary international law principles governing the protection of foreign investors and overview of the former regulatory investment regime were explained. The research found that, even in the absence of BITs, foreign investors are protected by principles of customary international law. The study has learnt that expropriation is permissible under customary international law. For expropriation to be lawful, it must be non-discriminatory and for public purpose, due process must be followed and there must be payment of compensation.

The study argues that the BITs pose several risks to South African government, including the possibility of being taken to international arbitration. It also argues that there is a need to strike a careful balance between the right of the foreign investors and the right of the host state to regulate for public benefit.

Chapter 3 discussed the regulatory power of the host state and protection of foreign investment in South Africa. The study posits that a conflict exists between the state regulatory power and the BITs to which South Africa is a party. The concept of indirect expropriation is not recognised under South African Constitution. It also argued that South Africa should clearly delineate the scope of its regulatory power if it is to remain attractive to foreign investors and not be seen as indirectly expropriating foreign investors' properties through the operation of its BEE programme and other historical mandates to address imbalances of the past. The research found that the rationale for the termination of BITs by South African government was that they were unconstitutional and reflected deep imbalances between the protection of foreign investment and South Africa's right to regulate for national interests.

Chapter 4 discusses the key provisions of the Protection of Investment Act. An assessment of the strengths and weakness of the Protection of Investment Act and the need to strike a careful balance for the protection of both the host state and foreign investors' interests was made. The study argued that efforts to regulate foreign investment by multilateral agreement failed due to conflicting interests of the parties. Regionally, the Protection of Investment Act is in contravention of key provisions of both the SADC BIT Model and the SADC protocol on Finance and Investment to which South Africa is a party.

5.3 Conclusion

From the literature reviewed, this study has determined that there is a need to strike a careful balance in the Protection of Investment Act. The right to regulate in South Africa forms an integral part of its sovereignty, but for South Africa to avoid the flight of investors, the country needs to make its regulatory regime very clear.

Despite the passing of the Protection of Investment Act, there still some weaknesses in the Act which require the creation of a more conducive regulatory framework. The absence of the concept of indirect expropriation in the South African Constitution and reference of disputes to local courts could raise reasonable suspicions from investors.

5.4 Recommendations

The lack of clear guidance as to what constitutes indirect expropriation under South African law could potentially give wide latitude to the South African government to adopt damaging measures pursuant to the BEE policy which would diminish the economic value of foreign investors' properties. It would be advisable for the South African government to assure foreign investors that it does not intend to penalise them. In that regard, it could possibly justify its actions through the use of the "public interest" clause.

The challenge therefore would be to identify criteria regulating indirect expropriation that would permit the South African Government to have recourse to the public interest clause without having to pay compensation to foreign investors in the event of the loss of their investment. It is important to note that, as a developing country, South Africa relies heavily on taxes for its expenditure. It is therefore important for the country to attract foreign direct investment to boost economic growth and development. With the government strapped for cash, it may not always have the means to compensate promptly, adequately and effectively for the loss of the investment of foreigners, and as such there should be restrained use of the public interest clause.

Arguably, while it is justifiable for the South African Government to enact the BEE policy and other affirmative action measures, the burden should not be borne entirely by foreign investors whose contribution can lead to robust economic growth and help the government to alleviate poverty. Foreign investors should not be held responsible for the injustices of the past. There needs to be a realigning of the interests of the South African Government and foreign investors. Policies such as the BEE and adequate protection for foreign investors are not mutually exclusive.

Although the position taken by South African government may seem to be in line with the position adopted by certain developing countries such as Argentina, Bolivia, Ecuador, India and Indonesia, it would seem that, if an appropriate balance is to be struck between the host state's interests and those of the foreign investor against all forms of expropriation and discrimination, the only feasible way is to define the relationship in a treaty. It will be necessary to improve upon the provisions of existing BITs to capture the interests of host states. It is proposed that there must be a reasonable relationship between the regulatory burden placed on a foreign investor by the host state and the

public interest aim of a measure which seeks to discriminate or deprive an investor of its full rights to his or her property.

In light of the fact that South Africa still has a number of investments agreements in force that protect foreign investors against indirect and direct expropriation, foreign investors still have a right under these agreements to claim compensation when they are discriminated against or when their properties are indirectly expropriated. Under the ICSID framework, foreign investors can challenge the legitimacy of government measures that have been taken pursuant to a public interest clause. A major challenge is the identification of common ground between existing BITs to which South Africa is a party and the new Protection of Investment Act, which has completely taken the opposite direction when it comes to the protection of foreign investors and their interests and those of the host state.

The South African government should have developed its own BIT template that would balance the protection of foreign investors and their investments with the regulatory power of the State. The main advantage of such an approach is that it would not be seen as a unilateral act of the host state. As it is a template, the provisions of each BIT could vary depending on the nature of the investment and the relevant sector. Even if such an approach was adopted, the lack of consistency and coherence in the decisions of international arbitral tribunal would still be a problem. There will not be any guarantee that such an approach will diminish the uncertainty that has come to characterise the BIT system. It should be noted, however, that differences in arbitral awards should not come as a surprise given the differences in the provisions of BITs and the background and training of the arbitrators. Such key differences are likely to lead to different awards even if the facts of relevant cases are strikingly similar.

The current BIT system has another inherent weakness and that relates to the absence of an appellate mechanism to review decisions of arbitral bodies that might have erred in their awards. An appellate mechanism can ensure consistency in arbitral decisions. It for this reason that Professor Surbedi has argued that 'the business of developing the law of foreign investment is too important an area to be left to some *ad hoc* tribunals established under the ICSID or UNCITRAL.

Hence the onus should primarily be on countries."[259] There have been trenchant debates as to whether arbitrators of international tribunals are well-positioned to evaluate domestic policies of host countries. It has argued that to increase the legitimacy of the international tribunals, there is a need to focus on the internal approach.[260]

The contemporary trends in treaty practice shows that host countries are keen to develop a level of control over their regulatory power rather than leave it in the hands of international arbitrators to define the scope of the regulatory power. There is growing evidence that countries are eager to balance investment protection and the right of the host state to regulate for public benefit. There is a new generation of BITs which attempt to strike a balance between these competing goals. This has been done to limit the power of arbitral tribunals and to ensure that effect is given to a host state's regulatory power.

The solution would therefore appear to be that major treaty provisions should not remain as vague and indeterminate as they are now and that there must be clarity in the provisions of bilateral investment treaties. For example, whereas some tribunals have suggested that FET provisions should be interpreted in a manner more supportive of the interests of investors, others have held that there should be an appropriate balance between the interests of foreign investors and those of the host state.

Although South Africa has not renewed some of its BITs, they are still effective due to the operation of survival clauses. It also has some BITs which are still in force. It should be noted that arbitrators have little room to manoeuvre if the provisions of BITs are very clear and unambiguous. In such situations, effect will be given to the terms of the treaties by arbitrators whatever their personal inclinations might be. It is imperative that the relationship between the right of a host state to exercise its regulatory power for the public interest is balanced against adequate protection for foreign investors. The sustainable development goals of the host state should be clearly spelt out in BITs and other investment agreements.

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[259] Surbedi (n 39 above) 135.

[260] As above.

The motivation underlying the regime change in South Africa seems to be more focused on the government's right to regulate in the public interest and the exercise of its sovereign right rather than the protection of foreign investors. This fits with the decision to terminate BITs which allow the government to be challenged before international tribunals and outside of the jurisdiction of South African courts. The protection of investment in the Act is subject to qualifications, which would likely lead to interpretational uncertainty.

There is no right to fair and equitable treatment and the right of an investor to refer an investment dispute to international tribunal. Compensation for expropriation is not guaranteed to be the market value of the affected property. The Act presents a high risk to investors as it may be unilaterally amended by the South African government without consulting interested parties and countries. Currently, the provisions of BITs can be changed upon consent by the signatory states.

Although the existence of a BIT is not the sole factor taken into account by foreign investors in deciding whether or not to invest in South Africa, the relations between South Africa and European countries are strained. As noted by Joubert, the importance of a BIT was seen when the Bilateral Investment Promotion Agreement (BIPA) between South Africa and Zimbabwe was signed. Most South African investors had completely pulled out of Zimbabwe but decided to invest in Zimbabwe when the BIPA entered into force. SA investors made it clear that they will only invest in Zimbabwe if there was reference in BIPA to international investment arbitration in the event of a dispute.[261]

It would appear that the development of a BIT template would have been a good option for South Africa. It could incorporate the sustainable development goals of South Africa and also allay the fears and concerns of foreign investors.

According to the leading research institution of South Africa, SAIIA, the position adopted by South Africa in the PPIB (now the Protection of Investment Act) is not entirely isolated from international law. The Constitution requires that international law must be considered when interpreting any legislation and that any Act must be consistent with the Constitution. From the

[261] Joubert (n 191 above) 8.

discussion above, it is clear the international investment law as codified in BITs is in contradiction with the South African Constitution in some respects. The objectives of the Constitution are to address the socio-economic inequalities in the country, while the paramount importance is placed on protection of foreign investors rights in the BITs.

The paper makes reference to a South African case where the public interest issue was raised in an expropriation case - *Agric SA v Minister of Minerals and Energy* - where the court held that the deprivation of rights in the Mineral and Petroleum Resources Development Amendment Act NO 49 of 2008 (MPRDA) was not arbitrary as the objective of the MPRDA is to facilitate equitable access to South Africa's mineral resources. The court suggested that acquisition of property must always occur for expropriation to be established, which differs from international practice where indirect expropriation is recognised without physical acquisition of property by a government.[262]

It has been discussed that expropriation is dealt with under Section 25 of the Constitution which addresses the socio-economic inequalities and does not recognise indirect expropriation. This raises questions about the balancing mechanism that the government of South Africa claims to have achieved through the entry into force of the new Act. The court in the *Agric SA* case acknowledged the socio-economic context of South Africa and decided not to over-emphasise private property rights at the expense of state social responsibility.

As noted by Adam, the general texture of the Protection of Investment Act reflects a government that is in need of an expansive regulatory space and progressive realisation of its socio-economic policies. The government has also made its position clear that it will not enter into negotiations on indirect expropriation and the FET standard, explaining their exclusion from the Promotion of Investment Act.[263]

South Africa needs to be conscious of the fact that the abuse of the public purpose clause will render the country unattractive to foreign investors. The ultimate success of South Africa's new investment regime will depend upon the acceptance of assurances by South Africa that the

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[262] Adeleke (n 17 above) 9.

[263] Peterson (n 188 above) 19.

properties of investors will not be subject to indirect expropriation and that this new regime provides adequate protection to them and their investments.

In order to achieve an appropriate balance between the protection of foreign investors and the right of the host state to regulate for in the public interest, the expropriation provision must not be based on the Constitution, but must be reformulated to state that the investments of foreign investors shall be protected and that there would not be any substantial deprivation of a foreign investor's right in a property in the host state. The reformulation of expropriation provisions would mean that measures which might impact negatively on foreign investment would not be considered as amounting to unlawful expropriation and that foreign investors would have remedies in cases where the measure crosses a certain threshold.

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