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INVESTOR-STATE ARBITRATION AND SA'S BILATERAL INVESTMENT TREATY POLICY FRAMEWORK REVIEW

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Comments on BIT Policy Framework Review

We are pleased to have this opportunity to contribute to the dti's review of South Africa's bilateral investment treaty (BIT) policy framework. As the Government position paper makes clear, this review is long overdue. Indeed, it is noteworthy that very few governments have engaged in this sort of public review of governmental policy regarding the treatment of inward investment. Given the implications of investment treaty policy for policy space, the government is to be applauded for instigating public discussion about these matters.

Our principal recommendation focuses on dispute resolution, though the arguments we make here are relevant to many aspects of South Africa's BIT policy including standards of treatment, the relationship of foreign direct investment (FDI) to human rights and to sustainable development, and appellate review mechanisms.

We consider this an opportune moment for South Africa to do away with investor-state dispute resolution in its BIT model treaty (if any). That is, we recommend that South Africa include only state-state dispute resolution mechanisms and omit dispute mechanisms to which investors have had direct access. We consider this a proactive measure that moves "beyond damage control", removing blockages to exploring and advancing Southern agendas of development.[1]

The historical context to our recommendation may be instructive. It is accurate to note, as the position paper does, that most international investment agreements are based on a 50-year old model.[2] Nonetheless, the more specific practice of investor-state dispute mechanisms is of more recent provenance. Though the investor-state dispute model appeared in some post-1989 US and Canadian BITs, it was with the advent of the 1994 North American Free Trade Agreement that this model took off globally. Described as a "revolutionary" development, most every BIT since then entitles investors, in addition to state parties, to enforce the terms of an investment treaty directly before international arbitration tribunals. Global lift-off of investor-state dispute mechanisms coincidentally occurred at the same time that the transition to democracy took place in South Africa, which helps to explain the absence of any serious consideration of these disciplines after the fall of apartheid.

If investors are not winning all cases in these mechanisms, it has become increasingly clear that investors can use BIT entitlements to meddle significantly in the regulatory systems of host states, as one of us has argued at some length.[3] A significant number of states, in addition to South Africa, are at least in part for this reason reconsidering the terms of BITs in light of this experience. Ecuador and Bolivia have each removed

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[1] The dti, 'Bilateral Investment Treaty Policy Framework Review: Government Position Paper (June 2009) 55. Such a recommendation goes beyond several more limited changes mooted in the position paper such as limiting the ability of indirect shareholders to assert claims under BITs and modifying the model investor-state arbitration process itself along the lines of enhanced transparency, an appellate process, and enacting a preference for domestic dispute settlement.

[2] Government Position Paper (June 2009) 11.

[3] Generally, see David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge: Cambridge University Press, 2008).

natural resource disputes from the jurisdiction of the arbitration facility at the World Bank, the International Centre for the Settlement of Investment Disputes (ICSID). The United States, and in similar respects Canada, altered their 2004 model BITs so that foreign investors would receive rights, in circumstances of expropriation and nationalization, no greater than those available to U.S. citizens under their Bill of Rights. Although very few states have excluded investor-state dispute from their BITs, we venture that international investment law – which remains somewhat fluid – will develop in this direction.

In this respect, we point most pertinently to the 2004 United States-Australia Free Trade Agreement which also omitted provisions for investor-state dispute mechanisms.[4] According to a press release issued by the Australian Department of Foreign Affairs and Trade, investor-state dispute was eliminated because of "the Parties' open economic environments," their "shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems." Though the United States has yet to evince this sort of confidence in later BITs with countries such as Chile, Jordon or regions such as Central America, the South African legal system should generate no less confidence in its fairness and integrity.[5]

In our view, there are at least five good reasons to take up our proposal and omit investor-state dispute mechanisms in a model South African BIT. First, the South African constitution, in myriad ways, provides sufficient guarantees, and thereby mitigates risks, to foreign investors. Second, evolving South African treaty practice, as documented in the dti's position paper, has appropriately been moving in the direction of reclaiming policy space – some of it constitutionally mandated – which has been lost to BIT practice. Third, though BITs are intended to be flexible in the use of treaty language and availability of exceptions, there simply is little assurance to those making and implementing policy that treaties will be interpreted in predictable ways. Fourth, the available empirical evidence suggests that little is gained, in terms of new inward foreign investment, by guaranteeing access to dispute mechanisms directly to investors. These first four considerations apply to the case of inward direct investment. A fifth reason speaks specifically to outward investment (as does our fourth) and this has to do with enhancing the development of legal institutions within host states that can benefit both nationals and foreign investors. We develop each of these arguments below.

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[4] For one view, see W Dodge 'Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement' 39 VAND. J. TRANSNAT'L L. 1 (2006).

[5] The US is currently engaged in a review of the terms in its model BIT. See Federal Register Notice: Written Comments Concerning the Administration's Review of the U.S. Model Bilateral Investment Treaty July 14, 2009 Federal Register (Volume 74, Number 133) ("The Department of State and the Office of the United States Trade Representative (USTR), [which co-lead] the U.S. bilateral investment treaty (BIT) program, are soliciting written comments and will hold a public meeting [29 July 2009] concerning the Administration's review of the U.S. model BIT. The review is intended to ensure that the model BIT is consistent with the public interest and the overall U.S. economic agenda. The key question is whether the current model text, last updated in 2004, achieves these objectives or whether there are changes that should be made." Comments received as part of this process are available online at www.regulations.gov and are referenced under BIT Review: Written Comments Concerning the Administration's Review of the U.S. Model Bilateral Investment Treaty, Docket ID: USTR-2009-0019.

First, the Constitution sufficiently mitigates risk faced by inward investment flows and foreign investors. We begin here by noting that South Africa's thus-far-concluded BITs do not distinguish, as the government position paper notes, between deprivation and expropriation, a distinction that is entrenched in the Constitution.[6] This is only one of several salient differences between South Africa's constitutional property clause and the BIT investment rules.[7] The scope of protected investment interests may well differ from the Constitution to a typical BIT. The BITs have had no explicit accommodation for land and water reform as exists in section 25. As opposed to the section 25 baseline of "just and equitable" – effectively the "appropriate" standard – the typical BIT standard of compensation in the event of expropriation or nationalization, as well as measures equivalent thereto, is modelled on the Hull standard of prompt, effective and immediately realizable compensation. The Constitutional Court property jurisprudence is still developing and is arguably more factor than rule driven.[8] Indeed, that jurisprudence is supplemented in significant and important ways by the protection given by the equality clause – which has been interpreted by the Constitutional Court in a fashion largely friendly to non-South Africans. Nonetheless, we can fairly conclude two points. First, the constraints concerning expropriation and nationalization in BITs are more onerous than those found in the text of the South African Constitution. Second, the South African property rights regime itself is substantially coherent and guarantees considerable protection of property interests. Finally, beyond the property rights regime strictly speaking, there are other significant constitutional mechanisms that operate to give assurance to foreign investors. These include the Chapter Nine protections afforded to the office of the Auditor-General and the Public Protector, institutions that directly assist in protecting rights and ensuring the rule of law. The protection given by the South African Constitution overall to foreign investment is considerable.

Second, constitutionally demanded and government guarded policy space arguably has been appropriated by BIT practice. As is noted, not only is compliance with Black Economic Empowerment (BEE) viewed as a significant risk factor shaping investment decisions[9], some foreign investors take the view that features of BEE are not in compliance with existing BIT commitments. South Africa was provoked to modify its BIT text to exclude from the scope of the rule of national treatment equality-promoting measures that are intended "to protect or advance persons . . . disadvantaged by unfair discrimination".[10] Significantly, this equality-promoting exception does not extend to other BIT disciplines such as measures that might be considered equivalent to expropriation or nationalization. Elsewhere, one of us has written in detail about how well aspects of BEE stack up against the vaunted flexibilities of investment rules. We do not intend to repeat these arguments here.[11] It should be enough to assert that equality

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[6] Government Position Paper (June 2009) 41.

[7] This is developed in more detail in David Schneiderman, "Investment Rules and the New Constitutionalism" (2000) 25 *Law and Social Inquiry* 757 and Schneiderman, *Constitutionalizing Economic Globalization*, *supra* note 1 at pp. 137-147.

[8] See Theunis Roux 'The "Arbitrary Deprivation Vortex": Constitutional Property Law after FNB" in Stuart Woolman and Michael Bishop (eds) *Constitutional Conversations* (forthcoming, 2008).

[9] Government Position Paper (June 2009) 20.

[10] Government Position Paper (June 2009) 38.

[11] David Schneiderman, "Promoting Equality, Black Economic Empowerment, and the Future of Investment Rules" (2009 forthcoming).

as entrenched in the SA Constitution ought to at least militate against giving foreign investors more enforcement rights than those enjoyed by South Africans, including historically disadvantaged South Africans.[12] Model BITs are only as developmentally friendly as states can anticipate they are required to be. BIT policy is reliant on *ex ante* predictions about how state policy will develop going forward. It thereby places an unfair burden on states that may choose to experiment with social and economic policy – particularly where the national constitution mandates the development of public policy – in ways that foreign investors may find disagreeable.

Third, even then, there can be little assurance that BITs will be interpreted by tribunals in a way that is constrained, respectful of state party intentions, and mindful of other commitments such as constitutional ones. As a recent UNCTAD document admits, it is 'in the very nature of international [investment] agreements to constrain policy options at the national level.'[13] Given that this preference is embedded within most BIT models, it comes as little surprise that many international investment tribunals have interpreted BITs in ways that enhance the protections otherwise available to foreign investors. Sornarajah describes these as "expansionary attitudes taken by arbitrators who have accepted the expansionary litigation theories of lawyers who are seemingly taking the law in investment treaties beyond what the parties had originally intended.[14]" There is no better example of this than the expansionary interpretation of the opaque "fair and equitable treatment" requirement. This has been interpreted by a variety of tribunals to amount to requiring the payment of compensation in the case of regulatory changes that unreasonably upset investor expectations.[15] In a series of tribunal decisions arising out of the meltdown of the Argentinian peso in 2001, successive tribunals have interpreted the standard so as to render Argentina fiscally responsible for sunk costs and lost profits for regulatory changes made in the wake of a financial emergency that was likened to the economic depression of the 1930s (*CMS*, *LG&E*, *Enron*, *Sempra*, and *Continental Casualty*). In this same series of cases, there has been disagreement among the various tribunals about the degree to which Argentina can take advantage of US-Argentina BIT emergency clause, which would absolve Argentina for the duration of the emergency. Even then, Argentina remains responsible for damages suffered by investors once the emergency subsides. Disagreement even has arisen in cases where two different arbitrators, participating in the first three awards (*CMS*, *LG&E*, and *Enron*), appear to have changed their minds without explanation. This is evidence that there is little that is stable and predictable about international investment law for non-investors. Indeed, inconsistency of decisions is an acknowledged feature of the investor-

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[12] For a discussion of the policy development towards giving foreign investors national treatment, see A Hirsch *Season of Hope* 53.

[13] U.N. Conf. on Trade & Dev., *Reserving Flexibility in IIAs: The Use Of Reservations* 6 (New York & Geneva: United Nations, 2006).

[14] M. Sornarajah, "A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration" in Karl P. Sauvant with Michael Chiswick-Patterson, eds., *Appeals Mechanism in International Investment Disputes* (Oxford: Oxford University Press, 2008) 39-77 at 40.

[15] See, for example, *Tecnicas Medioambientales TECMED S.A.* v. Mexico. 2003. International Legal Materials (2004) 43: 133, para. 154.

state arbitration system and one which has led to concerns regarding the legitimacy of this system.[16]

Fourth, there is little threat to new inward investment by doing away with investor-state dispute resolution in a model BIT. UNCTAD early on, with little empirical back up, concluded that BITs are relatively insignificant in determining amounts of FDI. Other factors such as market size and growth, exchange rates and country risks appeared to be more important determinants of FDI.[17] This probably remains the case. In one of the few comprehensive studies completed to date, Neumayer and Spess find that there is a positive relationship between the signing of BITs and FDI flows.[18] Yackee, on the other hand, replicated Neumayer and Spess' model and found that the relationship of BITs to FDI flows is marginal and much smaller than they had suggested.[19] The scant empirical evidence, then, is ambivalent.[20] The available anecdotal evidence confirms this. According to a discussion thread amongst international investment lawyers posted in 2006 on 'transnational-dispute management,' most investment lawyers will admit that the existence of a BIT rarely is determinative of investment decisions. The case of Brazil lends credence to this view. Brazil is one of the largest magnets for inward FDI in Latin America, yet Brazil has not one BIT presently in force.[21] It likely is the case, then, that investors would not be frightened away from investing in South Africa if investor-dispute mechanisms were abolished and reliance placed on South Africa's national legal system.

The **fifth** and final line of argument has a specific bearing on the question of whether doing away with investor-state dispute mechanisms will affect South African outward investment, particularly within the continent. We believe that greater emphasis should be placed on host state legal reform and, to the extent

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[16] See generally Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521, 1582–83 (2005) (expressing concerns about the legitimacy of resolution of investment treaty disputes generally) and Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2007) (as international investment law concerns high public policy matters, an appellate system of judicial review is required).

[17] UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (New York and London: United Nations, 1998) at 118; UNCTAD, *World Investment Report 1998: Trends and Determinants* (New York and London: United Nations, 1998) at 117; UNCTAD, *World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy* (New York and London: United Nations 1997) at 37.

[18] Eric Neumayer and Laura Spess. 2005. "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?" *World Development* 33: 1567-85 at 1568,1585.

[19] Jason W Yackee, "Sacrificing Sovereignty: Bilateral Investment Treaties, International Arbitration, and the Quest for Capital" 2006 USC Center in Law, Economics and Organization Research Paper No. C06-15 at 31 online at http://law.usc.edu/academics/assets/docs/C06_15_paper.pdf

[20] According to Susan Franck, while a BIT is a popular tactic, "there is mixed empirical evidence as to its actual success in securing foreign investment". S Franck 'Integrating Investment Treaty Conflict and Dispute Systems Design' 92 Minnesota Law Review 161, 171 (2007); see also S Franck 'Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law' 19 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 337, 338 (2007) 348–53 (surveying the empirical literature, including studies by Hallward-Dreimer, Rose-Ackerman and Tobin, UNCTAD, Salacuse and Sullivan, Neumayer and Spess, and Swenson, on the topic of how investment treaties affect foreign investment).

[21] UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*. New York and Geneva: United Nations 2003) at 53. Fourteen BITs have been signed by Brazil and none are in force.

necessary, capacity-building within the system of the administration of justice, rather than on international investment arbitration. This is so for several reasons. First, as a simple matter of fairness and reciprocity, South Africa should not be desirous of limiting the policy space of other countries in the same way that South Africa is disadvantaged vis-à-vis powerful OECD states. Second, as a matter of institution-building, an emphasis on host-state legal reform and development in a model BIT could generate greater interest in changes at the domestic level that benefit citizens and investors alike. Daniels hypothesizes that generating legal enclaves for foreign investors "siphons off the investor voice from the enterprise of creating good and generalized rule of law institutions" in the host country.[22] Investors become not only less interested in host state legal developments, they demand contractual concessions from host states that are likely "to limit the state's capacity to respond to legitimate public policy concerns through the creation of credible, transparent and participatory regulatory institutions."[23] Tobin and Rose-Ackerman have similarly suggested that a world replete with BITs "reduces the interest of MNCs in property rights reform and enforcement in developing countries."[24] When foreign investors "bypass local law and lower their risk through BITs, developing country governments may have lost a major incentive to strengthen their domestic property rights regimes."[25]

This argument regarding greater domestic emphasis means both that more 'investment' should and would be made in the host state property and equality rights regime and that positive effects can be anticipated to occur more broadly throughout the host state national legal system. Abolishing the investor-state dispute mechanism and encouraging resort to national state legal systems (with state-state dispute mechanisms remaining available) could enhance existing legal institutions in unanticipated ways, even in legal systems other than those of constitutional democracies. Consider an episode of Egyptian history. Desperate for new inward investment but preferring not to constitutionalize property rights, President Anwar Sadat used the then-new Egyptian Constitutional Court and revived administrative tribunals to attract such funds. This domestic legal reform then had the effect of generating a new forum for Egyptian politics and enhancing democracy. These judicial reforms, Tamir Moustafa argues, "provided institutional openings for political activists to challenge the executive in ways that fundamentally transformed patterns of interaction between the state and society."[26] Constitutional litigation, institutionalized in order to provide credible support to the property rights of foreign investors, became a new

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[22] Ronald J. Daniels, "Defecting on Development: Bilateral Investment Treaties and the Subversion of the Rule of Law in the Developing World" Faculty Workshop, Faculty of Law, University of Toronto (29 November 2004) at 4 online at http://www.unisi.it/lawandeconomics/stile2004/daniels.pdf.
[23] Daniels, *ibid.* at 31.
[24] Jennifer Tobin and Susan Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties," Center for Law, Economics and Public Policy Research Paper No. 293 (2004), Yale Law School at 10, online at http://ssrn.com
[25] Tobin and Rose-Ackerman, *ibid.* at 34.
[26] Tamir Moustafa, *The Struggle for Constitutional Power: Law, Politics, and Economic Development in Egypt* (Cambridge: Cambridge University Press, 2007) at 6.

weapon for civil society to challenge Egyptian authoritarianism. The emphasis on host state legal systems thus becomes a mechanism to prod institutional development to achieve justice and rights for all.

A greater emphasis on host state legal reform and development is, in our view, consistent with the strengthening of regional mechanisms for the protection of rights, including property rights.[27] The position paper notes 5 BITs concluded with SADC countries.[28] Thus, with respect to the SADC regional system, it may be important to note the recent Tribunal litigation, *In re Mike Campbell (Pvt) Ltd and others v The Republic of Zimbabwe*.[29] In this litigation, the Tribunal has issued three decisions on admissibility, the merits, and most recently on contempt and enforcement.[30] While the enforcement power is mediated through the political organs of SADC, this series of decisions gives at least some legal significance to the concept and status of SADC citizenship and pertinently operationalizes protection of investor expectations.

While accurate empirical information in this field is hard to come by, a final set of points may be suggested based on a recent study by Susan Franck.[31] She studied publicly available and finalized awards, finding 82 cases and 102 awards, and treating them as representative of the spectrum of resolved claims. While she calls for more research, three findings are of particular interest here. First, of the 107 investors involved: '… ninety-six were from "high income" countries, ten were from "upper middle income" countries and only one investor was from a "lower-middle income" country. None were from Africa. Second, in terms of cases against governments, her findings suggested that the highest risk was for countries of "middle income", rather than either OECD countries or LDCs. South Africans take note. Two African governments were respondent governments in her study: Burundi and the DRC. Finally, Franck notes a

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27 According to the Tribunal, the SADC Treaty must be interpreted to mean "that SADC as a collectivity and as individual member States are under a legal obligation to respect and protect human rights of SADC citizens."

28 Policy Paper p. 17.

29 *Mike Campbell (Pvt) Ltd and Others v Republic of Zimbabwe* (2/2007) [2008] SADCT 2 (28 November 2008) (available at http://www.saflii.org/sa/cases/SADCT/2008/2.html). In an earlier 2007 judgment on admissibility, the Tribunal delivered itself of some far-reaching language in holding the complaint admissible despite the argument of the government of Zimbabwe and stating at page 3: "The interpretation and application of the SADC Treaty and the Protocol is therefore one of the bases of jurisdiction. For purposes of this application, the relevant provision of the Treaty which requires interpretation and application is Article 4, which in the relevant part provides: 'SADC and Member States are required to act in accordance with the following principles – (c) human rights, democracy and the rule of law.' This means that SADC as a collectivity and as individual member States are under a legal obligation to respect and protect human rights of SADC citizens. They also have to ensure that there is democracy and the rule of law within the region." *Mike Campbell (PVT) Limited and Another v Republic of Zimbabwe* (2/07) [2007] SADCT 1 (13 December 2007) (available at http://www.saflii.org/sa/cases/SADCT/2007/1.html). The Tribunal judged the application admissible on the basis of its governing Protocol on Tribunal Article 15(1) which provides in broad terms "The Tribunal shall have jurisdiction over disputes between States, and between natural or legal persons and States."

30 *Campbell and Another v Republic of Zimbabwe* (SADC (T) 03/2009) [2009] SADCT 1 (5 June 2009) (available at http://www.saflii.org/sa/cases/SADCT/2009/1.html).

31 S Franck 'Empirically Evaluating Claims About Investment Treaty Arbitration' 86 North Carolina Law Review 1 (2007).

comment made to the effect that investment treaties "are reciprocal in theory but not in fact, for it is generally only the less developed country that bears the risk of being sued" and agrees that the data tends to support that view. In sum, perhaps the most significant conclusion to draw here is that the investor-state system seems to currently be of relatively little use or relevance in protecting South Africa's outward investments in Africa.

In justifying our suggestion that the investor-state arbitration mechanism be omitted from the terms of any South African model BIT, we have raised a number of points of principle. To a great extent, these are of course arguments both of morality and of constitutional and international law. Nonetheless, the decisions facing South Africa as outlined in the position paper can also be likened to the decisions facing investors about where to place their capital. Here, the usual assumption is that the rational investor calculates the costs and the benefits, the risks and the potential rewards, does the sums, and makes the decision. Working within that paradigm, we would argue that, at least for the state side of the investor-state relationship outside of the developed world, the costs clearly outweigh whatever benefits there might be.

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