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BITs and pieces

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A new approach to foreign direct investment by the South African government looks set to drastically limit investors' rights.

On 1 November 2013, the South African government approved the draft Promotion and Protection of Investment Bill (the "Bill"), publishing it for public comment. The new investment law, which will come into effect in 2014, replaces a number of individual Bilateral Investment Treaties ("BITs"), and marks a change in South Africa's approach to foreign investor protection.

Currently, foreign investment in South Africa is protected by a system of BITs between South Africa and a number of countries with which it frequently trades. The BITs give foreign investors certain key safeguards, such as protection against expropriation without adequate compensation, equality of treatment with domestic investors and international arbitration of disputes.

They also afford those investors with the opportunity to enforce the protections against the South African government directly via ICSID arbitration, which has no legal seat and is tailored to investment disputes.

The Bill follows South Africa's decision to review its BITs, many of which were entered into soon after the end of the apartheid era. According to South Africa's Department of Trade and Industry ("DTI"), the treaties have extended too far into the policy sphere, and allowed the legal and business community to challenge regulatory reforms, which were considered by the government to be in the public interest.

As a result, a large number of BITs have recently been terminated by the South African government. Amongst others, cancellation notices have been issued to the Netherlands, Spain, Luxembourg, Belgium, Germany and, most recently, Switzerland.

The aim of the Bill is to provide a new framework to regulate the protection of foreign investment in South Africa, in place of BITs. Foreign investors may consider the mere adoption of domestic legislation to replace bilateral treaties as reducing the degree of investment protection.

Unlike a treaty, which cannot be amended unilaterally, domestic legislation is subject to change by the government of the host state. The Bill itself also introduces substantive changes to South Africa's investment protection regime. Its main provisions are considered below.

Expropriation

Expropriation is a common concern of foreign investors, who may fear that their assets will be appropriated, confiscated or nationalised. In line with common practice, South Africa's BITs address this by including a provision prohibiting expropriation of foreign investments and providing for compensation for any such expropriation.

The new Bill narrows the definition of expropriation found in most of South Africa's BITs. It is limited to acts of direct expropriation, and does not cover measures which may have an equivalent effect.

It also contains a list of acts which expressly do not amount to expropriation, including measures taken by the government to protect or enhance public welfare objectives, and deprivation of property where the previous owner is allowed to continue to manage the asset. As a result, the scope for the government legitimately to introduce measures which investors may consider to amount to indirect or effective expropriation is increased.

Moreover, where expropriation is established, the Bill does not guarantee that the foreign investor will be compensated with the full market value of their investment. Instead, it provides that the investor will receive compensation that is "just and equitable", and that market value is only one of the factors to be considered, alongside the public interest and the use of the investment, amongst others.

This is a marked departure from the traditional formula in public international law, reproduced in the majority of South Africa's BITs, by which "prompt, adequate and effective compensation" amounting to the "genuine value of the investment" must be paid to an investor following an expropriation.

While expropriation under the Bill will not necessarily result in compensation below market value, it creates uncertainty for foreign investors who could previously be assured of receiving compensation to the actual value of their investment.

Fair and equitable treatment

Fair and equitable treatment of foreign investment is a common protection provided by BITs. This ensures foreign investors are able to seek compensation if a host state introduces legislation that alters investment conditions in an unreasonable or discriminatory way.

This provision is markedly absent from the new Bill, which expressly gives the government broad power to regulate the public interest, which includes taking measures to redress historical inequalities, promote cultural heritage and realise socio-economic rights.

The result, again, is uncertainty for foreign investors, as they can no longer rely on protection or seek compensation if the conditions under which they invested in South Africa change.

Dispute resolution

A central feature of BITs is recourse to international arbitration for the settlement of disputes. Foreign investors can be unwilling to pursue a dispute against a particular country through its courts for fear that they may be partial. By taking the dispute to a neutral arbitral tribunal, the investor can be more certain that it will receive equal treatment.

Significantly, the Bill does not provide foreign investors with recourse to international arbitration. Instead, investors must bring their disputes either to the South African courts, to mediation facilitated by the DTI, or to arbitration in accordance with South Africa's Arbitration Act of 1965 (the "Act"). The Act provides that if parties fail to agree on an arbitrator, either party may apply to the South African courts for determination.

Recent commentary from South African government officials suggests that it is unlikely that the government would agree to international arbitration: South Africa's trade minister has stated that "international arbitration was established to address situations where the national court systems are weak, ineffective or biased against foreigners, [which] is not the case in South Africa".

Foreign investors are, therefore, likely to consider this change to the dispute resolution regime as considerably undermining the protection of their investment.

Conclusion

The Bill is currently in draft form, and is, therefore, still subject to revision, with interested parties invited to submit proposals before 1 February 2014. Once the Bill comes into effect, existing investors will continue to enjoy the protection provided under those BITs, which have been terminated, for a period of between 10 to 20 years, depending on the BIT's sunset clause.

In effect, they will have to contend with two parallel protection systems; however, they may have a claim for breach of the relevant treaty in the event of a conflict between a BIT and the Bill.

Moreover, foreign investors may enjoy increased protection under the Finance and Investment Protocol (the "Protocol") of the Southern African Development Community ("SADC"), to which South Africa is a party. The Bill does not address the fact that the Protocol allows foreign investors who have invested in the SADC region to take disputes against a party to the Protocol to international arbitration.

Therefore, in the absence of clarification or change to the Bill, foreign investors may still have the possibility of seeking redress via international arbitration, even in the absence of BITs.

Overall, the provisions of the Bill indicate that foreign investors will not be provided with the same standard of protection as under South Africa's BITs. The South African government has defended the Bill, stating that it is not removing foreign investor protections, but simply making changes to the way in which these are ensured, while enabling it to enact policies in the public interest.

Although its reasons for the overhaul of investment policy may be legitimate, whether foreign investors will be comforted by the South African government's assurances remains to be seen.

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