

The Third Annual Forum of Developing Country Investment Negotiators

“Nothing Sacred: Developing Countries and the Future of International Investment Treaties”

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I want to share with you my country, South Africa's experience, including my personal experience with the negotiations of Bilateral Investment Treaties (BITs) and our past and current approaches to such negotiations. It will become clear to you from my speech about my country's gradual development from a country that merely accepted, without question, the claim made by developed countries that it is a necessity for developing countries to enter into BITs in order to attract foreign investment, to a country today that questions the purpose and content of BITs, and in particular whether there is a real need for South Africa to enter into such international agreements that limit its sovereignty.

South Africa first entered into a BIT with the United Kingdom (UK) in 1994. Although this BIT was signed by the new SA government in 1994, it was presented to the outgoing government in 1992/93. It seems that the UK government was prompted by the fear that the new black government of SA would nationalize or expropriate the property of its investors that caused them to present their draft model BIT to the outgoing government of SA. SA government officials simply accepted the draft model BIT without any negotiations when it was presented to them in 1992/93. In fact this is the reason why I say SA "entered" into BITs and do not use the word "negotiate". Subsequently, after the new president signed the BIT in 1994, the officials appeared before a parliamentary committee and informed the committee that SA does not have anything to worry about as the BIT with the UK does not contain any substantive obligations that would be placed on SA.

They further compounded their error by adopting the UK draft model BIT as South Africa's (SA's) model BIT and used it as a basis to conclude further BITs with other developed countries that had the same political concerns as the UK government. SA has, therefore, never done a risk/benefit analysis before adopting this model BIT. It should have been clear to those government officials that SA, being a developing country, is not in the same position as the UK and would accordingly have to consider different interest before taking such a step.

When I took over as SA's BIT negotiator at the beginning of 2001, I was quite horrified to read the content of a BIT. The BIT places all the obligations on the host state and gives all the rights to the investors. Obviously, if this were a personal contract, no one would sign it in their personal lives. This then begs the question - why would officials enter into such agreements on behalf of their countries?

On my advice, SA immediately ceased all negotiations with developed countries. However, at the same time we recognised what a powerful weapon BITs would be for South African investors. The dilemma facing SA is that we are both a capital importing and exporting country. In fact we are the biggest foreign investor on the continent of Africa. As a result we then adopted a dual approach whereby we continued concluding BITs with other developing

countries. However, we sought to soften the harsh consequences of our model BIT by bringing certain amendments to it. For example, we changed the definition of what constitutes a foreign investment in terms of the treaty from “any kind of asset” to a long term foreign direct investment which must hold economic value for the host country. We also excluded short term portfolio investments from the definition. And further we changed the meaning of expropriation to exclude regulatory expropriation and to bring it in line with its customary international law meaning.

I should also add that our decision to continue negotiating BITs with other developing countries, mostly other African countries, was influenced by the fact that these countries would request us to negotiate these agreements with them because they honestly believe that if they conclude BITs they will attract foreign investment. Empirical evidence to this effect is inconclusive and, therefore, it is false for developed countries to claim that it is in the interest of developing countries to enter into BITs because, as a result, they will attract foreign investment. Clearly, the determinants of foreign direct investment are numerous and include, amongst others, market size; infrastructure; the availability of skilled labour, availability of natural resources; tax policy; labour laws; legal certainty; etc.. Developed countries seek only to address one determinant of FDI, which is legal certainty. The BIT is, therefore, merely seen by them as a means of protection of their foreign investments.

A study was undertaken by a private consulting firm in SA and it was found by them that foreign investors only ranked “legal certainty” as the 8th determinant in their decision on whether to invest in SA or not. The most important determinant of FDI for them is that of “market size”. It should also be noted that in 2007 SA’s two biggest foreign investors were Canada and the United States. SA did not enter into BITs with these two countries. Of course, I must add that the ranking of what is the most important determinant for FDI depends on the circumstances of the specific country. It is, therefore, important for developing countries to know, when they devise an Investment Promotion Policy, what the ranking of these determinants are in their respective countries.

I also want to recount my experience of negotiating a BIT with a particular developing country, which highlights the problem faced by most developing countries. I presented SA’s amended model BIT to this country’s negotiators but instead of them using it as a basis for negotiations, they presented SA with a model BIT of their own that was based on the old US model BIT, which included pre-establishment rights. The SA BIT is limited to post-establishment rights only. The other developing country’s model BIT, accordingly, was more restrictive than the pre-amended SA BIT. After the SA negotiations team explained to them the content and consequences of their model BIT and also that of the amendments brought to the SA BIT, they were quite shocked when they realised what they wanted to get themselves into. As stated, this highlights a major problem in most developing countries, that negotiators are not properly informed or capacitated to deal with such specialised

agreements. In many instances I have come across negotiators who negotiate these agreements without the presence of a lawyer. This has also been the case of South Africa before 2001.

However, we realised early on that the dualistic approach would not be sustainable and that it was merely a stop-gap or interim measure. We were aware that in adopting this approach we had to contend with the MFN principle apart from the political considerations relating to diplomatic relations.

A further concern that we have was the procedural mechanism surrounding BIT arbitrations and international arbitrations itself. In about 2005 I received a request from the SA Department of Justice and Constitutional Affairs to provide them with comments and a recommendation whether SA should accede to ICSID (International Convention for the Settlement of Investment Disputes). It appeared from the document that I received that what was known as the South African Law Reform Commission recommended to the SA government in 1996 that it would be in SA's interest to accede to the ICSID convention. I consequently looked at the history of the commission's study to inform me of how they arrived at that conclusion. What I found was that only two academics submitted comments supporting SA acceding to the convention and that there was no engagement with any government department. The comments from the academics included statements made by ICSID that the convention was specifically beneficial for developing countries and that it would attract foreign investment. We clearly know this not to be the case.

To further capacitate myself to make an informed recommendation, I looked at the history of how the convention was drafted and compared its content with that of other treaties such as the UNCITRAL Arbitral Rules and the New York Convention for the Enforcement of Arbitral Awards. I found it surprising that in a convention that World Bank officials claimed was beneficial to developing countries, they did their utmost to reduce the rights and defences that developing countries had in terms of these two treaties. They specifically included strong enforcement provisions in the convention and made it a self contained system for arbitration. This was specifically done to limit the risk of awards being annulled by domestic courts because this was a major problem for developed countries as awards were regularly being annulled under ad hoc arbitrations. Therefore, an application for annulment of an ICSID award can only be brought to an internal ICSID review committee and not an outside court. The World Bank also excluded public policy defences, which are crucial for developing countries, more so today, as SA has found out, as its public policies have been under attack in an international arbitration.

It was as a result of the challenges faced by SA, in particular, that we started to conceptualise a comprehensive and holistic approach to dealing with the issue of BITs. Accordingly, in 2007 we started a process to develop a policy framework for BITs. The policy looked at both the macro and micro environment surrounding BITs. In looking at the macro environment questions were raised, such as, what would be the economic rationale for SA to enter into a BIT with a certain country. The micro environment study looked at what are the legal aspects currently covered in BITs and what is it that SA, from its own perspective, would like to see covered in a BIT if it is found that negotiating BITs would be in SA's interest. As far as we are concerned nothing is sacred and we are starting from a blank slate. In this regard the most important questions that need to be answered are – what purpose do BITs serve – and does SA really need BITs. But, as stated before, SA needs to take into consideration that it is not only a capital importing developing country but that it is also a capital exporting country.

The policy framework process included the drafting of an initial policy document through research work and interviewing the bilateral units in the international trade division who directly worked with BITs, including other divisions in the Department of Trade and Industry and other government departments. After the initial document was circulated internally in government for comment an internal government workshop was held. The internal workshop turned out to be an important educational exercise. As a result there was a better understanding of what BITs are about but we still received a limited amount of comments of value.

Subsequently, we produced a second draft of the policy paper that was published on the internet and in newspapers for public comment. Again a limited amount of public comments were received. Following this a public workshop was held that was attended by a wide range of stakeholders that included academics, government, NGOs, business peoples, lawyers, labour unions and civil society. An important comment was made by a judge in the workshop who said that allowing a foreign investor to bypass the domestic courts to go to international arbitration will result in the impoverishment of the judiciary as far as adjudicating disputes involving foreign investment. An extended period was granted for further comments and a number of useful comments were received. SA is now in the process of completing a third draft of the policy paper, which will be forwarded to the SA Cabinet for adoption.

SA also engages in other forums such as the OECD, the Heiligendamm Aquila Process (G8 + G5) and UNCTAD. When we engage in discussions on the regulation of foreign investment we start from the point of view that currently it cannot be said that an international investment law exists. For such a law to develop there needs to be, amongst others, universal acceptance of the principles contained in BITs and other international agreements. There is no such universal acceptance despite the numerous BITs that have

been signed. International arbitrations have resulted in a confusing array of many different interpretations of the same principles on the same points in issue. Our view is that what we currently have is a system of investment arbitration based on treaty rules not international law. Accordingly, we believe, just as other treaties are subject to principles of customary international law and international law as a whole, for example, the application of the Vienna Convention on the Interpretation of Treaties, BITs are equally subject to international law. Bilateral Investment Treaties, therefore, cannot be interpreted in isolation from other treaties to which the two contracting states are parties. It is a principle of public international law that there are some obligations, namely *jus cogens*, that states cannot contract out of, for example, *jus cogens* contained in human rights treaties.

In one forum we also discussed a topic titled “non jurisdictional issues in investment arbitration”. This debate starts from the premise that investment arbitrators’ jurisdiction is limited to what is contained in the BIT and has to interpret the BITs in isolation. The question that is posed in the debate is whether there are any other issues which arbitrators may look at in arriving at an award. It is SA’s view that countries cannot be treated as commercial entities that are involved in a contractual dispute, in this instance the contract being the BIT. A state’s responsibilities are not limited to the foreign investor only and there are many other obligations placed on states in relation to all its citizens. And in a number of instances the obligations resting on a state in relation to the investor and its obligations in relation to all its citizens can be in conflict with one another.

We also participate in debates where we look at the different understanding existing between developed and developing countries concerning the purpose of BITs. From a developed country perspective BITs are seen as an instrument of protection. Whereas, developing countries look at it from a sustainable development perspective and are quite concerned about the limitations placed on them by BITs regarding flexibility and policy space they would normally have as a sovereign state without BITs.

In conclusion I would want to add that it is in the interest of all developing countries to evaluate the risk/benefits of concluding BITs taking into consideration their particular and unique circumstances. This should be done as soon as possible and developing countries should not wait till they face the daunting challenge of an international arbitration.