

Ad hoc Committee on Legislation Amending Section 25 of the Constitution

Briefing by the Department of Trade and Industry on the impact of land expropriation without compensation on international law and treaties to which South Africa is a signatory

Expropriation without Compensation Bill

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**13:30 in Committee Room E249, 2nd Floor,
National Assembly Wing**

Input on Bilateral Investment Treaties

by

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Introduction

The DTI received a request from the Committee Secretary to make an input on:

- SA's international obligations in respect of the expropriation of land and the obligation to pay compensation when land is expropriated; and that we answer the question:
- What has been done to align our international obligations with the developmental obligations contained in our Constitution?

This input is not a legal opinion. The input is based on the DTI's experience with Bilateral Investment Treaties to which South Africa is a Party; the 3-year Review we undertook on BITs that concluded in 2010; and the international debate on reform of BITs that we have engaged in since then.

Our input on bilateral investment treaties sets out a series of policy consideration that may be useful for the debate in this committee.

Current debate

Section 25 of the SA Constitution of the Property Clause envisions that property may be expropriated by the State on condition that the measure is taken under a law of general application, for a public purpose or in the public interest; and is subject to compensation, the amount of which, time and manner have either been agreed to by those affected or decided or approved by a court.

On compensation, the Constitution states that the time and manner of payment must be "just and equitable", reflecting an equitable balance between the public interest and the interests of those affected, having regard to all relevant

circumstances and then it sets out some relevant circumstances.

We understand that the Constitutional Amendment under debate is about setting out in law situations where compensation for the expropriation of land can be “nil” or, in other words, “without compensation”.

Bilateral Investment Treaties (BITs)

SA Executive signed 49 BITs but just 22 entered into force. BITs contain legal undertakings on Expropriation and Compensation that cover property of any foreign investor from the home country with whom we signed the BIT.

BITs make no reference to “land” but extend protection to ‘investments’ defined in open-ended terms following an asset-based approach. This covers “every kind of asset” of an investor in the territory of the host country - with some economic benefit associated with the investment.

BITs recognize the right of host countries to expropriate foreign property, subject to certain requirements. In general, lawful expropriation of foreign investment has to be taken for a public purpose, on a non-discriminatory basis, under due process of law, and based upon the payment of prompt, adequate and effective compensation.

On Compensation, there is some variation in the language employed in the various SA BITs. The SA-Italy BIT (1997) calls for ‘immediate, *full* and effective compensation’. Several other BITs explicitly specify compensation at market value. In general, arbitration tribunals have concluded that in the absence of express indications to the contrary, compensation is always due for lawful expropriation and that compensation should be at “fair market value”.

Relationship between BITs and the Constitution

In South Africa the Constitution is the supreme law to which all law and conduct must comply. From an international law perspective, however, BITs constitute an international treaty. The Constitution of any country is seen as part of the ‘internal’ law. A government cannot invoke its internal law, including its Constitution, as justification for not meeting its treaty obligations. This is set out in Article 28 of the Vienna Law on Treaties.

Background and Context

The first BIT was signed in 1959 (Germany-Pakistan). For 30 years after that, few BITs were in force but in the 1990s the number of BITs increased rapidly. SA’s emerged from its isolation under apartheid in this period. Our first BIT was concluded with the UK in August 1994 and that was followed other BITs with European countries, largely modeled on UK BIT.

Rationale for entering BITs was a combination of:

- An effort to provide confidence to foreign investors in the immediate post-apartheid period at a time when democratic South Africa's economic policy was largely unknown.
- Part of SA's re-entry to the international community after isolation and to promote bilateral relations.

At that time, there was little understanding of the full implications of BITs, both in South Africa and across the world. BITs did not raise concern, as there was little evidence of legal challenge under their terms.

We should also note that South Africa's first BITs entered into force before South Africa's Constitution was adopted in 1996.

Complacency with BITs was replaced by growing concerns following the spike of legal challenges by investors against Governments across the world in the wake of the financial crisis at the end of the '90s and early 2000s.

South Africa lost a case against a Swiss investor in 2004. Scrutiny in South Africa intensified in 2007 when several Italian citizens and a Luxembourg corporation filed a claim under the Belgium-Luxembourg BIT against the SA government. The claimants argued that the 2004 Mineral and Petroleum Resources Development Act (MPRDA) – part of South Africa's efforts to increase participation by historically disadvantaged South Africans in the mining industry – amounted to the expropriation of their mineral rights. While the case was later withdrawn, it focused our attention as it demonstrated how investors could challenge democratic government policy and legislation through BITs.

This led to South Africa's BITs review 2008-2010. Many other jurisdictions were undertaking similar reviews at that time.

South Africa's Review of BITs (2008-2010)

DTI organised extensive national consultations over three years, with participation from business, labour, other government departments, and with national and international experts. The review highlighted the following:

- BITs are **unbalanced**: investors can challenge government policy and actions - but not vice versa.
- Discriminates in favour of foreign not domestic investors
- **Standard provisions are not precise** (definition of investor, investment, direct and indirect expropriation, fair and equitable treatment, compensation).
- This ambiguity leaves wide scope for **inconsistent and unpredictable outcomes under arbitration**.

- This legal uncertainty can lead to ‘**regulatory chill**’ as Governments may be reluctant to regulate in the public interest if those could be subject to challenge.
- Some BITs **provisions are inconsistent with SA’s Constitution**, including its transformation objectives.
- The main motivation for entering into BITs is that they encourage inward FDI flows. The review showed there was **no clear relationship between BITs and increased FDI flows**.
- South Africa does not receive significant inflows of FDI from many partners with whom we have BITs, and we continue to receive significant investment from jurisdictions with which we have no BITs. International evidence shows the same.
- There has been a **dramatic increase in the number of claims** brought by foreign investors against governments with the first in 1987, growing cumulatively to 50 by 2000, and 514 by 2012 and 942 by 2019.
- As some arbitration is confidential, the actual number of disputes filed is likely to be higher.
- Most challenges are against developing country governments.
- Most awards favour of investors.
- Amounts of compensation are growing significantly.
- **Deficiencies in the international investment arbitration system.**
- The ISDS system is fragmented with various venues for arbitration, each with its own rules of procedure, history and culture.
- Recurring episodes of inconsistent awards and interpretations by panels aggravate uncertainty.
- Arbitrators are chosen in an *ad hoc* manner.
- Questions on whether arbitration processes conducted by three individuals possess sufficient legitimacy to assess acts of State particularly on sensitive public policy issues.
- In South Africa we were concerned that arbitration awards, issued by panels of three arbitrators, could undermine democratic decision-making.
- The system lacks an institutional framework for judicial accountability or the independence of arbitrators

These concerns are widely shared across the world, and reform efforts to the system are underway along a variety of lines. Many other countries have terminated their BITs. Some began to re-negotiate the treaties or provide interpretative notes for certain provisions. There are also efforts to reform the arbitration system. In short, the system is under reform.

Cabinet Decision July 2010

Taking account of the Review, the SA Cabinet adopted a new framework for investment policy making in SA in a decision in July 2010. There were five core elements to the decision:

- Develop a new national Investment Act;
- SA will only enter into BITs in future on the basis of compelling economic or political reasons where there is clear benefit;
- Development of a new BIT template that is in line with SA Constitution and policy;
- Terminate BITs in force;
- Establish an Inter-Ministerial Committee (IMC) to oversee work on investment.

Termination

In accordance with the Cabinet mandate, terminations of BITs formally commenced in 2013. We were required to begin with European BITs (14) as dates for termination/roll-over were imminent. This was also the time that competence for negotiating BITs was moving from EU Member States to the EU Commission, under the Lisbon Treaty.

Europe: [Netherlands, Belgium and Luxemburg, Germany, Austria, UK, France, Spain, Italy, Greece, Sweden, Denmark, Finland, Switzerland]
Latin America [Cuba, Argentina]; Asia [China, South Korea]
Africa [Nigeria, Senegal, Mauritius, Zimbabwe]

Survival Clause

BITs contain what is referred to as a “survival clause”. Following formal termination, the already existing investment protected under those BITs continues for a period of time. The periods vary: 10, 15 or 20 years.

14 BITs have been formally notified for termination, and the survival clause is in effect for 12 (as the date for termination is later): Netherlands, Austria, France, Germany, UK, Switzerland, Finland, Sweden, Belgium and Luxemburg, Spain, Denmark, Italy, Greece, Argentina. The BITs we have with African countries (Senegal, Nigeria, Zimbabwe and Mauritius) should be replaced by an Africa-wide Investment Protection Agreement under the AfCFTA. The BITs with China and Russia are under discussion.

SA BITs have been presented to Parliament inconsistently. Some have entered into force under Section 231 (2), and others under 231 (3).¹ Of the remaining

¹ The SA Constitution, in Section 231 on International Agreements specifies: “1. *The negotiating and signing of all international agreements is the responsibility of the national executive.* 2. *An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).* 3. *An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the*

BITs, we are advised that terminating BITs with Cuba and S. Korea will henceforth require a Parliamentary decision as they were ratified under Section 231(2).

Closing Remarks

The DTI has followed through on the instructions of Cabinet. We have embarked on terminating existing BITs. A New Investment Act was adopted in 2015 and we have developed a new Model BIT in SADC.

With respect to the matter of expropriation and compensation, we may indicate the following.

If land of a foreign investor is expropriated and that investor is a citizen of a country that has a BIT with South Africa (including where the survival clause is in effect), the affected investor would be in a position to invoke a legal challenge under the BIT against the Government if the investor is not satisfied by the amount of the compensation.

Three arbitrators under terms of International Settlement of Investment Disputes (ISID) would make a determination on the matter. While the outcome cannot be predicted, arbitrators' may take into account national legislation but their primary reference would be the terms of the BIT itself. On the question of compensation, past cases indicate that the standard has tended to be the "market value" of the investment immediately before the expropriation took place.

The Government may face a challenge if the new legislation could be construed to impact negatively on the land value of a foreign investor. Some of the jurisprudence on investment treaties has referenced a standard of "legitimate expectation" in respect to returns from investment.

It may be useful to draw attention to the relevant eligibility requirement set out in the United States General System of Preferences. While this does not constitute an international obligation for South Africa, it does set a standard to benefit from preferential access provided under the GSP to the US market. The relevant criterion reads:

"A beneficiary may not have nationalized, expropriated or otherwise seized property of U.S. citizens or corporations without providing or taking steps to provide, prompt, adequate, and effective compensation, or submitting such issues to a mutually agreed forum for arbitration;"

Finally, the 2015 Investment Act, article 10, on Legal protection of investment reads: "Investors have the right to property in terms of section 25 of the Constitution." A minor change to the Investment Act may be required if Section 25 if the Constitution is adjusted.

National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time."