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Will They Stay or Will They Go? An Examination of South Africa's International Invest Arbitration Policy

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WILL THEY STAY OR WILL THEY GO?: AN EXAMINATION OF SOUTH AFRICA'S INTERNATIONAL INVESTMENT ARBITRATION POLICY

As the world becomes more interconnected, international investment disputes are on the rise.[1] For states who host foreign investors the stakes are higher than ever. Uncertainty surrounding the outcome of investment disputes, coupled with their high price and lengthy duration, are leading some states to reconsider the effectiveness of bilateral investment treaties (BITs).[2] Reconsideration of BITs has pushed the international investment treaty regime towards a legitimacy crisis.[3] It is evident that the current system needs to undergo reform, but it is less apparent how that reform should be implemented and what issues should take priority.[4] Responding to the crisis, the United Nations Commission on International Trade Law (UNCITRAL)[5] began researching "possible reforms in the field of investor-state arbitration" hoping to stabilize the regime.[6] In 2017, UNCITRAL established Working Group III and tasked it with procedural reform of investor-state dispute settlement

1. *Current Trends in International Investment Arbitration,* AM. BAR ASS'N (Mar. 1, 2015), https://www.americanbar.org/groups/litigation/publications/litigation_journal/2014-15/spring/current_trends_international_investment_arbitration/.

2. U.N. Comm'n on Int'l Trade Law [UNCITRAL], Possible Reform of Investor State Dispute Settlement (ISDS), ¶¶ 9, 14-16 U.N. Doc. A/CN.9/WG.III/WP.149 (Sept. 4, 2018) [hereinafter W.P. 149]; Holger Hestermeyer & Anna De Luca, *Duration of ISDS Proceedings* EJIL:TALK! (Apr. 3, 2019), https://www.ejiltalk.org/duration-of-isds-proceedings/.

3. The term legitimacy crisis will be discussed *infra* Section II.

4. W.P. 149, *supra* note 2, ¶¶ 1–3.

5. UNCITRAL is a body established by the United Nations General Assembly which "[promotes] the progressive harmonization and unification of the law of international trade" G.A. Res. 2205 (XXI), §I, U.N. Doc. A/RES/2205 (Dec. 17, 1966).

6. UNCITRAL, Rep. Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Thirty-Fourth Session, ¶ 1, U.N. Doc. A/CN.9/930/Rev.1 (Dec. 19, 2017).

(ISDS).[7] The Working Group was tasked with a three-step process and broad discretion to accomplish its mandate.[8]

However, not all states are content remaining in the international investment treaty regime or waiting for the Working Group to promulgate its suggested reforms. In 2018, South Africa's much debated Protection of Investment Act, 2015 (the Act) went into effect.[9] Designed to replace the state's BITs, the Act signified a radical shift in South Africa's attitude towards international investment policy.[10] Onlookers feared that South Africa's decision to terminate these agreements would make the state less attractive to foreign investors.[11] Investors worried about the safety of their investments in South Africa.[12] However, South Africa is not alone in its decision to terminate its BITs; it joined four other states exploring alternative frameworks for international investment.[13] Many former Euro-

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7. *Id.* ¶ 6.

8. *Id*. The mandate is as follows: "(i) first, identify and consider concerns regarding ISDS; (ii) second, consider whether reform was desirable in light of any identified concerns; and (iii) . . . develop any relevant solutions to be recommended to the Commission." *Id*.

9. Phillip de Wet, *Ramaphosa just activated a law that scares foreign investors – and makes it harder for them to fight expropriation*, BUS. INSIDER: S. AFR. (July 13, 2018, 5:29 PM), https://www.businessinsider.co.za/protection-of-investment-act-commencement-gazetted-foreign-mediation-bee-section-25-constitution-2018-7.

10. *See id.* Prior to South Africa's decision to reform its international investment policy it was party to 23 BITs. Sarah McKenzie, Nick Alp, Vlad Movshovich & Trevor Versfeld, *SA investment laws: Foreign investors with treaty protection may challenge land expropriation*, IOL (Dec. 10, 2019), https://www.iol.co.za/business-report/opinion/sa-investment-laws-foreign-investors-with-treaty-protection-may-challenge-land-expropriation-38945189 [hereinafter SA Investment Laws]; Adam Green, *South Africa: BITs in pieces*, FIN. TIMES (Oct. 19, 2012), https://www.ft.com/content/b0eec497-5123-3939-92f7-a5fbcb73dd33. South Africa began unilaterally terminating treaties in 2013. SA Investment Laws, *supra* note 10. It is currently still party to 12 BITs, and is in the process of terminating half of them. *Id.*

11. Stephen Hurt, *Why South Africa has ripped up foreign investment deals*, THE CONVERSATION (Dec. 17, 2013, 1:43 AM), http://theconversation.com/why-south-africa-has-ripped-up-foreign-investment-deals-20868; Leandi Kolver, *SA proceeds with termination of bilateral investment treaties*, POLITY (Oct. 21, 2013), https://www.polity.org.za/article/sa-proceeds-with-termination-of-bilateral-investment-treaties-2013-10-21.

12. De Wet *supra* note 9.

13. *See Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries Foreign Direct Investment Inflows*, PUB. CITIZEN 1, 1

pean colonies hastily entered into BITs soon after gaining independence to finance ambitious infrastructure and education projects.[14] As a result, these states now find themselves bound to vague agreements that make it difficult to understand what obligations they owe foreign investors.[15]

This Note seeks to examine South Africa's Protection of Investment Act, 2015, its proposal for ISDS reform to Working Group III, and its comments during ISDS reform meetings through the lens of Albert Hirschman's Exit, Voice, and Loyalty theory.[16] This Note argues that, contrary to both popular belief and statements made by the nation, South Africa's apparent exit from the international investment regime is part of a long-term policy strategy to promote advantageous ISDS reform. To date, the content and application of the Act has been a source of significant academic discussion; however, there is little, if any, discussion that explains the seeming contradiction of South Africa's passage of the Act with its participation in Working Group III's reform discussions what might explain the contradiction.

This Note proceeds in four parts. Part I describes the history of the investment treaty regime, chronicling the shift from customary international law to BITs. Part II discusses the drawbacks of the current BIT regime.. Part III details the evolution of South Africa's investment policy, which culminated in the Protection of Investment Act, 2015. Finally, Part IV analyzes South Africa's words and actions under the Exit, Voice and Loyalty theory, arguing that, contrary to the suggestions of commentators, South Africa is not turning its back on the investment regime. Instead, it is attempting to promote desired reform within the existing international framework while pre-

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(Apr. 2018), https://www.citizen.org/wp-content/uploads/pcgtw_fdi-inflows-from-bit-termination_0.pdf.

14. *See* JONATHAN BONNITCHA, LAUGE N. SLOVGAARD POULSEN & MICHAEL WAIBEL, THE POLITICAL ECONOMY OF THE INVESTMENT TREATY REGIME 46 (Oxford U. Press 2017).

15. Kavaljit Singh & Burghard Ilge, *Introduction in* RETHINKING BILATERAL INVESTMENT TREATIES: CRITICAL ISSUES AND POLICY CHOICES 1, 3 (Kavaljit Singh et al. 2016); James x. Zhan, *International Investment Rulemaking; Trends, Challenges and Way Forwar*d *in* RETHINKING BILATERAL INVESTMENT TREATIES: CRITICAL ISSUES AND POLICY CHOICES, 17, 20 (Kavaljit Singh et al. 2016).

16. Exit, Voice, and Loyalty theory will be discussed at length *infra* Part IV.

serving an option to remain outside the system if adequate reform is not enacted.

I. CUSTOMARY INTERNATIONAL LAW AND INTERNATIONAL INVESTMENT PROTECTION

The modern international investment treaty regime is rooted in customary international law.[17] Initially, however, the protection of foreign investors and their investments derived from the domestic law where the investment was located.[18] Homogeneity between the domestic laws of the major states in the 19th century led to a relatively uniform standard of treatment for domestic and foreign investors.[19] However, the Russian Revolution brought about a major shift in the law.[20] In accordance with the socialist principles underpinning their new government, the Soviets pursued aggressive expropriation policies against nationals and aliens.[21] Met with outrage from the international community, the Soviet government argued that they did not violate the rights of aliens because the expropriation policy did not solely target foreigners,[22] as the government was seizing the property of nationals and foreigners alike.[23] The Soviet government abolished private property ownership in favor of communal property ownership in sharp contrast with the West's emphasis on private property rights.[24] The Soviet Union's rationale would also prove influential, as Mexico employed the same argument in 1938 to defend nationalizing its agrarian and oil industries.[25]

This defense became the basis of the modern national treatment standard, which requires states to treat foreigners as well as they treat their own nationals.[26] Therefore, as long as there

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17. *See* RUDOLF DOLZER & CHRISTOPH SCHREUR, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 5 (2d ed. Oxford U. Press 2012)

18. *Id.* at 1.

19. *Id.*

20. *See id.* at 5.

21. *Id.* at 2.

22. *Id.* The Soviet government would ultimately be required to compensate the alien investor under a theory of unjust enrichment as part of the Lena Goldfields Arbitration of 1930. *Id.*

23. *Id.*

24. John N. Hazard, *Soviet Property Law*, 30 CORNELL L. REV., 466, 469 (1945).

25. DOLZER & SCHREUR, *supra* note 17, at 2.

26. *See id.*

is no disparity in treatment between the two groups, there is no a violation of international law.[27] The actions of the Soviet Union and Mexico demonstrated a shift in the status quo and signaled to investors that they could no longer rely on domestic laws to the same extent to protect their investments. For the first time, states had to confront a major difference in their views on investment, property and claims adjudication.[28] In response to the Mexican government's actions, United States Secretary of State Cordell Hull acknowledged that while expropriation may be legal under certain circumstances, it is only legal against foreigners with "prompt, adequate and effective compensation."[29]

The international investment system remained largely unchanged until the end of World War II. As decolonization continued in the post-war period, new states seeking economic freedom took their fight to the United Nations and passed a resolution titled "Permanent Sovereignty Over Natural Resources."[30] The General Assembly's one country, one vote mechanism tipped in favor of the developing, capital-importing states—a bloc that constituted a bulk of United Nations membership.[31] Notably, the General Assembly passed Resolution 1803, which stated, inter alia, that "the admission of foreign investment was subject to the authorization, restriction or prohibition of the state and would be treated in accordance with national and international law."[32] It further stipulated that expropriation should be compensated but declined to adopt the Hull Standard.[33] Instead, Resolution 1803 required that compensation be "appropriate."[34]

Separately, the international community began to reexamine the status and protection of aliens in other areas of interna-

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27. *Id.*

28. *Id.*

29. *Id.* Secretary Hull's response would become known as the Hull Formula. BONNITCHA ET AL., *supra* note 14, at 121.

30. ANDREW NEWCOMBE & LUIS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES 26 (Kluwer Law International 2009).

31. *See Growth in United Nations membership, 1945-present*, U.N., https://www.un.org/en/sections/member-states/growth-united-nations-membership-1945-present/index.html (charting UN membership during decolonization).

32. NEWCOMBE & PARADELL, *supra* note 30, at 26.

33. *Id.* at 26–27.

34. *Id.* at 26.

tional law.[35] The European Court of Human Rights raised concerns about the vulnerability of aliens given their inability to participate in the policymaking process in foreign states.[36] After much debate, consensus emerged that aliens should be protected against certain measures of a foreign state by the rules of international law, operating independently of a state's domestic law.[37] This rationale bled into the fledgling international investment regime leading to the development of the international minimum standard.[38] A violation of this standard occurs when the treatment of an alien amounts to "an outrage . . . bad faith . . . willful neglect of duty, or to an insufficiency of governmental action so far short of the international standards that every reasonable . . . man would . . . recognize its insufficiency."[39] The addition of the international minimum standard complicated international dispute resolution.[40] States now had to choose between the international minimum standard or the national treatment standard as their guiding standard of treatment for foreign investments.[41] Following decolonization, emerging states favored the national treatment standard which promoted state sovereignty, while established states favored the international minimum standard, which preserved the status quo for its investors.[42]

A. Dispute Resolution under Customary Law

If a standard of treatment is breached, the home state may pursue a claim via diplomatic protection on behalf of its injured citizen.[43] Diplomatic protection allows a home state to claim the injury of their national as its own and use its discretion to pursue a claim against the host state.[44] To receive diplomatic protection, the injured investor must show that they are a na-

35. DOLZER & SCHREUR, *supra* note 17, at 3.
36. *Id.*
37. *Id.*
38. *Id.*
39. L.F.H. Neer and Pauline Neer (U.S.) v. United Mexican States, 4 R.I.A.A 60, 61-62 (U.S.-Mex. Gen. Claims Comm'n 1926).
40. BONNITCHA ET AL., *supra* note 14, at 12.
41. *See* DOLZER & SCHREUR, *supra* note 17, at 1–4 (explaining the development and application of the international minimum standard and the national treatment standard).
42. BONNITCHA ET AL., *supra* note 14, at 46.
43. *Id.* at 22.
44. *Id.* at 23, 68.

tional of the home state and that they have exhausted all local remedies in the host state.[45]

The exercise of diplomatic protection has several drawbacks for injured investors. First and foremost is the requirement the investor exhaust local remedies.[46] Moving a claim through the host state's legal system can take years and be very costly.[47] Second, the home state is under no obligation to pursue the claim of the investor.[48] The doctrine of diplomatic protection merely grants the state discretion to pursue a claim—it does not mandate its pursuit.[49] Since states prefer to maintain the status quo in international relations, they may choose not to pursue claims against their strategic allies.[50] However, failure to intervene on behalf of an injured national may have drastic political costs domestically.[51] As a result, home states must weigh the costs of pursuing a claim as to do so may conflict with broader foreign policy objectives.[52] Furthermore, when an individual seeks the assistance of their home state to pursue a claim, they relinquish control over the claim.[53] When exercising diplomatic protection, the state claims the individual's injury as its own and is thus entitled to any compensation; i.e., there

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45. Barcelona Traction, Light and Power Company, Ltd. (Belg. v. Spain), Judgment, 1970 I.C.J. Rep. 3, at 27, 46 (Feb. 5).

46. BONNITCHA ET AL., *supra* note 14, at 68.

47. CHRISTIAN TIETJE & FREYA BAETENS, THE IMPACT OF INVESTOR-STATE-DISPUTE SETTLEMENT (ISDS) IN THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP 95 (2014), https://www.eumonitor.eu/9353000/1/j4nvgs5kjg27kof_j9vvik7m1c3gyxp/vjn8exgvufya/f=/blg378683.pdf.

48. Belg. v. Spain, 1970 I.C.J. at 50.

49. Christoph Schreuer, *Investment Protection and International Relations, in* THE LAW OF INTERNATIONAL RELATIONS: LIBER AMICORUM HANSPETER NEUHOLD 345, 345 (August Reinisch & Ursula Kriebaum eds., Eleven Int'l Pub. 2007).

50. Jack S. Levy, *Prospect Theory and International Relations: Theoretical Applications and Analytical Problems*, 13 POL. PSYCHOL. 283, 284 (1992).

51. BONNITCHA ET AL., *supra* note 14, at 194–95.

52. *Id.* One prominent example of this can be seen in a 1938 dispute between the United States and Mexico. *Id.* The executive branch of the United States was hesitant to pursue a claim for fear that the pursuit would push Mexico towards the Soviets. *Id.* However, Congress was more responsive to investors who lobbied for their interest, particularly during an election year. *Id.* This set up a clash between foreign policy goals and domestic goals. *See generally id.*

53. Schreuer, *supra* note 49, at 345.

is no guarantee that the state will pass the compensation on to their national.[54]

Proponents of diplomatic protection argue that the international system is comprised of states and that they alone are the entities empowered to bring claims against other states.[55] They further argue that the discretion to pursue claims serves as a gatekeeping function preventing the system from being overburdened by frivolous claims.[56] Those in favor of allowing individuals to bring claims argue that states abuse their discretion to bring claims, filtering claims based on politics rather than merit.[57] Thus, the ability for an individual to bring their own claim depoliticizes the dispute, allows them to retain control for the life of the claim, and ensures that any compensation for injury goes to directly to the injured investor.[58]

B. Shifting from Customary Law to Bilateral Investment Treaties

After losing the fight for favorable and predictable investor protections at the United Nations, capital-exporting states responded by implementing a network of bilateral investment treaties. BITs allow capital-exporting states, to obtain more favorable access to capital-importing markets.[59] While each agreement varies, virtually all BITs provide foreign investors protection from expropriation and discrimination, and with a dispute resolution mechanism via binding arbitration.[60] Understanding how BITs differ from investor protections derived from customary law serves as an important backdrop to understanding why countries such as South Africa have terminated them.

Modern day BITs are "treaties between two or more states that have the protection of foreign investment as the primary,

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54. *Draft Articles on Diplomatic Protection with commentaries*, [2006] 2 Y.B. of Int'l Law Comm'n, pt. 2, art. 19, cmt. 1 U.N. Doc (A/61/10).

55. BONNITCHA ET AL., *supra* note 14, at 65.

56. *See id.* at 67.

57. *Id*. at 193.

58. *See Primer: International Investment Treaties and Investor-State Dispute Settlement,* COLUMBIA CENTER ON SUSTAINABLE INVESTMENT, http://ccsi.columbia.edu/2019/06/03/primer-international-investment-treaties-and-investor-state-dispute-settlement/ (last updated May 31, 2019).

59. *See* NEWCOMBE & PARADELL, *supra* note 30, at 41.

60. BONNITCHA ET AL., *supra* note 14, at 3.

or only subject matter."[61] While no two BITs are identical, virtually all investment treaties provide broad provisions that protect the foreign investor against expropriation absent adequate compensation and discrimination.[62] Increasingly, BITs provide investors with additional protections including breaches of contract and against losses as a result of political or social upheaval.[63] BITs also reduce the transaction costs associated with investing for investors who now no longer need to negotiate individual contracts with the host state before investing.[64] However, because these BITs are intended to cover investments in all sectors of the economy, they are often drafted expansively to ensure broad applicability.[65] This broad applicability, coupled with a decentralized claims process, opens the door to a flood of litigation against host states.[66]

Another major development provided by BITs is their dispute resolution mechanism. Rather than relying on diplomatic protection, states included provisions allowing foreign investors to seek resolution of their claims through binding international arbitration.[67] Today, 96% of all BITs contain language for ISDS via binding arbitration.[68] ISDS provisions and coverage vary widely, making it difficult for a uniform set of rules to emerge.[69] However almost all BITs provide for "broad and binding consent . . . to arbitration of disputes between foreign investors and host state."[70] These arbitrations can be either ad hoc or institutional proceedings presided over by a variety of organizations.[71] Ad hoc arbitration gives investors and states wide

61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* at 24.
65. *See id.* at 26.
66. Luke Peterson, *Changing Investment Litigation, Bit by BIT,* 5, INT'L CENTRE FOR TRADE AND SUSTAINABLE DEV. 11, 11 (2001).
67. *See* BONNITCHA ET AL., *supra* note 14, at 4. The first BIT to include state consent to arbitration as a mechanism for dispute resolution was the Italy-Chad BIT (1969). *Id.* at 62.
68. JOACHIM POHL, KEKELETSO MASHIGO & ALEXIS NOHEN, DISPUTE SETTLEMENT PROVISIONS IN INTERNATIONAL INVESTMENT AGREEMENTS: A LARGE SAMPLE SURVEY 10 (2012).
69. *See* BONNITCHA ET AL., *supra* note 14, at 55.
70. *Id.* at 4.
71. *Institutional vs.'ad hoc' arbitration,* PINSENT MASONS (Aug. 12, 2011, 10:56 a.m.), https://www.pinsentmasons.com/out-law/guides/institutional-vs-ad-hoc-arbitration.

latitude to decide who will serve as an arbitrator, how they will be selected, and what rules will govern the proceeding.[72] Institutional arbitrations allow significantly less flexibility in the procedure surrounding the arbitration, which is carried out by a predetermined arbitral body maintaining its own rules and procedures.[73] Arbitration provisions not only give the arbitral body the power to decide the claim on the merits, but also broad power to determine their own jurisdiction, and deliver awards that exceed amounts available in domestic courts.[74]

Foreign investors can bring a variety of claims to an arbitral tribunal under the BIT, but the majority of claims are claims based on expropriation or discrimination.[75] Arbitral tribunals have distinguished between two types of expropriation: "de facto" or "creeping" expropriation.[76] A de facto expropriation occurs when a host state's "actions or laws transfer assets to third parties different from the [host] State or where . . . persons [are deprived] of their ownership of . . . assets" without reallocation to a third party or government.[77] A particularly influential standard of de facto expropriation arose from *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (*Tecmed*).[78] The award states that a de facto expropriation has occurred if the claimant is "deprived of the economical use and enjoyment of its investment."[79] While there is no widely agreed upon definition of creeping expropriation, it is "generally understood that [it] materialize[s] through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect.[80]

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72. *Id.*

73. *Id.* Some common international arbitral bodies include the international court of arbitration, International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), and the International Centre for Settlement of Investment Disputes (ICSID). *Id; see generally,* BONNITCHA ET AL., *supra* note 14, at 5, 22–23. ICSID arbitrations account for over 60% of public investor-state arbitrations with over 2/3rds of those based on treaties. BONNITCHA ET AL., *supra* note 14, at 69.

74. BONNITCHA ET AL., *supra* note 14, at 4.

75. *Id*. at 94.

76. *Id.* at 93, 104–05.

77. Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States, ICSID Case No. ARB (AF)/00/2, Award, ¶ 113 (May 29, 2003).

78. *Id.*

79. *Id.* ¶ 114.

80. *Id.*

Creeping expropriation can occur through either a single action or a series of actions over time that deprive a foreign investor of their asset.[81]

However, not all expropriations constitute a violation of the BIT. An expropriation may be legal if it comports with due process, pursues a legitimate public policy, and is appropriately compensated.[82] To determine whether an unlawful expropriation has occurred, an arbitral tribunal must examine the evidence presented and determine whether the state validly exercised its regulatory powers or whether the state's actions were designed to devalue foreign assets.[83] While regulations passed by the host state may be well-intentioned, arbitral bodies have determined that the intent of regulations at issue are less important than their effect.[84] This sweeping determination has led to a regulatory chill among host states who hesitate to regulate in the interest of their citizens because of looming lawsuits by powerful foreign investors.[85]

Investors also bring claims against the host state on the basis of discrimination.[86] Discrimination claims can be brought for violations of the national treatment standard or the most-favored-nation standard.[87]

Foreign direct investment (FDI) is a vital part of a developing state's economy. As a finite resource, basic economic principles drive developing states to compete with one another to attract foreign investment.[88] Following the advice of the World Bank, United Nations, and other international experts, a majority of developing states began to negotiate and implement bilateral investment treaties to entice foreign investors.[89]

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81. *Id.*
82. BONNITCHA ET AL., *supra* note 14, at 16.
83. Tecnicas Medioambientales, ICSID Case No. ARB (AF)/00/2, ¶115.
84. *Id.* ¶ 116.
85. BONNITCHA ET AL., *supra* note 14, at 17.
86. *Id.* at 96.
87. *Id.* at 151.
88. CHARLES OMAN, POLICY COMPETITION FOR FOREIGN DIRECT INVESTMENT: A STUDY OF COMPETITION AMONG GOVERNMENTS TO ATTRACT FDI 7 (OECD 2000).
89. BONNITCHA ET AL, *supra* note 14, at 11.

II. DRAWBACKS OF THE BILATERAL INVESTMENT TREATY REGIME

The bilateral investment treaty regime is experiencing a legitimacy crisis.[90] Institutional legitimacy is subject to dynamic perspectives on "appropriate behavior . . . revised through changing practices and interstate deliberation."[91] Perspectives on what is appropriate are shaped by complex political and social structures.[92] These structures are subject to evolution over time as attitudes and expectations shift with the addition of new players and new agendas.[93] New additions "reopen deliberations over the bases of legitimacy through which the institution is empowered."[94] While these shocks to the system can be expected, it is much more difficult to predict when they will occur and what impact they will have on the institution.[95]

When these shocks occur, disputes arise over the best response.[96] The intensity of disagreement depends on the intensity of change, with intensity of disagreement increasing with the intensity of change. For example, it is common for major reform to be obstructed rather than being adopted by general

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90. Legitimacy is defined as "the appropriateness of certain rules governing state behavior." Diane Imerman, *Contested Legitimacy and Institutional Change: Unpacking the Dynamics of Institutional Legitimacy*, 20 INT'L STUDIES REV., 74, 74–75 (2018). Legitimacy is comprised of a temporal dynamic and a subjective dynamic. *Id.* at 74. The temporal dynamic is defined as "how perceptions of legitimacy vary in response to an intrinsically dynamic political environment." *Id.* at 75. The subjective dynamic is defined as "the variability with which individual states and other actors in the international system understand an institution's legitimacy." *Id.* These two dynamics work together to inform a state's opinion on the legitimacy of an institution. *See id.* at 75–76. As a result, two states may determine an institution is legitimate for different reasons. *Id.* at 76. During a period where an institution's legitimacy is in question, renegotiating can uncover tensions between two state's reasons for conferring legitimacy. *Id.* While negotiating requires some compromise, changes to some institutional behaviors while ignoring others, threatens the underlying perceptions that legitimize the institution. *Id.* The degree of reform success depends on the degree to which the reform "aggravate[s] or alleviate[s] the contested notions of legitimacy." *Id.* Therefore, institutions should balance the collection of information about the contested notions of legitimacy with the urgency of reform.

91. *Id.* at 75.

92. *Id.*

93. S*ee id.* at 76.

94. *Id.*

95. *See id.* at 75.

96. *Id.* at 76.

consensus.[97] New players with new ideas place pressure on the institution to adapt to remain legitimate.[98] As the pressure increases, the institution risks falling into a legitimacy trap.[99] A legitimacy trap occurs at the point when the "probability of obstructive disagreement is highest precisely when the pressures to adapt are [the] most intense."[100]

The termination of BITs signals that states are questioning the legitimacy of the BIT regime. States began terminating BITs in 2008.[101] In 2013 and 2014, UNCITRAL took note of the growing dissatisfaction among states and began discussing possible steps for reform.[102] By 2017, UNCITRAL gave Working Group III its mandate for reform. During its thirty-fourth session, Working Group III addressed state concerns regarding ISDS.[103] Those concerns broadly fell into two categories. First, concerns over the arbitral process and outcomes, and second, those over arbitrators and decision-makers.[104] Some examples of procedural concerns include the costs and duration associated with arbitration,[105] the lack of mechanisms to review awards,[106] issues with enforcement,[107] and the inconsistency of awards.[108] Each of these will be discussed briefly below to provide the context necessary to understand South Africa's at-

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97. *Id.* at 88 (See Figure 1, which compares intensity of change with intensity of disagreement).

98. *Id.* at 75.

99. *Id.* at 76.

100. *Id.*

101. *Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries 'Foreign Direct Investment Inflows*, PUB. CITIZEN 1, 2 (Apr. 2018), https://www.citizen.org/wp-content/uploads/pcgtw_fdi-inflows-from-bit-termination_0.pdf. Ecuador terminated its first BIT in 2008. *Id.* Bolivia began terminating BITs in 2009 and South Africa in 2010. *Id.* Indonesia and India gave notice that they would terminate their BITs in 2014 and 2016, respectively. *Id.*

102. UNCITRAL, Rep. on the Work of its Forty-Sixth Session, ¶¶ 129–133, U.N. Doc. A/68/17 (2013).

103. *See generally* UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS), U.N. Doc. A/CN.9/WG.III/WP.142 (Sept. 18, 2017) [hereinafter W.P. 142].

104. *Id.* ¶ 20.

105. *Id.* ¶ 16.

106. *Id.* ¶ 39–41.

107. *Id.* ¶ 39.

108. *Id.* ¶ 31–38.

tempt to seek reform through its domestic legislation and calls for reform in Working Group III.

A. Cost and Duration Associated with Arbitration

One of the initial allures of arbitration was that it provided a dispute resolution mechanism that was faster and less expensive than traditional litigation; however, that has not played out in practice.[109] In 2018, Working Group III determined that the average cost of ISDS arbitration is $8 million.[110] The average length of arbitration is three to four years.[111] The rising costs of ISDS arbitration have put a significant financial strain on host states who are then criticized by their citizens for improper use of public funds.[112] This complaint cannot be ignored since a majority of respondent states have limited financial resources, hence their need to import capital into their markets in the first place.[113] The increasing cost of arbitration may be a result of the legal complexities involved in the cases, however it is worth understanding exactly what is factored into the cost of an arbitration.[114]

The cost of arbitration can be broken down into tribunal costs, administrative costs, and party costs.[115] Tribunal costs capture those costs associated with arbitrator fees and tribunal secretaries, while administrative costs capture fees that may be charged by the governing arbitral institution.[116] A bulk of the costs—approximately 80-90%—are party costs.[117] These costs include the fees associated with legal counsel and expert witnesses.[118] While these costs may be burdensome for investors who seek to bring claims to arbitration, the burdens are compounded for respondent states who must engage in arbitrations

109. *Id.* ¶ 23.
110. UNCITRAL, Rep. of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Fourth Session, ¶ 36, U.N. Doc. A/CN.9/930/Rev.1 (2017) [hereinafter Rep. 930].
111. UNCITRAL, Possible Reform of Investor-State Dispute Settlement — Cost and Duration, ¶ 2, U.N. Doc. A/CN.9/WG.III/WP.153 (Aug. 31, 2018) [hereinafter W.P. 153].
112. W.P. 142, *supra* note 103, ¶ 25.
113. W.P. 153, *supra* note 111, ¶ 8.
114. W.P. 142, *supra* note 103, ¶ 24.
115. W.P. 153, *supra* note 111, ¶ 18.
116. *Id.*
117. *Id.* ¶ 19.
118. *Id.*

with numerous investors. Each arbitration that states are engaged in takes away valuable funds that could be used to fund public programs for their citizens. Finally, a state may incur additional costs associated with collection of an award or for defense against enforcement of an award.[119]

B. Lack of Review Mechanisms

Compared to domestic legal systems, the international arbitration system is rudimentary. Notably absent from the international arbitration system is a central body responsible for appeals of arbitral awards and overseeing the conduct of arbitral proceedings.[120] In response, Working Group III has received numerous proposals for the creation of a centralized dispute resolution institution with an appellate mechanism.[121] States argue that the creation of a centralized dispute mechanism will help ensure the "procedural and substantive correctness of decisions . . . providing parties with a coherent and fair decision."[122] Working Group III has reviewed various existing appellate mechanisms to determine the scope of review that the proposed appellate body would have.[123] The Working Group has also discussed the effect of appeal[124] and the composition of the ISDS appellate body.[125]

One argument in support of this decentralized system is that arbitration is a private dispute mechanism and as such, their decision has no bearing on future arbitral proceedings.[126] This

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119. *Id.* ¶ 21.

120. *See* BONNITCHA ET AL., *supra* note 14, at 77–78.

121. UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS) Appellate Mechanism and Enforcement Issues, ¶ 3, U.N. Doc. A/CN.9/WG.III/WP. — (unpublished) *available at* https://uncitral.un.org/en/working_groups/3/investor-state (last accessed Sept. 13, 2020) (author cites to the unpublished draft document which was open for comment at the time of publication); *See e.g., id.* at n.3 (detailing the proposals for an appellate mechanism received by Working Group III).

122. UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS) Appellate and Multilateral Court Mechanisms, ¶ 7, U.N. Doc. A/CN.9/WG.III/WP.185 (Nov. 29, 2019) [hereinafter W.P. 185].

123. *Id.* ¶¶ 11–18. Working Group III examined international and domestic appellate mechanisms including the World Trade Organization, the International Court of Justice, the International Tribunal for the Law of the Sea. *Id.*

124. *Id.* ¶¶ 24– 33.

125. *Id.* ¶¶ 34– 36.

126. BONNITCHA ET AL., *supra* note 14, at 246.

argument suggests that each arbitration is fully autonomous, rather than a piece of a complex legal regime.[127] However, arbitral awards frequently cite to awards from other tribunals that have confronted similar issues, reinforcing the belief that arbitral tribunals fulfill a governance role and help determine what the law should be going forward.[128] Bodies tasked with such an important role should be subject to certain norms including predictability, transparency, and consistency.[129]

C. Issues with Enforcement

The few defenses against enforcement relate to procedural defects, such as lack of transparency by the arbitrator or awards for issues beyond the scope of the arbitration clause.[130] The threshold to overcome the presumption of enforcement is high, and most courts will enforce an award unless there is overwhelming evidence of serious procedural misconduct.[131] As it stands, states argue that the arbitration system tends to favor investors and provides little review of awards rendered.[132] States that are against arbitration provisions argue that foreign investors are already the recipient of specialized protections and do not need their own dispute settlement mechanism.[133] They further argue that requiring states to bring claims on behalf of their injured nationals plays an important gatekeeping process.[134]

D. Inconsistency of Awards

States complain about the inconsistency in awards rendered by ISDS. Working Group III indicated that some of this inconsistency may result from the varying standards captured by BITs.[135] Other inconsistencies result from the types of claims brought to the arbitral tribunal.[136] Regardless of the cause of

127. *Id.*
128. *Id.* at 246–47.
129. *Id.* at 247.
130. *Id.* at 77.
131. *Id.* at 78.
132. *Id.*
133. *Id.* at 12.
134. *Id.* at 246.
135. W.P. 142, *supra* note 103, ¶ 32.
136. *Id.* ¶ 33.

the inconsistency, states argue that the inconsistencies must be resolved to preserve the legitimacy of ISDS.[137]

One scenario states expressed concern over instances where separate tribunals have reached different conclusions regarding standards or procedural issues under the same BIT.[138] In these cases, the facts were either the same or the differences were de minimis, and, in the opinion of the states, did not warrant differing conclusions.[139] The Working Group cited *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* and *Continental Casualty Company v. Argentine Republic* as an illustrative example of this problem.[140] Both arbitrations were governed by the US-Argentinian BIT.[141] Both claims arose following aggressive measures taken by the Argentinian government to reverse an economic crisis that began in the late '90s.[142] Claimants in both cases argued that the measures passed by the Argentinian government amounted to an unlawful regulatory expropriation.[143] In each case, Argentina argued that the measures taken were necessary for their own essential security interest and thus the regulatory measures were protected by Article XI of the US-Argentine BIT.[144] The tribunal in *Continental* found that the economic crisis fell within the scope of Article XI.[145] Conversely, the tribunal in *Enron* found that

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137. *Id.* ¶ 31.

138. UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS): Consistency and Related Matters, ¶ 9, U.N. Doc. A/CN.9/WG.III/WP.150 (Aug. 28, 2018) [hereinafter W.P. 150].

139. *Id.*

140. *Id.* at ¶¶ 11, 16, n. 5, 18.

141. Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3, ¶ 4 (May 22, 2007); Continental Casualty Company v. Argentine Republic, ICSID Case No. ARB/03/9, ¶ 1 (Sep. 5, 2008).

142. Enron, ICSID Case No. ARB/01/3, ¶ 63; Continental, ICSID Case No. ARB/03/9, ¶ 100.

143. Enron, ICSID Case No. ARB/01/3, ¶ 89; Continental, ICSID Case No. ARB/03/9, ¶ 63.

144. Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, U.S.-Arg., art. 11, Nov. 14, 1991, S. Treaty Doc. No. 103-2 (1993). Article XI reads: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the *protection of its own essential security interests*." *Id.* (emphasis added).

145. Continental, ICSID Case No. ARB/03/9, ¶ 262.

the economic crisis was not a qualifying event for Article XI protection.[146] Such diametrically inconsistent results raise questions about the extent of a state's ability to regulate in a way that ensures compliance with its international obligations. A decentralized system of treaty interpretation and enforcement leads to inconsistent enforcement of obligations and disparities in the size of awards.[147] Inconsistent results reduce the predictability and stability of the regime for both investors and host states,[148] making it difficult to for states to determine what is owed to foreign investors and place a value on non-compliance.[149]

III. EVOLUTION OF SOUTH AFRICA'S INVESTMENT POLICY

The end of apartheid signaled a fundamental change in South African politics.[150] Striving to create a more inclusive society, the new government included equalizing provisions in its new constitution and passed supplemental legislation, such as the Broad-Based Black Economic Empowerment Act.[151] Around this time, South Africa also began entering into BITs to secure foreign investment.[152] Two notable arbitrations in 2009, caused South Africa to review its BITs.[153] In 2010, South Africa began unilaterally cancelling BITs that it was party to.[154] In 2015, South Africa passed the Act, further signaling its intent to leave the bilateral investment treaty regime.[155] This Part will examine each of these critical junctures in South Africa's investment policy.

A. A New Era in South African Politics

Emerging from political isolation following the end of apartheid, South Africa hoped to attract foreign investors back to the

146. Enron, ICSID Case No. ARB/01/3, ¶ 339.
147. *See* BONNITCHA ET AL., *supra* note 14, at 6.
148. *Id.*
149. *Id.*
150. See Engela C. Schlemmer, An Overview of South African Bilateral Investment Treaties and Investment Policy 31(1) ICSID REV., 167, 168 (2016).
151. S. AFR. CONST. pmbl., chp. 1 art. 1, chp 2 art. 1; *Id.* at 172.
152. Schlemmer *supra* note 150, at 168.
153. *Id.* at 185.
154. *Id.* at 189, n.112.
155. *Id.* at 189.

state.[156] In a 1993 interview with *Fortune* magazine, Nelson Mandela explicitly called for foreign investment in South Africa.[157] To entice investors, Mandela guaranteed foreign investors would be protected against expropriation and nationalization.[158] Furthermore, all profits and dividends would be recoverable.[159] The national investment policy was designed to combat staggering unemployment that was contributing to unrest.[160]

Anxious to secure foreign investment, South Africa signed its first BIT in 1994 and would go on to sign 48 more through 2009—though only 21 would be effectuated.[161] Many of the BITs lacked a ratification clause requiring parliamentary consent before their enactment because Section 82(1)(i) of the Interim Constitution allowed the president to negotiate and sign treaties without such consent.[162] There is little evidence that the BITs were debated in the South African Parliament before their enactment, suggesting that Parliament was not aware of their existence until much later.[163] This denied Parliament an opportunity to discuss the substance of the BITs and the ramifications those agreements would have on domestic politics.[164] Failure to understand the obligations imposed on South Africa by the BITs and their interaction with domestic politics would prove to be problematic as Parliament enacted national policies to rectify the harms of apartheid.[165]

One of South Africa's most notable apartheid-correcting policies is the Broad-Based Black Economic Empowerment Act, which came into effect in 2003.[166] This legislation is designed to

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156. Fortune Editors, *Mandela reaches out to business*, FORTUNE (Jul. 12, 1993), https://fortune.com/2013/12/05/mandela-reaches-out-to-business-fortune-1993/.

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

161. Schlemmer, *supra* note 150, at 169.

162. *Id.* at 170–71; S. AFR. (INTERIM) CONST., 1993, art. 82(1)(i).

163. Schlemmer, *supra* note 150, at 170–71.

164. *Id.*

165. *Id.* at 172–73.

166. *Broad-based black economic empowerment—basic principles*, NORTON ROSE FULBRIGHT (July 2018), https://www.nortonrosefulbright.com/en-za/knowledge/publications/fe87cd48/broad-based-black-economic-empowerment—basic-principles.

"advance economic transformation and enhance the economic participation of Black people . . . in the South African economy."[167] This policy is supported by supplemental legislation, including the Codes of Good Practice on Broad-Based Economic Empowerment (BEE) and Codes of Good Practice.[168] Entities are given a Black Economic Empowerment Scorecard with five elements.[169] After an assessment, the entity is given a BEE score, which is necessary for the entity to receiving licensing from the state and transacting with the state or private entities.[170]

This legislation is in tension with the national treatment standard provided for in South Africa's BITs.[171] As discussed in Part I, under the national treatment standard, South Africa must treat foreign investors as well as they treat their own nationals.[172] However, the implementation of broad-based black economic empowerment creates two classes of South African citizens: those who receive economic preference and those who do not.[173] This leaves the door open for investors to claim that South Africa has violated the national treatment standard if they are treated as well as citizens who qualify for the BEE program.[174] Pursuant to the BITs dispute settlement clause, this issue must be decided by an arbitration tribunal.[175] However, the arbitrator would not have the South African constitutional expertise of a domestic judge, who is better equipped to analyze the interaction between the constitution and the Broad-Based Black Economic Empowerment Act.[176] Despite emerging awareness of the tensions created by the interactions

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167. *Id.*

168. *Id.*

169. *Id.* The five elements are ownership, management control, skills development, enterprise and supplier development, and socio-economic development. *Id.* The requirements for each element vary depending on the size of the entity but are all aimed at increasing Black participation in the economy. *Id.*

170. *Id.*

171. *See* Schlemmer *supra* note 150, at 172–173.

172. *See* BONNITCHA ET AL., *supra* note 14, at 15–16.

173. *See* NORTON ROSE FULBRIGHT s*upra* note 166 (discussing how Broad-based economic empowerment enhances the participation of certain groups of South Africans.); *See* Schlemmer *supra* note 150, at 178–79.

174. *See* Schlemmer *supra* note 150, at 178–79.

175. *See id.* at 173.

176. *See id.* at 173–74.

between domestic policy and BITs, BITs underwent few changes between 1994 and 2009.[177]

The BITs concluded by South Africa contained nearly uniform protections for foreign investors.[178] The preambles express a desire to "maintain favourable conditions for investments and investors" and increase foreign investment resulting in economic benefit for both countries.[179] Notably, most of the preambles of the BITs reserve no right to South Africa to rectify apartheid through domestic legislation.[180] The preamble of the current South African Constitution makes reference to achieving equality and remedying past wrongs; however, these values were noticeably absent from South Africa's international agreements.[181] Failure to consistently protect South Africa's right to legislate in this area exposed South Africa to arbitration for violating the national treatment standard.

South African BITs included a broad, open list definition of investments.[182] They afforded protection to natural and legal persons.[183] The BITs did not uniformly select a standard of treatment to be adhered to, and while some BITs did provide protections for the preferential treatment of citizens related to the constitutional values discussed above, there is not enough evidence to suggest that it was the official policy of South Africa for these protections to be a standard provision.[184]

Under the BITs, foreign investors had the opportunity to bring investor-state dispute claims to either the domestic court system or international arbitration.[185] Still, some BITs contained a clause that prevented a foreign investor from seeking arbitration if it had attempted to settle the dispute in domestic courts.[186] Finally, South Africa's dispute resolution clauses also contained a provision that allowed foreign investors to call South Africa to arbitration without first asking its consent.[187]

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177. *Id.* at 172, 173.
178. *Id.* at 172.
179. *Id.* at 173.
180. *See id.* at 173–74.
181. *Id.*
182. *Id.* at 174.
183. *Id.* at 175.
184. *Id.* at 179.
185. *Id.* at 183.
186. *Id.* at 184.
187. *Id.*

This provision prevented South Africa from choosing which disputes it would arbitrate.

Both the broad definitions and provisions contained in South Africa's BITs are considered standard for a developing country attempting to attract foreign investment by capital exporting countries.[188] Despite information about the potential harm of these agreements, the evolution of South Africa's BITs from 1994–2009 shows that drafters did very little to minimize South Africa's risk in the international investment regime.[189] Arguably, the policies were made to secure a large number of international investors rather than protect its own domestic policy needs.[190] This disregard for its domestic policy led to two disastrous arbitral awards.[191] These awards coupled with an increase in South Africa's bargaining power have led to an abrupt change in the state's international investment policy.[192]

B. South African BIT Arbitrations

In 2009, the South African Department of Trade and Industry (the Department) reviewed and compiled a risk assessment of the state's international investment agreements.[193] This review was preceded by two major arbitration cases discussed below and mentioned in the Department's report.[194] Following a review of the report Parliament found that the benefits of BITs were marginal while the costs attributed to BIT arbitration continued to grow.[195]

The first detrimental arbitration was convened under the UNCITRAL Arbitration Rules allowing the arbitration to be conducted confidentially.[196] Although many details remain unknown, an investigation revealed the following facts.[197] The ar-

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188. *See id.* at 185.
189. *Id.*
190. *See id.*
191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *See id.* at 185–89 (discussing South Africa's reaction to major arbitral decisions and Parliament's decision not to renew expiring BITs.) Assuming that the South African Parliament is a rational actor, the decision not to renew the expiring BITs indicates that the value of renewing them was less than the value of cancelling them.
196. *Id.* at 186.
197. *Id.*

bitration took place between 2001 and 2004 after a Swiss investor accused South Africa of breaching its obligation to provide full protection to guarantee the investor's safety and the safety of his investment under the Swiss-South Africa BIT.[198] The investor also made a claim for expropriation.[199] The tribunal held that South Africa failed to provide adequate protection to the investor and awarded the investor 6.6 million rand plus interest in compensation.[200] It also required South Africa to pay two-thirds of the investor's legal fees.[201]

South Africa received an award covering the costs of the proceedings in *Piero Foresti, Laura de Carli and others v. Republic of South Africa.*[202] While the merits of the claim were never argued before the convened ICSID panel, the foreign investors claimed breaches of the expropriation and discrimination standards contained in the South Africa-Italy BIT (1997) and the South Africa-BLEU BIT (1998).[203] The breach of the agreements stemmed from domestic Black Economic Empowerment legislation.[204] The investors sought 260 million euros in compensation; however, the dispute was settled privately for an undisclosed amount.[205] The investors were ordered to pay South Africa 400,000 euros even though South Africa's counterclaim was worth over 5 million euros.[206] Though victorious on paper, the arbitration put South Africa on notice that it had traded a portion of its legislative sovereignty for foreign investment.

In addition to a chill on their legislative powers, each arbitration costs the South African government taxpayer funds that could be used to fund public programs in line with the values enshrined in its Constitution, such as education.[207] With no gatekeeping mechanism to filter out frivolous claims, host states like South Africa are battered with arbitrations that risk emptying their coffers. Even a favorable outcome from the arbi-

198. *Id.*
199. *Id* at 186–87.
200. *Id.* at 187.
201. *Id.*
202. *Id.* at 186.
203. Piero Foresti, Laura de Carli and others v. Republic of South Africa, ICSID Case No. ARB(AF)/07/1, ¶ 1, 47 (Aug. 4, 2010).
204. Schlemmer, *supra* note 150, at 186.
205. *Id.*
206. *Id.*
207. *See id.* at 187; *see e.g.* S. AFR. CONST. pmbl.

tration does little to ease the burden of the state who must seek enforcement of the award in a jurisdiction where the losing party maintains assets.[208] Additionally, the state may face numerous hurdles and costs associated with collecting an award if the foreign investor mounts a defense against enforcement.[209] Even with an award in hand, the state is still a long way from recovering any or all of the costs associated with the arbitration and any amount awarded by the tribunal.

C. Termination of BITs and the Development of Domestic Protections

Responding to these developments, South Africa launched a multi-step plan of action. First, it began unilaterally terminating its BITs[210] and then passed the Protection of Investment Act, 2015.[211] The Act, which came into force in 2018, replaces the BITs with a domestic framework that offers similar protections for investors while allowing South Africa to more fully retain its sovereignty.[212] It also addresses several of the weaknesses contained in the BITs. Correcting its failure to intertwine constitutional values with investment protections, Section Four of the Act explicitly states that its purpose is to "protect investment in accordance with and subject to the Constitution" while maintaining a balance between the public interest and "obligations of investors."[213] Taking this a step further, it also grants South Africa the right to regulate in the areas of public policy, economic inequality, cultural protections, and protection of the environment.[214] The Act mandates that its interpretation must be consistent with the Constitution of South Africa, international law,[215] and any relevant convention or in-

208. BONNITCHA ET AL., *supra* note 14, at 80.

209. *Id.* at 78–82.

210. Schlemmer, *supra* note 150, at 189. While the BITs have been cancelled, many contain sunset provisions which keep the provisions contained within the BIT in effect for a period of time after its termination. *Id.*

211. Protection of Investment (Act No. 22 of 2015) (S. Afr.) [hereinafter the Act].

212. *See* De Wet, *supra* note 9.

213. The Act, *supra* note 211, §4(a).

214. *Id.,* §12.

215. As defined by sections 232 and 233 of the Constitution. S. AFR. CONST., §§232, 233; The Act, *supra* note 211, §3(b).

ternational agreement that South Africa is or will become party to.[216]

The Act defines both investors and investments broadly, and protects them from discrimination under the national treatment standard.[217] Making reference to customary international law, the Act provides foreign investors with "a level of physical security [equal to security] provided to domestic investors . . . and subject to available resources and capacity."[218] This wording appears to correspond to the confidential Swiss arbitration where the arbitral tribunal held that "there was no policing of the property . . . for several years."[219] The tribunal noted that it was "unclear whether this failing stemmed from a lack of resources or other systemic failures."[220] Incorporating a restriction on security based on resources suggests that the tribunal was correct to believe that the inadequate protection was a result of a lack of resources. Rather than relitigate the issue, South Africa has chosen preemptively set limitations on protection.

Disputes arising under the Act between foreign investors and the State are subject to mediation or may be brought to any domestic court, independent tribunal, or statutory body with proper jurisdiction.[221] The government may consent to international arbitration with the investor's home state only if all local remedies have been exhausted.[222] South Africa has again chosen to draft legislation that models the customary international law approach. Rather than provide blanket consent to be hauled in front of an arbitral tribunal, South Africa has created a multistep system to address complaints domestically.[223] By mandating that all claims exhaust local remedies before proceeding to international arbitration, South Africa has the option to remedy the problem locally and publicly. Domestic remedies provide the country an opportunity to examine and apply its own laws. This opportunity is particularly important in South Africa because of the aforementioned Black Economic

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216. The Act, *supra* note 211, §3(c).
217. *Id.* at §§2(1), (2), 8(1).
218. *Id.*, §9.
219. Schlemmer, *supra* note 150, at 187.
220. *Id.*
221. The Act, *supra* note 211, §13.
222. *Id.*
223. *See generally id.*

Empowerment Act, which mandates that certain nationals receive specialized treatment to correct for apartheid.[224] South African courts are in the best position to interpret and apply domestic law given their better understanding of the context and stakes surrounding its enactment.

Should the foreign investor exhaust all local remedies and remain unsatisfied, they are left with the option of appealing to their home state for state-to-state arbitration.[225] Once again, the model that South Africa has created for arbitration resembles the customary international law approach to dispute resolution via diplomatic protection.[226] Through this method, South Africa hopes to reduce the number of claims it will be required to arbitrate by assuming that few states will want to press claims on behalf of their nationals against South Africa. Requiring state-to-state arbitration also reduces incentives for investors to pursue the option because they are not guaranteed to receive compensation from their home state.[227]

Reactions to the cancellation of BITs and the passage of the Act have been mixed. [228] Those against the passage of the Act tend to be foreign investors and their host states, who see the change in investor protections as diminishing their rights.[229] There may be some merit to this argument. Rather than maintain a separate and higher standard of treatment for foreign investors, South Africa has chosen to equalize the playing field for domestic and foreign investors while preserving its sovereignty. Unhappy with ISDS's numerous problems, including interpretation and application of BITs, South Africa seeks to exercise control over exactly when and how it will be required to defend itself and its domestic legislation on the international

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224. NORTON ROSE FULBRIGHT, *supra* note 166.

225. The Act, s*upra* note 211, §13.

226. *Id.*

227. Schreuer, *supra* note 49, at 345.

228. Mills Soko & Mzukisi Qobo, *SA's cancellation of bilateral investment treaties - strategic or hostile?* FIN24 (Sept. 28, 2018), https://www.fin24.com/Opinion/sas-cancellation-of-bilateral-investment-treaties-strategic-or-hostile-20180928-3 (comparing reactions to the passage of South Africa's passage of The Act. On the one hand, the EU believes the cancellation of BITs is hostile. On the other, South Africa has passed several measures of investment and is "widely regarded as one of the world's most open investment jurisdictions, with a favourable investment climate by international standard, not based on the BITs.") *Id.*

229. Soko & Qobo, *supra* note 228.

stage. Unsurprisingly, South Africa has chosen to adopt the customary international law long favored by developing states over the prevalence of BITs. Rather than attempting to change the status quo on the global stage, South Africa has chosen to enact policies at the state level. This policy reduces the state's exposure to risk as well as lengthy and costly arbitrations.

IV. SOUTH AFRICA AND ISDS REFORM

If South Africa truly intended to remove itself from the prevailing ISDS regime, it credibly could have done so with the passage of the Act and the unilateral termination of their BITs. However, there are several reasons to believe that the passage of the Act may not be South Africa's final word on international investment protection.

A. South Africa's Actions and Statements Surrounding International Investment

Section 3(c) of the Act allows South Africa to enter into any "conventions or international agreements" on international investment.[230] This leaves the door open for South Africa to rejoin the international investment space at a later date.[231] If South Africa had intended for the Act to be the final word on how the state would handle investment disputes, it could have made that clear by narrowing the provision to only allow an interpretation consistent with international agreements it was already party to.

Another indication that South Africa may not truly leave the ISDS space is its participation in UNCITRAL's ISDS reform meetings as an observer state. The meetings, conducted by Working Group III, are comprised of the forty member states of the commission, nonmember observer states, and international non-governmental organizations (IGOs).[232] Observer States may participate in the deliberations.[233] South Africa has attended the reform meetings as an observer state and has actively participated in deliberations on the floor.[234] During de-

230. The Act, *supra* note 211, §3(c).

231. *Id.*

232. UNCITRAL, Annotated Provisional Agenda, ¶ 1–2 , U.N. Doc. A/CN.9/WG.III/WP.144, (Feb. 5, 2018) [hereinafter WP 144].

233. *Id.*

234. *See generally* Audio files: UNCITRAL Working Group III Sessions Thirty-Fourth through Thirty-Eight (Dec. 1, 2017- Oct. 10, 2019) (on file with

liberations the South African delegation advanced arguments for reform that are consistent with provisions contained in the Act.[235] Though the Working Group's mandate only gives them the authority to make recommendations on procedural matters, South Africa and others have criticized both the procedural and substantive elements of ISDS, and advocated for broad and wholistic reform, incorporating both human rights treaties and the sustainable development goals.[236] Additionally, South Africa has expressed concerns about the cost of arbitration and the regulatory chill that arbitration has on states.[237]

On July 17, 2019, South Africa submitted a comprehensive reform proposal to the Working Group.[238] The proposal captured South Africa's policy arguments advanced during the meetings and noted the substantive problems with ISDS including defaulting to international arbitration for dispute resolution.[239] South Africa put forth a recommendation that mirrors the dispute settlement process outlined in the Act calling for alternative mechanisms such as mediation and reliance on the domestic courts.[240] South Africa chastised the current ISDS regime for placing greater weight on property and investor rights than human rights and environmental principles, and recommended a framework which places the two sets of rights on a more level playing field.[241]

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author). Working Group III has met five times for a total of fifty sessions. *See generally id.* During this time, South Africa has spoken thirty-seven times. *See generally id.* In addition to advancing policy arguments, South Africa requested changes to the official record of the deliberations compiled by the secretariat. *See generally id.* It should be noted that South Africa asserts that they are only attending the ISDS reform meetings to learn more about other positions. *See generally id.* This statement is incongruous with the level of engagement with the reform process South Africa exhibits. *See generally id.*

235. *Id.*

236. *Id.*

237. *Id.*

238. Talkmore Chidede, *South Africa's submission on UNCITRAL ISDS reforms: Comments and implications* TRALAC (Oct. 16, 2019), https://www.tralac.org/blog/article/14276-south-africa-s-submission-on-uncitral-isds-reforms-comments-and-implications.html.

239. *Id.*

240. *Id.*

241. *Id.*

B. Analyzing South Africa's Actions and Statements Using the Exit, Voice, and Loyalty Theory

South Africa's significant participation in ISDS reform efforts despite its stated desire to turn its back on the system suggests the State's policy goals are more complex than usually presented. Albert Hirschman's Exit, Voice, and Loyalty theory provides a useful framework to view South Africa's actions and helps illuminate the state's motives. It postulates that when a decision maker experiences dissatisfaction with an organization that they belong to or engage with, they may remedy their dissatisfaction in three ways.[242] First, they may choose to remain loyal to the organization[243] and continue to engage with the organization while silent about their dissatisfaction.[244] Second, the decision maker may choose to exit the system.[245] A decision maker may decide that it is more beneficial to leave the system rather than seek to reform it.[246] Finally, a decision maker may decide to stay engaged in the system and voice their concerns.[247] The decision to exit, voice concerns, or stay silently loyal depends on a host of factors, including the availability of alternative systems to exit to and the power of the decision maker within the system.[248] Though Hirschman's framework was initially applied to economic enterprises, the theory has been applied to domestic and international politics.[249]

Hirschman's theory can be applied to the ISDS regime. The regime functions as a body that must remain responsive to its members, the states. Each state has a different level of influence on the regime, which corresponds to the impact that its exit would have on the stability of the regime. States with more power in the system will likely exercise their option to voice their concerns rather than exit the system.[250] While the system

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242. Albert O. Hirschman, Exit, Voice and the State, 31 WORLD POLITICS 90, 90 (1978).

243. WILLIAM ROBERTS CLARK, MATT GOLDER & SONA N. GOLDER, POWER AND POLITICAL INSIGHT FROM AN EXIT, VOICE, AND LOYALTY GAME, 3 (2013).

244. *Id.*

245. Hirschman, *supra* note 242, at 90.

246. *Id.* at 95.

247. *Id.* at 90.

248. Clark et al., *supra* note 243, at 4, 5.

249. *See* Hirschman, *supra* note 242, at 100.

250. *Id.*

is not perfect, it is more costly politically and economically for states with power to exit rather than to reform the system.[251] Decision makers exercising their voice option will attempt to generate reform by changing public policy and public opinion about the issue at hand.[252] Whether the reform comes to fruition depends on the system's assessment regarding the need for reform.[253] Reform is typically easier when it is apparent that a need for it exists.[254] Thus, states that have spent a considerable amount of time and capital—both political and economic—will not easily abandon the system but will seek to reform it if possible.[255]

The same dynamic does not exist for smaller states.[256] Smaller states would likely prefer to exercise their option to exit rather than openly challenge the regime and those with power.[257] Challenging the regime costs more political capital for these states and may result in unintended consequences in unrelated negotiations.[258] Instead, small states will either remain loyal to the system and continue to reap some benefits or may exit the system in favor of another system.[259] Small states can increase the impact of their exit if they form a coalition and exit en masse.[260] A threat of mass exit would represent an existential problem for the ISDS regime as currently constructed and one that must be addressed in order for the members of the system to stay.[261] However a system will not seek to reform if the members that choose to exit have little effect on the operation of the system. This is why mass exit from the ISDS regime is powerful. If most or all of the capital-importing states left the

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251. *See id.* at 100, 103–04.
252. *Id*. at 100.
253. *See id*.
254. *Id*.
255. *See id.,* at 100–01.
256. *See id.,* at 101.
257. *See id.,* at 104–06.
258. Clark et al., *supra* note 243, at 8.
259. *See* Hirschman, *supra* note 242, at 101–07.
260. *See generally* Hirschman, *supra* note 242*; see* Clark et al.*, supra* note 243*,* at 7–8 (explaining that the choice to exit provides a pay off to citizens and a loss to states if the state is dependent on the citizen. Logically, the loss to the state is multiplied when more than one citizen chooses to exit).
261. *See* Clark et al., *supra* note 243, at 5 (explaining that the basic condition that prompts a citizen to consider exit, voice or loyalty is "a deleterious change to the citizen's environment.").

ISDS regime, the regime would be worthless because the only remaining members would be capital exporters with no market to export to.

However, a dramatic mass exit may not be necessary. Instead, states like South Africa, a regional power with a large market, could exit the system and produce similar straining results for the system. As a regional power and an investment hub, other states in the region will look to South Africa for guidance.[262] A complete exit from the system may persuade surrounding states to adopt similar policies and exit the regime, a huge risk for capital-exporting states that have heavily invested in the current regime. Further, South Africa's large market share, robust economy, and regional leadership is capable of crafting a new regime that rivals the old.[263] In a circumstance such as this, the states that invested considerably in the success of the old system risk losing their investment if they remain unwilling to enact reform. If capital-exporting states wish to retain the system they have invested in, they must draw the lines of reform in such a way that small states with increasing demands continue to participate in the system but don't completely devalue the investment already made. All actors in the system must also take the needs of their citizens into consideration when discussing reform options.

South Africa's influence provides significant leverage to promote reform proposals to the ISDS system. However, rather than simply reiterating their policy objectives on the floor, South Africa elevates reform proposals from smaller regional partners who share similar policy goals.[264] This showing of solidarity reinforces the coalition and highlights the risks associated with failure to reform the system in a meaningful way.

In sum, South Africa's actions do not entirely resemble either exit or voice. Instead, its actions are a hybrid of the two. By participating in the ISDS reform meetings, South Africa exercises its option to voice their complaints about the system. In contrast, the passage of the Act, coupled with its statement at the reform meeting that the state is turning its back on the ISDS system can be viewed as South Africa exercising its op-

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262. Daniel Trachsler, *South Africa: A Hamstrung Regional Power*, 102 CSS ANALYSIS IN SEC. POLICY, 1, 1 (2011).

263. *See* Clark et al., *supra* note 243, at 8.

264. Audio files: UNCITRAL Working Group III Session (October 31, 2018) (on file with author).

tion to exit the system. There are two alternative explanations for South Africa's behavior. The first is that South Africa would ultimately like to remain a part of the ISDS system and truly seeks to reform it. In this scenario the Act may serve as a model framework for the international community to base reform on. The similarities between the Act and South Africa's reform proposal are too great to ignore.[265] The passage and enactment of the Act demonstrates to the international community that South Africa's reform proposal is a viable solution.

The second is that South Africa would prefer to remain in the ISDS system, but it seeks to increase the credibility of its exit threat if acceptable reform is not achieved. A credible exit threat occurs when the payoff to the decision maker, in this case a state, is larger than the payoff for loyalty or using voice.[266] However, simply having a credible exit threat does not guarantee that reform will occur.[267] From the perspective of the state contemplating its next move within the Exit, Voice and Loyalty framework, the largest payoff may derive from its exit. However, that exit will be meaningless to those in control of the system if the system is not dependent on the exiting decision maker.[268] Therefore, in order to promote reform, South Africa must have a credible exit threat and show that the continuance of ISDS would harmed if it chose to exit. To create a credible exit threat, South Africa has passed domestic legislation that will allow it to fully exit the ISDS system at any time. This is where South Africa's position as a regional power is strongest.[269]

It would appear that South Africa believes that there is a similar payoff for using either its voice or exit options, thus explaining their willingness to pursue both options. Assuming that South Africa is a rational actor, if the payoff for either

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265. *Compare generally* the Act, *supra* note 211 (creating the new domestic framework for international investment arbitration *with* UNCITRAL, Possible Reform of Investor-State Dispute Settlement (ISDS) Submission from the Government of South Africa, A/CN.9/WG.III/WP.176 (July 17, 2019) (proposing changes to investor-State dispute settlement regime which is remarkably similar to the domestic legislation).

266. Clark et al., *supra* note 243, at 8.

267. *Id.*

268. *Id.*

269. This note assumes like Clark, Golder & Golder that the system will favor some actors over others because "the potential for unequal influence is central to the study of politics." *Id.*

voice or exit was substantially higher, it would simply choose not to pursue the other option. Instead, it is more likely that South Africa is confident that they will be able to achieve substantial ISDS reform in their favor, allowing them to continue participation in the system.

CONCLUSION

After completing a comprehensive review of its BITs and determining that the costs associated with them outweighed the benefits, South Africa elected to terminate them. In place of the BITs, South Africa passed the Protection of Investments Act, 2015, codifying many investment protections historically found in customary international law. South Africa is one of many states who have become increasingly dissatisfied with ISDS and is one of five states to cancel its BITs. Observers believe that the cancellation of the BITs and the passage of the Act signaled to foreign investors that South Africa was headed down a path of protectionism and speculated that FDI levels would decrease as a result. These moves were seen as South Africa's exit from the international investment space.

Sensing a disruption in the international status quo, UNCITRAL convened Working Group III and tasked it with exploring procedural ISDS reform. To fulfill their mandate, Working Group III first sought to identify the problems with the current regime before undertaking deliberations to correct them. As an observer state to these reform meetings, South Africa advanced several reforms targeting problems such as transparency, the cost and length of investor state arbitrations, and a lack of reciprocal obligations for investors in the area of human rights and environmental protections. South Africa also submitted a policy proposal capturing these arguments while maintaining they had turned their back on the ISDS system.

An analysis of the actions and statements of South Africa under the Exit, Voice, and Loyalty theory suggests that it may not be so cut and dry. This Note proposes that South Africa may wish to remain involved in ISDS if acceptable reforms are made to the system. This conclusion is supported by the following evidence. The text of the Act contains a provision allowing South Africa to enter into future international agreements and conventions related to investment. South Africa's attendance and high level of participation at the reform conferences. The reform proposal submitted by South Africa which contains

many of the same principles and objectives as its domestic legislation. If South Africa truly intended to exit the international investment regime, efforts to seek reform substantially similar to its domestic legislation would expensive and duplicative. It is much more likely that South Africa sees the payoff for exiting the system or reforming the system as nearly identical in value. Making use of its growing regional influence, South Africa hopes to advance reform while maintaining a viable alternative if it cannot negotiate an acceptable regime.

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