INSIDE ARBITRATION: A VIEW OF JOHANNESBURG

01 July 2016 | Johannesburg
Legal Briefings – By **Peter Leon, Partner**

In April 2016, the South African government gazetted a draft International Arbitration Bill, which will – at long last – domesticate the 1985 UNCITRAL Model Law on International Commercial Arbitration, alongside the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (which South Africa ratified in 1976 but only partially implemented).

The International Arbitration Bill (**the Bill**), will effectively replace the antiquated Arbitration Act of 1965, which was designed for domestic disputes and is thus, according to the Department of Justice, "*deficient for an expanding international trade and investment regime*". That Act affords domestic courts wide discretion to interfere with the functioning of any arbitral tribunal seated in South Africa, which is inimical to the efficiency and consistency that modern international businesses seek when selecting a seat for arbitration.

"THE GOVERNMENT BEGAN TO APPRECIATE THE RISKS OF INTERNATIONAL INVESTMENT ARBITRATION: FROM 2001 TO 2003, A SWISS NATIONAL SUCCESSFULLY CLAIMED AN UNDISCLOSED SUM OF DAMAGES FROM SOUTH AFRICA UNDER THE UNCITRAL ARBITRATION RULES"

While South African courts have exercised restraint in interpreting the 1965 Act and developed a strong culture of deference to arbitral tribunals, the lack of legislation based on the UNCITRAL Model Law has deprived business of the predictability it seeks. It also effectively confines the country's highly-qualified practitioners and respected institutions such as the Arbitration Foundation of Southern Africa (founded in 1996) largely to domestic disputes.

The Bill will thus help to modernise South Africa's dispute resolution regime and make the country a more hospitable hub for international commerce. As Cabinet explained when announcing the Bill, "*the international arbitration process is an .tool for doing business across the borders of the country*", and thus the Bill "*will improve access to justice services for companies doing business outside the country and foreign companies in South Africa*". It is hoped that this will help South Africa to realise its long-held ambition to become the consummate "*Gateway to Africa*" for international investors.

While the Bill is a most welcome development, it is rather late in the day and too limited to bring about the fulfilment of this vision.

A LITTLE TOO LATE?

Regrettably, the Bill is being introduced almost two decades after it was first developed by the South African Law Commission, chaired by the late Chief Justice Ismail Mahomed. In July 1998, after two years of thorough consultative and comparative research, the Commission produced a comprehensive report recommending the adoption of a single statute which would domesticate not only the UNCITRAL Model Law and the New York Convention, but also the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (**ICSID Convention**).

The latter proposal was motivated as follows:

"*Although South Africa is a developing country, its relatively strong infrastructure and position as the major economic power in the region place South Africa in a somewhat unique position as a country which could get a dual benefit from ICSID membership. On the one hand, the country is anxious to attract more foreign investment and some of the potential projects could benefit from the availability of arbitration or conciliation under the Washington Convention*."

"*On the other hand, South African companies are eagerly looking for investment opportunities in other African countries, virtually all of which are members of ICSID. Ratification of the Convention by South Africa would facilitate such investment and further the economic development of the region. Failure to ratify the Convention would leave South Africa as one of the very few African countries which have not done so and a continued failure to do so appears difficult to justify*."

Notwithstanding its obvious benefits, and despite being classified by Parliament in 2002 as one of the "*urgent bills of a high priority*", the Law Commission's first draft of the Bill fell victim to legislative languor and was never formally tabled. Meanwhile, the government began to appreciate the risks of international investment arbitration: from 2001 to 2003, a Swiss national successfully claimed an undisclosed sum of damages from South Africa under the UNCITRAL Arbitration Rules, for failing to protect his game farm from vandalism following a land invasion, in breach of the guarantee of "*full protection and security*" under South Africa's Bilateral Investment Treaty (**BIT**) with Switzerland.

The draft Bill (and with it the domestication of the UNCITRAL Model Law) fell hostage to Cabinet's concerns about investor-state arbitration, which escalated further after South Africa received its second investment claim in 2007, as investors from Italy and Luxembourg argued that black empowerment quotas imposed on mining companies amounted to uncompensated expropriation, discrimination and derogation from fair and equitable treatment.[1] Cabinet responded with a "*review*" of South Africa's BIT policy framework, completed in 2009, recommending the development of "*a model BIT which is in line with its development needs*". A year later, Cabinet decided that this would be "*the basis on which BITs could be evaluated and renegotiated*", mandating the Minister of Trade and Industry (**Minister**) "*to draft legislation in this regard*".

Somewhat deviating from this mandate, the Minister decided against such renegotiation and instead unilaterally terminated all of South Africa's BITs with EU and EFTA member states (giving the minimum of one year's notice), commencing with Belgium-Luxembourg in 2011-2012, Switzerland in 2012-2013, followed by Austria, Denmark, Finland, France, Germany, Greece, Italy, the Netherlands, Spain, Sweden and the United Kingdom in 2013-2014. South Africa has yet to terminate any BITs with non-European states, including those with BRICS partners Russia and China, as well as several African states and Argentina and Cuba.

Alongside these targeted BIT terminations, the Minister developed the Promotion and Protection of Investment Bill, declaring that foreign investors will only be entitled to the same treatment as South African nationals, subject to domestic law and the jurisdiction of domestic courts. Signed into law in December 2015, the slightly retitled Protection of Investment Act proclaims that South Africa will no longer subject itself to investor-state arbitration, but may consent to state-state dispute settlement.

The passage of this legislation, ironically, cleared the path for the Bill to be reintroduced into Parliament this year, of course without the troublesome chapter domesticating the ICSID Convention. It is not known why that chapter could not simply have been separated from the Bill over a decade ago, so that South African law could at least have been aligned with the uncontroversial UNCITRAL Model Law and New York Convention in relatively good time.

This delay has retarded South Africa's ambitions of becoming a leading dispute resolution destination, as well as the business gateway to Africa. Selected in 2007 to host the Permanent Court of Arbitration's Regional Facility for Africa, South Africa later lost this title to Mauritius, which adopted the UNCITRAL Model Law in 2008 and has since developed world-class arbitration facilities in collaboration with the London Court of International Arbitration. The increasingly busy Mauritius International Arbitration Centre won the Global Arbitration Review award for up-and-coming regional arbitral institution in 2015, and hosted the prestigious International Council for Commercial Arbitration Congress earlier this year.

Another African state to domesticate the UNCITRAL Model Law in 2008 was Rwanda – lately dubbed the Switzerland or Singapore of Africa. Rwanda is the closest challenger to Mauritius for the title of Africa's arbitration hub, having set up the Kigali International Arbitration Centre in 2012.

South Africa has regrettably fallen behind. Having drafted a law domesticating the UNCITRAL Model Law ten years before Mauritius and Rwanda, it has given them an almost ten-year head start in implementing it. In that time, both Mauritius and Rwanda have overtaken South Africa in the World Bank's Ease of Doing Business rankings, which consider the availability of arbitration as one of the factors that make it easier for investors to enforce contracts. (In 2016, Mauritius placed 32nd overall, Rwanda 62nd, and South Africa 73rd.)

TOO LIMITED

While the tabling of the Bill is an indispensable first step for South Africa to catch up to the continent's leading international arbitration jurisdictions, it is insufficient, on its own and in its current form, to bridge the gap.

The Bill's potential is affected by the same insularity that has delayed its enactment for so many years, and has driven the country to move from rules-based investor-state arbitration back to the outdated and arbitrary regime of state-state diplomatic protection for foreign investments.

Provision for investor-state international arbitration has not only been removed from the Bill (with the deletion of the original chapter domesticating the ICSID Convention), but is in fact explicitly ruled out. The Bill's application to state organs is made subject to the Protection of Investment Act, which provides that the South African government may consent to international investment arbitration only after exhaustion of domestic remedies and only if "*[s]uch arbitration will be conducted between [South Africa] and the home state of the applicable investor*".

This significantly inhibits the Bill’s potential to modernise South Africa’s arbitration framework and to persuade international businesses to place their confidence in it. African economies are renowned for the prominent role played by state organs, not only as regulators but as commercial participants, and thus an effective and efficient system of international dispute settlement is inadequate if it does not afford investors access to arbitration outside the sovereign reach of the host state. This protection is essential not only for enterprises considering South Africa as an investment destination itself but also for those considering it as a regional base for investment into other African countries.

In disavowing investor-state international arbitration, South Africa not only forfeited the “*dual benefit*” of ICSID membership identified by the Law Commission in 1998, but also unilaterally repudiated the Southern African Development Community Protocol on Finance and Investment (**SADC Protocol**), a binding regional treaty which was signed in 2006, ratified by South Africa in 2008 and entered into force in 2010. The Protocol binds SADC members to honour the classic BIT protections (balanced with sustainable development imperatives and the host state’s right to regulate in the public interest), and records their consent to investor-state international arbitration after exhaustion of domestic remedies.

The SADC Protocol obliges member states to harmonise their legal regimes for foreign investment in accordance with international best practice, resulting in the development of a SADC Model BIT in June 2012. Rather than using this template to renegotiate BITs with European states, South Africa terminated them entirely and enacted the Protection of Investment Act in their place. This has created a dual disadvantage, discouraging new investments while giving pre-existing investments the very privileges the Act aimed to curtail (by triggering lengthy survival clauses in the terminated BITs).

“SOUTH AFRICA OFFERS SIGNIFICANT ATTRACTIONS AS A PROSPECTIVE SEAT FOR COMMERCIAL ARBITRATION”

By contrast, fellow SADC member Mauritius has placed itself at the forefront of modern investment promotion. In 2011, the government announced a “*new economic diplomacy initiative to position Mauritius as the preferred gateway for investment into Africa*”, which included the development of a model BIT, an international arbitration centre and a one-stop shop for foreign investors. Five years later, this vision has clearly been realised, as the Mauritius International Arbitration Centre, a prodigious network of BITs and Double Taxation Agreements with African states, among many others (as well as membership of ICSID), have helped to make Mauritius the premier seat of regional management for countless foreign investors into Africa.

As South Africa deliberates over the Bill, it would be worthwhile to reflect on what opportunities were lost in the two decades’ delay since it was first drafted, and what more opportunities may be lost if the Bill remains limited by such a narrow approach.

South Africa still has the potential to become the Gateway to Africa. As the continent's most industrialised, technologically advanced and financially sophisticated jurisdiction, boasting a robust and well respected judiciary, South Africa offers significant attractions as a prospective seat for commercial arbitration. In this uncertain and increasingly competitive global economy, however, South Africa simply cannot continue to do without a world-class arbitration framework.

---

1 Peter Leon was co-counsel in the matter of *Foresti and Others v South Africa*, ICSID Case No. ARB(AF)/07/01.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

PETER LEON
PARTNER,
JOHANNESBURG
+27 10 500 2620
Peter.Leon@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.