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**Solving the Conflict Between  
Foreign Direct Investment  
Protection and Human Rights  
in Emerging Countries:  
A South African Example**

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## **ABBREVIATIONS**

ANC	African National Congress
BB-BEE	Broad-based Black Economic Empowerment
BEE	Black Economic Empowerment
BIT	Bilateral investment treaty
CEDAW	Convention on the Elimination of All Forms of Discrimination against Women
CERD	International Convention on the Elimination of All Forms of Racial Discrimination
FDI	Foreign direct investment
FET	Fair and equitable treatment
GEAR	Growth Employment and Redistribution
HDSA	Historically disadvantaged South African
ICESCR	International Covenant on Economic, Social and Cultural Rights
ICSID	International Centre for Settlement of Investment Disputes
MFN	Most favored nation
MPRDA	Mining and Petroleum Resources Development Act
NDP	Non-disputing party
NGO	Non-governmental organization
NT	National treatment
RDP	Reconstruction and Development Programme
UNCITRAL	United Nations Commission on International Trade Law
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

## 1. INTRODUCTION

The conflict of human rights promotion and the protection of foreign direct investment (FDI) has become ever more relevant to the debates surrounding international relations and international law in recent years. While the number of bilateral investment treaties (BITs) throughout the world is steadily increasing, the legitimacy of international investment law seems to be declining. One significant reason for this backward development is that governments in developing and emerging countries are suffering from serious constraints due to the unfavorable BITs they have concluded with stronger economies. The clash lies in the non-compliance of many BITs with international human rights law. In South Africa, the government's Black Economic Empowerment (BEE) strategy was at stake because European investors claimed to have been discriminated against by this affirmative action program, aimed at increasing the economic activities of historically disadvantaged South Africans (HDSAs). These affirmative action policies in terms of BEE do not only encounter criticism that alleges them to be discriminatory in relation to white South Africans. Much rather, BEE is facing potentially fatal threats by the current standards of international investment law which in many cases favor investors' interests over interests of public concern. This recent example shows the importance of the topic of the tension between investment protection and human rights promotion. Therefore the research question of this thesis is as follows: *What is the nature of the cleavage between the protection of FDI in South Africa and the government's efforts to protect human rights by means of BEE? Which instruments does international law provide in order to bridge this particular divide without neglecting either party's legitimate interests?*

This work argues that the tension between human rights protection and international investment law is due to institutional and methodological failures in the system of international investment protection. The South African example shows that states are caught up between the need of attracting foreign investment in order to further economic development on one side, and the fact that they are bound to international human rights treaties as well as to their own social policies on the other. BEE as a measure of human rights promotion has already been in a situation of conflict with BITs, and is likely to arrive there again. In order to resolve this situation, this thesis proposes several solutions. The most important one is the implementation of public law standards in order to change the perspective of international investment law, which so far has been dominated by commercial law. As contemporary international investment law lacks transparency and consistency while

at the same time it is highly influential, the discipline is suffering from a severe legitimacy crisis. Consequently, numerous scholars have joined a discourse that aims at providing solutions to this crisis. The predominant set of solutions is concentrated in the *comparative public law approach*. According to this approach, international investment arbitration would do best if it adopted concepts of legal interpretation and procedures from the spheres of domestic and international public law. Besides, institutional reform is perceived as a necessary measure to increase the legitimacy of investment arbitration. According to most scholarly convictions, a revised version of international investment law would involve civil society in its proceedings and acknowledge the implications of its rulings for public concerns. Therefore, an expected consequence of the public law approach would be greater respect for human rights, *inter alia*, in investor-state arbitrations.

This thesis shall be understood as a comprehensive approach to addressing the core problems of the conflict between human rights protection and foreign direct investment. This work does not raise the claim to develop new theories regarding the addressed problem, yet it may make a contribution by uniting important approaches in one comprehensive concept that provides both, a detailed analysis of the conflict and effective proposals for an improvement of the current situation.

In order to grasp the tensions between social state policies in emerging countries that aim at promoting human rights, on the one hand, and the interests of foreign investors, on the other hand, and to find suitable solutions to the conflict, this thesis proceeds in four steps.

The first part will reveal the tensions that have existed between South Africa's economic needs and its efforts to compensate for past injustices since the end of apartheid. As it is often contested that South Africa's Black Economic Empowerment program is an appropriate means of fostering HDSAs, the second part attempts to demonstrate that affirmative action is a necessary measure of compliance with international human rights obligations and therefore deserves the protection of international law. Accordingly, an analysis of BEE from a human rights perspective is going to be made. The findings in the third part are going to demonstrate that even though South Africa's social policies emanate from its international human rights obligations, contemporary international investment law is greatly disregardful of this fact. Much rather, it represents a serious threat to poorer countries like South Africa in their efforts to cope with severe domestic problems. The last part is going to analyze new legal approaches aimed at solving the conflict between necessary social policies and the interests of investors.

## 2. ENFORCING SOCIAL POLICIES IN SOUTH AFRICA: BEE AND ITS EFFECTS

### 2.1 THE EVOLUTION OF BEE

BEE is a social policy launched after the end of apartheid in 1994 by the then provisional South African Government of National Unity (GNU) under a solid leadership of the African National Congress (ANC). Next to other aspects, such as developing professional skills and to increase household incomes within the community of HDSAs, BEE generally aims at creating a *black business class* or a class of *black capitalists*, i.e. HDSAs that are engaged in entrepreneurship or hold positions in the ranks of the economy's upper management.<sup>1</sup> This applies especially to the sectors that can be referred to as the *commanding heights* of South Africa's economy, i.e. mining, energy and finance.<sup>2</sup> BEE must be understood in the wider terms of the objectives of the 1993 Interim Constitution and the 1996 final South African Constitution regarding their particular focus on equality promotion; i.e. amending the social and economic injustices of the apartheid system.<sup>3</sup> The 1996 Constitution is far reaching in that it does not only "promote equality of opportunity but also of outcome".<sup>4</sup> In its early stage, BEE was more of a broader state motto than a concrete program, implicitly incorporated in the state's Reconstruction and Development Programme (RDP) and was usually referred to simply as *affirmative action* or *employment equity*.<sup>5</sup> Obviously, in this first phase of BEE, right after the downfall of the apartheid regime, what the hoped-for class of black capitalists lacked most, was capital. This condition was partly mitigated by South Africa's large parastatal sector, serving the purposes of BEE as a major "site of transformation"<sup>6</sup> with its roughly 300 state-owned enterprises and about 300,000 employees, most notably in the

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<sup>1</sup> Alan Hirsch, *Season of Hope : Economic Reform under Mandela and Mbeki* (Scottsville, South Africa; Ottawa: University of KwaZulu-Natal Press; International Development Research Centre, 2005), 193; David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge; New York: Cambridge University Press, 2008), 149.

<sup>2</sup> Roger Southall, "Ten Propositions About Black Economic Empowerment in South Africa," *Review of African Political Economy* 34, no. 111 (2007): 73.

<sup>3</sup> The constitutional focus on equality is noteworthy. For the exact wording see Constitution (Act No. 108 of 1996), preamble and sec. 9; Constitution (Interim), (Act No. 200 of 1993), preamble and sec. 8

<sup>4</sup> Schneiderman, 149.

<sup>5</sup> Johanna Glaser and Caroline Schebesta, "Der Weg zu Fairness und sozialer Gerechtigkeit? Eine Transformationscharter für die Weinindustrie," in *To BEE or Not to Be?: Black Economic Empowerment im neuen Südafrika am Beispiel der Weinindustrie*, ed. Werner Zips (Münster: LIT, 2008), 197; Reconstruction and Development Programme (Act No. 7 of 1994) [hereinafter RDP], sec. 1.3.6.

<sup>6</sup> Southall: 72.

financial and telecommunications sectors.<sup>7</sup> The private sector was even more beneficial to BEE during this period, facilitating it by means of an innovative banking system, which generously provided black entrepreneurs with loans. Yet the Asian financial crisis during the period from 1997 to 1998 was a major drawback to this private sector empowerment mechanism. It represented the end of the first phase of BEE.<sup>8</sup> The second phase of the policy was initiated by then-President Thabo Mbeki who endorsed the report of the Black Economic Empowerment Commission, a newly created advisory body to the government, mainly made up of black business people.<sup>9</sup> According to its 2001 report, BEE

is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa's financial and economic resources to the majority of its citizens. It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity.<sup>10</sup>

In the report, the notion of *blacks* includes South Africans of African and Asian (or Indian) descent as well as coloreds.<sup>11</sup> After the attempts to have a black business class emerging by itself predominantly as an outcome of the mechanisms of a liberalized market during the first phase of BEE, President Mbeki resorted to different means: He shifted toward a *developmental state* policy, meaning that BEE increasingly involved "the abandonment of privatization and a willingness to use fiscal benefits to engage in more far reaching social change and more generous budgets to attack the massive problems of poverty in the country."<sup>12</sup> In contrast to the first phase of BEE, the second phase introduced a *broad-based* approach in the sense that it aimed not only at increasing the amount of capital owned by (not necessarily many) HDSAs, but also the absolute number of black business people.<sup>13</sup> The first bill from a catalogue of legal provisions that stirred considerable controversy was the Mineral and Petroleum Resources Development Act (MPRDA) of 2002, which nationalized the country's mining sector in order to assure the inclusion of black business people in the sector. This revised version of BEE has consequently caused considerable reluctance among the proponents of economic orthodoxy, i.e. foreign investors and the white business

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<sup>7</sup> Ibid., 71.

<sup>8</sup> Ibid., 77.

<sup>9</sup> Ibid.

<sup>10</sup> Black Economic Empowerment Commission, *A National Integrated Black Economic Empowerment Strategy* (Johannesburg: Skotaville Press, 2001), 2.

<sup>11</sup> Ibid., 15.

<sup>12</sup> Bill Freund, "South Africa: The End of Apartheid & the Emergence of the 'BEE Elite,'" *Review of African Political Economy* 34, no. 114 (2007): 661.

<sup>13</sup> Schneideman, 150.

establishment, *inter alia*.<sup>14</sup> In the third phase of BEE, the *broad-based* approach has been legally consolidated in the Broad-Based Black Economic Empowerment (BBBEE) Act of 2003, again to counter allegations that BEE had only been advantageous to an elite of black business people. The law set the legal foundation for a set of codes of good practice that were introduced in ten industrial sectors. If companies applied for government contracts, their compliance with these codes, measured with government *scorecards*, has become a major selection criterion.<sup>15</sup>

Broad-based BEE led to fears that South African capitalism was going to become “entrapped in a web of red tape”.<sup>16</sup> Nevertheless, in the eyes of some commentators of BEE, the developmental approach of the Mbeki administration was too modest and not holistic enough to effectively solve South Africa’s equality issues.<sup>17</sup>

## 2.2 TENSIONS BETWEEN EQUALITY PROMOTION AND ECONOMIC INTERESTS

Since its start, the relationship of BEE with the economy has been complicated. The ANC government’s scope of determining social policies has always been fairly limited due to considerable political and economic constraints.<sup>18</sup> In its early stages, South Africa’s post-apartheid government put an exceptionally strong emphasis on attracting foreign investment in order to secure its economic development; a prerequisite for equality promotion.<sup>19</sup> Yet this emphasis was of an extent that could barely comply with the equality provisions of the Interim Constitution and the RDP of 1994. The country quickly entered numerous BITs that did not leave much room for social policies like BEE.<sup>20</sup> Consistent with this pro-investment policy, the ANC instantly acceded the World Trade Organization’s (WTO) Agreement on

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<sup>14</sup> Freund: 671; Schneiderman, 149; Southall: 77.

<sup>15</sup> Southall: 78.

<sup>16</sup> Ibid.

<sup>17</sup> See, e.g., Neva Seidman Makgetla, "The Post-Apartheid Economy," *Review of African Political Economy* 31, no. 100 (2004): 279-280; Southall: 82.

<sup>18</sup> Geeta Kingdon and John Knight, "Unemployment in South Africa, 1995–2003: Causes, Problems and Policies," *Journal of African Economies* 16, no. 5 (2007): 839.

<sup>19</sup> Marianne W. Chow, "Discriminatory Equality v. Nondiscriminatory Inequality: The Legitimacy of South Africa's Affirmative Action Policies under International Law," *Connecticut Journal of International Law* 24, (2009): 316; Ursula Kriebaum, "Privatizing Human Rights. The Interface between International Investment Protection and Human Rights," in *The Law of International Relations - Liber Amicorum Hanspeter Neuhold*, ed. August Reinisch and Ursula Kriebaum (Den Haag: Eleven International Publishing, 2007), 16.

<sup>20</sup> Luke Eric Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, Dialogue on Globalization - Occasional Papers (Berlin; Geneva; New York: Friedrich-Ebert-Stiftung, 2006), 10.

Trade Related Aspects of Intellectual Property Rights (TRIPS), which limited international economic competition. To give an example, TRIPS generously provided the pharmaceutical industry of the Global North with considerable discretion to determine the prices for medication. Thereby South Africa hampered its own efforts to cope with HIV/AIDS; a great issue in view of the high prevalence of the pandemic in South Africa, most notably among HDSAs.<sup>21</sup> In terms of its commitment to the Agreement on Trade-Related Aspects of Investment Measures (TRIMs) the government further limited its options to engage in a sensible amount of protectionism.<sup>22</sup>

However, BEE in its very beginnings – or the stance of the government on equality promotion in general - raised fears of expropriations through the nationalizations of private enterprises, which seemed a realistic threat to business owners. Yet at that time, the ANC followed a liberal non-interventionist approach not only internationally, but also domestically and assumed that a black business elite could best be empowered by means of a presumably self-regulating market.<sup>23</sup> The ANC publicly committed to this approach and succeeded fairly well in removing corporate fears by promoting its liberal *Growth, Employment and Redistribution* (GEAR) strategy in 1996; whilst as a matter of fact, *Redistribution* was not the top priority of GEAR.<sup>24</sup> At the same time, RDP was, if not formally, but in fact relinquished, which caused discontent within the ANC's left wing.<sup>25</sup> In this course, the “people-driven process”<sup>26</sup> of RDP was replaced by a market-driven process.<sup>27</sup> Despite GEAR, the state of the economy worsened, meaning that employment rates as well as FDI decreased and inequality could not be tackled. The failure of the strategy was most likely due to a lack of skilled workforce as a result of apartheid, strict protectionism in the Global North, numerous risk-averse investors generally refraining from investing on the African continent, and the government's efforts to hastily implement new labor regulations - away from the old apartheid practices - which encountered significant rigidity on the *old-fashioned* labor market.<sup>28</sup>

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<sup>21</sup> Stephen Gelb, *Inequality in South Africa: Nature, Causes and Responses*, DfID Policy Initiative on Addressing Inequality in Middle-Income Countries (Johannesburg: The EDGE Institute, 2004), 10; Schneiderman, 147.

<sup>22</sup> Schneiderman, 148.

<sup>23</sup> Adam Habib and Vishnu Padayachee, "Economic Policy and Power Relations in South Africa's Transition to Democracy," *World Development* 28, no. 2 (2000): 253; Schneiderman, 148.

<sup>24</sup> Schneiderman, 148.

<sup>25</sup> Okechukwu C. Iheduru, "Why 'Anglo Licks the ANC's Boots': Globalization and State-Capital Relations in South Africa," *African Affairs* 107, no. 428 (2008): 335.

<sup>26</sup> RDP, sec. 1.3.3.

<sup>27</sup> Southall: 70.

<sup>28</sup> Seidman Makgetla: 269.

In sum, a major difficulty of governing South Africa lies in the particular tension between the urgent need for capital to secure economic growth on the one hand, and the need for state intervention for the purpose of more immediate equality promotion, on the other hand. Okechukwu Iheduru illustrates this situation quite well when he notes about Nelson Mandela that

[h]is stance toward BEE was typical of governments confronted by minority domination of the economy along racial lines. They hesitate to address economic inequalities in order not to frighten away capital, disrupt the economy, and lead to a loss of skilled human resources. Mandela tolerated the economic subordination of the black majority in the hope of gradual vindication of such imbalances through autonomous but unspecified economic processes.<sup>29</sup>

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<sup>29</sup> Okechukwu C. Iheduru, "Black Economic Power and Nation-Building in Post-Apartheid South Africa," *The Journal of Modern African Studies* 42, no. 1 (2004): 7.

### **3. BEE: THE ANC'S COMPLIANCE WITH INTERNATIONAL HUMAN RIGHTS LAW**

In order to adequately address the conflict of human rights promotion with FDI protection, the relationship of BEE and human rights has to be clarified. However, in terms of this work the assumption that by enforcing BEE, South Africa complies – or at least attempts to comply - with its legally binding obligations emanating from relevant international human rights treaties shall not be taken for granted. The issue is “hotly contested”<sup>30</sup> and therefore in no way supposed to be ignored. Accordingly, the outcome of the next step shall prove that affirmative action policies like BEE can in principle be subsumed under the promotion of human rights. Two subsequent steps aim at demonstrating that state intervention, in general, is a necessary and BEE, in particular, a suitable measure to foster equality in South Africa. If the outcomes of all three steps are affirmative, BEE is indeed South Africa’s embracement of its duties under international human rights law.

#### **3.1 RELEVANT TREATIES**

According to the BEE Commission Report that sets out the goals of BEE, the final outcome of BEE shall be the achievement of “sustainable development and prosperity” by means of economic equality promotion. Therefore, “the imbalances” of apartheid shall be redressed.<sup>31</sup> South Africa has ratified several human rights treaties which contain provisions in support of these goals.<sup>32</sup> In the following, a closer look is going be taken at the treatment of affirmative action policies – in contrast to mere restrictions of state behavior - in the International Convention on the Elimination of All Forms of Racial Discrimination (CERD), the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW) and the International Covenant on Economic, Social and Cultural Rights (ICESCR).

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<sup>30</sup> Luke Eric Peterson, "Investment Treaty News - Analysis: South African Arbitration May Raise Delicate Human Rights Issues.", International Institute for Sustainable Development, [http://www.iisd.org/itn/wp-content/uploads/2010/10/itn\\_feb14\\_2007.pdf](http://www.iisd.org/itn/wp-content/uploads/2010/10/itn_feb14_2007.pdf) (accessed November 12, 2011).

<sup>31</sup> Black Economic Empowerment Commission, 2.

<sup>32</sup> For a detailed overview of South Africa's endorsement of human rights treaties see: Republic of South Africa, National Action Plan for the Protection and Promotion of Human Rights, [http://www2.ohchr.org/english/issues/plan\\_actions/safrica.htm](http://www2.ohchr.org/english/issues/plan_actions/safrica.htm) (accessed December 14, 2011).

### **3.1.1 THE INTERNATIONAL CONVENTION ON THE ELIMINATION OF ALL FORMS OF RACIAL DISCRIMINATION**

CERD has been ratified by 175 states since its inception in 1965, which gives the treaty a high degree of significance.<sup>33</sup> CERD - just like CEDAW – is a “bedrock doctrine”<sup>34</sup> in the United Nations Charter (UN Charter) and the Universal Declaration of Human Rights (UDHR). If it does not even require affirmative action, CERD at least provides a solid legal foundation for policies like BEE. Its preamble says that all states parties are “resolved to adopt all necessary measures for speedily eliminating racial discrimination in all its forms and manifestations”.<sup>35</sup> Some opponents of this view, claiming that CERD does not support affirmative action, argue that such policies racially discriminate those ethnic groups who do not benefit from affirmative action and therefore cannot be in accordance with the treaty.<sup>36</sup> Yet one can hardly imagine what kind of measure, if not affirmative action, CERD intends to promote. The Convention’s text is sufficiently clear about the fact that affirmative action – if it is required and not arbitrary - is covered by the treaty for no longer than the period of time which is necessary to compensate past racial discrimination:

Special measures taken for the sole purpose of securing adequate advancement of certain racial or ethnic groups or individuals requiring such protection as may be necessary in order to ensure such groups or individuals equal enjoyment or exercise of human rights and fundamental freedoms shall not be deemed racial discrimination, provided, however, that such measures do not, as a consequence, lead to the maintenance of separate rights for different racial groups and that they shall not be continued after the objectives for which they were taken have been achieved.<sup>37</sup>

Article 2 is even more assertive as it does not only allow affirmative action, but requires it under certain circumstances; yet again, affirmative action must not exceed the amount of time due for compensating past racial discrimination:

States Parties shall, when the circumstances so warrant, take, in the social, economic, cultural and other fields, special and concrete measures to ensure the adequate development and protection of certain racial groups or individuals belonging to them, for the purpose of guaranteeing them the full and equal enjoyment of human rights and fundamental freedoms. These measures shall in

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<sup>33</sup> United Nations Treaty Collection, Status of the International Convention on the Elimination of All Forms of Racial Discrimination, [http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=IV-2&chapter=4&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-2&chapter=4&lang=en) (accessed December 15, 2011).

<sup>34</sup> Marjorie Cohn, "Affirmative Action and the Equality Principle in Human Rights Treaties: United States' Violation of Its International Obligations," *Virginia Journal of International Law* 43, no. 249 (2002): 250.

<sup>35</sup> United Nations Declaration on the Elimination of All Forms of Racial Discrimination [hereinafter CERD], preamble.

<sup>36</sup> Cohn: 251.

<sup>37</sup> CERD, art. 1 (4).

no case entail as a consequence the maintenance of unequal or separate rights for different racial groups after the objectives for which they were taken have been achieved.<sup>38</sup>

There still is an issue with regard to the interpretation of CERD in view of some notions which have not yet been sufficiently defined by scholars and legal commentators.<sup>39</sup> Here, terms such as *equality* or *concrete measures* therefore still leave some room for interpretative discretion. Complete legal clarity in terms of affirmative action generally, is still an unresolved issue.<sup>40</sup> However, all things considered, affirmative action – such as BEE – is most likely mandated for by CERD.<sup>41</sup>

### **3.1.2 THE CONVENTION ON THE ELIMINATION OF ALL FORMS OF DISCRIMINATION AGAINST WOMEN**

Since its entry into force in 1981, CEDAW has been ratified by 187 states.<sup>42</sup> CEDAW advocates affirmative action like BEE in a similar fashion to CERD, with the exception, of course, that it focuses on promoting the equality of women. The member states shall thus, *inter alia*

take all appropriate measures to ensure ... the right to work as an inalienable right of all human beings; the right to the same employment opportunities, including the application of the same criteria for selection in matters of employment; the right to free choice of profession and employment, the right to promotion, job security and all benefits and conditions of service; ... the right to equal remuneration, including benefits, and to equal treatment in respect of work of equal value, as well as equality of treatment in the evaluation of the quality of work.<sup>43</sup>

The purpose of BEE to create a class of black business people, irrespective of their gender, complies with these provisions. Moreover, the Convention clearly exempts “temporary

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<sup>38</sup> Ibid., art. 2 (2).

<sup>39</sup> Constance De la Vega, "The Special Measures Mandate of the International Convention on the Elimination of All Forms of Race Discrimination: Lessons from the United States and South Africa," *Univ. of San Francisco Law Research Paper*, no. 08 (2009): 41.

<sup>40</sup> Chow: 346.

<sup>41</sup> Ruth Bader Ginsburg and Deborah Jones Merritt, "Affirmative Action: An International Human Rights Dialogue," *The Record of the Association of the Bar of the City of New York* 54, no. 3 (1999): 287; Cohn: 251; Andrew Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South," *Brigham Young International Law and Management Review* 7, no. 37 (2010): 45.

<sup>42</sup> United Nations Treaty Collection, Status of the Convention on the Elimination of All Forms of Discrimination against Women, [http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=IV-8&chapter=4&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-8&chapter=4&lang=en) (accessed December 15, 2011).

<sup>43</sup> Convention on the Elimination of All Forms of Discrimination against Women [hereinafter CEDAW], art. 11 (a)-(d).

special measures aimed at accelerating de facto equality between men and women" from being discriminatory, yet provided that they are limited in time.<sup>44</sup> As a result, CEDAW essentially mandates for the goals of BEE, as they are in accordance with the Convention's provisions and inclusive of both genders.<sup>45</sup>

### **3.1.3 THE INTERNATIONAL COVENANT ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS**

The ICESCR is an exception among the human rights treaties endorsed by South Africa. It was only signed but not ratified. However South Africa's "international obligations are guided by ... the International Covenant on Economic, Social and Cultural Rights", *inter alia*.<sup>46</sup> Another distinctive feature of the ICESCR is, that compared to civil and political rights, its scope of application - namely economic, social and cultural rights - lacks clarity; this is due to the content of the treaty which was long neglected and an ideological issue during the Cold War.<sup>47</sup> Anyhow, Article 2 (1) of the Covenant is implicitly supportive of affirmative action as it obliges its states parties to actively "take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures."<sup>48</sup>

### **3.1.4 INTERIM CONCLUSION**

Marianne Chow concludes on human rights conventions and affirmative action policies that "[e]ven though these treaties may not be enough to establish a customary international law regarding affirmative action, they do show that there is support for such policies within the international community."<sup>49</sup> Marjorie Cohn goes even further and is convinced that, especially on the basis of CERD, affirmative action policies are not only admissible but compulsory.<sup>50</sup> For Simma and Kill, "affirmative claims" as an obligation arising from international human rights regimes are the starting point of their work on the conflict of FDI protection and human

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<sup>44</sup> Ibid., art. 4 (1).

<sup>45</sup> Cohn: 250.

<sup>46</sup> Republic of South Africa, National Action Plan for the Protection and Promotion of Human Rights.

<sup>47</sup> Kriebaum, 173.

<sup>48</sup> International Covenant on Economic, Social and Cultural Rights [hereinafter ICESCR], art. 2 (1).

<sup>49</sup> Chow: 346.

<sup>50</sup> Cohn: 264.

rights.<sup>51</sup> In sum, affirmative action can be subsumed under the state of South Africa's obligations to comply with international human rights regimes under two further conditions: BEE shall be *necessary* and generally *suitable* to achieve its declared goals.

### 3.2 THE NECESSITY OF EMPOWERMENT POLICIES

Next to the proven possibility of subsuming BEE under affirmative action in accordance with the most relevant human rights treaties, BEE shall further fulfill the requirement of being a *necessary* endeavor.

After 350 years of firm white domination in 1994, the South African economy has become structured in a way that was exclusively fitted to the interests of white South Africans and had given them the control over virtually all of its sectors; very much to the detriment of Africans, coloreds and Indians, whose only monopoly during apartheid was to supply the white economy with cheap labor. Furthermore, they were not in a position to benefit from their share of South Africa's natural resources.<sup>52</sup> African and colored South Africans were unable to get deliberately involved in running their own businesses, while the Indian minority was only able to do so under highly restrictive conditions.<sup>53</sup> The old apartheid structures are still having noticeable repercussions on South Africa's economic and social structures, maintaining a highly disproportionate income gap to the particular disadvantage of Africans and Indians (see figure 1).<sup>54</sup> In the absence of perceptible equality promotion by means of market mechanisms alone, state intervention in the form of a social policy like BEE therefore seems to be a sensible – if not imperative – step; not least in order to secure the stability of South Africa's young democracy as a whole.<sup>55</sup>

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<sup>51</sup> Bruno Simma and Theodore Kill, "Harmonizing Investment Protection and International Human Rights: First Steps Towards a Methodology," in *International Investment Law for the 21st Century - Essays in Honour of Christoph Schreuer*, ed. Christina Binder et al. (Oxford: Oxford University Press, 2009), 679.

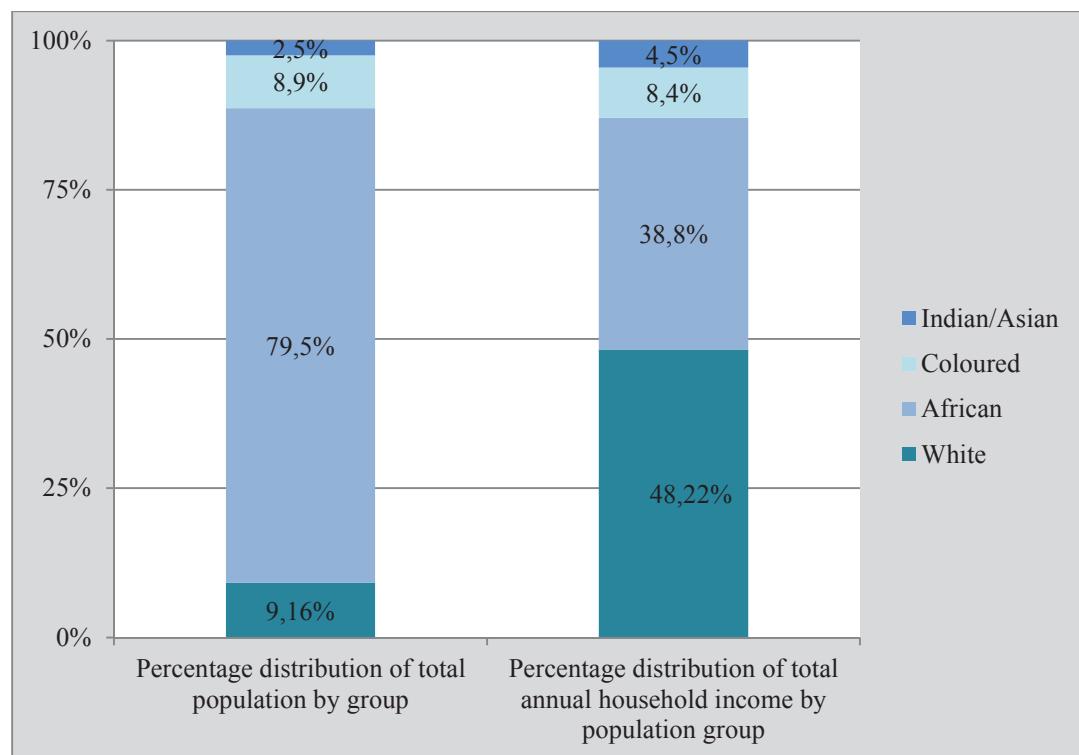
<sup>52</sup> Seidman Makgetla: 271.

<sup>53</sup> Iheduru, "Black Economic Power and Nation-Building in Post-Apartheid South Africa," 4; Southall: 68.

<sup>54</sup> Carlton M. Waterhouse, "The Good, the Bad, and the Ugly: Moral Agency and the Role of Victims in Reparations Programs," *FIU Legal Studies Research Paper Series*, no. 08-25 (2009): 281.

<sup>55</sup> Iheduru, "Black Economic Power and Nation-Building in Post-Apartheid South Africa," 8; Southall: 69.

Figure 1. Distribution of household income per population group, 2005/2006



Source: Selected data from Statistics South Africa, *P0100 - Income and expenditure of households 2005/2006: Statistical release; P0302 - Mid-year population estimates, 2006*.

Note: As of December 8, 2011 the latest figures on income distribution published by Statistics South Africa were those covering the 2005/2006 period.

Moreover, looking beyond the scope of *social peace*, compared to most other African states, South Africa's economy is closely linked to global markets. As Africa's strongest diversified economy it has an important manufacturing and service industry. A major future challenge to the government in order to attract investors and to foster exports is to increase the country's skilled workforce.<sup>56</sup> Providing better access to education and business to black South Africans – who represent the large majority of South Africa's population - is therefore also advisable from a purely economic perspective.

In view of the social and economic conditions in South Africa and the failure of more liberal policies such as GEAR, the state is obliged under international human rights law to actively take measures of affirmative action in order to improve the participation of HDSAs in the economy.

<sup>56</sup> Tarik Alatovik and others, *Lions on the Move: The Progress and Potential of African Economies* (McKinsey Global Institute, 2010), 5; Rhys Jenkins, "Globalization and the Labour Market in South Africa," *Journal of International Development* 18, no. 5 (2006): 653.

### 3.3 THE SUITABILITY OF BEE FOR THE PROMOTION OF EQUALITY

When in 2007, Cape Town University professor of philosophy David Benatar published an article very critical of the concept of South Africa's racially based affirmative action policies, a major debate about the effectiveness of black empowerment arose.<sup>57</sup> However Benatar does not question the necessity of affirmative action *per se* as he writes about *equal opportunity affirmative action* that it

is a badly-needed corrective to unfairness, much of which is hidden rather than obvious. Equal opportunity affirmative action, unlike all other forms of affirmative action, does not require us to enter the fetid terrain of racial classification and racial preference. It seeks to undo unfairness whoever its victims might be. ... The controversy arises once affirmative action requires a system of racial classification and a mechanism for assigning individuals to racial categories, favouring some people merely on the basis of such assignments.<sup>58</sup>

According to Benatar, *race* is the wrong criterion to distinguish those who shall benefit from affirmative action, from those who shall not. Corresponding to him, affirmative action like in *Black Economic Empowerment*, as a measure which is aimed at compensating the racist injustices that occurred under apartheid, is therefore racist itself. Furthermore, he claims that affirmative action based on race is not suitable to achieving equality but counterproductive and unethical because<sup>59</sup>

[t]he more weight an affirmative action policy attaches to "race", the weaker a candidate of the desired "race" can be in other ways while still obtaining the place or position for which he or she is competing. In saying this, I am not making a value judgement, but stating a scientific truth. The same would be true if one accorded special weight to eye or hair colour, height, age, national origin or any other such attribute. That is simply how weights and scales work. Although it is a simple fact, it has implications for an ethical assessment of affirmative action. The more weight an affirmative action policy attaches to "race" the less easily it can be justified. In other words, it is less implausible to attach minimal weight to "race" than it is to accord it significant weight.<sup>60</sup>

Here, Benatar may be right in implicitly asserting that South Africa's affirmative action policy may to a certain extent further incompetence in professional life and cause potential drawbacks to the economy. Yet when he alleges that the criterion of *black skin* is equally random as *hair color, height, age* etc. he is – as a matter of *scientific truth*, as he puts it – wrong. In contrast to *race*, none of the latter criteria have resulted in 350 years of

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<sup>57</sup> De la Vega: 3.

<sup>58</sup> David Benatar, "'Affirmative Action' Not the Way to Tackle Injustice," *University of Cape Town Monday Paper* 26, no. 5 (2007).

<sup>59</sup> Ibid.

<sup>60</sup> Ibid.

discrimination during apartheid, with its known fatal repercussions for the *black* community, most notably. If South Africa is willing to accept the short-term losses that may possibly come with favoring potentially less competent black business people – who still need to fulfill certain requirements – over more competent white entrepreneurs, involving its slightly more than 90% of non-white citizens in white collar businesses by means of affirmative action, will – as stated above – most likely be beneficial in the long run. Benatar concludes his article by stating that “[r]ejecting this policy does not in the least diminish the duty to address injustice, either past or present. Indeed it might help focus the mind on more appropriate methods of rectification.”<sup>61</sup> However, Benatar remains silent and does not elaborate on such *more appropriate*, i.e. *suitable* steps like what he previously called *equal opportunity affirmative action*, and how they could be beneficial to solving South Africa’s severe equality problem. This renders his contribution to dealing with the issue fairly unconstructive.

Apart from Benatar’s general criticism of the ANC’s racially based affirmative action policies, in view of their suitability to amend past injustices, there have indeed occurred significant problems with regard to the realization of BEE, particularly during its first phase. These issues have greatly challenged the credibility of the empowerment program and raised public doubts about its suitability to achieve the long-term goals of “sustainable development and prosperity”<sup>62</sup>. Instead of promoting a broader black capitalist class, *real-life* BEE has been alleged to mostly have created networks of corruption and nepotism and given birth to a small privileged class of so called *BEE-llionaires*. This justified criticism is chiefly a product of corrupt practices that have merely supplied a few select ANC members with equity shares in South African companies in order to increase black ownership on paper; which did not require genuine entrepreneurship.<sup>63</sup>

Yet the government has responded to this challenge and adapted BEE by endorsing the report of the BEE Commission. It thereby made efforts to switch from a policy that often creates state-funded black *fake* investors to the broad-based program that aims at fostering genuine and more inclusive black entrepreneurship.<sup>64</sup> As a consequence, BEE is presumed to have indeed facilitated the integration of a fair amount of HDSAs into the higher ranks of the economy.<sup>65</sup> It is furthermore conceivable that BEE has contributed to the “dramatically

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<sup>61</sup> Ibid.

<sup>62</sup> See above, Black Economic Empowerment Commission, 2.

<sup>63</sup> Freund: 665; Schneiderman, 150; Waterhouse: 291.

<sup>64</sup> Gelb, 39.

<sup>65</sup> Southall: 79.

increased black middle class”<sup>66</sup> which has been emerging in South Africa since 1994. However, BEE has not caused better living conditions for the majority of HDSAs, i.e. South Africa’s poorest people.<sup>67</sup> Hence it can be said that, on the one hand, BEE is suitable for creating a class of black capitalists while, on the other hand, it is not sure “whether the ANC is doing enough to combine its empowerment strategies with delivering ‘a better life for all’”.<sup>68</sup>

To conclude, one may say that South Africa’s BEE strategy is a measure of compliance with international human rights law as it is a necessary and suitable step in order to promote equality among South Africans, albeit only a limited share of them.

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<sup>66</sup> Freund: 672.

<sup>67</sup> Ibid., 673; Southall: 81.

<sup>68</sup> Southall: 83.

## 4. INVESTMENT LAW'S DISREGARD OF HUMAN RIGHTS

South Africa's affirmative action policy in the form of BEE does not only encounter domestic, but also international obstacles. The point at which South Africa's social policies have to face these international barriers is at the center of this work.

As seen above, this thesis presumes that BEE is the embodiment of human rights promotion and that for this reason it has the legal backing of international human rights law. Nevertheless, the legitimate interests of foreign investors – most notably the protection against expropriation and nationalization - are equally binding and supported by international law, namely international investment law. The most remarkable difficulties, which South Africa is sharing with numerous developing and emerging nations, arise from the provisions of the BITs it has concluded with the developed world and the current arbitration standards for the settlement of investment disputes.<sup>69</sup> The upcoming section is going to follow the main argument that international investment law does not yet adequately take into account the domestic and international human rights obligations of developing and emerging host states. In doing so, it will analyze the underlying systemic reasons of the conflict between FDI protection and human rights concerns, by elaborating on the particularities of (1) FDI, the (2) relevant principles of international investment law as well as the (3) BIT system. At the end of the section, the outline of an investment dispute, which South Africa had to face as a consequence of its black empowerment policy – the *Foresti* case –, shall further illustrate how these systemic issues can be translated into practice.

### 4.1 THE BASIC CONCEPTS OF INTERNATIONAL INVESTMENT LAW

As stated above, social policies can be a momentous tool for emerging and developing countries to further human rights, *inter alia*. South Africa's discretion over its empowerment policies is limited by the rules of international investment law, as they do at times also affect the interests of foreigners and their home countries.<sup>70</sup> Given these circumstances, and the costs that may incur in case of a lost dispute, “the prospects are that any number of [foreign] investor disputes could render BEE fiscally unsustainable.”<sup>71</sup> Accordingly, one paramount

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<sup>69</sup> Marc Jacob, *International Investment Agreements and Human Rights*, INEF Research Paper Series on Human Rights, Corporate Responsibility and Sustainable Development 03/2010 (Duisburg: Institute for Development and Peace, University of Duisburg-Essen), 7; Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 2.

<sup>70</sup> Friedman: 51.

<sup>71</sup> Schneiderman, 155.

realm of international investment law is to govern the relationships between host states and foreign investors. Conflicts do often arise in cases where states interfere in the business activities of foreign investors by means of regulatory measures, as South Africa occasionally has through BEE. For such legislative actions not to unjustifiably put foreign investors at disadvantage, international investment law over time has developed a set of standards and tools that protect FDI. However, international investment law is lagging behind in taking due account of human rights concerns.<sup>72</sup>

#### **4.1.1 FOREIGN INVESTMENT**

On behalf of investors, there are two basic and plausible reasons for foreign investment: First, businesses may feel compelled to expand their activities into new markets if the potential to achieve benefits in an explored market is already exhausted due to its saturation. Second, there are *speculative reasons*, meaning that companies or individuals hoping to benefit from lower costs in a value chain, i.e. higher profit margins, in a country other than their own are prone to investing abroad.<sup>73</sup> Foreign investment can be distinguished into FDI and foreign portfolio investment (FPI), depending on the degree of the involvement of an investor in the host country. Direct investors take ownership as well as the control of companies they invest in, while portfolio investors usually delegate the management of the business to locals in the host state and focus uniquely on generating capital from their ownership shares.<sup>74</sup> FDI is furthermore different from traditional trade relations in that it usually represents a long-term commitment.<sup>75</sup> The reason as to why these distinctions are relevant is that FDI plays a far greater role in investment disputes and has a significantly higher potential to influence its host country's development.<sup>76</sup> On the part of the receiving host state, the motivation to attract direct investors makes equal sense, especially when there is a special need for development:

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<sup>72</sup> Jacob, 7.

<sup>73</sup> Cordula A. Meckenstock, *Investment Protection and Human Rights Regulation : Two Aims in a Relationship of Solvable Tension* (Baden-Baden: Nomos, 2010), 19.

<sup>74</sup> Itay Goldstein and Assaf Razin, "Foreign Direct Investment vs. Foreign Portfolio Investment," *National Bureau of Economic Research Working Paper Series*, no. 11047 (2005): 2.

<sup>75</sup> Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford; New York: Oxford University Press, 2008), 3.

<sup>76</sup> Meckenstock, 20.

FDI creates jobs, transfers specialized knowledge and skills and increases tax revenues, to name only a few. Yet it also bears the risk of political interference, *inter alia*.<sup>77</sup>

#### 4.1.2 THE COMPLEXITY OF INTERNATIONAL INVESTMENT LAW

FDI is regulated by international investment law – also referred to as investment protection law -, which is particularly complicated as it is composed of “a plethora of legal instruments, international, national, and contractual.”<sup>78</sup> Its realm spans from public international law to private commercial law.<sup>79</sup> This complex scope and the lack of a particular conceptual framework for international investment law are at the origin of a current legitimacy crisis that this discipline is suffering from - an issue which is going to be addressed more specifically in the later course of this work.<sup>80</sup> As to that effect, public international law has yet failed to provide a particular set of rules dedicated to investment law, i.e. comprehensive multilateral agreements. Hence to date, bilateral treaties are the predominant legal tools employed to regulate investor-state relationships.<sup>81</sup> In contrast to the vast majority of other realms of international law, it is not different states that are the most significant stakeholders in disputes. Instead, the typical layout of an investment dispute much rather involves a host state and an investor as counterparties.<sup>82</sup> By consequence, international investment law certainly shares some features with domestic public law, i.e. administrative and constitutional law and its typical legal relationship between a state and a private person or entity which claim a violation of their rights by an executive state act.<sup>83</sup> The enforcement of a social policy like BEE can be one such example. As distinct from domestic law however, investors’ rights are additionally enshrined in BITs and disputes would often be settled before international arbitration institutions within the realm of international commercial law; a circumstance that

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<sup>77</sup> Ilija Mitrev Penusliski, "A Dispute Systems Design Diagnosis of ICSID," in *The Backlash against Investment Arbitration : Perceptions and Reality*, ed. Michael Waibel (Alphen aan den Rijn, The Netherlands: Wolters Kluwer Law & Business, 2010), 516.

<sup>78</sup> Ibid., 515.

<sup>79</sup> Dolzer and Schreuer, 3; Stephan W. Schill, "Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach," *Virginia Journal of International Law* 52, no. 1 (2011): 59.

<sup>80</sup> Schill: 59.

<sup>81</sup> Meckenstock, 24; Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 6.

<sup>82</sup> Mitrev Penusliski, 516.

<sup>83</sup> Stephan W. Schill, "International Investment Law and Comparative Public Law - an Introduction," in *International Investment Law and Public International Law*, ed. Stephan W. Schill (Oxford; New York, N.Y.: Oxford University Press, 2010), 3; Gus Van Harten and Martin Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law," *European Journal of International Law* 17, no. 1 (2006): 146.

has proven unsuitable.<sup>84</sup> Therefore, international investment protection is widely perceived to be caught up in a “commercial arbitration legacy” that does consequently not fit its scope of application.<sup>85</sup> This deficiency is going to be addressed below in the relevant section, which is going to elaborate on international dispute settlement in a more detailed manner.

#### **4.1.3 THE BIAS OF BILATERAL INVESTMENT TREATIES**

In the following section, the general features of BITs are going to be outlined in order to subsequently shed light on South Africa’s contractual positioning relative to Europe’s major capital exporting countries. Next to the systemic pro-investor biases investment treaties generally dispose of, the BITs South Africa has concluded with European strong economies are emblematic for the little consideration that is given to human rights concerns.

##### **4.1.3.1 GENERAL FEATURES AND PRINCIPLES**

Even though outgoing capital is generally detrimental to governments, there are two important reasons, *inter alia*, that motivate the investors’ states of origin to conclude BITs so as to protect their nationals’ investments: First, they appreciate the potential backflow of financial benefits, and second, they welcome the increased competitiveness on global markets that their corporations may obtain.<sup>86</sup> BITs have emerged from the exposure of foreign investors to the jurisdictions and regulatory frameworks of their host states, i.e. typical long-term investment risks.<sup>87</sup> The particular need for the legal stability of foreign investors has made of BITs the most commonly applied legal instrument to regulate FDI and replaced the minimum protection standards of customary international law.<sup>88</sup> As a consequence, by the end of 2010 there were 2,807 BITs in force.<sup>89</sup> As the purpose of BITs is to protect investors, they do not impose enforceable obligations on them; while accordingly, they usually do not imply rights available to states.<sup>90</sup> The first BIT was concluded in 1959 between Germany and Pakistan,

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<sup>84</sup> Dolzer and Schreuer, 222.

<sup>85</sup> Alessandra Asteriti and Christian J. Tams, "Transparency and Representation of the Public Interest in Investment Treaty Arbitration," in *International Investment Law and Comparative Public Law*, ed. Stephan W. Schill and James Crawford (Oxford; New York, N.Y.: Oxford University Press, 2010), 816.

<sup>86</sup> Meckenstock, 23.

<sup>87</sup> Dolzer and Schreuer, 22.

<sup>88</sup> Ibid., 122; Jacob, 7. For a more detailed overview of the roots of investment protection standards incorporated in customary international law, see e.g. Dolzer and Schreuer, 11-17, and Meckenstock 26-27.

<sup>89</sup> United Nations Conference on Trade and Development, *World Investment Report 2011* (Geneva: United Nations, 2011), 100.

<sup>90</sup> Jacob, 8.

whereas the largest number of BITs entered into force during the 1990s, coinciding with a boom of FDI.<sup>91</sup> In the vast majority of cases, BITs exclusively regulate either the investment relations between one industrialized and one developing nation, or between two developing states. The main reason therefore is that states commonly have general legal security concerns due to frequent deficiencies of the rule of law in less developed states.<sup>92</sup>

BITs are negotiated and concluded within the frameworks of diplomatic relations, under the exclusion of civil society. In view of the vital implications major investments may have for the public of a host state, this contracting mechanism suffers from an “acute participation deficit.”<sup>93</sup>

BITs are almost entirely based on a compendium of so called *model BITs*.<sup>94</sup> These *templates* follow a certain pattern that begins with a preamble, stating the parties’ motives and the treaty’s purpose which, in accordance with Article 31 (1) of the Vienna Convention on the Law of the Treaties, can be significant for interpretations in terms of potential arbitration.<sup>95</sup> Furthermore, all model BITs include the definitions of *investment* and *investor* as well as the *absolute* and *relative* standards of equal treatment.<sup>96</sup> As the exact meaning of these principles remains “notoriously vague”<sup>97</sup>, the following description thereof will merely consider the minimum consensus on the catalog of included aspects, as found in the relevant literature.<sup>98</sup>

The absolute standards are (1) *fair and equitable treatment* (FET) as well as (2) *full protection and security*. *Absolute* in contrast to *relative* signifies that these standards are rights which are granted to investors regardless of how others are treated. The *relative standards* of non-discrimination are composed of the (3) *most favored nation* (MFN) and (4) *national treatment* (NT) rules. Accordingly, they regard the treatment of investors in relation to the treatment of other foreign investors or the host country’s nationals.<sup>99</sup>

Threats to the *legitimate expectations* of investors traditionally materialize in terms of expropriations and nationalizations, most notably.<sup>100</sup> The scope of these expectations is

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<sup>91</sup> Meckenstock, 27-28.

<sup>92</sup> Dolzer and Schreuer, 21.

<sup>93</sup> Jacob, 22.

<sup>94</sup> For a comprehensive compilation of the most commonly used model BIT texts, see Dolzer and Schreuer, 352-419.

<sup>95</sup> Peterson, *South Africa’s Bilateral Investment Treaties - Implications for Development and Human Rights*, 10.

<sup>96</sup> Meckenstock, 29.

<sup>97</sup> Jacob, 28.

<sup>98</sup> Cf. Chow: 311; Jacob, 17.

<sup>99</sup> Chow: 306.

<sup>100</sup> Jacob, 6; Meckenstock, 23; Mitrev Penusliski, 517.

enshrined in the FET standard. Yet the exact meaning of FET is vague and may vary from case by case.<sup>101</sup> However, the consensus subsumes under FET conditions such as *basic vigilance and protection, transparency, procedural propriety, good faith, and the absence of abuses of authority*.<sup>102</sup> In short, the FET standard in BITs shall serve as a guarantee for the investor's legal security.<sup>103</sup> The *full protection and security* standard signifies "a state's responsibility to protect its foreign investors against damages caused by the state itself or by private persons as a result of state action or omission."<sup>104</sup>

MFN treatment protects an investor from being treated less favorably than an investor from the host country or a third state.<sup>105</sup> The NT standard forbids host states to treat foreign investors worse than domestic investors.<sup>106</sup> Furthermore, BITs usually determine the conditions of potential dispute settlements, i.e. the settlement procedures including the tribunal, and the choice of law.<sup>107</sup> Provisions that take into account domestic obligations of host states in general, and human rights provisions in particular, are absent from the vast majority of BITs.<sup>108</sup> However, this issue is going to be addressed more thoroughly in the later course of this work, next to further approaches eligible to facilitate greater consideration for human rights in international investment law.

As the result of this section, one may say, that BITs dispose of a strong systemic pro-investor bias.<sup>109</sup>

#### 4.1.3.2 *SOUTH AFRICA'S UNFAVORABLE TREATIES*

South Africa's first BIT, concluded with the United Kingdom in 1994 and entered into force in 1998, has for the most part served as a model for the fourteen BITs South Africa has subsequently signed with other capital-exporting developed European countries. Most of these

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<sup>101</sup> Dolzer and Schreuer, 128.

<sup>102</sup> Jacob, 17.

<sup>103</sup> For more profound information on the controversies surrounding the scope of the FET standard see, Christoph Schreuer, "Fair and Equitable Treatment in Arbitral Practice", *The Journal of World Investment & Trade* 6, no. 3 (2005).

<sup>104</sup> Chow: 310.

<sup>105</sup> Dolzer and Schreuer, 186.

<sup>106</sup> Ibid., 178.

<sup>107</sup> Jacob, 8.

<sup>108</sup> Ibid., 26.

<sup>109</sup> Ibid., 21.

were signed during the 1990s.<sup>110</sup> After the end of apartheid - as mentioned above - the new South African government was in need of quickly attracting foreign investment. To these ends the officials in charge were apparently willing to make major concessions during the negotiations of their new BITs. However, a lack of expertise may as well have contributed to those concessions.<sup>111</sup> Besides, one must not forget South Africa's interests in exporting its local products that may have led to compromises in the process of drafting BITs.<sup>112</sup> The UK model BIT is greatly *generous* toward investors and "has proven inadequate in addressing the needs of a developing country such as South Africa".<sup>113</sup> In the UK model, the concessions to the European contracting parties are expressed in the particularities of the treaty text: First, the preambles do not include any developmental, social or human rights purposes, but merely focus on creating "favourable conditions for greater investment" and welcome "prosperity in both States".<sup>114</sup> Second, investments are defined broadly, which leaves no room for South Africa to restrict the influx of potentially harmful investments in coherence with its social policies. Third, the full protection and security, MFN, NT and FET standards are accorded to European investors to their highest possible extents.<sup>115</sup> Another major disadvantage the South African negotiators have accepted is the option for investors, in case of a dispute, to immediately call for international arbitration without being obliged to first exhaust the domestic legal path of South African jurisdiction.<sup>116</sup> It is understandable that an investor may justifiably fear the potentially biased jurisdiction of a host state - especially in a state where the rule of law is weak.<sup>117</sup> The major drawback of this provision however, lies in the possibility of an investor to evade to a jurisdiction that is likely to be much less concerned with South Africa's broader policies such as BEE than a domestic court would be.<sup>118</sup>

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<sup>110</sup> Chow: 318; International Centre for Settlement of Investment Disputes, Overview of Bilateral Investment Treaties Concluded by South Africa, <http://icsid.worldbank.org/ICSID/FrontServlet> (accessed November 10, 2011).

<sup>111</sup> Cf. Chow: 330-331; Jacob, 22; Gus Van Harten, "Five Justifications for Investment Treaties: A Critical Discussion," *Trade, Law & Development* 2, no. 1 (2010): 23.

<sup>112</sup> Alatovik and others, 4; Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 39.

<sup>113</sup> Chow: 318.

<sup>114</sup> Cf. Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 10; Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa for the Promotion and Protection of Investments (Cm 4039) (August 1998) [hereinafter South Africa-UK BIT], preamble.

<sup>115</sup> Chow: 327; Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 10.

<sup>116</sup> South Africa-UK BIT, art. 8 (1).

<sup>117</sup> Dolzer and Schreuer, 214.

<sup>118</sup> Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 21.

Giving one possible explanation as to why states agree to consent to such disadvantageous agreements, Marc Jacob finds “that, from a regulatory perspective, BITs involve a type of ‘prisoner’s dilemma’: states would be better off if they collectively rejected restrictions of their regulatory capacity in the form of BITs, but capital-importing countries are individually tempted to conclude investment agreements to gain a competitive advantage.”<sup>119</sup>

#### **4.1.4 THE FLAWS OF INTERNATIONAL DISPUTE SETTLEMENT**

The permanent courts in charge of investment arbitration are the World Bank’s International Centre for Settlement of Investment Disputes (ICSID) in Washington D.C., the International Chamber of Commerce (ICC) in Paris, the London Court of Arbitration and the Permanent Court of Arbitration in The Hague. Ad-hoc arbitration according to the standard rules of the United Nations Commission on International Trade Law (UNCITRAL) is a further possibility to settle investor-state disputes.<sup>120</sup> The present work will only pay further attention to ICSID arbitration as by virtue of most BITs it is the main forum of investment disputes.<sup>121</sup> Since 1966, 147 states have accepted ICSID jurisdiction.<sup>122</sup> In addition to this, the rising number of cases settled by ICSID demonstrates the growing need and importance of ICSID arbitration.<sup>123</sup> For these reasons, the potential impact of ICSID-generated case law on the development of investment law standards may not be underestimated.<sup>124</sup> Furthermore, ICSID does not substantially differ from other mechanisms in that the entire international legal regime for foreign investment is being criticized in view of its preferential treatment vis-à-vis capital-exporting countries and its disregard of human rights concerns, most notably in developing countries.<sup>125</sup>

The main feature, which all international investment arbitration procedures have in common, is that the disputing parties may freely choose the law to be applied and have the authority to appoint the tribunal.<sup>126</sup> Therein lays one flaw of the ICSID dispute settlement mechanism:

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<sup>119</sup> Jacob, 23.

<sup>120</sup> Dolzer and Schreuer, 222-229.

<sup>121</sup> Meckenstock, 27.

<sup>122</sup> The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965) [hereinafter ICSID Convention], introduction; International Centre for Settlement of Investment Disputes, List of Member States, [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal>ShowHome&pageName=MemberStates\\_Home](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal>ShowHome&pageName=MemberStates_Home) (accessed November 30, 2011).

<sup>123</sup> Dolzer and Schreuer, 224.

<sup>124</sup> Meckenstock, 27.

<sup>125</sup> Friedman: 51; Mitrev Penusliski, 507.

<sup>126</sup> Dolzer and Schreuer, 226.

Most eligible arbitrators have a commercial law background and are therefore presumed to lack sensitivity, flexibility and due expertise in order to make proper considerations with regard to human rights issues.<sup>127</sup> The latter would require arbitrators to look quite beyond the legal scopes of BITs and thoroughly analyze the social context of the particular case at hand.<sup>128</sup> As a consequence, ICSID arbitrators are often perceived as strict legal positivists who would in an inflexible fashion, usually abide by the texts of BITs. One may at times as well suspect a certain degree of judicial bias and question there impartiality, as traditionally, ICSID arbitrators have also served as legal counsels to foreign investors.<sup>129</sup>

Another particular feature of investment disputes is that they do not follow fixed rules. The inconsistencies emanating from this kind of *flexibility* justify fears of significant legal uncertainty.<sup>130</sup> The reasons for this circumstance can be found in the *ad-hoc character* of tribunals – even with regard to ICSID, as arbitrators are elected on a case-by-case basis.<sup>131</sup> Legal uncertainty is further due to rare reference to precedent cases that may foster consistent legal practice.<sup>132</sup> In the few cases where non-investment rules may be part of the obligations deriving from a BIT, there are no fixed procedural rules on how to deal with such provisions.<sup>133</sup> Arbitrators have at times even been reluctant to dealing with non-investment-related provisions and have avoided such tasks by professing conflicts with procedural matters.<sup>134</sup>

Transparency is a further major issue because civil society has only very limited possibilities to follow legal disputes. Awards may increasingly be published; however the arguments brought forth by the parties to a dispute are in most cases not available to the public.<sup>135</sup> International investment arbitration sets a particular focus on confidentiality, which of course contradicts the principles of transparency and public representation of domestic approaches; particular features which are commonly perceived as essential to a strong rule of law.<sup>136</sup> However, the inclusion of non-disputing parties (NDPs) - also referred to as *amici curiae* - seems to be increasing. In case their involvement is accepted by the tribunal, they may serve

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<sup>127</sup> Friedman: 50.

<sup>128</sup> Ibid., 46.

<sup>129</sup> Jacob, 25; Mitrev Penusliski, 525.

<sup>130</sup> Susan D. Franck, "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions," *Fordham Law Review* 73, (2005): 1523; Mitrev Penusliski, 522.

<sup>131</sup> Chow: 332.

<sup>132</sup> Jacob, 24.

<sup>133</sup> Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 11.

<sup>134</sup> Jacob, 30; Mitrev Penusliski, 521.

<sup>135</sup> Jacob, 24; Mitrev Penusliski, 523.

<sup>136</sup> Asteriti and Tams, 814.

as experts, giving specialized advice to the arbitrators. However, their participation is restricted to them being granted to inspect the written proceedings of a dispute and submit their recommendations without actively participating in hearings.<sup>137</sup>

The origins of this entire catalog of flaws must be seen as a result of the historic and unguided process of the jurisdictional evolution of international investment arbitration. It is an outgrowth of international commercial arbitration. Thus it can be seen as an anachronism that still follows the procedures as well as the enforcement mechanisms of commercial arbitration.<sup>138</sup> This deficiency which has already been addressed above, translates into confidential arbitration behind closed doors and widely inaccessible to the public. As commercial arbitration traditionally does not involve jurisdiction over public policies, this practice has further culminated in a condition which effectively allows privately-contracted arbitrators to take governmental decisions.<sup>139</sup>

In sum, there is still significant potential to harmonize, update and thereby give new legitimacy to international investment dispute settlement standards. In effect, this could likely avoid situations in which human rights concerns conflict with investors' interests.

## 4.2 THE “FORESTI” CASE: A RESULT OF SYSTEMIC DEFICITS

The case *Piero Foresti, Laura de Carli and others v. Republic of South Africa* (Foresti case) is a well suited and repeatedly taken example to illustrate the deficiencies of current international investment law standards with regard to the little consideration they accord to public policy interests.<sup>140</sup> More concretely, it is the practical example of a conflict between investor-friendly BITs and South African BEE provisions. The *Foresti* case was finally settled out of court, by mutual agreement of the parties, leaving many questions unanswered.<sup>141</sup> It is a typical model for the legal uncertainty inherent to current international investment arbitration, with regard to investor-state disputes over public policy concerns. In this course, the *Foresti* case shall further provide an illustrative context to briefly touch upon the subject of

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<sup>137</sup> Andrew Friedman, "Friends of the Panel: The Evolution of Amicus Participation in International Investment Arbitration," *Group of Lecce International Workshop on "Legitimacy and Efficiency in Global Economic Governance" in Lecce, Italy*, (May 2011): 10, 6, 3.

<sup>138</sup> Van Harten and Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law," 125.

<sup>139</sup> Ibid., 126.

<sup>140</sup> See also, Chow; Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South."; Jacob; Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*.

<sup>141</sup> Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South," 37.

expropriation under international investment law, while emphasizing the legal uncertainty that often accompany it, given the current conditions of investment arbitration.

The *Foresti* case was initialized on November 8, 2006, when ICSID received a complaint from seven Italian nationals as well as Finstone s.à.r.l., a company incorporated in Luxembourg, against the Republic of South Africa.<sup>142</sup> These investors (Foresti et al.) were involved in the granite mining business and accused the government of South Africa of their unlawful expropriations, most notably. In this manner South Africa would have breached its BITs with Italy and the Belgo-Luxembourg Economic Union. The subjects to the complaint, causing the alleged violations contested by Foresti et al., were two BEE policies: the Mining and Petroleum Resources Development Act (MPRDA) of 2002 on the one hand, and the Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry (Mining Charter) on the other hand.<sup>143</sup>

#### 4.2.1 BEE MINING LAW: AN ANNOYANCE TO FOREIGN INVESTORS

The Mineral and Petroleum Resources Act of 2002, which entered into force in 2004, was the first pivotal initiative during the second phase of BEE.<sup>144</sup> It represented the first *hard law* measure in terms of BEE, which up until then could be characterized as *soft law*.<sup>145</sup> A main goal the South African Government wanted to achieve with the MPRDA was “to substantially and meaningfully expand opportunities for historically disadvantaged persons … to enter the mineral and petroleum industries and to benefit from the exploitation of the nation's mineral and petroleum resources.”<sup>146</sup> Consistent with its aforementioned intention to lift HDSAs up to the *commanding heights* of the economy, the government aimed to gain control over the country's natural resources by introducing a system of licensing that investors – foreign as well as domestic ones – would have to adhere to. According to this new system, the *old order* mining rights of private corporations were converted into newly emitted licenses – or *new order rights*. Owners of the old order were therefore required to reapply for a right to convert

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<sup>142</sup> On July 13, 2009 three additional investors - all members of the Foresti family – have been granted by ICSID to join the complaint; ICSID, Award of the Tribunal: Piero Foresti, Laura De Carli and Others v. Republic of South Africa (ICSID Case No ARB(Af)/07/1), August 04, 2010, [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1651\\_E&caseId=C90](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1651_E&caseId=C90) (accessed September 29, 2011)., para. 3.

<sup>143</sup> Ibid., para. 54-56.

<sup>144</sup> Roger Southall, "The ANC & Black Capitalism in South Africa," *Review of African Political Economy* 31, no. 100 (2004): 323; Southall, "Ten Propositions About Black Economic Empowerment in South Africa," 77.

<sup>145</sup> Schneideman, 151.

<sup>146</sup> Mineral and Petroleum Resources Development (Act No. 28 of 2002), art. 2 (d).

their titles to new licenses to be able to continue their operations.<sup>147</sup> Thereby the access of HDSAs to the upper ranks of the mining business was supposed to be ensured in conformity with South Africa's overall constitutional goals.<sup>148</sup> Consequently, the 2002 Mining Charter, which was enacted by virtue of the MPRDA, provides that within ten years at least 26% of the mining operations be owned by HDSAs.<sup>149</sup> It must be noted that the Mining Charter already represents a substantial concession to equity markets as its first draft intended a 51% ownership share for HSDAs. Yet the ANC could not withstand the pressure exerted by South Africa's well organized major mining companies who had encountered a significant decline in the prices of their stocks.<sup>150</sup> The industry was largely critical of the Mining Charter, and even more rigid to accepting the original draft's 51% share.<sup>151</sup> The fact that this earlier version of the Mining Charter was not officially publicized but leaked, may be another sign of the controversies that surrounded the MPRDA - and perhaps hard law BEE in general - within South Africa's political circles.<sup>152</sup>

#### 4.2.2 ALLEGATIONS AND OUTCOMES

The major allegation of Foresti et al. was made in relation to *indirect expropriation* as they regarded the *new order* mining rights as inferior in value compared to their *old order* rights, which they would neither have to reapply for nor sell a share thereof to HDSAs within a given time frame.<sup>153</sup> As opposed to *direct expropriation*, an “indirect expropriation leaves the investor’s title untouched but deprives him of the possibility to utilize the investment in a meaningful way”.<sup>154</sup> Nowadays, indirect expropriation is much more common than the direct variety, as directly expropriating a foreign investor is very likely to meaningfully harm a host state’s reputation.<sup>155</sup> In order to assess whether an indirect expropriation has unjustifiably materialized, “ICSID traditionally has looked to whether an expropriation occurred under international law. According to this standard, an expropriation occurs where constructive expropriation is found to have taken place and where the effect on the owner is found to be

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<sup>147</sup> Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South," 38.

<sup>148</sup> Southall, "The ANC & Black Capitalism in South Africa," 323.

<sup>149</sup> Broad-Based Socio-Economic Empowerment Charter for the South African Mining Industry (2002) s. 4.7; MPRDA. s. 100 (2) (a).

<sup>150</sup> Suzanne Dansereau, "Win-Win or New Imperialism? Public-Private Partnerships in Africa Mining," *Review of African Political Economy* 32, no. 103 (2005): 56.

<sup>151</sup> Schneiderman, 151.

<sup>152</sup> Southall, "The ANC & Black Capitalism in South Africa," 323.

<sup>153</sup> Jacob, 15.

<sup>154</sup> Dolzer and Schreuer, 92.

<sup>155</sup> Ibid.

tantamount to an expropriation.”<sup>156</sup> This definition already suggests that the uncertain scope of expropriation under international law “remains a deeply contentious issue”.<sup>157</sup> Accordingly, in the *Foresti* case, opinions are equally diverging.<sup>158</sup>

However, this work does not intend to determine as to whether an unjustifiable expropriation according to the current standards of international investment law has actually taken place or not. Much rather, it points toward the legal uncertainty that is sustained and puts some necessary social policies at stake.

The fact to note is that a judgment to the detriment of the South African government could very well have been made.<sup>159</sup> The settlement by mutual agreement in late 2010 has spared South Africa expensive compensation payments; however, it had to bear the large majority of the arbitration costs, amounting to fairly more than five million euros.<sup>160</sup> In the long run, however, BEE would become unaffordable, if South Africa was to be indicted on a frequent basis.<sup>161</sup> Given the legal insecurity that currently is inherent to international investment law, equality promotion, i.e. human rights, in South Africa and other concerned countries may be at stake.

Marc Jacob puts the essence of the case in a nutshell when he finds that “the law here is far from settled, with the battle lines drawn between those who claim the purpose of a state measure plays a crucial role in deciding on its lawfulness and those denying this.”<sup>162</sup>

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<sup>156</sup> Friedman, “Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South,” 43.

<sup>157</sup> Peterson, *South Africa’s Bilateral Investment Treaties - Implications for Development and Human Rights*, 21.

<sup>158</sup> Friedman, “Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South,” 43.

<sup>159</sup> Chow: 353.

<sup>160</sup> ICSID, Award of the Tribunal: Piero Foresti, Laura De Carli and Others V. Republic of South Africa (ICSID Case No ARB(Af)/07/1), para. 96.

<sup>161</sup> Schneiderman, 155.

<sup>162</sup> Jacob, 15.

## 5. INCORPORATING HUMAN RIGHTS INTO INVESTMENT LAW

Had the disputing parties not settled their conflict out of court, the long awaited outcome of the *Foresti* case – a subject to speculation - may potentially have not been in favor of South Africa's efforts to promote equality. As no such award has materialized, there still remains considerable legal uncertainty with regard to investment arbitration outcomes. Such uncertainty is very likely to have severe repercussions on developing countries that aim at assuming their responsibilities for the promotion of human rights, especially.<sup>163</sup> Thus the present work's last part shall elaborate on possible solutions to this far reaching deficiency in international investment law. It is going to provide an analysis of relevant approaches that are currently part of the discourse among scholars and aims at presenting solutions to the conflict between paramount public interests and the legitimate expectations of foreign investors.

In a first step, a widely discussed *public law approach* is going to be introduced. The approach aims at creating investment arbitration outcomes that take major public concerns duly into account. They shall furthermore create a sensible amount of legal certainty in investment disputes. The last section discusses a set of policy options, available to states that need to insulate their domestic policies from the legal interferences of foreign investors. Where appropriate, the South African example shall illustrate possible implications if such approaches were to be applied in practice.

### 5.1 STRENGTHENING PUBLIC LAW STANDARDS IN INTERNATIONAL INVESTMENT LAW

As a result of the current legitimacy crisis international investment arbitration is suffering from, a comparative approach that aims at transferring ever more public law principles to international investment law, has since recently become a dominant view among scholars, with Stephan Schill leading the way:

The public function of international investment law consists of establishing principles of investment protection under international law that provide for the protection of property and endorse rule of law standards for the treatment of foreign investors by states. These principles have the purpose of reducing the so-called “political risk” inherent in any foreign investment situation. In that sense, the substantive principles of international investment law, therefore, assume a function that is much closer to that of domestic constitutional and

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<sup>163</sup> Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South," 51.

administrative law than to private law and commercial contracts negotiated between equals.<sup>164</sup>

The yet known underlying assumption is that commercial law is no longer an appropriate basis for investment arbitration. Therefore, the approach suggests the “need for a relatively deferential standard that minimizes the second-guessing of state policies and the direct balancing of state and investor interests”.<sup>165</sup> The principles to be integrated in international investment law range from public international law standards to aspects of domestic administrative law. The first section of this part is going to address domestic and international public law techniques of legal interpretation that are eligible to make their way into international investment law. The second section focuses on the potential of institutional reforms with regard to dispute settlement mechanisms. The last section is going to assess the potential implications of *amici curiae* participation in investment disputes in view of public interests.

### **5.1.1 COMPREHENSIVE STANDARDS OF LEGAL INTERPRETATION**

There are two promising methodological approaches that may provide arbitrators with an appropriate set of tools of interpretation, in order to achieve a fair balance between the protection of the legitimate expectations of foreign investors and human rights concerns.

#### *5.1.1.1 ARTICLE 31 OF THE VIENNA CONVENTION*

The simple fact that “BITs are not created in legal vacuum but in a system of public international law”<sup>166</sup>, may have inspired Bruno Simma and Theodore Kill to view BITs in the context of international public law as a whole, which, of course, includes human rights regimes. Accordingly, investment arbitrators may have yet failed to *consistently* consider the provisions of the Vienna Convention on the Law of Treaties (VCLT).<sup>167</sup> Article 31, the Convention’s *general rule of interpretation*, provides in section (3) (c) that “any relevant rules of international law applicable in the relations between the parties”, shall be taken into

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<sup>164</sup> Schill, "Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach," 59.

<sup>165</sup> William Burke-White and Andreas von Staden, "The Need for Public Law Standards of Review in Investor-State Arbitrations," in *International Investment Law and Comparative Public Law*, ed. Stephan W. Schill (Oxford; New York: Oxford University Press, 2010), 719-720.

<sup>166</sup> Jacob, 31.

<sup>167</sup> Simma and Kill, 691.

account when a treaty, including a BIT is interpreted.<sup>168</sup>

What we seek to confirm is the fact that a State's obligations with regard to the basic welfare of its citizens has unquestionably become a matter for community interest. Since these norms have taken the first steps away from bilateralism, it is possible that norms relating to economic, social, and cultural rights could also constitute 'rules applicable in the relations' among States, even if there is no independent treaty obligation running between the States in question ... In close cases, the fact that the Vienna Convention's preamble proclaims the States Parties' 'universal respect for, and observance of, human rights and fundamental freedoms for all' may tip the scales towards a broader conception of applicability.<sup>169</sup>

In the *Foresti* case, such legal practice would have taken into account the fact that next to South Africa, both Italy and Luxembourg have ratified the relevant human rights treaties, South Africa tries to comply with by means of BEE. In this case, South Africa's switch from *new order* to *old order* mining rights would presumably not have been regarded as an unlawful expropriation. However, this approach is not enforceable. So far, there has not been much support for this strategy that aims at harmonizing the various realms of international law.<sup>170</sup>

### 5.1.1.2 PROPORTIONALITY ANALYSIS

As the public law approach draws on domestic methods of public and administrative adjudication, *proportionality analysis* has made its way into this comparative concept. Proportionality analysis stems from German administrative law and is also used by German arbitrators to adjudicate constitutional complaints.<sup>171</sup> The principle has equally made its way into the European Court of Human Rights, for instance, where it is referred to as *fair-balance-test*.<sup>172</sup> Proportionality analysis is "a method of legal interpretation and decision-making in situations of collisions or conflicts of different principles and legitimate public policy objectives."<sup>173</sup> In the words of Alec Stone Sweet and Jud Mathew, it is a "preferred procedure for managing disputes involving an alleged conflict between two rights claims, or between a

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<sup>168</sup> Vienna Convention on the Law of Treaties, art. 31 (3) (c).

<sup>169</sup> Simma and Kill, 702.

<sup>170</sup> Jacob, 29.

<sup>171</sup> Benedict Kingsbury and Stephan W. Schill, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - the Concept of Proportionality," in *International Investment Law and Comparative Public Law*, ed. Stephan W. Schill and James Crawford (Oxford; New York, N.Y.: Oxford University Press, 2010), 80.

<sup>172</sup> Meckenstock, 116.

<sup>173</sup> Kingsbury and Schill, 79.

rights provision and a legitimate state or public interest".<sup>174</sup> In other words, proportionality analysis examines the relationship between the aims of a particular government action and the *proportionality* of the methods applied to achieve the defined goal.<sup>175</sup>

To give such an example: in the *Foresti* case, the *aim of the government action* was to achieve equality while the *method or means* is equivalent to the MPRDA and the Mining Charter. There are two conflicting legally protected interests involved: South African equality promotion on the one hand, and the property rights of Foresti et al., on the other hand. The aim of proportionality analysis is to achieve a fair balance between the two. The method involves three core elements the "(1) the principle of suitability, (2) the principle of necessity, and (3) the principle of proportionality *stricto sensu*".<sup>176</sup>

The first step shall determine „whether the measure adopted by the state or government agency serves a legitimate government purpose and is generally suitable to achieve this purpose".<sup>177</sup>

Applied to the case, the mining laws do undoubtedly serve a legitimate purpose, i.e. equality promotion, which is enshrined in widely accepted human rights treaties. BEE is also generally suitable to realizing this purpose. However, if there are doubts concerning the suitability of BEE as it is not highly inclusive of all HDSAs, one may add that a government needs a certain scope for decision-making: it cannot predict if a measure is suitable or not. A sufficient amount of legislative discretion needs to be granted. Kingsbury and Schill address this issue by stating that "only very few measures will not pass this part of the suitability test, as good faith actions by governments will usually not involve the use of means that are wholly ineffective in pursuing the stated purpose."<sup>178</sup>

The second step shall determine "whether there are other, less intrusive means with regard to the right or interest affected that are equally able to achieve the stated goal"; it "requires that there is no less restrictive measure that is equally effective".<sup>179</sup>

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<sup>174</sup> Alec Stone Sweet and Jud Mathews, "Proportionality Balancing and Global Constitutionalism," *The Columbia Journal of Transnational Law*, 47, no. 1 (2008): 74.

<sup>175</sup> Kingsbury and Schill, 85.

<sup>176</sup> Ibid., 86.

<sup>177</sup> Ibid.; see also Stone Sweet and Mathews: 76. They proceed from the assumption that this phase is "devoted to judicial verification that, with respect to the act in question, the means adopted by the government are rationally related to stated policy objectives".

<sup>178</sup> Kingsbury and Schill, 86.

<sup>179</sup> Ibid., 86-87; see also Stone Sweet and Mathews: 76. According to Stone Sweet and Mathew, during this phase "the judge ensures that the measure does not curtail the right any more than is necessary for the government to achieve its stated goals".

In response to this requirement, it must be said that affirmative action measures are a necessity in view of the social conditions in South Africa. The fact that the ANC had already tried to create a class of black business people relying on market mechanisms alone, and not succeeded shows that less restrictive means than affirmative action are unlikely to exist. Moreover, the Mining Charter has reduced the original 51% of black ownership to 26%. This modest share in contrast to the total rate of 80% HDSAs in South Africa does not seem *intrusive*.

The third and last step of “proportionality analysis involves a balancing between the effects of the state measure on the affected right or interests and the importance of the government purpose”, which is referred to as proportionality *stricto sensu*. It “requires that the measure is not excessive with regard to the objective pursued and the relative weight is given to each principle”.<sup>180</sup> This phase just applies if the measure under review passed the previous steps. A judge’s task is here is to weigh “the benefits of the act”.<sup>181</sup>

Analyzing proportionality *stricto sensu* would require arbitrators “to take into account the on-the-ground-reality”.<sup>182</sup> By this means, they would be more likely to assume responsibility; and comprehend the far reaching consequences that their decisions could mean for a state as a whole if they judge a government measure. “Without proportionality analysis, the concept of indirect expropriation, for example, risks degrading to an analysis without rationalization.”<sup>183</sup> Applied to BEE in South Africa, where ICSID’s award may have had fatal repercussions, if made in favor of *Foresti* et al., proportionality analysis seems to be a promising approach.

### **5.1.2 INSTITUTIONAL REFORM**

According to the public law approach, the investment dispute settlement system is equally in need of an institutional reform.

Investment treaty arbitration, in turn, can be understood as more akin to administrative or constitutional judicial review than to commercial arbitration, even though international investment law makes use of the arbitral process to settle disputes between states and foreign investors. Yet, despite the functional

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<sup>180</sup> Kingsbury and Schill, 87.

<sup>181</sup> Stone Sweet and Mathews: 76. Stone Sweet and Mathews term this phase the "balancing phase".

<sup>182</sup> Friedman, "Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South," 44.

<sup>183</sup> Kingsbury and Schill, 103.

equivalence to domestic public law, international investment law lacks a comparable conceptual and doctrinal clarity.<sup>184</sup>

However no other body able to arbitrate independently and more efficiently could be identified.<sup>185</sup> Nevertheless, there are several changes to be made in order to improve the mode of operation of the international investment dispute settlement system. Penusliski defines four fundamental innovations with regard to the problematic features of ICSID: (1) “strengthening mediation procedures” that aim at finding solutions addressing “both parties’ interests”, (2) establishing an appellate body, (3) “enabling judicial interpretation that considers the importance of other international commitments and the demands of domestic governance” and (4) “setting up a screening mechanism for arbitrator and mediator selection”.<sup>186</sup> This chapter focuses on two main features of an ICSID-reform, the appellate body and the screening mechanism for the selection of arbitrators, as the integration of “various legal interpretation techniques”<sup>187</sup> has been discussed in the previous section.

The objective of an appellate body is the provision of “a public forum for the review of public disputes” in order to “create a determinate and coherent jurisprudence”.<sup>188</sup> This is inasmuch necessary for ICSID, as “there is no higher standing body to correct tribunals’ determinations and ensure uniform application of international investment law or the ICSID Convention”.<sup>189</sup> Such a body would encourage both, a decent occurrence of decisions and strengthen the court’s legal argumentation, as ICSID still lacks reliability and legitimacy.<sup>190</sup> The non-existence of an appellate body substantially diminishes judicial constraint as the prospects for the tribunal’s awards are that they will not face any review.

Furthermore, the selection of arbitrators needs to be proceeded “in a more neutral manner through the procedural frameworks of choice, which would further strengthen the legitimacy and acceptance of the process”.<sup>191</sup> According to the ICSID Convention, arbitrators must be “qualified persons”<sup>192</sup> with “high moral character” and “competence in the fields of law”.<sup>193</sup> Yet, there was no criticism of potential corruptibility of the tribunal. Nevertheless, “there

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<sup>184</sup> Schill, "Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach," 59.

<sup>185</sup> Franck: 1606.

<sup>186</sup> Mitrev Penusliski, 527.

<sup>187</sup> Ibid., 532.

<sup>188</sup> Franck: 1607.

<sup>189</sup> Mitrev Penusliski, 529.

<sup>190</sup> Franck: 1606; Mitrev Penusliski, 529.

<sup>191</sup> Jacob, 37.

<sup>192</sup> ICSID Convention, art. 12.

<sup>193</sup> Ibid., art. 14 (1).

exists little formal control over the overall group of professionals who serve on ICSID”, which is also a lack of legitimacy to the tribunal.<sup>194</sup> In order to address such issues, a code of conduct for arbitrators that includes ethical rules, such as fairness and neutrality could be adopted.<sup>195</sup> Additionally an amendment to the ICSID Convention in order to e.g. allow the disputing parties to select ICSID arbitrators from a register, would make the system of arbitrator selection more transparent. In “conjunction with an appellate body” the arbitrator’s conduct could be reviewed and create a system of *checks and balances*.<sup>196</sup>

All these innovations together might lead to a stronger and more legitimate ICSID. However, challenging the rationale of ICSID remains difficult: for most of the addressed proposals, amendments to the ICSID convention would be necessary, which, in turn, would require consensus among all member states.<sup>197</sup>

### **5.1.3 AMICI CURIAE: REPRESENTING CIVIL SOCIETY IN INVESTMENT DISPUTES**

A further step toward public law standards of taking into account general interests in investor-state arbitrations is the participation of *amici curiae*, or *non-disputing parties* (NDPs). This applies “in particular when neither investor nor state are minded to invoke human rights points”<sup>198</sup>, which may often coincide with little government accountability and interest in the promotion of human rights on the domestic level.<sup>199</sup> NDP participation took place for the first time in the *Methanex Corporation v. United States* (‘Methanex’) arbitration in 2001, when the tribunal allowed the submission of a non-governmental organization (NGO) as *amicus*. Since then, *amicus curiae* participation has been occurring increasingly in investor-state arbitrations.<sup>200</sup> Art. 37 (2) of the ICSID Arbitration Rules provides the legal foundation for this new feature of the investment dispute settlement system; a result of an amendment in

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<sup>194</sup> Mitrev Penusliski, 533.

<sup>195</sup> American Bar Association House of Delegates, *Code of Ethics for Arbitrators in Commercial Disputes* (New York: American Arbitration Association, 1977), [www.abanet.org/dispute/commercial\\_disputes.pdf](http://www.abanet.org/dispute/commercial_disputes.pdf) (accessed December 14, 2011); Mitrev Penusliski, 533.

<sup>196</sup> Mitrev Penusliski, 533.

<sup>197</sup> Ibid., 534.

<sup>198</sup> Jacob, 37.

<sup>199</sup> Kenneth A. Rodman, ““Think Globally, Punish Locally”: Nonstate Actors, Multinational Corporations, and Human Rights Sanctions,” *Ethics & International Affairs* 12, no. 1 (1998): 20.

<sup>200</sup> Friedman, “Friends of the Panel: The Evolution of Amicus Participation in International Investment Arbitration,” 3; see also Amokura Kawharu, “Participation of Non-Governmental Organizations in Investment Arbitration as Amici Curiae,” in *The Backlash against Investment Arbitration : Perceptions and Reality*, ed. Michael Waibel (Alphen aan den Rijn, The Netherlands: Wolters Kluwer Law & Business, 2010), 276-277.

April 2006.<sup>201</sup> The integration of observers has two main advantages: first, the impartiality of disputing parties and arbitrators is likely to be compensated and second, significant expertise is provided to tribunals.<sup>202</sup> NDPs become particularly relevant, when the claims relate to social, cultural and economic human rights.<sup>203</sup>

Amicus participation is also endorsed by governments: The US model BIT, for example, includes a clause which provides that “[t]he tribunal shall have the authority to accept and consider *amicus curiae* submissions from a person or entity that is not a disputing party”.<sup>204</sup> The inclusion of article 37 (2) in the ICSID arbitration rules can be explained by the perseverance of NGOs that have long been a part of international relations and international law.<sup>205</sup> It is therefore not surprising that they “have also successfully petitioned tribunals for the right to participate in arbitral proceedings through submissions of written briefs on issues of interest to them”.<sup>206</sup> Another reason for the “call for non-party participation … is chiefly grounded on the claim of a legitimacy deficit inherent in the application of private commercial arbitration procedures to investor-state dispute settlement”.<sup>207</sup> As argued above, an important part of the legitimacy issue stems from the ever-recurring lack of public participation in international tribunals.<sup>208</sup> To render amicus participations genuinely effective though, the publicity of arbitrations needs to be assured. An important step toward greater transparency would be to grant public access to documents or at least provide the entire catalog of written arbitration proceedings to non-disputing parties.<sup>209</sup>

In the *Foresti* case, two *amicus* submissions were made: first, by a group of NGOs following up with human rights and environmental topics, and second, a group of international lawyers, the International Commission of Jurists, whose main interest was to arrive at a certain level of legal certainty with regard to questions of international law by means of the tribunal’s

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<sup>201</sup> Chester Brown, "Procedure in Investment Treaty Arbitration and the Relevance of Comparative Public Law," in *International Investment Law and Comparative Public Law*, ed. Stephan W. Schill and James Crawford (Oxford; New York, N.Y.: Oxford University Press, 2010), 686; Rules of Procedure for Arbitration Proceedings, art. 37 (2).

<sup>202</sup> Jacob, 37.

<sup>203</sup> Brown, 685.

<sup>204</sup> The US model BIT of 2004, art. 28 (3), available in Dolzer and Schreuer, 385-419.

<sup>205</sup> Kawharu, 277-278.

<sup>206</sup> Ibid., 275.

<sup>207</sup> Ibid., 284.

<sup>208</sup> Friedman, "Friends of the Panel: The Evolution of Amicus Participation in International Investment Arbitration," 15.

<sup>209</sup> Jacob, 37.

decisions.<sup>210</sup> A particular novelty in the *Foresti* case was that the tribunal revealed the arbitration records to NDPs “without the consent of the disputing parties”.<sup>211</sup>

Thus the main feature of the *amicus* in investment arbitrations is to “offer its views on important public interest considerations arising from the dispute, and, to an extent, to represent those considerations”. NDP participation may not only contribute to representing public concerns in a particular trial but also to politicizing international investment arbitration.<sup>212</sup> Integrating amici curiae may by these means establish a desirable “connection between a dispute and those who are affected by its outcomes”,<sup>213</sup> and “similarly increase the efficiency of the system”.<sup>214</sup> The *Foresti* case is even said to have been settled without severe consequences for South Africa “because of the barrage of negative publicity it received”.<sup>215</sup>

To conclude, the recent evolution of ICSID’s arbitration rules with regard to *amicus curiae* participation shows that current investment law provisions are in no way static. Therefore, moving toward greater consideration for public concerns in investment arbitration seems not to be a necessarily unfeasible endeavor.

#### **5.1.4 INTERIM CONCLUSION**

Transferring public law standards of legal interpretation to the realm of international investment law does not mean doing an injustice to foreign investors. The public law approach must merely be understood as a tool that is more suitable to prevent a pro-investor bias – or any bias – that happens to occur frequently throughout investment dispute settlements. As a consequence, if affirmative action policies such as BEE went too far in contradicting the legitimate expectations of investors, they shall still be judged unlawful. Common experience with domestic administrative jurisdiction does not give an indication of a particular lack of justice inherent to this approach. Besides, if legal insecurity were to be replaced by consistent arbitration, each party shall benefit from such innovation; even if not to equal extents. The approach would therefore most likely be substantially beneficial to solving the conflict of human rights and the protection of foreign investors at the systemic level.

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<sup>210</sup> Friedman, "Friends of the Panel: The Evolution of Amicus Participation in International Investment Arbitration," 9-10.

<sup>211</sup> Ibid., 10.

<sup>212</sup> Kawharu, 294.

<sup>213</sup> Ibid., 295.

<sup>214</sup> Friedman, "Friends of the Panel: The Evolution of Amicus Participation in International Investment Arbitration," 16.

<sup>215</sup> Jacob, 15.

## 5.2 STATE POLICY OPTIONS: RENEGOTIATING TREATIES

Next to solutions that aim at amending the entire system of investment arbitration, there are further diplomatic options within this system already that deserve attention.

In order to better ensure their regulatory independence to address human rights issues, countries like South Africa might as well follow the recommendations made by the UN High Commissioner for Human Rights, and renegotiate their BITs.<sup>216</sup> The United States and Canada for instance, have included clauses and notions in their model BITs that allow them to ensure public interests.<sup>217</sup> The preamble of the United States' model BIT, for example, prescribes that investment protection be “consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights”.<sup>218</sup> Further sensible adaptations to BITs include a revision of the standards of treatment clauses, i.e. FET, MFN and NT or even an insertion of investor obligation clauses.<sup>219</sup>

Consequently there is some, albeit limited hope for South Africa's BEE policies in two cases: first, if South Africa's presumably strong European BIT counterparties' commitment to human rights finds its way into their BITs, by means of conviction or public pressure; and second, if South Africa manages to review and renegotiate its BITs in a manner that protects public welfare interests.<sup>220</sup>

However, given the aforementioned problem of South Africa's apparently weak bargaining power, the second case is rather unlikely to materialize. In very general terms, and by means of perception, “states are unlikely to make explicit provision for human rights in their international agreements relating to investment.”<sup>221</sup> Furthermore, foreign investors might as well become hesitant to invest in South Africa if the relevant BITs made investments too risky; and due to the fact that competitors are unlikely to rest.<sup>222</sup> At least for the time being, there are no signs that South Africa would have seriously renounced its *unfavorable* BITs

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<sup>216</sup> Chow: 328; Economic, Social and Cultural Rights - Human Rights, Trade and Investment, July 02, 2003, UN Doc. E/CN.4/Sub.2/2003/9, para. 4 (a).

<sup>217</sup> Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 37.

<sup>218</sup> The US model BIT of 2004, available in Dolzer and Schreuer, 385-419.

<sup>219</sup> Jacob, 35-36.

<sup>220</sup> Peterson, *South Africa's Bilateral Investment Treaties - Implications for Development and Human Rights*, 38.

<sup>221</sup> Simma and Kill, 681.

<sup>222</sup> "Africa Rising - after Decades of Slow Growth, Africa Has a Real Chance to Follow in the Footsteps of Asia," *The Economist*, December 03, 2011.

with strong exporting economies. Nevertheless, there are commentators like Okechukwu Iheduru that contradict this view:

[S]tates still govern. Globalization equally exerts tremendous competitive pressures on corporations to beat other firms in order to capture market shares, and/or appease shareholders and institutional investors worried about the bottom line. In some cases, these firms act less like rational profit-maximizing enterprises and more like mercantilist states who view access to state procurements, business incentives, and subsidies from a zero-sum perspective. Consequently, they are willing to accept some state intervention or compromise, especially if such action advances the interests of capital as well.<sup>223</sup>

If Iheduru is right, the ANC could increase its bargaining power over foreign investors and the states that negotiate BITs on their behalf. Consequently, state policy options to advance BEE must not be rejected as a whole.

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<sup>223</sup> Iheduru, "Why 'Anglo Licks the ANC's Boots': Globalization and State-Capital Relations in South Africa," 338.

## 6. CONCLUSION

This thesis has pointed toward the particular difficulties of the conflict between the legitimate expectations of foreign investors and human rights promotion, which was illustrated by a South African example. The work has furthermore analyzed a set of legal solutions that might be of help to solve this conflict.

The major difficulty of governing South Africa lies in the particular tension between the urgent need for capital to secure economic growth on the one hand, and the need for state intervention for the purpose of more immediate equality promotion, on the other hand. With BEE being a measure of equality promotion in line with relevant human rights treaties and furthermore *necessary* and *suitable* to implementing them, South Africa is fulfilling its obligations to comply with international law.

On the other hand, BITs – which are equally binding obligations - dispose of a strong systemic pro-investor bias. One possible explanation as to why states consent to such unfavorable agreements is their competitive disadvantage within the international economic system. Consequently, states are on the horns of a dilemma. However, this work finds that there is still significant potential to harmonize and revise current standards. Thereby new legitimacy may be attributed to international investment dispute settlement procedures.

For the solution of the conflict, this thesis finds several approaches that might have a significant impact if they were implemented altogether. First, a *public law standard* of review needs to be introduced to the international investment dispute settlement system. The approach aims at creating investment arbitration outcomes that take major public concerns duly into account and shall furthermore create a sensible amount of legal certainty in investment disputes. A consistent application of the VCLT when interpreting rules of international law would lead to a more appropriate consideration of all relevant international rules and do justice to complex contexts of application of law. *Proportionality analysis* can be seen as a practical method to integrate domestic public law standards into international investment dispute settlement systems. This method examines the relationship between the aims of a particular government action and the *proportionality* of the methods applied to achieve the defined goal. Thereby, public law standards, as applied by other international courts, would enter international investment arbitrations. Furthermore, an institutional reform of ICSID, including the creation of an appellate body and a rethinking of the selection-system for arbitrators, as well as the admission of non-disputing parties to investment arbitrations

could contribute to a resolution of the known conflict of interests. Finally, several state policy options, e.g. the renegotiation of BITs in order to include human rights norms complement the range of possible solutions to solving the tension between FDI and human rights.

By taking the South African example, this work has shown that there are several different approaches regarding the solution of the addressed tension. The full range of aspects within this discussion cannot be covered by this thesis, but it tried to highlight the main aspects within the theoretical legal debate. But several problems still persist. Although many of the proposed approaches that circulate among scholars seem elaborate, practical solutions may still be difficult to achieve. The institutional reform of ICSID, for example needs the consent of all member states, which is fairly unlikely to materialize. A further aspect that may not fall into oblivion regards the distribution of interests in international relations. To states, attracting foreign investment and thereby creating prosperity and economic growth, is in many cases much more important than sincere human rights promotion. This applies even more to developing countries. This circumstance illustrates the initial problem of this thesis: BITs are very often concluded with states that do already suffer from human rights deficits.

A comparative analysis of select developing and emerging countries with regard to their FDI policies and human rights standards seems to provide a tempting incentive for further research. The thesis concludes with the words of Jan Eliasson who stresses the interconnectedness of human rights, development and peace; and consequently the importance of achieving a balance between all three:

[L]asting solutions require that the pursuit of peace, development and human rights must take place in parallel. There is no peace without development; there is no development without peace; and there is no sustainable peace and development without respect for human rights. If one of these three pillars is weak in a nation or a region, the whole structure is weak. Therefore, walls and barriers between these areas must be taken down.<sup>224</sup>

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<sup>224</sup> Jan Eliasson, "Peace, Development and Human Rights - the Indispensable Connection", excerpt from a speech held at The Dag Hammarskjöld Lecture 2011 in Uppsala, Sweden, on September 19, 2011, [http://www.dhf.uu.se/wordpress/wp-content/uploads/2011/09/dh\\_lecture\\_2011\\_eliasson-web.pdf](http://www.dhf.uu.se/wordpress/wp-content/uploads/2011/09/dh_lecture_2011_eliasson-web.pdf) (accessed December 25, 2011).

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