South African Institute of Race Relations NPC (IRR)
SUBMISSION
to the Department of Trade and Industry,
regarding the
Regulations on Mediation Rules
in terms of the
Protection of Investment Act of 2015
Johannesburg, 28th February 2017

Introduction

The Department of Trade and Industry (DTI) has invited public commented by interested persons on the Regulations on Mediation Rules in terms of the Protection of Investment Act of 2015 (the Regulations) by an amended deadline of 28th February 2017.

This submission on the Regulations is made by the South African Institute of Race Relations NPC (IRR), a non-profit organisation formed in 1929 to oppose racial discrimination and promote racial goodwill. Its current objects are to promote democracy, human rights, development, and reconciliation between the peoples of South Africa.

Background to the Regulations

According to its Preamble, the Promotion of Investment Act of 2015 (the Act) 'recognises the importance that investment plays in job creation, economic growth, sustainable development, and the well-being of the people of South Africa'. It thus seeks to 'promote investment' by creating a facilitating environment and 'providing a sound legislative framework for the…protection of all investments, including foreign investments'. [Preamble, Act]

At the same time, however, South Africa has greatly undermined the confidence of foreign investors by unilaterally terminating 13 bilateral investment treaties (BITs) with the United Kingdom (UK) and 12 European countries. These nations have long been South Africa's most important direct and indirect investors. The DTI may believe that reduced investment from these Western countries can readily be replaced by fresh foreign direct investment (FDI) from China and Russia, but the numbers suggest that this will not in fact be easy to achieve.

At the end of 2014, the cumulative value of all direct and indirect investments into South Africa from the UK and other European countries stood at more than R3 060bn. By contrast, the cumulative value of investments from China stood at a mere R86bn at that time, while the cumulative value of investments from Russia was even more limited. [South African Reserve Bank, *Quarterly Bulletin*, June 2016, pp92-95; 2017 *South Africa Survey*, IRR, Johannesburg, 2017, p140]

In addition, figures compiled by the United Nations Conference on Trade and Investment (Unctad) show that South Africa has suffered a precipitous decline in FDI inflows in recent years. In 2015, in particular, South Africa's investment inflows fell to their lowest level in ten years. FDI inflows then totalled $1.77bn, which was 69% lower than in 2014 ($5.77bn) and 79% lower than in 2013 ($8.3bn). [Peter Leon, Achilles heel of investment in SA, *Business Day* 25 January 2017]

In the first two quarters of 2016, as the World Bank notes, FDI inflows into South Africa increased off this low base. The country nevertheless remained a net exporter of capital in this period, as its investment outflows exceeded its inflows. According to the World Bank, it thus 'it remains important for policy makers to stimulate FDI inflows', as this in turn will 'stimulate economic growth'. [Leon, ibid]

FDI into South Africa is also needed to compensate for the country's low domestic savings rate. Expressed as a ratio of gross domestic savings to gross domestic product (GDP), the country's savings rate stood at 16.4% in 2015. [2017 *South Africa Survey*, p124] Domestic savings are thus insufficient to fund the much higher rate of fixed investment (30% of GDP) advocated in the National Development Plan (NDP). This means that domestic savings must be supplemented by inflows from elsewhere if the development of infrastructure is to expand to the extent required.

If South Africa is to succeed in attracting much more foreign investment, it must give potential investors increased confidence in the security of their investments. Instead, however, the cancellation of the British and European BITs has undermined that confidence. So too has the DTI's failure to include within the Act the standard protections found in BITs, as it earlier pledged to do. That the Act also fails to give foreign investors the protections found in the 2006 SADC Protocol on Trade and Investment (the SADC Protocol) – which is binding on South Africa, but has effectively been disregarded – provides yet further reason for concern. [Leon, Achilles heel, op cit]

Against this background, it is vitally important that the Regulations should be crafted in a way that boosts foreign investor confidence as much as possible. Instead, many of the provisions in the Regulations seem likely to undermine that confidence still more.

Content of the Regulations

The most worrying elements in the Regulations are briefly set out below:

Government consent for mediation

The cancelled BITs, the SADC Protocol, and international best practice give foreign investors the right to refer disputes to investor-state arbitration. [Leon, ibid] The Act excludes these protections, thus deviating significantly from international norms. Instead, it provides that 'the government may consent to international arbitration' (provided that local remedies have first been exhausted). This wording excludes any right to international arbitration and makes resort to it dependent on the South African government's agreement. The Act also excludes investor participation in any such arbitration by providing that 'such arbitration will be conducted between the Republic and the home state of the applicable investor'. [Section 13(5), Investment Act]

In one concession to foreign investors, which was included in the statute under pressure from foreign business chambers, the Act also provides that a foreign investor with a dispute against the government may request the DTI 'to facilitate the resolution of [that] dispute by appointing a mediator'. [Section 13(1), Investment Act] Under this wording, foreign investors are not obliged to obtain the government's agreement to such mediation. [Leon, op cit] However, the Regulations ignore this. Instead, they state that 'the [foreign] investor and the government [must] have agreed that a dispute which has arisen between them shall be submitted to mediation'. [Preamble, Regulations]

This about-turn will further damage the confidence of foreign investors. Writes legal expert Peter Leon, a partner in Herbert Smith Freehills, an international law firm: 'As they stand, the regulations, in effect, give the government a veto over any referral to mediation and deprive foreign investors of the only special protection provided [for them] by the Act.' [Leon, op cit]

In addition, the rule of law prohibits the executive from prescribing regulations that are inconsistent with the statute authorising the making of those regulations. [Leon, ibid] Such regulations are *ultra vires* (beyond the powers conferred on the minister) and unlawful. Since the Constitution recognises 'the supremacy…of the rule of law' as one of the founding values of South Africa's new order, [Section 1(c), 1996 Constitution] the requirements of the rule of law must be upheld, not disregarded.

In this instance, the Regulations are *ultra vires* the Act and must be brought into line with the Act, failing which they could be struck down on judicial review. [Leon, op cit]

The appointment of mediators

The Regulations echo the Act in requiring the DTI to 'maintain a list of suitably qualified mediators, who are willing and able to serve as mediators'. The mediators on this list must be 'of a high moral character, with recognised competence in the fields of law, commerce, industry or finance'. [Clause 6, Regulations; Section 13(2)(a, Act]

The Act makes it clear that mediators qualify for inclusion on the DTI's list only if they 'may be relied upon to exercise independent judgement'. This is an important criterion, which

helps provide some guarantee that the mediators on the list will be impartial. But the Regulations effectively dispense with this requirement. All they say in this regard is that mediators must 'exercise independent judgement' in the execution of their duties. This is an important change in wording, which undermines the Act's attempt to ensure the impartiality of the mediators included in the DTI list. [Clause 6(3), Regulations; Section 13(2)(a), Act]

The Regulations go on to state that 'a mediator shall be appointed by agreement between the investor and the DTI' and must be chosen from the 'list of mediators' maintained by the DTI. [Clause 7(2), Regulations; Section 13(2(b), Act] This requirement follows that in the Act and cannot easily be challenged. It is unfortunate, however, that both the Act and the Regulations differ so greatly from international best practice, which seeks to ensure a more independent appointments process.

Where the DTI is itself a party to a dispute, the Act caters for this situation by stating that 'the parties may jointly request the Judge President of one of the divisions of the High Court to appoint a mediator'. [Section 13(2)(c)]. The Regulations echo this provision. But they also go further than the Act in adding that the Judge President, in exercising his discretion in this regard, 'may take into consideration mediators on the list of mediators compiled by the DTI'. [Clause 6 (3),(4), Regulations] Though there is no clear conflict between the Act and the Regulations in this wording, it is unnecessary and inadvisable for the Regulations to point the Judge President towards the DTI's list of mediators in this way.

Recusal of a mediator

The Act is silent as to how an application for the recusal of a mediator should be handled. The Regulations could thus have followed the Rules for Investor-State Mediation adopted by the International Bar Association (IBA) in 2012 (the IBA Rules).

The IBA Rules state that, if either party objects for any reason to a mediator, that mediator may attempt to resolve the issue by consulting with the parties. However, if a party maintains its objection, the mediator must resign and be replaced. [Article 5(2)(c), IBA Rules]

Under the Regulations, by contrast, though any party may apply for the recusal of a mediator, the decision on this issue rests firstly with the mediator himself, who 'may recuse himself only if cogent and justifiable grounds for recusal are presented by the applicant'. If the mediator declines to recuse himself, the objecting party may 'file a recusal application dispute' with the DTI. Once the mediator has given the DTI his reasons for deciding not to recuse himself, the DTI must 'nominate and appoint a mediator to resolve the recusal dispute'. The decision of this mediator on the recusal dispute is 'final'. [Clause 13, Regulations]

These provisions in the Regulations differ sharply from international best practice, as set out in the IBA Rules. They are thus likely to undermine the confidence of foreign investors still further.

Confidentiality and the filing of documents with the DTI

Where parties to a dispute attempt to settle it by mediation – a process which may not, of course, succeed – they must have confidence that the information provided during the mediation process will remain confidential. The IBA Rules thus stress that 'the mediation shall be private'. They also say that, unless the parties and the mediator otherwise agree, 'no person' (other than those involved in the mediation) 'shall be permitted to…view…any communications relating to the mediation'. [Article 10 (1), IBA Rules]

The Regulations differ in a vital respect. They oblige the mediator to convene a preliminary meeting with the parties to 'plan and agree…where appropriate, a timetable for the exchange of information, including position papers and other relevant documents, *and the filing of same with the DTI'*. [Clause 10(2), Regulations, emphasis supplied by the IRR] The italicised portion is an extraordinary provision which contradicts international best practice and for which there is no authority in the Act. Many foreign investors will be reluctant to resort to mediation when their confidential documents and other data could end up being 'filed' with the DTI.

The Regulations do also state that 'confidential undertakings' can 'if necessary' be signed by all parties. [Clause 10(2)(c), Regulations] They further provide that 'the mediation process and all documentation related thereto are privileged and shall not be disclosed…in any judicial proceedings arising out of the dispute'. [Clause 16(1), Regulations] However, investors are unlikely to find this reassuring or convincing when the DTI has custody of their documents. [*Business Day* 12 January 2017]

Moreover, though the Regulations also say that 'the mediator, the parties, and all advisors and representatives of the parties shall…ensure that all information disclosed during and after the mediation process remains confidential', [Clause 17(1)(a), Regulations] this obligation is not binding on the DTI officials with whom confidential documents may have had to be lodged.

Other weaknesses in the Regulations

As Mr Leon points out, the Regulations have other weaknesses too, especially when compared to the IBA Rules. The Regulations do not prescribe any concrete outcome, whereas the IBA Rules envisage a written and signed settlement agreement. Adds Mr Leon: 'Of greater concern is that (again, unlike the IBA Rules) the regulations view mediation in a vacuum, divorced from any potential recourse to investor-state arbitration if it fails. This insular approach strips investor-state mediation of much of its effectiveness. A key driver of good faith participation in mediation, as well as compliance with its outcome, is the risk of a costly and lengthy arbitration, [which can] potentially result in an adverse award, [which is] binding and enforceable anywhere in the world.' [Leon, op cit]

This too is a fundamental weakness in the Regulations. It stems, of course, from the fact that the Act not only bars investor-state mediation but also makes any state-to-state mediation dependent on the South African government being willing to agree to such a process. In this

situation, there is little to encourage the parties to mediation – and especially those on the government side of any dispute – to make any serious attempt to settle a matter.

In this regard, the Regulations are, of course, consistent with the Act and cannot be seen as *ultra vires*. However, that they depart so strongly from international norms and the IBA Rules will further erode investor confidence in the mediation option.

Conclusion

South Africa is in an increasingly difficult economic situation, as finance minister Pravin Gordhan's budget speech on 22nd February 2017 has once again made clear. New taxes are being introduced and public spending is being cut in an endeavour to reduce public debt. Yet public debt already exceeds R2.2 trillion in total and has almost quadrupled from the R577 billion at which it stood in the 2007/08 financial year. The interest payable on this debt is increasing rapidly and is expected to total some R162bn in the 2017/18 financial year alone. The 2016 growth rate is projected to come in at a mere 0.5% of GDP, while future growth rates are unlikely to exceed the population growth rate of 1.7% for many years to come. South Africa still risks having its sovereign credit ratings downgraded to sub-investment grade (or 'junk' status) before the end of the year, and must boost its tepid rate of economic growth in order to avoid this. In addition, unless it succeeds in raising the annual growth rate to 5% of GDP or more, it will not be able to overcome its mounting unemployment crisis.

However, increased growth requires increased investment, which in turn depends on increased investor confidence. At the very least, the DTI must thus remove the provisions in the Regulations which are *ultra vires* or inconsistent with the Act. Wherever possible, it should also bring the Regulations into line with the IBA Rules. Improvements of this kind would ensure the lawfulness of the Regulations and make them a little less damaging than they are now.

However, if the DTI wants to see the economy grow and the jobless rate fall, then it must do very much more to attract foreign investors. If it wants increased prosperity for all, it should scrap these Regulations and repeal the current Act. It should then introduce new investment protection legislation which is in keeping with South Africa's binding obligations under the SADC Protocol – and which will help to reassure foreign investors that they can safely commit their capital to this country.

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