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COLLEGE OF HUMANITIES AND SOCIAL SCIENCES

SCHOOL OF LAW

THE PRINCIPLE OF SANCTITY OF CONTRACT IN INTERNATIONAL INVESTMENT AGREEMENTS: THE ROLE OF BILATERAL INVESTMENT TREATIES IN AFRICA

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DEDICATION

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ABBREVIATIONS

BIT	Bilateral Investment Treaty
CCIA	Investment Agreement for the COMESA Common Investment Area
COMESA	Common Market for Eastern and Southern Africa
FDI	Foreign Direct Investment
ICC	International Chamber of Commerce, located in Paris, established in Paris in 1923
ICSID	International Centre for the Settlement of Investment Disputes also Convention on Settlement of Investment Disputes between States and Nationals of other States
IOC	International Oil Company
LCIA	London Court of International Arbitration
OECD	Organisation for Economic Co-operation and Development
SADC	South African Development Community
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development

A. LIST OF KENYAN STATUTES

1. Companies Act 2015.
2. Mining Act, Act No. 12 of 2016 Laws of Kenya.

B. LIST OF INTERNATIONAL CONVENTIONS AND INSTRUMENTS

1. Vienna Convention on the Law of Treaties.
2. Convention on Settlement of Investment Disputes between States and Nationals of other States

C. LIST OF KENYAN CASE LAW

1. WalAm Energy Inc v Republic of Kenya (ICSID Case No. ARB/15/17).

D. LIST OF NON-KENYAN CASE LAW

1. Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria (ICSID Case No. ARB/07/18).
2. SGS v. Pakistan (ICSID Case No. ARB/01/13 (2003)) and SGS v. Philippines (ICSID Case No. ARB/02/6 (2004)).
3. S.D. Myers v. Canada (UNCITRAL, First Partial Award, 13 November 2000 (NAFTA)).
4. Emilio Augustin Maffezini v. The Kingdom of Spain, ICSID (Case No. ARB/97/7).
5. Philip Morris Brand Sarl (Switzerland), Philip Morris Products S.A. (Switzerland) and Philip Morris Brand Srl Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay (ICSID Case No. ARB/10/7).
6. Tecmed v. Mexico (ICSID Case No. ARB (AF)/00/2).
7. Metalclad Corporation v. United Mexican States (ICSID Case No. ARB (AF)/97/1).
8. Methanex v. United States, UNCITRAL, Decision on Amici Curiae, 15 January 2001 and 1st Partial Award, 7 August 2002 (NAFTA). Final Award, 3 August 2005.
9. Unión Fenosa Gas, SA v Arab Republic of Egypt (ICSID Case No. ARB/14/4).

10. Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria (ICSID Case No. ARB/07/18).
11. African Petroleum Gambia Limited (Block A4) v Republic of the Gambia (ICSID Case No. ARB/14/7).
12. African Petroleum Gambia Limited (Block A1) v Republic of the Gambia (ICSID Case No. ARB/14/6).
13. Total E&P Uganda BV v Republic of Uganda (ICSID Case No. ARB/15/11).

ABSTRACT

The number of BITs signed between developing and developed countries in Africa has increased over the years. This is more so due to the large deposits of natural resources that a number of African countries are endowed with but for which they lack the skill, technological know-how, financial resources and capacity to exploit and hence require partnership with the foreign investors in the exploitation of these resources.

The signing of bilateral investments treaties by an African host state is aimed at reassuring foreign investors that the host state is committed to the promotion and protection of foreign investments through legally binding obligations. The treaties therefore call for compliance with the obligations set out in the treaty and any attendant international investment agreement as an important element of investment protection and promotion.

Despite the existence of BITs, African state parties have blatantly ignored, terminated or varied the terms of the international investment agreements entered into with foreign investors. Generally, a number of African state parties have failed to comply with their obligations under the treaties and the respective international investment agreements. This is evidenced by the increase in the number of investor-state disputes in Africa that are before various arbitral tribunals which point towards the general non-compliance of treaty obligations mostly by the African host states.

The specific objective of this study is to analyse the role BITs play in ensuring compliance with legal obligations aimed at promoting and protecting foreign investments especially in the oil, gas and mining sector in sub-Saharan Africa.

The methodology adopted in researching into this topic is based on analysis of case law, treaties, books, articles, journals, reports and online resources.

CHAPTER ONE

BACKGROUND OF THE RESEARCH

1.1 Introduction

There are hundreds of investor-state disputes that are before various arbitral tribunals which point towards the general non-compliance of treaty obligations and international investment agreements mostly by state parties. Some of the widely used arbitral tribunals when it comes to investor-state disputes are those established under ICSID, UNCTAD, ICC and LCIA.

According to the ICSID Caseload Statistics Issue 2016, ICSID had registered 549 cases under the ICSID Convention and Additional Facility Rules as of 31st December 2015.[1] 88 of these cases involved state parties in sub-Saharan Africa whilst 143 cases involved disputes touching on the oil, gas and mining sector.[2]

In 2015 alone, there were 50 new cases registered under the ICSID Convention and Additional Facility Rules out of which 8 cases involved state parties in sub-Saharan Africa, more particularly, Kenya, Uganda, Tanzania, Senegal, Cameroon, Guinea and Cape Verde and most of which related to disputes touching on oil, gas and mining sector which is the sector that dominate the economy of sub-Saharan African countries and that attracts the most foreign investment in the region.[3]

Furthermore, according to the International Chamber of Commerce Dispute Resolution Statics 2014, the number of Africa-related ICC arbitrations has more than doubled from 72 cases in 2004 to 163 cases in 2014 and disputes involving the oil and gas industry account for a significant proportion of this increase.[4]

Out of the disputes decided by the arbitral tribunals under the ICSID Convention, 46% of the arbitral awards upheld claims of breach by the foreign investors either in part or in full.[5]

[1] The ICSID Caseload – Statistics (Issue 2016 – 1) 2016 < at http://www.icsid.worldbank.org> accessed 17September 2016).
[2] Ibid.
[3] Ibid.
[4] Steven P Finizio, 'Energy Arbitration in Africa' (*Global Arbitration Review*, 20 April 2016) < http://globalarbitrationreview.com> accessed20 September 2016.
[5] ICSID Caseload – Statistics (n 1).

The two types of state conduct most commonly challenged by investors are cancellations or alleged violations of contracts and concessions and revocations or denials of licences by state parties [6].

For example, the case of *Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria*[7] relates to claims arising out of the alleged breach of a production-sharing contract concluded between Shell Nigeria Ultra Deep Limited and Nigeria's state oil company whereby the state sought to transfer the oil and gas concession exploration and development rights over the relevant exploration blocks to third parties.

The case of *WalAm Energy Inc v Republic of Kenya*[8] on the other hand relates to the revocation of a licence granted to the Canadian claimant by the state to explore and develop geothermal resources at the Suswa Geothermal Concession in Kenya.

There are a myriad of reasons relied on by state parties in cancelling or violating contracts and concessions and revoking or denying licences which this study seeks to explore in detail. These cancellations or alleged violations of contracts and concessions and revocations or denials of licences by state parties occur despite the existence of bilateral investment agreements which are aimed at promoting and protecting foreign investments.

1.2 Statement of the Problem

The number of African signatories of BITs has increased over the years. According to the United Nations Economic Commission for Africa Survey on Investment Agreement Landscape in Africa, as at 2014, African state parties had signed a total of 1007 BITs.[9]

The increase in the number of treaties entered into with African countries can be attributed to the large deposits of natural resources that a number of African countries are endowed with but for which they lack the skill, technological know-how, financial resources and capacity to exploit and hence require partnership with the foreign investors in the exploitation of these resources.

[6] UNCTAD, Investor-State Dispute Settlement: Review of Developments in 2015, IIA Issue Note No. 2 June 2016 < at http://www.unctad.org> accessed 17 September 2016.
[7] ICSID Case No. ARB/07/18.
[8] ICSID Case No. ARB/15/17.
[9] United Nations Economic Commission for Africa, *Investment Policies and Bilateral Investment Treaties in Africa: Implications for Regional Integration* < at http://www.uneca.org > accessed 20 September 2016.

The purpose of these treaties is therefore to guarantee the promotion and protection of incoming foreign investments through legally binding obligations. However, despite the increase in the number of treaties and the protections sought thereunder, there has been a surge in the number of arbitrations involving these investment treaties as a result of breaches by state parties.

As mentioned above, there are currently 8 new cases involving state parties in sub-Saharan Africa which were filed in 2015 before the ICSID tribunal.[10] Furthermore, out of the disputes decided by the arbitral tribunals under the ICSID Convention, 46% of the arbitral awards upheld claims of breach by the foreign investors either in part or in full.[11]

The purpose of this study is to examine the role BITs play in ensuring compliance by state parties with legal obligations aimed at promoting and protecting foreign investments especially in the oil, gas and mining sector in sub-Saharan Africa thereby enforcing the principle of sanctity of contract.

In this regard, this study will investigate why state parties abrogate international investment agreements despite the express obligations set out in the BITs and underlying investment contracts. It will also investigate whether there has been a decrease in the legitimacy of BITs as a means of upholding state responsibility under international investment agreements.

1.3 Justification of the Study

This study seeks to plug the existing knowledge gap in as far as the role played by bilateral investment agreements in enforcing sanctity of contract under an international investment agreement is concerned.

There has not been any conclusive evidence regarding the effect of BITs on compliance by a state party with its obligations under an international investment agreement it has entered into with a foreign investor.

Furthermore, the increased acceptance of and reliance on various defenses by state parties to state responsibility under BITs and the international investment agreements has exacerbated this situation and required an in depth study.

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[10] ICSID Caseload - Statistics (n 1).
[11] ICSID Caseload – Statistics (n 1).

The reason for carrying out this study is also so as to contribute to the policy discussions on the need to change the structure and terms of some of the BITs entered into by African state parties from the existing models and whether such changes, if implemented, would enhance compliance by state parties of their legal obligations under the treaties and investment contracts.

It has been argued that the existing models of BITs with African state parties confer more protection to foreign investors to the detriment of the state party.[12] It has also been argued that the existing models of the treaties include skewed conditions to the detriment of domestic and regional investors thereby reducing the potential for growth of indigenous investors.[13] These treaties have also been faulted for exposing the host states to legal disputes before international arbitral tribunal which are costly.

This has seen countries such as Morocco attempt to renegotiate the terms of the treaties it has entered into. South Africa on the other hand has taken a policy decision to terminate a majority of its BITs pursuant to the terms of the treaties. It has given notice to terminate a number of its most important BITs which include the treaties it had entered into with Germany, Switzerland, Netherlands, Belgium and Spain.[14]

1.4 Objectives of the Study

The study has the following objectives:

a) To evaluate the importance of BITs in international investment agreements and whether they promote FDI.
b) To analyse the protection that BITs offers to foreign investors under international investment agreements.
c) To explore whether BITs play a key role in ensuring compliance with legal obligations aimed at promoting and protecting foreign investments especially in the oil, gas and mining sector in sub-Saharan Africa.
d) To examine the reasons why state parties abrogate the terms of the BITs and international investment agreements.

[12] United Nations Economic Commission for Africa, *Investment Agreement Landscape in Africa*, E/ECA/CRCI/9/5 < at http://www.uneca.org> accessed 21 September 2016.
[13] Ibid.
[14] Jackwell Feris, 'Challenging the Status Quo – South Africa's Termination of its Bilateral Trade Agreements' International Arbitration Newsletter (2014) 2 < at http://www.dlapiper.com > accessed 10 September 2015.

1.5 Research Question

The study seeks to answer the following questions:

a) What is the rationale of BITs?
b) Why do state parties abrogate the terms of international investment agreements despite the existence of BITs aimed at promoting and protecting foreign investments?
c) Have the BITs been successful in ensuring that state parties in sub-Saharan Africa uphold the principle of sanctity of contract by enforcing compliance with the terms of the international investment agreements entered into under it?

1.6 Research Hypotheses

The study will test the following hypotheses:

a) BITs have not been successful in ensuring that state parties uphold the principle of sanctity of contract in international investment agreements.
b) There has been a decrease in the legitimacy of BITs as a means of upholding state responsibility under international investment agreements.
c) BITs do not necessarily prevent a state party from reneging or breaching the terms of the international investment agreement.

1.7 Literature Review

There is a dearth of information on the role played by BITs in enforcing sanctity of contract under an international investment contract. This study endeavours to contribute to literature in the area of the effect of BITs on compliance by a state party with its obligations under an international investment contract it has entered into with a foreign investor.

This research analyses texts, report, journals and online articles on the principle of sanctity of contract in international investment contracts and the effect of BITs on compliance with state parties' obligations under the investment contracts. The research also focuses on whether BITs leads to increased FDI and whether this has any bearing on compliance with the treaties and investment contracts by the state parties.

1.7.1 The role played by BITs in enforcing sanctity of contract

The principle of sanctity of contract posits that agreements must be obeyed and is found in BIT provisions more commonly known as the umbrella clause or the mirror or parallel effect clause or *pacta sunt servanda*. The principle of sanctity of contract in international investment contracts between state parties and foreign investors has been addressed by various scholars.

One of such scholars is Jarrod Wong who states that the umbrella clause imposes a requirement on each contracting state to observe all the investment obligations entered into with investors from other contracting states.[15] According to Wong, umbrella clauses are designed to allow for any breach of an international investment contract to be resolved under the BIT in an international forum.[16] In other words, it allows breaches of investor-state contracts to be resolved as if they were treaty violations. Wong further opines that the umbrella clause applies to all investment commitments undertaken by each state party with investors from any other state party.[17]

However, Wong, in attempting to come up with the proper construction of the umbrella clause as a result of the various conflicting arbitration decisions touching on the matter, fails to succinctly address the issue whether the umbrella clause in the BIT does indeed affirm the principle of sanctity of contract.[18]

Nkiru Okobi argues that the existence of BITs ensures contract stability through the umbrella clauses.[19] As stated above, the umbrella clause in BITs requires the observance of all investment obligations and commitments entered into by state parties with investors from the contracting states.

A foreign investor is thus assured that the promises made under the international investment agreements will be upheld owing to the protection by the umbrella clause in the BITs. This is

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[15] Jarrod Wong, 'Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations and the Divide Between Developing and Developed Countries in Foreign Investment Disputes' (2006) Pacific McGeorge Scholarly Commons 138 < at http://digitalcommons.mcgeorge.edu > accessed 17 September 2016.
[16] Jarrod (n 13) 145.
[17] Jarrod (n 13) 147.
[18] SGS v. Pakistan (ICSID Case No. ARB/01/13 (2003)) and SGS v. Philippines (ICSID Case No. ARB/02/6 (2004)) brought to the forefront the question of whether the umbrella clause applies to obligations arising under otherwise independent investment contracts between the investor and the host state.
[19] Nkiru Okobi, 'The Umbrella Clause: A Panacea for Contractual Instability? A Look at Production Sharing Contracts' (2009) Centre for Energy, Petroleum and Mineral Law and Policy < at http://www.dundee.ac.uk> (last visited in November 2013).

because the umbrella clause serves to bring independent contracts entered into by a state with a foreign investor under the umbrella protection of the treaty.[20] The umbrella clause thus creates interstate obligations to observe investment commitments and on this basis, it mirrors the principle of sanctity of contract.[21]

Maniruzzaman in his article argues that the principle of absolute sanctity of contract does not exist in international investment agreements.[22] This is because state contracts are mutable. According to Maniruzzaman, certain factors may provide a state party with reasonable grounds to terminate or vary an international investment agreement. This is regardless of the existence of the principle of sanctity of contract. Thus the principle of sanctity of contract is limited by various qualifications such as public interest. Maniruzzaman does not however touch on the relationship between the sanctity of contract and BITs.

Webb on the other hand argues that state parties honor their obligation under an international investment agreement whether or not BITs are in place to offer the foreign investor protection.[23] He further argues that BITs have not added any value in ensuring that state parties keep to their promises. He advances this argument by pointing out that the various mechanisms that were in place before the establishment of BITs was sufficient to ensure that state parties honored their obligations. Such mechanisms included international arbitration.

In this regard, Webb opines that BITs have no relation to sanctity of contract as even before the existence of BITs parties honored their obligations.[24] He concludes by saying that the idea that BITs seek to ensure sanctity of contracts is a myth as international arbitration provided an avenue for compliance. However, Webb assumes that mechanisms of international arbitration have always existed to provide foreign investors with protection and that these mechanisms were sufficient.

None of the scholars mentioned above have explicitly analysed whether BITs play a significant role in enforcing the principle of sanctity of contract. They fail to consider the direct link

[20] Ibid.
[21] Ibid.
[22] A.F.M. Maniruzzaman, 'State Contracts with Aliens – The Question of Unilateral Change by the State in Contemporary International Law' (1992) Vol 9 Journal of International Arbitration 142.
[23] Jason Webb Yackee, 'Bilateral Investment Treaties, Credible Commitment and the Rule of International Law: Do Bilateral Investment Treaties promote Foreign Direct Investments?' (2008) Vol 42 Law and Society Review 805.
[24] Ibid.

between BITs and the principle of sanctity of contract in international investment agreements exclusive of other intervening factors such as the existence of dispute resolution mechanisms.

The above scholars fail to critically address the issue whether or not the principle of sanctity of contract has been upheld in the international investment agreements arena by BITs. They also fail to address the issue as to numerous breaches by state parties of their obligations under international investment agreements despite the existence of BITs.

This research will therefore attempt to plug this gap by analysing whether or not the principle of sanctity of contract has been upheld in the international investment agreements arena by BITs.

1.7.2 The impact of BITs on FDI

The question whether BITs do promote FDI inflows has been the subject of many scholarly articles. Some scholars argue that BITs do lead to an increase in FDI inflows to a country whilst others have concluded that these treaties have no bearing on FDI inflows.

According to Neumayer and Spess, there is a positive effect of BITs on FDI inflows. Having undertaken an empirical study that analysed, among other variables, the cumulative number of BITs a developing country has signed with OECD countries and the share of the outward FDI flows the OECD country accounts for vis-a-vis the total world outflow, Neumayer and Spess concluded that developing countries that sign more BITs with developed countries receive more FDI inflows.[25] By developing countries succumbing to the obligations under the treaties which for instance interfere with its regulatory sovereignty, they are assured of the desired pay off of higher FDI.[26]

Having empirically examined FDI inflows into 122 developing countries, Buthe and Milner concluded that developing countries that are signatories or members of trade agreements experience statistically and substantively significantly higher FDI inflows.[27] Buthe and Milner

[25] Neumayer, E. and Spess, L, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?' (2005) 17 and 27 < at http://eprints.lse.ac.uk> accessed 10 October 2016.

[26] Neumayer. and Spess (n 25) 27.

[27] Buthe Tim and Helen V. Milner, 'The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through Policy Commitment via Trade Agreements and Investment Treaties?' (2008) 749 <at http://people.duke.edu> accessed 10 October 2016.

further conclude that the greater the number of trade agreements to which a country is a party the higher is the inward FDI that it experiences.[28]

Salacuse and Sullivan in their study on the effect of BITs on FDI also found that BITs do promote FDI flows from the developed countries to the developing countries.[29]

On the other hand, Yackee argues that BITs do not meaningfully influence FDI decisions. According to his findings, although BITs may influence certain investment decisions, they probably have not been the primary cause, and perhaps not even a partial cause, of the massive increase in foreign investment to the developing world that began in the 1990s.[30]

A study by Tobin and Rose-Ackerman also finds that the number of BITs signed by a country appears to have little impact on a country's ability to attract FDI.[31] The study by Tobin and Rose-Ackerman demonstrate the importance of variables such as GDP per capita, political risk, and population or market size in determining FDI inflows. However, according to the findings of the study, the remaining variables which include BITs appeared to have no effect on FDI.[32]

Sornarajah also holds a similar view as he states that foreign investors are seen to place greater significance on other factors in deciding whether or not to enter into a particular country despite the existence of BITs. The factors include political stability and the economic climate of the developing country that they are targeting.[33]

The above scholars however do not address whether the promotion of direct foreign investment inflows or lack thereof through BITs has any bearing on compliance with the treaties and investment contracts by the state parties. This research will therefore attempt to contribute to the knowledge gap in this area.

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[28] Buthe and Helen (n 27) 758.
[29] Salacuse, J. and Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain', (2004) Harvard International Law Journal 24 <at https://www.files.ethz.ch/isn> accessed 11October 2016.
[30] Yackee, J. W 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' (2007) Volume 51 Virginia Journal of International Law 400 < at http://www.vjil.org/assets/pdfs/vol51/issue2/Yackee.pdf > (last visited October 2016).
[31] Tobin, J. and Rose-Ackerman, 'Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties' (2004) 19 <at https://deepblue.lib.umich.edu> accessed 16 October 2016.
[32] Tobin and Rose-Ackerman (n 31).
[33] Sornarajah. M., 'State Responsibility and Bilateral Investment Treaties' (1986) Vol 20 Journal of World Trade Law79-98.

1.8 Theoretical Framework

This paper is based on two theories, the utilitarian theory of law and the middle path theory on foreign investment.

One of the research problems that this study seeks to address is whether BITs play a key role in upholding the principle of sanctity of contract by enforcing compliance with the terms of the international investment agreements entered into under it.

In addressing this problem, the utilitarian theory of law as advanced by John Stuart Mills posits that actions are right in proportion as they tend to promote happiness and this theory is therefore concerned with the greatest happiness for the greatest number of people.[34] It aims at maximum pleasure while minimising misery.

Through this theory, the principle of sanctity of contract should not be applied in absolute terms in international investment agreements. The standard against which compliance with the international investment agreements and BITs should be measured is if they serve to benefit the public at large and not just the foreign investor.

Therefore, despite the existence of BITs, where there are policy concerns and public interest issues, the state party is justified in reneging on promises made to the foreign investor under the investment agreement. This is because public policy and public interest issues reflect the notion of the greatest happiness for the greatest number of people.

The principle of sanctity of contract under international investment agreements contracts is therefore limited by the utilitarian theory. Despite the fact the government has made certain promises to foreign investors, such promises should not be upheld simply on the basis of good faith and the underlying force of BITs.

The main question if such promises are challenged should be whether the interests of both parties shall be balanced in upholding such a promise. Where it is evident that the investment agreement does not serve the interests of the public in the host state, the principle fails on this basis.

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[34]John Stuart Mill, *Utilitarianism* <at http://www.utilitarianism.com> accessed 5 November 2013.

However, this theory will not justify cases in which the state party arbitrarily goes back on its word or promise in spite of the fact that the wider interest of the public is met under the existing arrangements.

The utilitarian theory is also based on results and usefulness. In this regard, the usefulness of the principle of sanctity of contract in international investment agreements is the need to ensure that the sensible expectations induced by a promisor in a commercial civilization are not too often defeated.[35]

Thus this theory strives to ensure that state parties fulfill their obligations under international investment agreements due to the legitimate expectation of the foreign investor based on the promises made. However, such usefulness is limited to the extent that it ensures the greatest happiness for the greatest number of people.

This study also seeks to address the question on the rationale of BITs. In addressing this problem, the middle path theory on foreign investments posits that foreign investment is both beneficial and detrimental to the economy of the host state.[36]

The beneficial aspects of foreign investments include transfer of technological advancement, know-how and skill set, which was not presently available, from the foreign investors to the developing host state. FDI leads to the creation of employment opportunities through the various ventures that are set up locally by the foreign investors.

FDI leads to an improvement of the host state's infrastructure and other facilities such as transport, health and education for the benefit of the general public. The improvement in infrastructure could either be that it is built by the foreign investor under concession agreements entered into with the host state. It could also be that the host state has undertaken major projects to an upgrade its infrastructure in order to attract foreign investors.

This beneficial aspect of foreign investments may lead to the economic development of the host state and must therefore be protected. Such protection will facilitate further flow of foreign investments and lead to the economic development of the less developed host state.

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[35]Malcolm P. Sharp, 'Pacta Sunt Servanda' (1941) Vol 41Colombia Law Review 784.
[36] M. Sornarajah, *The International Law on Foreign Investment*, (3rd edn, Cambridge University Press 2010) 56.

The detrimental effects of foreign investments on the other hand include various harmful activities of multinational corporations such as human rights abuses through the use of child labour by various corporations. The activities of these multinational corporations have often led to environmental degradation especially in the developing countries which lack strong systems to evaluate the impact of a foreign investors operation to the environment.

Transfer pricing mechanisms employed by multinational corporations are detrimental to the economy as it denies the host state the benefit of taxes which would have been derived from the profits of the multinational corporations which have been understated through transfer pricing.

The importation of obsolete and hazardous technology in the transfer of technology from the home state to the host state portends a serious risk to life and environment in the host state. Some multinational corporations often use technology in the developing states which they are not permitted to use in their home states because it is cheaper to do so and there are no regulations that govern the use of such technology in the developing countries.

Therefore, the middle path theory recognises that whereas foreign investments may have positive development effects, it may also limit growth of a host state.

1.9 Research Methodology

This is a qualitative research based on desktop review of primary and secondary data. Library and internet research will be conducted.

Legislative enactments, rules, treaties, conventions, and decided cases relevant to the study constitute the primary sources of data while textbooks, journals, articles, reports, on line sources and international investment agreements constitute secondary sources.

Due to time constraints, it was not possible to engage other primary sources of data such as interviews and questionnaires in conducting this study.

1.10 Limitations

Investor-state disputes have not only increased in number but also cut across the geographical divide in the world. Furthermore, these disputes relate to various economic sectors such as oil, gas and mining, construction, tourism, finance, services and trade, transportation, information and communication, electric power and other energy and agriculture, fishing and forestry.

The investor-state dispute scenario is therefore wide.

This study limits itself to investor-state disputes involving African state parties and which disputes relate to the oil, gas and mining sector.

1.11 Chapter Breakdown

Chapter one of this research work is the introduction to the study. It covers the background to research, statement of problem, the study objectives, research questions and literature review.

Chapter two gives an overview of the BITs regime. It covers the historical background of the international investment environment in Africa before the existence of BITs. It then touches on the emergence of BITs in Africa and analyses their importance in directing foreign investments. This chapter also delves into the nature of bilateral investments treaties.

Chapter three takes a look at state interference with international investment contracts and BITs. Here, the various reasons for non-compliance with BITs by state parties are analysed in detail including the various defenses to state responsibility. Having looked at the reasons for state interference with international investment contracts and BITs, this chapter will briefly focus on South Africa's BIT regime more so the steps its taking in dealing with some of the reasons it deems justifiable for interference with international investment contracts and BITs.

Chapter four analyses the role of BITs in enforcing the principle of sanctity of contract in international investment agreements. This chapter will debate the prospects and challenges of BITs in enforcing the principle of sanctity of contract. This chapter will also analyse a number of treaty claims involving oil and gas projects in Africa.

Finally, chapter five covers a general summary of the research work, the conclusions drawn from each chapter, the recommendations and the way forward in enforcing the principle of sanctity of contract in FDI agreements.

CHAPTER TWO

OVERVIEW OF BILATERAL INVESTMENT TREATIES

2.1 Introduction

Before delving into the nature of BITs and the role that they play in the international investment arena, it is first important to understand the historical origin of these treaties and the reason behind their advent into the foreign investment scene. An analysis of the pre-BIT era is critical to the understanding of these treaties and the protections sought there under.

2.1.2. Historical Background of BITs in Africa

During the colonial era in Africa, the colonial powers wielded great power over their colonies and protectorates. They were thus able to protect absolutely whatever form of investments they or their nationals had brought and established around these colonies and protectorates. The protection of these investments was primarily through use of military power to dissuade and dissipate any resistance and threat to their assets that they faced from within their colonies.

This situation gravely changed upon attainment of independence by most colonies. The imperial states had to relinquish power to the new regimes that took over from them. It ultimately meant that the absolute protection of the investments by an investor from an imperial state which had hitherto been guaranteed was lost.

This scenario was further compounded by the fact that the newly independent states were resentful of the accumulation of wealth by the nationals of the former imperialist states. They therefore sought to have these nationals return property that they deemed was rightfully theirs. The period of decolonisation saw properties owned by foreigners being nationalized, foreign investors being forced to relinquish their investments to the nationals and others being forcibly ejected from their properties.

This was the ideology behind the black economic empowerment in South Africa where white-owned businesses were required to transfer part of their stake to blacks. This was also the case in Zimbabwe where white-owned business were nationalised and the whites ejected from their farms and property.

The risk to foreign investors intensified long after the period of decolonisation was over owing to a myriad of factors:

2.1.2.1 Sovereignty

Owing to developments in international law such as permanent sovereignty over natural resources, state parties exercised their sovereign right to nationalise property hitherto owned by foreign investors with or without paying compensation.

This saw the nationalisation of Libya American Oil Company's concessions in Libya in 1955 and the Suez in Egypt in 1956.

2.1.2.2 Nationalism

The nationalism movement that swept across various developing countries in Africa greatly undermined foreign investments due to the apprehension that private property owned by foreigners would be divested.

The nationalism movement sought to end all forms of foreign control and influence on the political, social and economic affairs of the African states. This was the case in Zimbabwe whereby President Mugabe directed the divestment of ownership of foreign owned businesses and properties.

2.1.2.3 Regime Change

The change of regime from one government to another posed a great threat to existing foreign investments as the incoming regime would rescind contracts previously entered into between the outgoing regime and the foreign investors. The foreign investors were left without recourse in such cases. This was especially the case if the outgoing regime was an authoritarian and undemocratic one.

This was the case during the post-Sadam era where the previous concession agreements entered into between Sadam Hussein's regime and foreign investors were called into question as lacking legitimacy.

2.1.2.4 Legislation

There was the tendency by governments to enact legislation aimed at interfering with the terms of a foreign investment contract. This was the case where the contracts previously entered into later on proved to be too onerous for the government to comply with and thusthe governments sought interventions through legislation to lessen the burden of compliance.[37]

The enactment of regulatory mechanisms to control foreign investments also posed a threat to foreign investments due to the interference it created.[38] Some of these regulatory measures included requiring a foreign investor to merge with a local partner prior to entry in a developing country.[39]

2.1.2.5 Protection of Human Rights and the Environment

Issues of human rights and protection of the environment gained prominence. A number of multinational corporations were found to have perpetrated human rights abuses at their local operations.[40] Others were accused of degrading the environment through some of their activities especially in the extractive industry.

Such abuses by foreign investors were considered to override any protections and promises that had been made by the host state under any investment agreement. These abuses were seen as warranting the actions taken by governments even if they were adverse to the operations of these multinational corporations. Some of the actions taken would include withdrawal of licenses without which a foreign investor would not be able to carry out activities it had set up to do.

2.1.2.6 Political Instability

Political instability in any given state has proven to greatly undermine the extent of foreign investments in that state. This is due to the risk posed by an unstable government. A stable political landscape is critical for any investments, whether local or foreign. Where there is instability, a lot of uncertainty arises as investors are not able to predict the suitability of the political environment for further investments in that country.

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[37] Sornarajah (n 36) 76.
[38] Sornarajah (n 36) 77.
[39] Companies Act 2015 that was recently enacted in Kenya requires a foreign owned company to have at least 30% local shareholding.
[40] For example, Nestle is the third largest buyer of cocoa from the Ivory Coast, a country which is reported to employ child labour on cocoa farms. Nestle together with other multinationals create the demand for thereby putting pressure on the country to look for additional labour, mostly children, who work in very squalid conditions. Although these multinationals are aware of the tragically unjust labor practices taking place on the farms, they continue to do business with these countries. <at http://www.laborrights.org > (last visited in September 2015).

2.2 Development of BITS in Africa

It is against this background that the number of foreign investments into these young democracies in Africa dwindled significantly. The impact of this on economic development was greatly felt as most of these states were capital-importing countries. This is because these were young democracies in the nascent stages of economic development and required capital injection to propel development.

Many of the developing countries experienced recession in the 1990's with some defaulting on the sovereign lending by banks. With the low levels of foreign investments coming in, there was a dearth in capital across the developing countries. This led to increased and intensified competition amongst the developing countries for the little foreign investments that were still forthcoming at this point.

In a bid to attract foreign investments, various legal methods were devised aimed at protecting foreign investments. This included the establishment of the bilateral investment regime as a means of guaranteeing foreign investors protection of their investments.

Furthermore, there was the need to come up with a body of rules that would sought of codify the rules pertaining to foreign investments. The aim was for this body of rules to strike a balance between the interests of the developing countries and the developed states. This was because at this juncture, the body of rules that were being advocated by developing countries in relation to foreign investments stood in stark opposition to the rules advanced by the developed countries.

There was therefore the need to balance issues of state sovereignty over natural resources and economic self-determination with protection of foreign investments from state interference. The bilateral investment regime was seen as a means of striking this balance through codifying rules pertaining to foreign investments.

It is against this background that there was a surge in BIT-making with African countries in the 1990's and onwards.[41]

[41] African state parties had signed a total of 1007 bilateral investment treaties. See United Nations Economic Commission for Africa, *Investment Policies and Bilateral Investment Treaties in Africa: Implications for Regional Integration* < at http://www.uneca.org > accessed 20 September 2016.

2.3 BITs and the Promotion of Foreign Investments in Africa

A BIT is the primary vehicle by which foreign investments are regulated and governed as it sets out definite rules and norms that apply to foreign investments.[42] These rules include the standards of protection of foreign investments as well as the applicable rules in case of a dispute between the contracting parties.

Although the treaties envisages a two-way flow of investments between the state parties, the contracting parties are usually the capital rich "home" country which is the source of investment and a developing "host" country that seeks to attract greater investment from investors in the home country.[43]

The main purpose of BITs is to encourage and protect foreign investments.[44] This is because foreign investments are a great source of capital inflow to any country more so the developing countries.[45] These foreign investments open up accessibility to advanced technologies, know-how, capital, inventions, intellectual property rights, foreign exchange amongst a host of other resources. These are important elements of economic growth and eradication of poverty in the developing countries in Africa.[46]

BITs are therefore seen as a way of stimulating investments between the contracting states owing to the protection and security offered under the treaty by setting minimum standards of protection of investments and by also providing international arbitration to settle disputes.[47]

Through BITs, host states commit themselves to legally binding obligations aimed at protecting the investments of the foreign investors.[48] By signing a BIT, a host state conveys its seriousness about protecting the foreign investments and also signals its true intention not to interfere with the foreign investments.[49]

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[42] Sornarajah (n 36) 175.
[43] Sornarajah (n 36) 177.
[44] This is the preamble of almost all bilateral investment treaties.
[45] Matthias Busse, Jens Koniger and Peter Nunnenkamp, 'FDI Promotion through Bilateral Investment Treaties: More than a bit?' (2010) Vol 146 Review of World Economics 147.
[46] Matthias, Jens and Peter (n 50) 148.
[47] Todd Allee and Clint Peinhardt, 'Contigent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment' (2011) Vol 65 International Organisation 403.
[48] Matthias, Jens and Peter (n 50) 149.
[49] Todd and Clint (n 52) 404.

The rationale for signing a BIT is that the host state is seen as more credibly committed to protecting whatever foreign investment they receive.[50] This in turn is seen as leading to increased confidence among investors and ultimately greater foreign investment inflows.[51]

The credibility gained by the host state in signing a BIT was evident in previously communist regimes such as states of the old Soviet bloc, China and Vietnam whose ideologies opposed influx of foreign investments and the notion of private ownership of property.[52] It therefore became crucial for these countries, in seeking to attract foreign investors, to assure them that their properties and investments would be protected by signing these BITs.

The BITs thus signaled to the home states and foreign investors that there had been a shift in ideology and that these countries were committed to creating an enabling environment for investments where certain minimum protections as enshrined in the treaties were guaranteed.

However, it is important to point that there is no conclusive empirical evidence to the effect that the treaties actually do encourage investment or affect investment flows in a significant way, beyond isolated cases.[53] It is therefore doubtful as to whether any signalling effect of the treaties by a host state to foreign investors of the host state's intention to protect foreign investments has any actual effect on investor decision-making about where to commit capital.

Furthermore, few, if any, of the BITs impose an obligation on the home state's investors which are aimed at encouraging or facilitating outward investment by its nationals.[54] The treaties do not make it mandatory for the signatories to ensure that there is flow of investments between the state parties. Instead, the treaties focus mostly on the protection of the home state's foreign investors.

It therefore appears that the primary aim of the BITs is to protect the economic position of the foreign investors and not to encourage investment flows between the state parties.[55] Consequently, the assertion that bilateral investments treaties lead to increased FDI has been called into question.

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[50] Todd and Clint (n 52) 403.
[51] Ibid.
[52] Sornarajah (n 36) 172.
[53] Gus Van Harten, 'A critique of Investment Treaties' 42.
[54] Ibid.
[55] Ibid.

2.4 Features of BITs

BITs provide significant protections to foreign investments through various features which include:

2.4.1 National Treatment Obligations

BITs seek to protect foreign investors by setting a national treatment obligation as a standard of treatment of foreign investors. The national treatment obligation requires a host state to accord a foreign investor treatment that is no less favourable than domestic investors in like circumstances.[56] This implies that a foreign investor should not be discriminated against through the legal, administrative or such other actions of the host state. It is intended to accord equal treatment for foreign investors.

The test of establishing whether this standard of treatment has been violated by the host state was set out in the *S.D. Myers v. Canada*.[57] The court held that in order to assess whether a decision or action taken by the host state went against the national treatment obligation, it was necessary to take into account two factors. This included whether the practical effect of the decision or action taken by the host state was to create a disproportionate benefit to nationals over non-nationals and whether such decision or action, on its face, appeared to favour the nationals over the non-nationals who are protected by the relevant treaty.

This standard has however faced a lot of criticism as

the national treatment obligation does not usually establish criteria for determining what amounts to "like circumstances" or of determining the similarity or likeness of an investment.[58] This has therefore left room for varied interpretations by tribunals in dispute settlement processes.

2.4.2 Most Favoured Nation Treatment Obligation

This standard of treatment in a BIT requires that a foreign investor in the host state be accorded the highest standard of treatment available to an investor from any other foreign country in the

[56] Article 2 (2) (c) of the Charter of Economic Rights and Duties of States articulates the national treatment principle.
[57] UNCITRAL, First Partial Award, 13 November 2000 (NAFTA).
[58] Edgar Jalang'o Odari, 'Africa's Agrarian Revolution: Legal and Policy Prescriptions to Promote Impact Investment for Foreign Land Acquisitions' (2011) Trade Policy Training Centre in Africa 6.

host state.[59] The most favoured nation treatment obligation enables the foreign investor to profit from favourable treatment that may be given to any other third party foreign investor by the host state.

This obligation has been interpreted by various tribunals to expand the scope of the foreign investor's procedural and substantive rights beyond those contained in the treaty under which the investor claims protection.[60]

In *Maffezini v. Spain*, a claim was filed by an argentine investor in Spain under a BIT between Argentina and Spain. The argentine investor was permitted to rely on a beneficial time requirement in the arbitration process found in a different treaty between Chile and Spain.[61]

The most favoured nation obligation also enables a foreign investor to use a better dispute settlement provision in a treaty made by the host state with a third state.

In *Morris v. Uruguay*, the Switzerland-Uruguay BIT required a foreign investor to first resort to litigation in local courts in the resolution of a dispute with the host state. The foreign investor invoked the most favoured nation obligation in the treaty by proceeding directly to arbitration since other BITs which had been entered into by Uruguay with other states allowed for dispute resolution through arbitration in first instance.[62]

2.4.3 Fair and Equitable Treatment

The requirement for fair and equitable treatment in BITs sets out the minimum international standards of protection of foreign investments which can be condensed into five specific principles that must be observed by a host state to meet this threshold of investment protection.[63]

Firstly, the host state must maintain a stable, predictable and consistent legal framework within which the foreign investors operate. This is because an investor needs to know beforehand any and all rules and regulations that will govern its investments. They also need to know the

[59] Edgar (n 66) 7.
[60] Ibid 7.
[61] Emilio Augustin Maffezini v. The Kingdom of Spain, ICSID (Case No. ARB/97/7), Decision on Jurisdiction 25 January 2000; Award 13 November 2000; Rectification of Award 31 January 2001 (Argentina/Spain BIT).
[62] Philip Morris Brand Sarl (Switzerland), Philip Morris Products S.A. (Switzerland) and Philip Morris Brand Srl Abal Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay (ICSID Case No. ARB/10/7).
[63] Edgar (n 66) 9.

relevant policies, administrative practices and directives of the host state in order to plan its investments and comply with such directives.[64]

Secondly, the host state must protect the foreign investor's legitimate expectation by refraining from taking such actions that would affect the basic expectations that were taken into account by the foreign investors in making the decision to invest in the host state.[65]

Thirdly, the host state should maintain procedural and administrative due process and prohibit the denial of justice.[66] In this regard, the host state must refrain from making arbitrary decisions which are aimed at interfering with the foreign investments but instead follow the due procedure as laid out in the treaty or investment agreement.

Fourthly, the host state ought to be transparent in its dealings with the foreign investors. Lastly, the host state must conduct itself reasonably and any adverse action taken against a foreign investor ought to be proportional to the mischief that it seeks to cure.[67]

2.4.4 Repatriation of Profits

The aim of any investment is to make a return on these investments. In the case of foreign investments, it is not enough to make a return. There must be avenues by which once these returns have been made, the foreign investor is able to transmit the profits back to its home state. This is therefore a crucial guarantee sought by foreign investors.

Bilateral investment agreements seek to protect the investors' right to repatriate profits by including absolute statements guaranteeing these rights. It should however be noted that this right to repatriate profits may be fettered in instances where the host state is suffering from foreign exchange shortfalls, balance of payment difficulties or a financial crisis.[68] In such a case,

[64] This was the ruling in Metalclad v. Mexico (ICSID Case No. ARB (AF)/97/1).
[65] This observation was made by the arbitral tribunal in Tecnicas Medioambientales Tecmed S.A. v. The United Mexican State (ICSID Case No. ARB (AF)/00/2).
[66] Edgar (n 66) 9.
[67] In Tecmed v. Mexico (ICSID Case No. ARB (AF)/00/2), it was observed that there must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by an expropriatory measure.
[68] Sornarajah (n 36) 207.

the right to repatriate profits may therefore be suspended by the host state until such time that the financial or economic circumstances permit.[69]

2.4.5 Nationalisation and Compensation

A host state has a right to nationalise foreign-owned property provided that the nationalisation is for a public purpose, it is done in accordance with the applicable laws and due process, it is non-discriminatory and full compensation is paid for the investment.[70] These conditions relating to nationalisation are expressly stated in the BITs.

Nationalisation does not only include the open, deliberate and direct taking of foreign-owned property such as outright seizures but also includes covert, indirect or incidental interference with the use of the property which has the effect of depriving the foreign investor the use or economic benefit of the property.[71]

The BITs provide the means by which contracting states agree on the standard of compensation to be used in the event of nationalisation.[72]

2.4.6 Dispute Settlement

BITs seek to create a regime of investment protection by providing for arbitration as an investor-state dispute settlement mechanism. The treaties further provide for a neutral forum for settlement of the dispute through arbitration.[73] The forum would usually be an arbitral tribunal which would sit outside the host state. Most dispute settlement provisions in the investment treaties refer to the ICSID arbitration.

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[69] The Argentine financial crisis during the period from 1998 to 2002 resulted in a number of investment disputes. The issue at hand was whether these crises gave rise to situations of necessity justifying the suspension of the right of repatriation of profits made by foreign investors.

[70] In Antoine Goetz v. Republic of Burundi (ICSID Case No. ARB/95/3) the arbitral tribunal held that expropriation or measures tantamount to expropriation could only be taken once the above conditions were met.

[71] This was the observation made by the arbitral tribunal in Metalclad Corporation v. United Mexican States (ICSID Case No. ARB (AF)/97/1).

[72] There are various standards of compensation in use upon nationalisation of foreign-owned properties. Most of the capital exporting-home states clamour for prompt, adequate and effective compensation as the standard of compensation. This is mostly based on the fair market value of the expropriated investment and it ensures that the foreign investor receives payment of the full value of the property that has been taken over. The host states on the other hand advocate for the standard of appropriate compensation which takes into account factors such as the profits made by the foreign investor in assessing compensation. Other variations to the standards of compensation include "just" compensation or compensation based on the commercial value of the assets on the day expropriation.

[73] These may include ICSID, UNCITRAL, Stockholm Chamber of Commerce and the International Chamber of Commerce.

The reason for providing for arbitration as a form of dispute resolution mechanism at a neutral forum is because generally foreign investors do not have confidence in the impartiality of local tribunals and courts. They are often apprehensive of the fact that they may not obtain a fair hearing as the local tribunals and courts are often seen to be biased against the foreign investor.

An investor is thus able to invoke remedies for breaches through arbitration with the state deemed to have consented to such dispute resolution mechanism by the inclusion of the provision in the treaty. These foreign investors no longer have to convince their home states to pursue their claims but instead they are able to seek redress against the host state directly through international arbitration.[74]

However, it should be noted that the inclusion of the arbitration in a treaty does not automatically oust the application of the local remedies which are available for breaches by a party unless expressly stated so in the treaty. It is a generally accepted principle of international law that parties to an investor-state dispute ought to first exhaust all the locally available remedies for breaches provided by the host state prior to reference to arbitration.

This is the logic behind the arbitration provisions in most bilateral investor treaties which often provide for a time limit within which parties shall attempt to resolve an investor-state dispute through use of locally available remedies failure to which the investor, in most cases, shall have a right to refer the dispute to arbitration. This structure allows for a balance to be struck between judicial sovereignty of the host state and the investors' concerns over the impartiality of the local tribunals and courts.

There are also other clauses known as umbrella clauses which generally require parties to keep commitments that are made to each other's nationals. The umbrella clause which forms the crux of this paper will be dealt with in detail in the succeeding chapter.

2.5 International Investment Contracts

Various foreign investors whose home states have concluded BITs with a host state engage the host state with a view of entering into international investment contracts. The international

[74] However this will ultimately depend on the wording of the arbitration clause in the treaty. There are various types of arbitration provisions that are included in the treaty which either provide for an outright reference to arbitration or which require the agreement of the parties or a request by investor and consent by the state prior to reference to arbitration.

investment contracts are concluded between the foreign investors and the host state or state-owned enterprise with the intention of regulating specific investment projects in the host state.

The entry into the international investment contracts between a foreign investor and the host state is mostly founded on the already established BITs which regulate the treatment of the foreign investors from the home state within the territory of the host state.

There are various types of international investment contracts as they vary in the form, structure and model that they take.

2.5.1 Concession Agreements

Under this model of international investment contract, the foreign investor is granted exclusive rights by the host state to exploit natural resources or run a public utility in a given area for a fixed period of time in exchange of agreed royalties, taxes and fees paid to the host state by the foreign investor.[75]

This type of agreement is mostly employed in the extractive industry. An example of the a concession agreement is the concession granted by the governments of Kenya and Uganda to foreign investors under the group Rift Valley Railways to operate the Kenya-Uganda Railway for a period of 25 years.

2.5.2 Production Sharing Agreements

Under this model, the foreign investor provides technical capacity and the financing needed in respect to a particular activity, mostly in the oil and gas sector, and in return receives a share of the produce that is generated from that activity based on an agreed formula.[76]

This model is mostly attributed to complex and capital intensive projects that require advanced technical know-how and massive capital injection such as oil and gas exploration. The Mining Act, Act No. 12 of 2016, Law of Kenya envisages production sharing agreements in the extraction of minerals in Kenya by foreign investors.

[75] Edgar (n 66) 11.
[76] Edgar (n 66) 12.

2.5.3 Joint Venture Agreements

These are agreements between a foreign investor and a local partner in the host state with the common goal of jointly running a business venture. It may take the form of an incorporated company registered in the host state and whose shareholding is held by both the foreign investor and the local partner.

It can also be undertaken by an unincorporated body where both the local partner and the foreign investor administer the project jointly without forming a separate legal entity which is owned by both parties to run the project.

2.6 Conclusion

This chapter has considered what is viewed as the importance of BITs being that it encourages FDI to a host state owing to the protection of foreign investments guaranteed under these treaties. This chapter has also taken into account the fundamental fact that there is no conclusive empirical evidence that points towards increased inflows of FDI to a host state as a result of that host state having signed BITs.

Therefore, whether the desired gains of BITs, such as enhanced foreign direct in flows and protection of foreign investments, are realized ultimately depends on whether the host government adhere to the commitments set out in the treaty.[77]

Governments who enter into BITs and comply with the treaty terms experience significant FDI increases.[78] On the other hand, non-compliance by the host state with its treaty obligations negatively affects foreign investments in flows. This therefore point towards the importance of treaty compliance.

For instance, a host state may take such steps that flout the treaty provisions such as stopping a foreign investor from repatriating its profits. This outright breach ultimately sends a negative message to the foreign investment community about the host state's lack of commitment in protecting foreign investments.[79] As a result, foreign direct inflows to the host state decreases

[77] Todd and Clint (n 52) 406.
[78] Todd and Clint (n 52) 429.
[79] Todd and Clint (n 52) 407.

due to the perception that the host state may in future interfere with a foreign investors rights as enshrined in the treaty.

CHAPTER THREE

STATE INTERFERENCE WITH INTERNATIONAL INVESTMENT CONTRACTS AND BILATERAL INVESTMENT TREATIES

3.1 Introduction

International investment contracts are subject to the process of internationalisation. This means that these contracts are not governed by the municipal laws of the state party but are instead subject to an external system such as customary international law.[80]

Generally, a contract between a state party and a foreign investor would be governed by the municipal laws of the state party.[81] However, due to the need to protect the contractual rights and other economic interests of the foreign investor, the contract is removed from the sphere of the state party's municipal laws and subjected to a supranational system of international law.[82] This forms the basis of the theory of internationalisation of contracts between state parties and foreign investors.

The main justification for internationalisation of these contracts is the concern over the neutrality of the domestic courts and the exercise of state sovereignty in the event of any dispute between the state party and the foreign investor.[83] Therefore, by placing the contracts under the realm of international law, the contract acquires stability, which is essential to foreign investors, as it is removed from the legislative control and authority of the state party which would enable it to arbitrarily change the contract.

However, it is a generally accepted principle that not every breach of an international investment contract by a state party automatically entails a violation of international law or a breach of the applicable BIT.[84]

For an action by a state party to constitute a breach under international law, the state party ought to have acted in exercise of its sovereign authority in order to directly interfere with or terminate

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[80] UNCTAD, State Contracts, IIA Issue Paper Series 2004 6 < at http://www.unctad.org> accessed 15 September 2016.

[81] Samuel K. Asante,'International Law and Foreign Investment: A Reappraisal' (1988) Vol 37 The International and Comparative Law Quarterly 611.

[82] Sornarajah (n 34) 289.

[83] UNCTAD (n 97) 5.

[84] UNCTAD (n 97) 9.

the contract with the result being either a denial of justice or cancellation of licenses or expropriation without adequate compensation or violation of due process or a breach of such other treaty norms, for instance, fair and equitable treatment.[85]

On the other hand, a breach by a state party acting in its commercial and not sovereign capacity such as failure to make payments due under the contract does not amount to a breach under international law. Instead the breach will be resolved in accordance with the law and forum specified in the contract.[86]

It should also be noted that where a state party takes measures such as effecting a change in the law of general applicability which effect is to interfere with a foreign investor's rights under a contract with that state but such a measure was taken for a public purpose, then the state party would also not be held liable under international law unless other circumstances are present such as an abuse of law, lack of due process, or discriminatory intent.[87]

State interference with international investment contracts will usually take the form of issuance of an executive decree or passage of legislation modifying the government's performance required under a contract or cancelling such a contract all together or that negatively affects performance of or expected profits under, the contract.

A state party will also interfere with an international investment contract through cancellation of licenses previously issued to a foreign investor to undertake an economic activity or expropriation of the foreign investors' properties without adequate compensation or violation of due process or a breach of the substantive treaty provisions such as the most favoured nation principle or fair and equitable treatment.[88]

The next section analyses in detail the reasons for state interference with BITs and consequently, the underlying contracts with the foreign investors.

[85] Lise Johnson and Oleksandr Volkov (2013) 'Investor-State Contracts, Host-State "Commitments" and the Myth of Stability in International Law' (2013) Vol 24 The American Review of International Arbitration 5 <http://ccsi.columbia.edu/files/2013> accessed 12 October 2016.
[86]Ibid.
[87] Lise and Oleksandr (n 104) 7.
[88] UNCTAD (n 97) 2.

3.2 Non-compliance with BITs

Governments sign BITs with the intention that these treaties will be complied with. The signing of bilateral investments treaties by a host state reassures foreign investors that the host state is committed to the promotion and protection of foreign investments. However, this is not enough. The host government must also comply with the treaty provisions throughout the duration of the treaty and investment agreements.

The reality however is that not all governments comply with the terms of the treaty that they have signed. Even a well-intentioned government may in the future decide to modify the terms of investment or to behave in ways that contravene its obligations under the BIT.

Before parties enter into a BIT, there is in existence a lop-sided relationship between the home state and the host state. The home state being a capital-exporting country often has more leverage against the host state which is in need of the capital and therefore seeks to attract investment from the home state.[89]

Upon entry into the BIT, the leverage shifts from the home state to the host state.[90] The relationship between the state party and the foreign investor is one of respective superiority and subordination to one another.[91] This is because the protection of the foreign investments from the home state is now fully dependent on the host state's compliance with the treaty obligations.

It has often turned out that the initial entry into a BIT by a host state is just an attempt to hoodwink the investment community of its commitment to the protection of foreign investments.[92] At the point where the foreign direct inflows commence, the host state retreats on its earlier promises as enshrined in the treaty. The host state change course and behave in a manner that is hostile toward investments. The parties have unequal bargaining power and it is because of this unequal status of the contracting parties that a state party is able to unilaterally terminate or vary the terms of the international investment agreement.[93]

[89] Todd and Clint (n 52) 403.
[90] Ibid.
[91] Maniruzzaman (n 22) 145.
[92] Todd and Clint (n 52) 404.
[93] Maniruzzaman (n 22) 145.

Most investor-state disputes are arbitrated under the auspices of ICSID.[94] The number of investor-state disputes which are heard and determined by ICSID arbitral tribunals have markedly increased over the years. As previously stated, as of 31st December 2015, ICSID had registered 549 cases under the ICSID Convention and Additional Facility Rules with 88 of these cases involving state parties in sub-Saharan Africa.[95] ICSID therefore serves as an important reference point on the nature of these disputes and the extent of non-compliance with treaty obligations by the host state.

3.3 Reasons for Non-compliance with BITs

Non-compliance with treaty obligations has been mostly by the capital-importing host states. A number of reasons have attended the non-compliance with treaty obligations which require a detailed assessment.

3.3.1 Use of Model Treaties

The conclusion of BITs is initiated and driven by the capital-exporting home states, mostly the Western countries. This is because of the need to protect the investments of their nationals abroad.

The negotiation of the treaties is mostly based on model treaties which have previously been developed by the Western countries. These model treaties set out the kind of treaties that the capital-exporting home states are looking to enter into.

They include commitments and provisions that the capital-exporting states deem essential for the protection of foreign investments. The use of the model treaties thus gave the capital-exporting states a negotiating advantage since it was their document that formed the framework within which bargaining took place.[96]

The capital-importing host states were merely placed in a position of reacting to the model treaty. Often times because they were desperate for capital, the host states, had little, if any, say about

[94] The prominence of ICSID investor-state disputes is mostly because of its strong institutional structures, its establishment by an international convention and its direct ties to the World Bank. Furthermore, awards of ICSID carry the same effect as the judgment of a national court. Its rulings are legally binding on the parties and the domestic courts of an ICSID member state can be used to enforce the award.

[95] ICSID Caseload – Statistics (n 1).

[96] Jeswald .W. Salacuse, 'BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact in Developing Countries' (1990) Vol 24 The International Lawyer 663.

the nature of the model treaty. They negotiated the treaties from a position of weakness. Since substantive amendments to these model treaties were discouraged by the capital-exporting states, the resultant treaty that was concluded did not depart by far from the model treaty.[97]

A review of South Africa's BITs by the Department of Trade and Industry found that no policy framework informed the conclusion of BITs and that the BITs were negotiated blindly without individualized assessment of risks and benefits associated with negotiating an investment agreement with a given partner. This therefore led to conclusion of BITs that were stacked against South Africa.[98]

Over the years, the host states became emboldened due to the advancement in their economies. There was the realisation that the treaties they had entered into were heavily skewed in favour of the home states. The treaties did not provide for obligations of the investors. Moreover, the treaties did not touch on human rights and environmental concerns. This was a major concern for the host states as a result of several human rights and environmental degradation perpetrated by the foreign investors.

There was also the general feeling that the host state had relinquished a lot of its sovereign powers in an attempt to encourage and protect the foreign investments. Having taken little part in the drafting of the treaties, the host states lacked a genuine commitment to comply with the terms of the treaty.

It is against this background that the CCIA and SADC Model Treaty as advocated by a number of the sub-Saharan countries aims at introducing a balanced investment agreement regime that is not skewed in favour of the foreign investors as was the case with the Model BITs advanced by the Western countries.[99]

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[97] Ibid.

[98] Department of Trade and Industry, *Bilateral Investment Treaty Policy Framework Review* (Government Position Paper, 2009) 14 <at http://pmg-assets.s3-website-eu-west-1.amazonaws.com> accessed 16 November 2016.

[99] Uche Ewelukwa Ofodile, 'Africa and the System of Investor-State Dispute Settlement: To Reject or Not to Reject' (Africa International Legal Awareness 2014) < at http://blogaila.com/2014/10/12/africa-and-the-system-of-investor-state-dispute-settlement-to-reject-or-not-to-reject-uche-ewelukwa-ofodile/> accessed 17 November 2016.

The CCIA and SADC Model Treaty do this by attempting to preserve the regulatory space of the state party, incorporating investor obligations and responsibilities and striving to achieve a balance of rights and obligations between the state party and foreign investor.[100]

3.3.2 Inequality

The aim for the negotiation and entry into BITs is for the reciprocal encouragement and protection of investment between the contracting states. The entire bilateral investment regime is thus based on the misconception that the contracting states to the treaty are at all times equals.[101]

In reality however, the contracting states are never equals in most cases. Usually, the treaties are entered into between a developed country and developing country where the former is the source of capital and the latter is the recipient of the capital.[102] This therefore means that it is only the contracting party which actually exports capital that benefits from the treaty protection.

The BITs therefore entrench inequality between the contracting states.[103] This is due to the lack of recognition of the unequal status of the contracting parties which would pave the way for the implementation of such measures aimed at balancing the scales, for instance, imposition of an obligation on the home state aimed at ensuring flow of capital to the host state. Because of the perceived inequality, the developing state often feels justified in its breach of the treaty as a means of leveling the playing field between the contracting states.

3.3.3 Regulatory Sovereignty

There was the perception that by entering into the BITs, the host states surrendered their regulatory sovereignty. This is because the treaties internationalized the investor-state contractual agreements. The principle of customary international law which recognised the application of local laws to the agreements between a state and foreign investor was replaced with the BIT regime. The treaty therefore supplanted local legislation in dealing with foreign investments.

[100] Ibid.
[101] Jeswald (n 115) 664.
[102] There are bilateral investment treaties between developed countries such as Canada-US. There are also bilateral investment treaties between developing countries Srilanka and Singapore.
[103] Sornarajah (n 34) 177.

The inclusion of public law and administrative rights such as licenses and permits within the definition of investments to be protected under the BITs further curtailed the host state's regulatory powers.

Such inclusion technically meant that once the licenses and permits were granted by the host state to an investor they were irrevocable. A host state could not exercise its discretion to suspend or revoke such licenses or permits even if public interest called for it as this would be tantamount to a breach of the treaty. These treaties were therefore seen as a fetter to the discretion of the host state to make administrative decisions.

Against this background, the host states sought a return to regulatory control of the economy including foreign investments. There was the desire by host states to preserve their regulatory space which would enable them to interfere with foreign investment arrangements if public interest so dictate.

Both the CCIA and SADC Model BIT seek to preserve domestic regulatory space through the use of exception clauses which provide that nothing in the agreement shall be construed to prevent the adoption or enforcement by any state party of measures designed and applied to protect national security, public morals, human, animal or plant life or health, the environment or any other measures as may from time to time be determined by a state party.[104]

South Africa has on the other hand is attempting to preserve its policy space through its proposed Promotion and Protection of Investment Bill by excluding certain matters from investor-state dispute settlement mechanism, for instance, the existing taxation legislation measures, the defined governmental subsidies and grants and government procurement processes.[105]

3.3.4 Lack of Capital Inflows

Developing countries entered into BITs in the belief that such treaties would promote the flow of foreign investments. However this wasn't always the case.[106] Many smaller developing states signed a large number of treaties without witnessing significant inward investment flows.[107]

[104] Article 22 (1) of CCIA.
[105] Article 4(3) of the Promotion and Protection Investment Bill of South Africa.
[106] There is however no conclusive empirical data which directly links bilateral investment treaties with increased foreign direct investments.

As a result, the host state's legitimate expectations of increased investment flows were shattered. They no longer viewed the BITs as playing any significant role in their economic development. As such there was no value in complying with the terms of the existing treaties.

It this therefore for this reason that the SADC Model BIT allows states the discretion to grant preferential treatment to qualifying enterprises in order to achieve its development goals.[108]

3.3.5 Conflicting Interests

The interests of the capital-exporting home states were in constant conflict with those of the capital-importing host states. Whereas the home states sought absolute protection of foreign investments devoid of any state interference, the host states sought to retain its regulatory powers over foreign investments. There was therefore the need to balance the interests of the investors and the regulatory powers of the home states. In the absence of that balance, host states would often renege on some of its treaty obligations.

Furthermore, the goals and objectives of the capital exporting states and the capital importing states in treaty negotiations differed.[109] Whereas the capital exporting states were more concerned with protection of existing and future foreign investments, capital importing states sought to encourage foreign investments. These divergent objectives affected treaty compliance especially because the host states' objectives were not being attained through the treaty itself.

It is for this reason that the CCIA sets out the rights as well as the obligations of a COMESA Investor with a view to ensuring the overall balance of rights and obligations between investors and state parties.[110] In this regard, COMESA investors and their investments are required to comply with all applicable domestic measures of the state party in which their investment is made.[111]

The SADC Model BIT on the other hand imposes a wide range of obligations on the foreign investor which include, among others, the obligation to comply with domestic law at Article 11, the obligation to provide information at Article 12, the obligation to undertake environmental

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[107] Sornarajah (n 34) 187.
[108] Article 21.1 of SADC Model BIT.
[109]Jeswald (n 115) 661.
[110] Uche (n 118).
[111] Article 13 of CCIA.

and social impact assessment at Article 13 and the obligation to adhere to minimum standard for human rights, environment and labor at Article 15.

3.3.6 Change in Circumstances

Most BITs were entered into between the home and host states many years ago. In Africa, this was during the post-independence period. The development needs of post-independent Africa were different from the prevailing needs. With the passage of time, these treaties did not reflect the current developmental and investment needs and concerns of the developing host countries.

3.3.7 Public Interest

Some state parties vary or even terminate contracts with its foreign investor for the benefit of public interest or public policy subject only to the duty to pay compensation.[112] The argument here is that a state party is deemed to enter into an international investment agreement on behalf of its citizens and thus represents their collective interests.[113]

Therefore, where there is a material change in circumstances to the extent that the international investment agreement is no longer beneficial to the public, the state party may be justified in revising or terminating the agreement subject however to appropriate compensation.

This was the case when apartheid ended in 1994. South Africa's ruling party, the African National Congress (ANC) sought to remedy the economic injustice which many Africans had faced during apartheid as very few Africans had been able to accumulate capital under apartheid by introducing a program which sought to make Africans richer. To this end, white-owned businesses were required to transfer a stake to a new class of black investors.

It is against this backdrop that the South African Promotion and Protection of Investments Bill provide for its sovereign right to regulate in the public interest.[114] Furthermore, since a treaty is only valuable as matters stand, as enunciated in the principle of *rebus sic stantibus*, a change in

112Maniruzzaman (n 22) 144.
113Maniruzzaman (n 22) 156.
[114] Article 10 of the Promotion and Protection of Investments Bill.

circumstances which is detrimental to the public interest may be considered a reasonable ground for the state party to vary or terminate altogether an international investment agreement.[115]

3.3.8 Political Climate

The prevailing political climate in a state party often times determines whether the terms of an investment agreement will be observed. An autocratic regime is ordinarily averse to complying with the terms of an agreement it has entered into.

3.3.9 Nationalism

Owing to the customary international law position on permanent sovereignty over natural resources, state parties treat their resources, especially in the energy sector, as sovereign resources and central to economic development[116]. This is the reason why many arbitrations relating to the African energy sector arise in connection with state parties nationalizing energy resources leading to claims under the investment treaties.

This was the case in Zimbabwe where white-owned business were nationalised and the whites ejected from their farms and property.

3.3.10 Local content regulations

A number of African governments have amended their energy legislation, regulations and bidding practices to include 'local content' requirements and are increasingly requiring compliance by foreign investors with these regulations.[117]

These local content regulations may provide for a minimum threshold for the use of local services and materials, require that preference be given to local companies, promote the transfer of skills from the foreign investors to the local workforce, provide local employment by the foreign investors, ensure opportunities for local participation in bidding rounds, prioritise local suppliers among other things.

Local content regulations have been codified as part of national petroleum laws in countries such as Nigeria, Kenya, Ghana, Mozambique and Angola.

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115 Brett A. Leeds and Burcu Savun,'Terminating Alliances: Why Do States Abrogate Agreements?'(2007) Vol 69 The Journal of Politics 1118.

[116] Steven (n 4).

[117] Ibid.

The effect of these regulations is to increase the operating costs for foreign investors. Consequently, there has been an increasing number of disputes involving compliance with such requirements.[118]

3.3.11 Commodity price volatility

The recent fall in oil prices may give rise to an increased number of disputes in the African oil and gas sector as African governments dependent on hydrocarbon revenues take such steps to cushion themselves against a sustained price fall by, for instance, introducing new taxation regimes or renegotiating contractual arrangements in an attempt to increase their take from project revenues.[119]

3.4 Other Defenses to State Responsibility

In addition to the reasons given above for non-compliance with BITs by state parties, there has been the development of a number of defenses to state responsibility under the treaty. These defenses are invoked and relied upon by state parties for the breaches that they commit under the treaties.

The state party is seen as acknowledging its breach of the treaty provisions. However, it raises defenses which are aimed at justifying the breach it has committed. These defenses are aimed at providing the state party with an avenue to avoid responsibility. Some of these defenses are entrenched in the newer treaties as exceptions to the general rules and are aimed at limiting the scope of the treaties. Other defenses to state responsibility have been developed from the decisions by arbitral tribunals.

The defenses to state responsibility are based on customary international law as state parties' seek to preserve their regulatory sovereignty over foreign investments.[120] Furthermore, these defenses have sought to address some of the concerns raised by the developing countries. These concerns include issues of human rights abuses and environmental degradation that are sometimes perpetrated by foreign investors. It is therefore viewed that a host state would be justified in withdrawing its investment protection where a foreign investor is involved in lowering the human rights and environmental standards.

[118] Ibid.
[119] Ibid.
[120] Sornarajah (n 34) 453.

The CCIA and the SADC Model BIT seeks to limit the exposure of state parties to investment dispute claims by affording state parties with necessary defenses if and when investment disputes arise.[121]

The principle of sanctity of contract seems to run parallel with the use of the defenses to state responsibility. Although under the principal of sanctity of contract it is recognised that parties to a validly concluded contract may disregard some of their obligations under the contract, this is only permitted in exceptional circumstances.[122]

A party may therefore not be held liable for breach of contract if the breach is as a result of a change in circumstance that fundamentally strikes at the root of the contract or where there exist grounds of supervening impossibility or frustration.[123] Most of the defenses to state responsibility however do not fall within these exceptional circumstances.

As a result, the certainty of investment protection that was hitherto guaranteed by the treaties has been called into question. This is because some of the defenses relied on are so wide as to eat up the intended investment protection of the treaty. The continued reliance on defenses to state responsibility has the potential of ultimately eroding the protections granted to the foreign investors under the treaties.

Examples of the defenses to state responsibility include national security.[124] Therefore an investment which becomes a threat to national security could be denied protection under the treaty. This is especially so where the investors are from a hostile state and the investments are in sensitive sectors such as armaments industries.

Economic crises are another defense to responsibility. A country undergoing economic crisis may undertake such measures aimed at controlling the economy. These measures may include currency controls and closing the economy. Although such measures may affect a foreign

[121] Uche (n 118).
[122] David H. Parry, *The Sanctity of Contract in English Law,* (London: Stevens & Sons Ltd 1959) 77.
[123] Ibid.
[124] Article 22 (3) (a) of the CCIA also has a security exception which provides that nothing in the agreement shall be construed to preclude a Member State from applying measures that it considers necessary for the fulfillment of its obligations under the United Nations Charter with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

investor's right to repatriate profits due to currency controls, the host state may not be found to be in violation of the investment treaty based on this defense.

Acts of necessity by the host state may be relied on to avoid liability in the event of a breach. Therefore, measures taken by the host state which are necessary for the maintenance of public order or the protection of its national security interests may limit the state party's liability for breach of treaty.[125]

Violation of the fair and equitable standard by the foreign investor is yet another defense to state responsibility under the treaty. This is premised on the equitable maxim which requires that a person who comes to equity must to do so with clean hands.

Consequently, a foreign investor who seeks relief for a breach under the treaty must not have conducted itself in such a manner as to have prompted the host state to react the way it did by breaching its treaty obligations. Where the foreign investor is found to be at fault, then the host state may use this as a defense for breaching the treaty. This is mostly the case where the foreign investor is found culpable of human rights abuses or environmental degradation.

A host state is justified in breaching its treaty obligation to protect foreign investments where the investment transaction involves a violation of a *ius cogens* norm.[126] Such *ius cogens* norms include prohibition of genocide or racial discrimination. Protection should not be granted to investments made in violation of fundamental rules of protection of human rights like investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs.

Where foreign investors had previously entered into agreements with an autocratic and undemocratic government, such investment agreements may be repudiated by an incoming democratically elected regime. This is on the basis that the previous regime did not represent the collective will of the people and hence lacked legitimacy to enter into an agreement on behalf of the people. In such cases, the democratic regime may be justified in violating its treaty obligations by withdrawing protection over foreign investments.

[125] Excluded from the ambit of SADC Model BIT at Article 25 are measures that a State considers necessary for the protection of its national security interests as well as non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies.
[126] Sornarajah (n 34) 469.

Environmental degradation caused by activities of a foreign investor as well as human rights concerns may justify measures taken by the host state that negatively impact protection of foreign investors.[127]

3.5 Analysis of South Africa's Bilateral Investment Regime

South Africa has taken a policy decision to terminate a majority of its BITs pursuant to the terms of the treaties in order to address, within a legal framework, some of the reasons it deems justifiable for interference with international investment contracts and BITs.

South Africa had approximately entered into 47 BITs although not all of them were in force.[128] Most of these treaties were entered into during the post-apartheid period in order to attract investment in to the country.[129] They included treaties with Germany, Switzerland, Netherlands, Belgium, Luxembourg, Italy, Spain, Austria, Denmark and China.

In 2007, South Africa's policy and domestic interventionist measures came under attack by foreign investors in the mining sector. This was as a result of the implementation of the black economic empowerment programs as mandated by the South African constitution. These programs sought to correct the historical injustices faced by blacks in South Africa during the apartheid era.

South Africa enacted the South African Mineral and Petroleum Resource Development Act which required that black South Africans hold a partial shareholding in mining companies. Most of these mining companies were owned and operated by foreign investors. This legislation led to the filing of an investor-state dispute under ICSID by investors from Luxembourg and Italy who deemed the requirement of partial shareholding in their companies by blacks as expropriation contrary to the treaty provisions.

It is the realisation that the country's laws and policies which are backed by the Constitution could be challenged by foreign investor that prompted a review of South Africa's foreign investment regulatory regime. The Department of Trade and Industry was mandated to work on

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[127]This formed the basis of the tribunal in Methanex v. United States, UNCITRAL, Decision on Amici Curiae, 15 January 2001 and 1st Partial Award, 7 August 2002 (NAFTA). Final Award, 3 August 2005.
[128]Jonathan Lang, 'Bilateral Investment Treaties – A Shield or a Sword' < at http://www.bowman.za> accessed 2 October 2015.
[129] Magalie Masamba, 'Africa and Bilateral Investment Treaties: To "BIT" or not?' (2014) < at http://www.consultancyafrica.com> accessed 2 September 2015.

modernising and strengthening the country's investment regime to ensure South Africa remained open to FDI while preserving the sovereign right of the government to pursue policies.[130]

Based on the recommendations by the Department of Trade and Industry, the government of South Africa sought to implement a new policy framework to govern FDI. This included developing local foreign investment legislation, review and termination of old generation treaties and development of a new model BIT.

Following the implementation of this new policy framework, South Africa has terminated and provided notice for the termination of its BITs with various countries.[131] They include Germany, Switzerland, Netherlands, Belgium, Luxembourg and Spain.[132]

South Africa also released a draft Promotion and Protection of Investment Bill 2013 which aims at regulating the protection and promotion of foreign investments domestically. This Bill is yet to be passed into law. However it has faced a lot of criticism by foreign investors on two fronts.

Firstly, it proposes that the amount of compensation for expropriation must be deemed just and equitable. This is in line with the South African Constitution. It is however a significant shift from the treaties' standards of compensation which are based on an immediate, full and effective compensation.

The reference to just and equitable compensation implies that public interests will be taken into account in determining the amount of compensation due to a foreign investor.[133] The compensation might therefore not comprise of the market value of the investment.

Secondly, investor-state disputes will be referred to local tribunals and determined based on the local laws. The local dispute resolutions mechanisms may include mediation with the state, a domestic court action or an agreed domestic arbitration. A foreign investor will therefore have no recourse to any international arbitration or other neutral forum to resolve the dispute.

[130] Robert Hunter, 'South Africa Terminates Bilateral Investment Treaties with Germany, Netherlands and Switzerland' < at http://www.rh-arbitration.com> accessed 20 September 2015.
[131] Termination of the treaties does not mean the termination of all investment protection obligations for existing investors. Most of these treaties contain a sunset clause which provide for a sunset period of between 15to 20 years where existing investors would continue to be protected under the treaty provisions
[132] In total, South Africa has terminated approximately 13 bilateral investment treaties.
[133] Jackwell (n 14).

Speculation is however rife that the Bill if passed in its current format may discourage future investments in South Africa.[134]

The policy decision to terminate these treaties was prompted by an assessment of the value these treaties play in directing foreign investment in flows to the country.[135] Furthermore, it was based on the general view that certain policy decisions and domestic intervention decisions such as the black economic empowerment could be open to attack by foreign investors.[136]

3.6 Conclusion

The reasons for state interference with international investment contracts as detailed above can generally be attributed to the differing public and private sector interests of the state parties and foreign investors respectively. It is this differing public and private sector interests that sets the stage for state parties to abrogate the terms of the BITs and the underlying international investment contracts.

The interference with international investment contracts by state parties points towards the general lack of compliance by the state parties with the underlying BIT obligations between the contracting state parties. As a result, the certainty of investment protection that was hitherto guaranteed by the treaties has been called into question.

[134] Ibid.
[135] Ibid.
[136] Ibid.

CHAPTER FOUR

SANCTITY OF CONTRACT IN THE OIL, GAS AND MINING SECTOR IN AFRICA AND THE ROLE OF BILATERAL INVESTMENT TREATIES

4.1 Introduction

The principle of sanctity of contract also referred to as *pacta sunt servanda* is a general principle of customary international law posited as the right or rule that agreements must be carried out.[137]

This principle holds in all kinds of agreements whether it is an international agreement between state parties or an agreement between private parties within a municipal legal system or one between a state and a foreign investor.[138] This chapter will concentrate on the international investment agreements between a state party and a foreign investor.

The internationalization of international investment contracts between a state party and a foreign investor as examined in the previous chapter is built on the notion of sanctity and immutability of contracts.[139] Consequently, the investment contracts fall within the purview of international law are subject to the international legal principle of sanctity of contract.[140]

This principle places a duty on the state party under international law to respect contracts it has freely entered into with a foreign party and is of utmost relevance in international investment contracts. This is because it grants the foreign investor a guarantee that the state party, with whom it has entered into an agreement, will live up to its promises as set out in the contract.

4.2 Sanctity of Contract and BITs

The principle of sanctity of contract is sought to be entrenched further through treaties entered into between state parties such as BITs. A fundamental principle of treaty law is that agreements are binding and must be performed in good faith.[141] This principle forms the basis for the obligatory nature of treaties and was re-affirmed in Article 26 of the 1969 Vienna Convention on the Law of Treaties which provides that:

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[137]Malcom .M. Shaw, *International Law*, (6th edn, Cambridge University Press 2008) 29.
[138] Maniruzzaman (n 22) 142.
[139] UNCTAD (n 97) 25.
[140]Samuel (n 98).
[141]Malcom (n 149).

> Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

By entering into BITs, state parties extend legally binding promises to treat each other's foreign investors favourably.[142] The principle of sanctity of contract is sought to be enshrined in the BITs through the clauses which generally require parties to keep commitments that are made to each other's nationals. These clauses are usually referred to as umbrella clauses. Umbrella clauses are referred to as such because they put contractual commitments between a state party and foreign investor under the treaty's protective umbrella.[143]

Umbrella clauses are usually aimed at providing additional protection to investors.[144] The focus of umbrella clauses in BITs is the acceptance of contractual obligations by the state party with regard to foreign investments.[145]

The umbrella clause therefore imposes an obligation on the state party to not only observe obligations it may have entered into under an international investment contract but also to constantly guarantee the observance of those obligations and commitments. Consequently, umbrella clauses protect investors against breach of contract or interference with contractual rights by a state party through its legislative or administrative actions.[146]

For example, under the 2008 German Model BIT, the umbrella clause at Article 7 provides as follows:

> Each Contracting State shall fulfil any other obligation it may have entered into with regard to investments in its territory by investors of the Contracting State.

A sample of the United Kingdom BIT on the other hand provides for the umbrella clause at Article 2 in the following manner:

> Each Contracting Part shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party.

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[142] Jason (n 23).
[143] Katia Yannaca-Small, 'Interpretation of the Umbrella Clause in Investment Agreements' (2008) International Investment Law: Understanding Concepts and Tracking Innovation OECD 108.
[144] Katia (n 170) 102.
[145] Katia (n 170) 105.
[146] Katia (n 170) 108.

Although the umbrella clause in BITs is based on the notion that agreements should be respected in good faith there has been an increased trend of abrogation of validly concluded treaties and international investment agreements.

4.3 Sanctity of Contract and International Investment Contracts

Furthermore, in a bid to uphold the principle of sanctity of contract, there has been the development and use of several types of contractual clauses that seek to protect the interests of foreign investors against arbitrary and unwarranted interference by state parties.

In line with the BIT's aim of providing a virtually unchangeable system of secure protection to foreign investors, the international investments contracts include various contractual devices aimed at maintaining the same terms and conditions of an investment throughout the life of the project.

This is mostly through clauses known as stabilization clause by which a host state commits not to make any alteration to the regulatory framework of an investment which would otherwise prove detrimental to the foreign investor.[147]

The aim is to ensure that the investment environment remains substantially similar as at the time the parties entered into the contract in order to protect the foreign investor from changes in regulatory framework or such other changes which would be detrimental to the foreign investment.

There are various types of stabilisation clauses which may be employed in an international investment agreement and they include:

4.3.1 Intangibility Clause

An intangibility clause is whereby the parties agree not to modify the terms of the contract except with the prior written consent of both parties.[148] A host state cannot therefore purport to unilaterally amend the terms of an international investment contract.[149]

[147] The stabilisation clause involved in the concession agreement between Texaco and Libya which was relevant to the *Texaco v. Libya* (1977) 53 ILR 389 arbitration provided that "…The contractual rights created by this concession shall not be altered except by the mutual consent of the parties".

[148] Edgar (n 66) 13.

4.3.2 Freezing Clause

This clause freezes the law that was applicable at the time of entry into the contract. Only the existing law at that time is recognized as the law governing the investment despite any changes to the law in future.[150] Such future changes in the law are ignored to the extent that it is inconsistent with the law at the time the contract was signed.

4.3.3 Consistency Clause

This clause repudiates the applicability of local laws to an international investment contract to the extent that such a law is inconsistent with the investment contract. Therefore if any law is found to be inconsistent with the investment contract then the protection of the investor takes precedence.[151]

4.3.4 Economic Equilibrium Clause

Pursuant to this clause, any material adverse effect on the investment or one which causes the benefits derived by the foreign investor to materially decrease would require the parties to renegotiate the terms of the contract with a view to restoring the foreign investor to the same or an economically equivalent position it was in prior to such change or be paid prompt, adequate and effective compensation.

4.3.5 Issue-Specific Stabilisation Clause

These are clauses which address specific issues such as stabilization of the fiscal regime or tariff structures.

4.4 The Role of BITs in Upholding Sanctity of Contract in the Oil, Gas and Mining Sector in Africa

Africa is a resource rich continent in as far as sources of energy such as oil, gas, coal and other forms of renewable sources of energy are concerned. According to 2015 figures, Africa holds 7.6 per cent of the world's proven oil and gas reserves and accounted for 9.1 per cent of total global

[149] For example, the stabilization clause contained in the contract involved in *Aminoil V. Kuwait* (1982) 21 ILM 976 provided in part that "No alteration shall be made in terms of this Agreement by wither the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to the Agreement".
[150] Edgar (n 66) 13.
[151] Ibid.

oil production.[152] Furthermore, natural gas reserves in Africa are 7.5 per cent of total global reserves.[153]

Despite being resource-rich, most of these resources are undeveloped due to cash and technology strapped governments' inability to exploit these resources. This has consequently led to the increased practice of governments contracting with foreign investors to meet the financial and technological gap required to fully harness the available resources.[154] Furthermore, increased global competition among international oil companies has also brought new participants and investments into the African energy sector.[155]

The rising number of foreign investments in the oil gas and mining sector in Africa has contributed to the increase in the number of BITs that have been entered into with African state parties for purposes of protecting foreign investors and upholding the commitments laid out in the underlying investment contracts.

African states are currently party to over 1,000 BITs that include protection for the investments of foreign investors and offer arbitration for resolution of disputes between foreign investors and host governments under the ICSID or other arbitral rules.[156]

However, despite the prevailing BITs aimed at upholding the commitments laid out in the underlying investment contracts, the existing investments have led to a wide range of disputes between the state parties and foreign investors. These disputes are evidenced by the rising number of commercial arbitrations as well as ICSID arbitrations.

As mentioned earlier, the number of Africa-related ICC arbitrations has more than doubled, from 72 cases in 2004 to 163 cases in 2014 and disputes involving the oil and gas industry account for a significant proportion of this increase.[157] Furthermore, a significant number of Africa-related

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[152] BP Statistical Review of World Energy June 2016 <at https://www.bp.com/content/dam/bp/pdf/energy-economics/statistical-review-2016> accessed 20 October 2016.
[153] Ibid.
[154] Steven (n 4).
[155] Exploration companies are also moving into countries such as Somalia, which were until recently considered too risky due to conflict and political instability.
[156] United Nations Economic Commission for Africa (n 10).
[157] Steven (n 4).

ICSID cases have involved energy issues and a large percentage of the ICSID cases involving energy issues have involved African countries.[158]

Furthermore, and as highlighted in chapter onee, out of the disputes decided by the arbitral tribunals under the ICSID Convention, 46% of the arbitral awards upheld claims of breach by the foreign investors either in part or in full.[159]

Treaty claims involving oil and gas projects in Africa have related to a number of issues which are analysed in the cases detailed below:

Total E&P Uganda BV v Republic of Uganda[160]

This dispute involves the imposition of stamp duty by the Uganda Revenue Authority and associated breach of stabilisation provisions. The claimant maintains that a stamp duty was unlawfully imposed by the Uganda Revenue Authority upon the acquisition of interest in an oil and gas block in the Lake Albert region

In 2012, Total and China Offshore Oil Corporation bought stakes in three exploration blocks from London-listed Tullow Oil. According to Total, one of the exploration block's Production Sharing Agreement includes a tax waiver and therefore the imposition of stamp duty by the Uganda Revenue Authority was in breach of the agreement. The claimant invoked the BIT between Netherlands and Uganda of the year 2000 and filed a request for arbitration before the International Center for Settlement of Investment Disputes.

Unión Fenosa Gas, SA v Arab Republic of Egypt[161]

This dispute the suspension and interruption of midstream liquiefied natural gas operations by the Egyptian government. The Claimant was a majority shareholder in an Egyptian company that operated a liquefied natural gas plant. The claim arose out of the alleged suspension of gas supplies by the Government to the liquefied natural gas plant operated by the claimant, which caused the plant to be inoperative for over a year. The Claimant invoked the bilateral investment agreement between the Arab Republic of Egypt and Spain of 1992.

[158] ICSID Caseload – Statistics (n 1).
[159] Ibid.
[160] ICSID Case No. ARB/15/11.
[161] ICSID Case No. ARB/14/4.

***Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria*[162]**

The dispute involved the transfer of oil and gas concession exploration and development rights to third parties. The Claimant had been granted rights under an ultra-deep offshore production sharing agreement concluded between Nigeria's national oil company and the claimant. The claim arose out of the alleged breach of the production-sharing contract after the State sought to transfer the oil and gas concession exploration and development rights to a private company. The BIT between Netherlands and Nigeria of 1992 was invoked.

***WalAm Energy Inc v Republic of Kenya*[163]**

The claim related to the revocation of a licence granted to the Canadian claimant to explore and develop geothermal resources at the Suswa Geothermal Concession in Kenya based on an international investment contract entered into by the parties.

***African Petroleum Gambia Limited (Block A4) v Republic of the Gambia*[164] *and African Petroleum Gambia Limited (Block A1) v Republic of the Gambia*[165]**

These claims related to Gambia's revocations of an Australian IOC's two offshore oil licences on the basis that the licences violated the state's national petroleum law. Settlement was reached November 2014 when the Gambia reinstated the two licenses.

4.5 Conclusion

Despite the increase in the number of BITs, the legitimacy of BITs in enforcing compliance with contractual obligations aimed at promoting and protecting foreign investments has dwindled.

This is evidenced by the increase in the number of investor-state dispute arbitration which point to the increase in breaches of contractual obligations by state parties. The existence of BITs has therefore not prevented host-states from breaching the terms of an international investment agreement to which it is a party.

[162] ICSID Case No. ARB/07/18.
[163] ICSID Case No. ARB/15/17.
[164] ICSID Case No. ARB/14/7.
[165] ICSID Case No. ARB/14/6.

CHAPTER FIVE
CONCLUSION AND RECOMMENDATION

5.1 CONCLUSION

The number of BITs signed between developing and developed countries has increased over the years. This is especially the case in Africa where post-independent BITs soared in their numbers as a result of the post decolonization protection agendas of the 1960's.[166]

The imperial states sought to guarantee the protection of their investments and those of their nationals in the newly-independent countries through BITs which were heavily skewed in favour of the foreign investors.

In recent times, the number of BITs entered into with developing countries has continued to rise. This is because a number of developing countries are viewed as either frontier or emerging markets for foreign investments. For example, developing countries in Africa such as Kenya, Rwanda, Ghana and Nigeria are considered investment hubs by many developed countries.

This has led to the increased interest in Africa as an investment and business destination and therefore resulted in an increase in the number of BITs entered into between the African countries and the developed home-states.[167]

The increase in the number of BITs in Africa has also been propelled by the fact that Africa portends uncertain business environment thus creating the need to protect foreign investments through BITs.[168]

This is because many African countries have a reputation of weak adherence to rule of law. A number of African states do not meet their contractual obligations under the international investment agreements. This is evidenced by the fact that sixteen percent of the total investor-state disputes under ICSID arbitration involve African countries.[169]

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[166] Magalie (n 155).

[167] Egypt has entered into more than 100 BITs with developed and developing countries. Nigeria has entered into more than 20 BITS. Mauritius has signed or ratified BITs with 17 African countries.

[168] Magalie (n 155).

[169] The ICSID Caseload – Statistics (Issue 2015 – 1) 2015 < at http://www.icsid.worldbank.org> (last visited in October 2015).

Furthermore, the cost of enforcement of contracts is high in Africa due to lack of efficient regulatory and judicial mechanisms in employing local remedies for breach. This is complicated further by issues of corruption and lack of transparency in the adjudication of disputes at the local level as the arbiters are often corruptible and biased.

As a result, Africa is seen as both risky and costly in terms of doing business thereby increasing the need of having BITs aimed at protecting the foreign investors.[170]

However, as mentioned in the previous chapter, despite the increase in the number of BITs, there has been an increase in the number of investor-state dispute arbitration and approximately 50% of the arbitral awards uphold claims by the foreign investors which point to the increase in breaches of contractual obligations by state parties.

These findings have therefore served to prove the hypotheses laid out at the beginning of this study in chapter one, more particularly, that BITs have not been successful in ensuring that state parties uphold the principle of sanctity of contract in international investment agreements; that there has been a decrease in the legitimacy of BITs as a means of upholding state responsibility under international investment agreements and that BITs do not necessarily prevent a state party from reneging or breaching the terms of the international investment agreement.

The legitimacy of BITs has been affected by the fact that many developing countries have come to the realisation that the entry into a bilateral investment agreement is not directly related to an increase in FDI. State parties are therefore not incentivized to comply with the terms of the treaty as they perceive these treaties as not being of any real benefit to their country.

This is due to the fact that BITs were signed in their numbers due to the misconception that the signing of these treaties would automatically lead to increased foreign direct inflows.

The entry into BITs in some cases was not followed by the necessary structural changes and measures aimed at improving the ease of doing business and reducing transaction costs.[171] BITs were thus viewed as a replacement of such efforts and therefore did not result in increased foreign direct inflows.

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[170] Magalie (n 155).
[171] Ibid.

Furthermore, the issue of encroachment of a state-party's regulatory space has dealt the BIT regime a big blow. This is because state parties feel that by submitting a dispute to the international arbitration jurisdiction they have relinquished their regulatory sovereignty in determining the issues underlying the dispute. Furthermore, some of their policy decisions may come under threat for breaching the terms of the BIT.

The reduction in the legitimacy of BITs has led to the withdrawal from the system of investment arbitration by state parties.[172] Other developing countries have signified their intention not to renew or extend the existing BITs upon expiry. Countries such as Ecuador and Venezuela have withdrawn from the ICSID convention.

Furthermore, there have been attempts to exclude certain sectors of the economy such as taxation from arbitration in a bid to entrench regulatory sovereignty by state parties.[173] In addition to the use of defenses to state responsibility to avoid liability for breaches under a BIT, there has also been the inclusion of exceptions to responsibility in the treaty itself.

The overall effect of this has been that the system of investment protection through BITs has been undermined.

The place of the BIT regime in ensuring compliance with contractual obligations needs to be reviewed otherwise it will lose its significance in the promotion and protection of foreign investments.

5.2 RECOMMENDATION

5.2.1 Recognition of Equality of Parties and Current Development and Investment Needs

Majority of the BITs that were entered into between developing and developed countries during the post decolonisation era were based on the neo-liberal views that sought absolute protection of foreign investments.[174] These treaties were also based on the investment needs of the developing countries at the time.

The economies of the developing countries at this time were in the nascent stages of development and therefore required massive capital injection through foreign investment to

[172]Sornarajah (n 36) 453.
[173] Sornarajah (n 36) 453.
[174] Magalie (n 155).

facilitate growth. The treaties therefore sought to meet this need for capital by ensuring absolute protection of the foreign investments.

However, economic circumstances have significantly changed from the post decolonisation era to date. Some of the developing countries have experienced accelerated economic growth and are confident in managing their economies without any foreign intervention. The developing countries which were hitherto weak and need of foreign investment are now strong economies.

There is therefore a need to overhaul the old BITs which were structured with a view of protecting the stronger home-state at the expense of the weaker host-state which was in need of capital. These should be replaced with new treaties which not only reflect the equality of parties but also the current development and investment needs of the developing countries.[175]

5.2.2 Doing away with Model BITs

Instead of the capital importing host-states accepting the use of model BITs advanced by the Western countries, different countries should adopt different approaches to investment promotion and protection depending on their needs. This would require developing countries to better articulate their individual needs in the BITs and negotiate such agreements from a position of strength instead of weakness.[176]

This would also require recognition of the fact that it is not only the developing country that stands to gain in the inflow of FDI. The developed country also benefits substantially from a working BIT through the profits generated from the operations of the foreign investor in the host state which are repatriated back home.

In place of the Model BITs by the Western countries, African state-parties should consider borrowing from CCIA and SADC Model BIT in negotiating and restructuring their current BIT regime.

[175] Ibid.
[176] Ibid.

5.2.3 Incorporation of Obligations of Home States and Foreign Investors

There should also be a transformation of investment treaties to balanced treaties which not only impose obligations on the host state but also sets out the respective obligations of the foreign investor and home state.

The obligations of the foreign investor would include protection of human rights such as labour rights, the requirement to carry out operations in a sustainable manner in order to protect and preserve the environment and the obligation to promote the health and welfare of citizens through corporate social responsibility initiatives.

There should also be an obligation on the foreign investor to abide by the local laws and regulations of the host state which are aimed at capturing the maximum benefits the foreign investment can bring to the host state's economic development.

5.2.4 Development of Codes of Conduct for Foreign Investors

In line with the incorporation of obligations of foreign investors in the treaties, codes of conduct for foreign investors aimed at ensuring that the foreign investors are good corporate citizens should be developed.[177] These codes should identify the types of conduct of multinational corporations which are harmful to the economic development of the developing states and which must be avoided.

5.2.5 Development Concerns

As previously mentioned in this study, there is no conclusive empirical evidence to point to the fact that BITs lead to increased FDI inflows to and development of the home state. However, the need to ensure FDI inflows and development goal of the home state should be made apparent in the BITs. This can be achieved by providing in the treaties preferential treatment to its investors in order to encourage FDI inflows and development[178].

[177] Sornarajah (n 36) 56.
[178] Bandera Edwick, 'Bilateral Investment Treaties Encouraging Foreign Direct Investments: Zimbabwe-South Africa BIPPA as a Case Study' (LLM Thesis, University of Pretoria (2009).

5.2.6 Transparency

There should be transparency obligations aimed at not only fostering exchange of information between the state-party and foreign investors in as far as investment into the home state is concerned but also the obligation should extend to the domestic process of rule-making that impact on international investments in order to enable interested investors to participate in it.[179] This would ensure that the needs of the investors are taken into consideration and that the municipal laws are not inconsistent with the international investment agreements or BITs.

5.2.7 Abolition of International Minimum Standards of Protection

The use of international minimum standards of protection of foreign investments should be abolished as this insulates the foreign investors without any corresponding obligation on their part.[180] Instead foreign investments should be guaranteed protection only to the extent that they comply with the local laws which are aimed at encouraging economic development in the host state.

The foreign investors should abide by the laws and regulations of the host state which are aimed at maximising the benefits of the foreign investment to economic development for it to receive any protection from the host state.

5.2.8 Preservation of Regulatory Sovereignty

State parties should always sign BITs with the knowledge of their implications on their regulatory sovereignty at the time of negotiation. This is based on the fact that a developing country may be prevented from implementing legal reforms without the threat of dispute settlement proceedings. Such awareness will enable the state-party not to be caught by surprise when their policy decisions are called into question for breaching a BIT.[181]

There is also need to ensure that the treaties allow for the state parties to retain some level of regulatory sovereignty over their affairs and that these treaties are not too intrusive on the state parties' regulatory space.

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[179] Ibid.

[180] Sornarajah (n 34) 59.

[181] This was the case in South Africa when their black economic empowerment policy was challenged by foreign investors under the bilateral investment treaties it had entered into with Italy and Luxembourg.

5.2.9 Increased Compliance

Home states should abide by BITs. It is not enough that state parties have signed up BITs but they should adhere to the terms of the BITs. To ensure compliance, state parties should review their policy directives whilst negotiating BITs to ensure that any future policy decisions do not run contrary to the BITs. The BITs should therefore be negotiated with a view of the state party's current and future policy directives. This will not only help state parties preserve their regulatory space but also lead to increased compliance by state parties with the BITs having taken into consideration various policy directives, both current and future.

5.2.10 Abolition of BITs

On the extreme end, states should consider scrapping BITs completely and instead rely on domestic regulation for investment promotion and protection.[182] This is the move sought to be made by South Africa through its Promotion and Protection of Investment Bill 2013.

However due consideration should be given to international standards that govern investment law and practice as well as the effective enforcement of such laws in drafting domestic legislation aimed at promoting and protecting foreign investments.

Through these initiatives, a state party would be able to identify with the BIT and therefore be more inclined to comply with the terms of the treaty.

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[182] Magalie (n 155)..

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