



**Statement of Jacob Parker  
Director of Government Relations  
Security Industry Association**

**Before the**

**United States Trade Representative  
Trade Policy Staff Committee  
AGOA Implementation Subcommittee**

***African Growth and Opportunity Act: Out-of-Cycle Review of South Africa Eligibility for Benefits***

**August 7, 2015**

**1724 F Street NW., Washington, DC 20508**

The Security Industry Association is a non-profit international trade association representing nearly 600 security solutions providers. SIA members have driven security technology innovation globally and their investments have propelled adoption of advanced security measures designed to protect people and property around the world while creating thousands of jobs.

A number of our member companies provide private security products and services in South Africa. They employ thousands of South Africans and have contributed substantial capital investment and infrastructure development, as well as introducing international best practice in skills training and development which has uplifted the entire security sector. These are much-needed jobs in a country which is suffering from unemployment levels upwards of 25%.

We appreciate the opportunity to participate in the out-of-cycle review process for AGOA participation with respect to the Republic of South Africa, initiated under Public Law 114-27 in response to concerns about compliance with section 104 of the African Growth and Opportunity Act (AGOA).

### **Legislation Places South Africa in Violation of AGOA Eligibility Terms**

SIA believes that a pending South African law which will restrict foreign ownership of security firms operating in South Africa to a minority share, creates a significant barrier to trade in violation of eligibility criteria set out in Section 104.

The legislation, which is currently before the President of South Africa, would amend the Private Security Industry Regulation Act (PSIRA). Section 20 of the amendment bill provides that foreign-owned private security firms, including companies that supply, manufacture, install and distribute equipment to the private security industry, will be forced to sell at least 51 percent of their South African businesses to South Africans, in what is often referred to as a “forced localization” measure.

Specifically, AGOA requires eligible countries to provide evidence that they are meeting, or attempting to meet, the Act’s eligibility requirements, including *“the elimination of barriers to United States trade and investment, including...the provision of national treatment and measures to create an environment conducive to domestic and foreign investment.”*

As a signatory to the General Agreement on Trade in Services (GATS) treaty, South Africa is also committed to the “non-discrimination” principle in international trade. If the restrictions under Section 20 are enacted, it would violate Article XVI (2f) of GATS, which prohibits a “limitation on the participation of foreign equity capital in terms of maximum percentage limit on foreign shareholding.”

It is quite clear that enactment of this provision would result in the erection of a substantial barrier to trade contrary to Section 104 of AGOA.

In addition to SIA, the U.S. Ambassadors to South Africa and the WTO, and a range of South African industry organizations, organized business associations and chambers – including the American Chamber of Commerce in South Africa – trade and law experts, economists and diplomatic representatives have raised their deep concerns about Section 20. Their concerns and objections are reflected in the media reports included in Attachment A.

### **Breach of Trade Agreements and Impact on U.S. Security Firms Invested in South Africa**

In March of this year, the South African Security Industry Alliance (SIA SA, no relation to the U.S.-based Security Industry Association) obtained an opinion from leading South African law firm Webber Wentzel, in conjunction with Linklaters, which sought to provide clarity on the impact of Section 20 of the Private Security Industry Regulation Amendment Act on the country’s trade and investment agreements (see Attachment B for the full opinion). SIA SA represents the majority of the private security industry in South Africa, including multi-national firms operating in that country.

The opinion states that Section 20 is in clear violation of South Africa's global trade and investment agreements, concluding that:

- Section 20 breaches South Africa's commitments under the General Agreement on Trade in Services (GATS), 1994, under which it has promised full market access and national treatment to foreign suppliers of private security services.
- Section 20 would not fall within any of the relevant exclusions for 'governmental services', public policy or "essential security" under the GATS.
- South Africa could not withdraw from its GATS commitments without making "compensatory adjustments" to the affected member states.
- The Act also breaches South Africa's international investment law obligations under its various bilateral investment treaties, as well as under its free trade agreement with the European Union, the European Free Trade Association and the Southern African Development Protocol on Finance and Investment.

Another report, by the independent South African consulting firm DNA Economics entitled *Impact of foreign ownership restrictions in the private security industry*, analyzed the likely costs of implementation of Section 20. These include a range of negative impacts on the South African economy, crime levels, and foreign direct investment as well as international private security firms operating in South Africa. Among other effects, the report examined the risk to investor value. It found that Section 20 provisions would result in substantial risk to the value of the international firms currently operating in South Africa.

The author of the report, senior economist at DNA Economics, Sarah Truen says, "Where the parent company is uncomfortable with holding only a minority share, which is likely where brand identity and intellectual property are at stake, they would divest of their entire local stake. Furthermore, it would result in the foreign owned firms all having to simultaneously go to the market, with local investors having the ability to shop around and drive the cost of assets down. Because these firms will either partially or entirely lose the technical, strategic and financial support of their parent company, they will also lose real value. The net effect will be that assets will be sold at below their true value, to the detriment of investors. A full copy of the DNA Economics report is available at Attachment C.

### **Illusory Rationale for Section 20**

According to South Africa's Minister of Police, the provision was introduced to address concerns that foreign owned private security companies could pose a threat to national security. Quite simply, there is no reason or evidence to support this contention.

The multi-national security firms that have invested in South Africa for many years cannot pose a threat to South Africa's national security. Every person that works for these companies (approximately 50,000, or 10% of the entire security sector) is a permanent resident or citizen of South Africa under current law restrictions on who can work in this sector (the current Private Security Industry Regulation Act), applicable to both operational and management positions.

In addition, South African law does not allow any private security company (whether headquartered internationally or locally) to gather intelligence or participate in any mercenary activity. These restrictions are enforced through the Regulation of Foreign Military Assistance Act (1998), which is separate and distinct from PSIRA.

### **South Africa Participation in AGOA**

It is our view that the enactment of Section 20 of the PSIRA amendments bill would be in direct violation of the provisions of AGOA and, absent any correction, could be considered grounds for the exclusion of South Africa from participation. The President has the constitutional authority to refer the bill back to Parliament in order to remove provisions with which he disagrees, and we hope that will be the case with section 20.

Failure to remove the provision would be a major obstacle to South Africa moving toward reciprocal trade relationships with the United States. Moreover, we do not believe that AGOA recipient nations should be rewarded for maintaining trade barriers to U.S. investors beyond those permitted in international trade agreements. AGOA benefits are highly desirable and should not be taken for granted by participating countries. If there are no consequences, enactment of Section 20 would also signal support for erecting localization barriers to trade that are being contemplated by other AGOA participants. Not only are these measures contrary to AGOA's goals of deepening U.S. trade and investment ties to the region, in the long term they harm the local economy by inhibiting market-led growth.

We thank you for your time and attention to this important matter as you conduct the out-of-cycle review of South Africa AGOA participation. The Security Industry Association stands ready to provide any further information you may need.

Sincerely,

Jake Parker  
Director of Government Relations  
Security Industry Association  
[jparker@securityindustry.org](mailto:jparker@securityindustry.org)

#### **Supporting documentation**

- Attachment A: Copies of media coverage and commentary in both South African and international media on the subject of Section 20 of the PSIRA amendments bill.
- Attachment B: Legal opinion by Peter Leon/ Ben Winks from Webber Wentzel in association with Linklaters
- Attachment C: Impact of foreign ownership restrictions in the private security industry by DNA Economics

## **ATTACHMENT A**

### **Organizations that have voiced strong concerns with Section 20 of the Private Security Industry Regulation Amendment Act**

- South African Chamber of Commerce & Industry
  - American Chamber of Commerce in South Africa
  - British Chamber of Commerce in South Africa
  - South African Security Association
  - Security Industry Alliance
  - South African Institute for International Affairs
  - Tutwa Consulting trade expert Peter Draper
  - Trade Law Centre (Tralac)
  - Economist Mike Schussler
  - Economist Dawie Roodt
  - Economist Roelof Botha
  - Business Unity South Africa
  - Institute for Security Studies
  - Policing expert Maj Gen Bushie Engelbrecht
  - Constitutional law commentator Mark Oppenheimer
  - Webber Wentzel's Peter Leon
  - Centre for Constitutional Rights
  - South African Institute for Race Relations
  - De Klerk Foundation
  - Mr Herman Mashaba, prominent businessman
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## SOUTH AFRICAN CHAMBER OF COMMERCE AND INDUSTRY

PLATINUM HOUSE

24 STURDEE AVE.



PO BOX 213

SAXONWOLD, 2132

11 December 2014  
Hon. Minister Nhleko  
Department of Police  
Private Bag X463  
PRETORIA  
0001

Per email: [MonahengAmelia@saps.gov.za](mailto:MonahengAmelia@saps.gov.za)  
CC: Acting Secretary of Police, Ms Reneva Fourie  
Per email: [Xuban@saps.gov.za](mailto:Xuban@saps.gov.za)  
Dear Minister Nhleko,

### VOTE OF SUPPORT ON PSIRA ENGAGEMENT

The South African Chamber of Commerce and Industry (SACCI) notes the planned meeting between the Minister and the Security Industry Alliance (SIA), a member of SACCI, to discuss amongst others the proposed amendments to the Private Security Industry Regulation Act (PSIRA). SACCI is encouraged by the Minister's willingness to engage with Business and trusts the meeting will be a productive exchange of ideas.

The concern raised by the PSIRA amendment is relevant not only to the security industry but also the broader South African Business Community. SACCI believes the 51% domestic ownership requirement provided in Clause 20 of the Amendment Bill will introduce malign unintended consequences, impose severe economic costs and ultimately hurt investor confidence in South Africa.

SACCI and its membership would support and publically endorse a recommendation by the Minister to the President to refer the Bill back to Parliament for removal of Clause 20. It is our firm belief a referral to Parliament will send a strong signal to local and international investors that South Africa is indeed open for business.

SACCI is eager to discuss PSIRA or any Policing related issue with your office or with the Civilian Secretariat for Police and extends a warm invitation to call on SACCI.

Warm regards

Neren Rau  
CEO

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**Plenty of pain, no obvious gain except for a few lucky shareholders: foreign ownership limitation in PSIRA Act**

**By Peter Draper, MD Tutwa Consulting**

There is no doubt that the inclusion of the foreign ownership limitation clause in the Private Security Industry Regulation Amendment Act will mean plenty of pain for both the industry and South Africa, and no obvious gain except for a few lucky, connected shareholders.

The PSIRA Act is currently before President Zuma, awaiting his signature. If signed into law the now notorious clause 20 in the Act will force foreign owned private security firms to overnight yield at least 51% of their businesses to South Africans.

The provision would come into force immediately and would lead to a 'fire sale' of the affected companies' shares, providing access to cheap shares for a few lucky shareholders. The entire industry could be thrown into turmoil as a scramble ensued for the 'juiciest' assets.

It is important to note that it is not clear precisely which companies would be affected. The provision suggests that all foreign companies in the private security value chain, including, for example, electronics firms, would be affected by the measure. This could hit a significant component of SA's manufacturing sector, thereby compromising the government's drive to develop domestic industry. Aside from the core private security firms, other affected companies in the security value chain have been worryingly quiet. Are they in denial about what this expropriation clause means for their businesses, or are they too scared to speak out?

What is clear is that foreign owned companies are likely to respond by disinvesting in order to protect their brands. Besides the obvious impact on jobs, this would have negative implications for competition in the private security industry, and its suppliers, threatening the servicing of existing operations, and particularly at the higher ends of the value chain since it is these segments that foreign companies generally occupy.

Overall this will lead to higher prices for consumers and less access to cutting edge specialist industry knowledge and skills across the value chain.

Ironically, the Act will also not address the alleged national security threat that the Minister of Police argues is the reason for limiting foreign ownership. Foreign owned firms are less than 10% of the private security industry and all local employees from guards to management are already required to be South African.

So if empowerment is the real issue, there are far less destabilising ways to achieve this goal. Furthermore, the same standards should apply to domestic companies – why single out the foreigners?

It needs to be recalled that private security – in every country – fills a 'government failure' gap. This is particularly sharp in SA with its high crime levels. How would crime levels in SA be affected by this provision? It certainly won't help.

This legislation is likely to be rolled out in other policy terrains, adding to the accumulation of legislation undermining foreign, and domestic, investor confidence. Overall these negative implications would compound SA's already dire unemployment, poverty, and inequality challenges.

Furthermore, our neighbours watch us closely, and copy our policy stances. Should they take up the 51 percent ownership provision – itself perhaps modeled on Zimbabwe's approach to empowerment – then, taken together with their condemnation of recent violence against foreigners in SA, access for SA businesses into those markets could also be affected.

Moreover, key foreign trading partners could retaliate, notably the US, UK, Sweden and Switzerland, all of which have companies in the industry. The US could do so through selective graduation of South Africa from AGOA, notwithstanding the apparent resolution of the poultry dispute; whereas the UK, Sweden, and Switzerland could sue South Africa under bilateral investment treaties. These countries, and more, could demand compensation in the World Trade Organisation since SA would be obliged to revoke its commitment there to keep its private security industry market open to foreigners.

As a result SA could find that other domestic economic sectors are hit, not just those connected directly with private security provision.

Implementation of this law will cause instant widespread pain and will exacerbate the chronic suffering already plaguing our economy. It is time for more voices to call for the only solution to the problem; that our President heed the warnings and to send the Act back to Parliament for the removal of Section 20.

**Ends**

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**Tralac Newsletter, 26 March 2015**

***Will South Africa modify its GATS commitments?***



**JB Cronjé, tralac Researcher, discusses South Africa's regulation of the private security industry and willingness to negotiate the withdrawal of existing GATS commitments**

The Private Security Industry Regulation Amendment Bill of 2012 has been awaiting Presidential assent and signature since March 2014 when it was passed through both houses of parliament. The Bill provides in section 20 that a security business may only be registered if (among other requirements) "at least 51 percent of the ownership and control is exercised by South African citizens". The Bill gives the Minister of Police the authority to "taking into account the security interests of the Republic, prescribe by regulation a different percentage of ownership and control in respect of different categories" of security businesses. The Minister must, by regulation, prescribe how he intends to undertake the "verification of ownership and control of security businesses". The Bill also extends discretionary powers to the Minister to exempt certain businesses or categories of businesses from this provision after taking into consideration recommendations made by a yet to be established Exemption Advisory Committee.

As a founding Member of the World Trade Organization (WTO), South Africa must fulfil all the obligations assumed by it under all WTO Agreements including the General Agreement on Trade in Services (GATS). The WTO, and all its agreements, forms a single package from which Members cannot selectively pick and choose which agreements to join and implement. During the Uruguay Round of Multilateral Trade Negotiations, South Africa made extensive trade liberalisation commitments in many services sectors and sub-sectors for the reduction or elimination of restrictions on market access and national treatment. For example, South Africa made full liberalisation commitments on 'investigation and security' services under GATS. This includes a market access commitment not to maintain or introduce measures that would limit "the participation of foreign capital in terms of maximum percentage limits on foreign shareholding or the total value of foreign investment" (GATS Article XVI(f)). Therefore, introducing a domestic measure limiting foreign participation in the private security industry would constitute a clear violation of South Africa's commitments under the GATS (GATS/SC/78, 14 April 1994).

On 19 March 2015 the Minister of Police said in his address to a Private Security Industry Conference that the private security industry poses a potential threat to national security because "we are aware that this industry increasingly gathers intelligence which sometimes can compromise national security. Some of these companies have strong links outside the country and it would really be unrealistic not to guard against these potential dangers". This is ostensibly the rationale behind the proposed limitation on foreign ownership and control of private security companies. It suggests that foreign owned and controlled security companies incorporated and operating under South African law are conducting activities that could pose a threat to national security and that they are serving foreign (state) interests. Such a suggestion must be false, because if one starts insinuating that the interests of foreign private companies are tantamount to the interests of foreign states one could become suspicious of all foreign direct investment. The logical question then remains why the Minister chose not to address his concern by regulating the activities of all private security companies.

Nonetheless, the Minister conceded that the introduction of the proposed provision would be problematic given South Africa's existing GATS commitments and said "According to Article XXI of the GATS, A Member (referred to in the Article as the "modifying Member") may modify any

commitment in its Schedule". He went on to say "Government is intending to withdraw from its commitments under GATS and/or BITs [Bilateral Investment Treaties]".

According to GATS Article XXI(1)(b) a Member must communicate such intention to the WTO "no later than three months before the intended date of implementation of the modification or withdrawal". Thereafter certain prescribed procedures must be followed before a Member is legally permitted to implement the intended modification or withdrawal. It means that the proposed limitation on foreign ownership of private security companies cannot enter into force before the completion of the procedures contained in GATS Article XXI. Any Member whose interests may be affected by the intended modification or withdrawal must communicate its claim within 45 days. If no Member submits a claim the modification or withdrawal can be implemented. However, the modifying Member is obliged to negotiate with each affected Member with a view to reach agreement on any necessary compensatory adjustment within 3 months. Compensation must be negotiated in the form of other commitments in other services sectors. The period of negotiating can be extended by mutual agreement. It means that Members cannot withdraw or modify commitments unilaterally. To date, only the USA (regarding modification of measures affecting the cross-border supply of gambling and betting services) and EU (twice regarding enlargement of the EU under GATS Article V) have submitted notifications of intention to modify schedules of commitments. In both cases it took years to negotiate compensatory packages with affected Members. Compensatory adjustments must be made on a most-favoured-nation basis. It means that whatever agreement South Africa reach with any affected Member, the benefits thereof must be extended to all WTO Members.

If the Members cannot reach agreement within the prescribed period of negotiations, an affected Member may submit an arbitration request. In such a case, the modifying Member may not implement any modification or withdrawal until it has received the arbitration body's findings and is in conformity with those findings. The arbitration body must examine the compensatory adjustments offered by the modifying Member or requested by an affected Member in order to find a "balance of rights and obligations which maintains a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to the negotiations" (S/L/80). The comment made by the Minister regarding South Africa's willingness to negotiate the withdrawal of existing GATS commitments raises pertinent questions precisely because the outcome of the process is so uncertain. What will South Africa be willing to offer security companies from the United Kingdom, USA and elsewhere to compensate them for loss of trade opportunities in the South African private security industry? Given the fact that South Africa has already made substantial liberalisation commitments, in which services sectors will further liberalisation commitments be undertaken? One should anticipate that affected Members will not wait for an offer from South Africa. What concessions will affected Members likely request from South Africa? Will they request foreign participation in, for example, the postal, telecommunication, energy or transport sectors?

GATS Article XXI provides further that if the modifying Member implements its proposed modification or withdrawal and does not comply with the findings of the arbitration, any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits in conformity with those findings. In other words, affected Members have the right to retaliate or cross-retaliate by suspending concessions arising under the GATS or other obligations arising under another WTO agreement not in dispute such as those covering trade in goods or intellectual property.

South Africa has the right to modify or withdraw GATS commitments but it will come at a cost. If it was relatively easy to change commitments it would suggest that the GATS framework is flexible to changes in domestic regulatory regimes. Such a situation could only lead to uncertainty and unpredictability in doing business across borders. The overall objective of the GATS is the progressive liberalisation of international trade in services. In particular, GATS Article XIX: provides that "the process of progressive liberalisation shall be advanced in each round" of negotiations "directed towards increasing the general level of specific commitments undertaken by Members". Therefore, the general direction of trade negotiations is towards increasing, and not decreasing, market access and national treatment on trade in services.

The Department of Trade and Industry, not Police, is responsible for the negotiation of trade agreements, including the GATS. The negotiation of compensatory adjustments may result in the



liberalisation of domestic services sectors previously protected from foreign competition. It may also affect the way various government departments administer their areas of responsibility. None of these possible implications is a foregone conclusion. The President can still decide to refer the Bill back to the National Assembly for reconsideration.

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**Sunday Times Business Times 8 June 2014 AND BDLive, 9 June 2014**  
***New bill puts SA in breach of treaties***

*THE Private Security Industry Regulation Amendment Bill's effects go beyond security sector, writes Carol O'Brien*

THE Private Security Industry Regulation Amendment Bill is of grave concern to foreign investors. Foreign investment is one of the most crucial mechanisms for South Africa to spur economic growth, but multinationals need a stable and predictable policy environment.

Take the contribution that our members, who form part of the American Chamber of Commerce in South Africa, have made to the country. Just 80 US companies, surveyed two years ago, contributed a combined total of R233bn to the South African economy, employing 150,000 South Africans.

They spent R445m on corporate social investment and invested more than R500m on skills development, putting another R320m into training. These companies are fighting poverty and reducing unemployment in South Africa.

But they need to protect their investment in the host country and so they need policies linked to an established legal and regulatory framework that will provide security for these investments.

South Africa is competing against other developing markets for foreign investment and we have to ensure that our policies are business-friendly and devised to attract investors.

The bill, although it does bring much needed regulation to the industry, includes a controversial clause that requires foreign-owned security companies and their suppliers to hand over 51% of their companies to South Africans.

The main reason, ostensibly, is that these companies collect security intelligence that puts South Africa at risk. This is absurd.

Foreign-owned security companies in South Africa make up less than 10% of the local security industry. And, it is already a legal requirement that the management and staff of foreign-owned securities companies are South Africans.

We should be up in arms about the impact this bill will have on foreign investors. This goes far beyond the security industry. Investors will be wondering what sector will be forced to hand over more than half of their businesses next.

Will companies continue to use South Africa as a foothold economy from which to expand operations to Africa?

We think not.

There are other explicit costs and risks associated with this bill. South Africa would be in violation of its international trade obligations. The country will infringe its commitments under the World Trade Organisation General Agreement on Trade in Services.

South Africa has undertaken to give full market access and national treatment commitments to "investigation and security" services.

This obligation requires that “private companies must be able to provide these services, without restriction, on terms no less favourable than those applicable to local firms”.

If South Africa ignores its obligations, aggrieved countries could win the right to retaliate against our exports.

Just as important is the bill's implications for South Africa's eligibility for the US General System of Preferences, which is the platform for the African Growth and Opportunity Act. These treaties give South African exporters unprecedented access to the US market, enabling more than 98% of South African exports to enter the US duty-free.

It is no exaggeration to say that many international companies have chosen South Africa as an investment destination precisely for this preferential access, contributing to the country's rise as a manufacturing hub.

Let's translate the importance to numbers, however.

US trade data show that South African exports to the US under the General System of Preferences and the Africa Growth and Opportunity Act were worth \$3.6bn (about R38bn) in 2013.

The US was also the second-largest destination for South African exports after China, accounting for 7% of all exports. However, it was by far the largest destination for the vehicle sector (21% of all exports) and for passenger cars (42% of exports).

Overall, the US was the leading destination for South Africa's most important industrial exports - vehicles, machinery and chemicals.

By comparison, all the Bric countries — Brazil, Russia, India and China — combined made up 17% of South Africa's global exports, but only 3% of the vehicle sector and only 5% of top industrial exports.

South Africa's preferential access to the US is important to our plans for industrialisation and absolutely critical for our strategic auto sector.

We cannot risk that access.

Although we do not provide the US reciprocity for the access we gain, the Africa Growth and Opportunity Act requires that any country that uses this law must have “a market-based economy that protects private property rights”.

The US Trade Act also says that a country would not qualify as a beneficiary developing country if it has “nationalised, expropriated or otherwise seized ownership or control of property, including patents, trademarks or copyrights, owned by a US citizen or by a corporation, partnership or association which is 50% or more beneficially owned by US citizens”.

And yet, the new bill would make South Africa ineligible on this score. So, overall, it puts at risk 44% of our exports to the US, or about 3% of our global exports.

We encourage the government to reconsider certain of the policies that have been proposed recently, including the Protection and Promotion of Investment Bill, the Expropriation Bill and the Mineral and Petroleum Resources Development Act.

These policies have made investors jittery and create the perception that South Africa is closing its doors to foreign direct investment.

If implemented, these laws will lead to many foreign-owned companies reconsidering their investment, costing South Africa jobs and economic growth.

- *O'Brien is executive director of the American Chamber of Commerce*

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## ON MY MIND: Confusing signals

by David Dawson, August 07 2014, 06:45

POLICY certainty is vital to attract foreign investment from the UK. It was encouraging to hear President Jacob Zuma talk about the importance of foreign investment in his state of the nation address in June. It was particularly encouraging to note that the SA government is committed to working with the private sector to remove obstacles to investment.

SA has for many years been a popular choice for foreign investors seeking sustainable and secure investment returns in emerging economies. This popularity was driven largely by SA's commitment to providing foreign companies with an investment landscape that guaranteed the security of their investment.

Companies are excited about the opportunity that SA provides, and the UK is no exception.

SA is the UK's largest trading partner in Africa. In fact, British and UK-based global companies represent almost 50% of foreign direct investment in SA. Annual bilateral trade is around £9bn (R162bn).

Many hundreds of UK companies are invested in SA and these companies create around 250 000 jobs and invest in skills and enterprise development.

We believe that British companies will continue to look for opportunities to invest in and partner with SA, but we need to ensure that the policy environment remains aligned to facilitating economic growth and investment.

Since relaunching our chamber in April this year, UK companies have expressed concerns about recent changes to the regulatory environment.

Proposed changes to legislation around the private security industry, the minerals and petroleum regime and the cancellation of bilateral investment treaties have sent confusing signals about SA's overall approach and commitment to attracting and retaining foreign direct investment.

We are concerned about the message that this sends to investors and about the impact that these changes could have on the SA economy and its trade and investment with the UK.

Many of the proposals that are mooted contravene important international trade obligations and treaties and it is our sincere hope that President Zuma will intervene in the interest of economic growth.

Like any country, SA needs foreign investment to help build the economy.

Limiting foreign ownership and contravening international trade treaties will send negative signals to foreign investors at a time when SA is actively seeking investment for its industrial, manufacturing and infrastructure development plans.

The Private Security Industry Regulatory Amendment Bill is of particular concern to us. If signed into law by President Zuma, it will require that all foreign-owned companies providing private security services, as well those that supply equipment to the industry, will need to give up 51% of their SA business to local entities.

These are global companies like ADT, Chubb, G4S, Panasonic, Bosch, Honeywell and others.

Strong protection of equity and property rights is key for all foreign investors. Investing companies look for stable and predictable government policy environments that will provide security for their investments.

SA is competing with many other countries, both developed and developing, for scarce foreign investment. In our view, it is imperative that this country offer potential investors a stable and predictable policy environment to compete effectively.

A policy environment that is investor friendly holds enormous benefit for SA and its people, including job creation, developing the skills that are so desperately needed and facilitating the reduction of poverty.

As the British Chamber of Business we are committed to working with government to address the concerns of investors and are confident that mutually satisfactory outcomes can be achieved.

• *Dawson is CEO of the British Chamber of Business*

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## **BUSA: Statement by Business Unity South Africa, on the Private Security Industry Regulation Amendment Bill (15/05/2014)**

### **STATEMENT**

Published 15 May 2014

BUSA is the confederal body representing organised business in SA. One of our critical objectives is to engage government to promote, and maintain, a conducive environment for business growth and development in SA. An essential element of this objective is to facilitate an environment in which global investors are keen to invest in the SA economy. We have been following the debate on the PSIRA, which is awaiting the signature of the President of the Republic before promulgation. One of our members, the Security Industry Alliance (SIA) has been engaging government on this bill on behalf of the private security industry, but the implications of the bill being promulgated in its current form is serious for the business sector.

The business component of the OECD has written to BUSA and expressed serious concern about the PSIRA. Amongst these concerns is that the clause requiring majority control of security businesses by South Africans is in violation of various Bilateral Investment Treaties and SA's GATS commitments with the WTO. A report in the Business Day of Wednesday 14 May quotes Joseph Cronje, senior researcher at the Trade Law Centre for Southern Africa as saying the bill, in its current form, is in breach of international law and could have serious implications for SA's engagement at various trade agreements.

The government has indicated, since the elections, that it is keen on maintaining a policy environment that creates certainty, is consistent and will be guided by the NDP. This bill, in its current form, does not demonstrate such commitment from government. It is of the utmost importance that SA remains an attractive destination for foreign investment, particularly investment that has the potential of creating businesses and jobs. This is particularly critical in a global environment in which we have to compete with countries sending out consistent messages that they are “open for business”.

We have an imperative to address inequality and make an impact on improving socio-economic conditions for a significant proportion of our population. Investment in economic growth is critical to this and attracting foreign investment is very important. This bill, in its current form, will not send out a positive message to international investors.

We thus urge the President to refer the bill back to Parliament, for further discussion and consultation with critical stakeholders, with a view to presenting a draft bill that will address the concerns raised by various parties.

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SACCI Media Release  
DAY  
1 April 2014



#### **SACCI REQUEST FURTHER ENGAGEMENT ON SECURITY BILL**

In a statement issued today the CEO of SACCI, Mr. Neren Rau, said:

#### **QUOTE:**

The South African Chamber of Commerce and Industry (SACCI) is concerned about the proposed legislation that will force security companies to forego 51% of their ownership. The broad definition of a security company in the proposed Private Security Industry Regulation Amendment Bill will force multinational electronic companies like Apple, Sony, Samsung and Panasonic to sell 51% of their ownership to domestic shareholders. SACCI appreciates the objective of the Bill to improve regulation of the security industry, but believes the 51% domestic ownership requirement and wide scope of application will significantly undermine investor confidence.

Less than 10% of South Africa's typical security firms are owned by multinationals that provide their services across the world, but the ownership requirement sets a dangerous precedent that can spill onto other industries and weaken property rights and investor confidence. The Bill has been passed by both the Houses of Parliament, but has not been signed into law by President Zuma. The property rights infringement and vague scope of application cannot be said to be rationally linked to the goal of improving the regulation of South Africa's security industry, and for this reason is likely to be unconstitutional. In addition, the last minute introduction of the domestic ownership requirement also calls into question whether sufficient stakeholder engagement took place on the domestic ownership requirement.

SACCI has requested President Zuma to refer the Bill back to Parliament in order to fix some unintended drafting errors and withdraw the ownership requirement.

## UNQUOTE

Contacts:

Neren Rau  
**CEO**  
011 446 3800

Peggy Drodskie  
**COO**  
011 446 3800

Pietman Roos  
**Policy Consultant**  
011 446 3800

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## THE PRIVATE SECURITY INDUSTRY REGULATION AMENDMENT BILL

**J.B. Cronjé<sup>1</sup>**

*The recent decision by the National Assembly and National Council of Provinces to pass the Private Security Industry Regulation Amendment Bill provoked criticism from the private security industry. The Bill states that private security companies should have 51% South African ownership. Imposing restrictions on the ownership of security companies may be in breach of South Africa's obligations under international law.*

### Introduction

The Private Security Industry Amendment Bill was recently passed by both the National Assembly on 25 February 2014 and the National Council of Provinces on 4 March 2014. The Bill must now be submitted to the President for assent and signature before it enters into law.

The aim of the Bill is to amend certain provisions in the principal act, Private Security Industry Regulation Act 56 of 2001, to improve oversight and regulation of the industry. The Bill contains a controversial provision limiting foreign ownership and control in private security businesses to a maximum of 49 per cent. It also gives the Minister of Police discretionary power to prescribe different percentages of ownership and control for different categories of security businesses. A number of multinational firms operate in South Africa's private security industry.

The main objections to the introduction of limitations on foreign ownership are that expropriation of foreign assets will discourage investment beyond just the private security sector, lead to job losses and jeopardise the safety and security of persons relying on the services of foreign owned private security firms such as G4S, Chubb, ADT and Securitas. These firms also provide many other fire and security services such as cash in transit services for the financial services sector.

The Minister of Police has dispelled these claims and argues that foreign ownership of private security firms poses a threat to national security. In his remarks to the National Assembly on the debate of the Bill, the Minister said the limitation of foreign ownership "is necessary because the line between private security companies and private military companies is increasingly becoming blurred. The United Nations has recognised the blurring of these lines and these entities are now referred to as private military and security companies, which is an all-encompassing phrase. Equally private security companies are increasingly used in the field of intelligence." Evidence to support this claim remains absent.

Some commentators have argued in the media that the Bill will not pass constitutional muster due to irregularities in the way the Bill was passed through the Portfolio Committee on Police and that it violates South Africa's international obligations under existing Bilateral Investment Treaties (BITs), the General

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<sup>1</sup> J.B. Cronjé is a researcher at the Trade Law Centre (tralac) in Stellenbosch, South Africa. He holds a LL.M (International Trade) and LL.B from the University of Stellenbosch.

Agreement on Trade in Services (GATS) of the World Trade Organization (WTO) and the Protocol on Finance and Investment (FIP) of the Southern African Development Community (SADC).

The Constitution of the Republic of South Africa Act 108 of 1996 provides that the President must now either assent to and sign the Bill, or if he has reservations about its constitutionality, refer it back to the National Assembly for reconsideration. If, after reconsideration, the Bill fully accommodates the President's reservations, he must assent to and sign the Bill, or refer it to the Constitutional Court for a decision on its constitutionality. If the Constitutional Court decides the Bill is constitutional, the President must assent to and sign the Bill.

Even once the President has assented to and signed the Bill, one third of the members of the National Assembly may still apply to the Constitutional Court for an order declaring the Act unconstitutional. The Court may also make an interim order that all or part of the Act has no force until it has decided the matter. Article 233 of the Constitution provides "when interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law."

#### The World Trade Organization

Of particular interest to this article are South Africa's international obligations. As a Member of the WTO, South Africa must fulfil in good faith all the obligations assumed by it under the various WTO Agreements including the GATS. South Africa has undertaken commitments in a number of services sectors with respect to foreign services and foreign services suppliers. These commitments specify the terms, limitations and conditions on market access and the conditions and qualifications on national treatment the country can maintain or introduce in the sectors where such commitments were undertaken. These commitments are contained in the country's [Schedule of Specific Commitments](#) and form an integral part of the GATS.

South Africa made extensive liberalisation commitments on 'investigation and security' services under GATS by allowing the cross border supply of investigation and security services into South Africa; the consumption of investigation and security services abroad; the establishment of foreign owned and controlled investigation and security services businesses in South Africa; and the temporary movement of foreigners active in the security and investigation services sector to South Africa. Investigation and security services' is defined in the [United Nation's Provisional Central Product Classification](#) (UN CPC) which subdivides the sector into: investigation services; security consultation services; alarm monitoring services; armoured car services; guard services; and other security services not elsewhere classified. This definition corresponds to the definition of security services and security activities regulated in the Act. South Africa's GATS commitments are legally binding and domestic regulation on the private security industry must therefore adhere to these international law obligations.

The proposed provision in the Bill limiting foreign ownership and control of security businesses to a maximum of 49 percent would violate South Africa's market access commitment on the establishment of foreign services suppliers. This particular commitment provides that the country shall not maintain or introduce measures that would limit the participation of foreign capital in terms of maximum percentage limits on foreign shareholding or the total value of individual or aggregate foreign investment.

In the case of non-compliance with any obligation, any WTO Member may invoke dispute settlement proceedings to seek the withdrawal of the inconsistent measure. The GATS does make provision for the modification or withdrawal of a country's commitments, but requires such a country to enter into negotiations with any affected Member State and reach agreement on compensatory adjustments.

In seeming recognition of this potential breach, the South African Police Service, stated in their briefing note to the National Council of Provinces Committee on Security and Constitutional Development, that in order for "South Africa to withdraw from its commitments under GATS or BITs, there must be a sound basis for entering into negotiations with the other parties. A sound justification for this to happen must exist. Grounds for justification could be for South Africa to entrench its national security, particularly as a development state and in the broader African Union context, the potential for private security companies

to use its might, knowledge and weapons to destabilize the State, or be used by other agencies or States towards this end.” Regardless of the motivation for the modification or withdrawal of GATS commitments, any affected WTO Member may refer the matter to arbitration if agreement is not reached on any necessary compensatory adjustments. South Africa may not modify or withdraw its commitments until it has made compensatory adjustments in conformity with the findings of the arbitration. If it does not adhere to these obligations, any affected WTO Member that participated in the arbitration may retaliate and withdraw substantially equivalent trade benefits.

## **The Southern African Development Community**

As a member of SADC, South Africa ratified the FIP on 4 February 2008. The FIP entered into force on 16 April 2010. Article 3 of the FIP provides that State Parties must “co-ordinate their investment regimes and cooperate to create a favourable investment climate in the Region as set out in Annex 1”. The Annex applies to any investment in the territory of a host state regardless of the nationality of the investor. An investor is defined in Article 1 as a legal or natural person “that has been admitted to make or has made an investment”. As far as the author is aware, South Africa does not have legislation regulating the admission of investment. The Annex lacks a provision on national treatment that would oblige South Africa to treat foreign investors no less favourably than nationals engaged in similar business activities. The Annex does include other provisions on the treatment of investors including fair and equitable treatment clauses. The Annex also contains provisions on investment protection, providing for prompt, adequate and effective compensation in the case of nationalisation or expropriation and contains a prohibition on State Parties to “arbitrarily, and without good reason, amend or otherwise modify to the detriment of investors, the terms, conditions and any benefits specified in the letter of authorisation” of an investment. However, Article 14 contains a general exception provision which preserves the right to regulate in the “public interest” to ensure “investment activity is undertaken in a manner sensitive to health, safety and environmental concerns”.

The FIP provides for a system of recourse in the event of failure of implementation. The FIP is governed by a Committee of Ministers for Finance and Investment and operates entirely by consensus. The committee is obliged to oversee the implementation of the Protocol, supervise the activities of its committees, sub-committees or institutions and must seek to resolve disputes on the interpretation, application or implementation of the Protocol. If Member States are unable to resolve a dispute relating to any article in the Protocol, and an Annex relating to such article contains provisions on dispute resolution, then the provisions of that Annex must be applied in respect of the dispute. In this case, Article 28 of the Annex provides disputes between an investor and a State Party that have not been amicably settled, after exhausting local remedies, shall be submitted to international arbitration. The parties may agree to refer the dispute to

- The SADC Tribunal;
- The International Centre for the Settlement of Investment Disputes (having regard to the provisions, where applicable, of the ICSID Convention and the Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings); or
- An international arbitrator or ad hoc arbitral tribunal to be appointed by a special agreement or established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).

If agreement cannot be reached on any of the abovementioned alternative procedures, Article 28 (3) provides “the parties shall be bound to submit the dispute to arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law as then in force.”

In August 2010, the SADC Summit of Heads of State and Government suspended the SADC Tribunal. However, the strong wording of the provision suggests that State Parties have given the required prior consent needed to institute international arbitration proceedings. It follows from



this interpretation that the investor is guaranteed the right to bring his dispute before an arbitral tribunal which will decide its case based on the UNCITRAL Arbitration Rules.

Since the suspension of the SADC Tribunal in 2010, one investor, Swissbourn Diamond Mines (Pty) Limited has, for example, exercised this right in terms of the FIP Annex 1 to institute international arbitral proceedings against Lesotho, a SADC Member and State Party to FIP, under the UNCITRAL Arbitration Rules.

Similarly, an affected investor in South Africa may submit a dispute for arbitration and thereafter apply to a local court to make an international arbitration award an order of court and enforceable because South Africa has ratified the United Nations' Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

## **Bilateral Investment Treaties**

According to the United Nation's Trade and Development database on international investment agreements, South Africa has concluded BITs with almost 50 countries, including the United Kingdom, Italy, Switzerland and Sweden. The South African government has indicated its intention to terminate many BITs as part of an ongoing effort to overhaul its investment protection regime. As part of this effort, it has published the Promotion and Protection of Investment Bill 2013 to replace the terminated BITs and to provide a uniform standard of treatment to foreign investors. The Bill has caused much debate, because it is perceived to provide a lower level of investment protection than the BITs. In addition, the government is also developing a model BIT in line with the SADC Model BIT which will be used as a template in future BIT negotiations where there are compelling reasons for their conclusion.

Investment treaties are usually concluded between two states on a bilateral level in which they agree to offer certain standards of treatment to each other's nationals. All Bilateral Investment Treaties (BITs) are different. Their content and obligations usually vary on the treatment they provide to foreign investors; their provisions on investment protection; and dispute settlement mechanisms.

For example, the BIT concluded between South Africa and the United Kingdom provides national treatment, most-favoured nation treatment and fair and equitable treatment to nationals investing in each other's territories. In particular, the national treatment and most-favoured nation treatment clause (Article 3) provides "neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favourable than that which it accords to investments or returns of its own nationals or companies or to investments or returns of any third State". It provides further "neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investment, to treatment less favourable than that which it accords to its own nationals or companies of any third State." Securing national and most-favoured nation treatment ensures that investors are treated no less favourably within the host country than the nationals of the host country and those from third countries. The fair and equitable clause (Article 2) offers a minimum standard of treatment for investments of nationals of the other Contracting Party and provides they shall at all times "enjoy full protection and safety in the territory of the other Contracting Party. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory".

In general, investment protection provisions give investors the right to transfer investment funds out of the host country and to receive compensation for losses due to expropriation, armed conflict, revolution, or revolt in the host country. The BIT between South Africa and the United Kingdom guarantees restitution, indemnification, compensation or other settlement in all of these and other instances (Article 4). It prohibits nationalisation or expropriation except for a public purpose on a non-discriminatory basis and against prompt, adequate and effective compensation. Compensation must be paid in cases of direct government nationalisation or expropriation of an investment as well as indirect expropriation where

investments are “subjected to measures having effect equivalent to nationalisation or expropriation” (Article 5). Compensation must amount to “the genuine value of the investment expropriated”.

International investment agreements usually provide for the settlement of disputes arising between the contracting parties and between an investor and a host state. The agreements often stipulate fixed periods for negotiations, followed by binding arbitration proceedings if negotiations are unsuccessful. The BIT between South Africa and the United Kingdom provides for both types of dispute settlement. In case of investor-state dispute settlement, investors have the right to pursue the settlement of a dispute through international arbitration (Article 8). The parties to the dispute may agree to refer the dispute either to the ICSID, the Court of Arbitration of the International Chamber of Commerce, or an *ad hoc* arbitration tribunal appointed by a special agreement or established under the UNCITRAL Arbitration Rules.

## Conclusion

The provision in the Private Security Regulation Amendment Bill limiting foreign ownership and control of security businesses violates South Africa’s GATS commitment not to introduce measures what would limit the participation of foreign capital. The country’s GATS commitments are legally binding. It is clear from the minutes of the Parliamentary Portfolio Committee on Police that the government is aware of the state’s GATS obligations and the imminent breach.

The Investment Annex of the FIP and the BITs concluded between South Africa and other countries afford affected investors access to an investor-state dispute settlement mechanism that allows them to take a dispute directly to international arbitration; bypassing the domestic legal system. However, the Investment Annex of the FIP is an exception to this general rule and obliges aggrieved investors to first exhaust all domestic remedies before taking a dispute to international arbitration. These agreements effectively assign arbitral panels (located outside the country) the authority to interpret and implement the agreements. The agreements impose binding investment rules on the country with far-reaching financial and policy consequences for the State. Depending on the kind of international arbitration agreed upon, arbitration awards are not open to appeal and can be enforced through the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) or the ISCID Convention.

The President has yet to assent to and sign the Bill into law. Given the concerns regarding the challenged provision in terms of South Africa’s international obligations, the President may still find it necessary to refer the Bill back to the National Assembly for reconsideration.

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Professor Gerhard Erasmus, Trade Law Centre

### **The Regulation of Private Security Firms in South Africa: What are the Governance Signals?**



21 May 2014

#### **Gerhard Erasmus, tralac Associate, discusses the governance implications of the recent amendments to South Africa's private security industry regulation**

The South African Minister of Police has issued a detailed statement to explain why the national legal framework pertaining to security firms, and in particular those operated by foreign companies, has to be altered. Some of these 'explanations' give rise to concern. The implications for governance, legal certainty, foreign investment as well as policy making, merit further discussion.

The Minister's statement explains why a new legal framework has become necessary: "*The challenge has come about because private security companies are increasingly performing functions that once were the preserve of the police and this has an effect on the criminal justice system.*"<sup>[1]</sup> It is not quite clear how the administration of justice has been undermined by the practices of private security firms. If it is indeed the case the Minister should respond with effective remedial action and target actual problems. It is difficult to see how a change in ownership of these firms will bring about better criminal justice in South Africa.

The reasons why private security firms are a flourishing business seem to be relevant and should concern the Minister. Why have they become involved in functions such as crime prevention? The fact that South Africans (private households as well as companies) find it increasingly necessary to

pay security firms to protect them suggests that the police cannot cope. It would be a much needed and welcome response from the Minister to indicate how the underlying causes would be dealt with. Unfortunately that is not the gist of his most recent statement.

Security firms must comply with the law of the land. The principle that this sector, like many others, should not escape appropriate regulation is not contested. What should such regulation entail? One could think of matters such as training, transparency, how firearm licences are issued and whether taxes are paid. It has not been suggested that private security firms have become a threat to law and order. If the Minister anticipates a new need to properly regulate their conduct and to *“improve the capacity of the regulatory authority, enhance firearm management, public accountability mechanisms and tighten registration procedures”* then he should indeed do so. These would then constitute the ‘jurisdictional facts’ for implementing his new policy.

Why local ownership of this (apparently quite lucrative) business sector is necessary in order to regulate their conduct as security firms is not clear. Neither does he explain why foreign private ownership of a business enterprise is tantamount to ‘foreign interests’. If that were true international investment generally becomes suspect. The Minister only says that the Government *“believes that some restriction on foreign ownership is sensible. We believe a sound approach is that majority control must be vested in South African hands. This means foreigners may still invest in security firms, but control will always remain locally. This will go some way to ensuring that SA’s interests are served and not those of foreign interests.”*

And then the Minister explains how he intends to deal with the implications flowing from South Africa’s international legal obligations: *“The amended legislation was drafted taking cognisance of our constitution and our international commitments. SA is part of the Southern African Development Community’s agreement with the World Trade Organisation<sup>[2]</sup> and the General Agreement on Tariffs and Trade and we will fully honour our obligations. In terms of the protocols governing these agreements, we may withdraw from all or part of the agreement by giving three months’ notice that we are doing so in the public interest. Such a withdrawal is not a signal that should negatively affect investor sentiment because, in accordance with our constitution, SA has to take proactive steps to protect its national interests.”*

The relevant WTO agreement is the General Agreement on Trade in Services (GATS), not the GATT. South Africa has scheduled certain obligations under the GATS which will be affected by the Minister’s proposed legislation. ([See a previous Discussion on this matter by JB Cronjé](#)). Unfortunately it is not possible for a WTO member state simply to ‘withdraw’ from obligations. The WTO package is a single undertaking. It also contains detailed provisions on how members could subsequently alter their commitments or deal with emergencies. These subsequent actions are governed by specific rules.

In terms of Article III of the GATS each Member must publish promptly *“all relevant measures of general application which pertain to or affect the operation of”* the GATS. Members are required to inform the Council for Trade in Services of the introduction of any new, or any changes to existing laws, regulations or administrative guidelines which *“significantly affect trade in services covered by its specific commitments”*. They are also required to respond promptly to all requests from other Members for specific information on any such measures.

Article VI contains general obligations which require Members to comply with the basic and fundamental principles of transparency and due process. In sectors where specific commitments have been undertaken, each Member is obliged to ensure that all measures of general application affecting trade in services are *“administered in a reasonable, objective and impartial manner”*.

Article XIV might be of particular interest to the Minister; provided he can justify the South African legislation as being permitted by one of the stated exceptions. It might be difficult. This GATS Article provides for General Exceptions but clearly draws the boundaries as to when exceptions would be possible and what legal principles must be respected:

*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement of measures necessary .....to protect public morals or to maintain public order; necessary to protect human, animal or plant life or health; necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement.....(Abbreviated.)*

One of the most important features of the WTO is that it is rules-based. Respect for obligations is ultimately ensured through the possibility that other members are entitled to bring an action under the Dispute Settlement Understanding to enforce the rules. The defending state cannot prevent litigation by refusing to cooperate in such proceedings. The same applies to obligations under the GATS. The defending Member may for example plead one of the exceptions contained in Article XIV. The burden of proof is on the party seeking to invoke it. In order to claim the benefit of this defence, the defending party must demonstrate that its measure would not constitute a means of *arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services*, and it must be based on one of the stated exceptions.

Under Article XXI of the GATS a Member may modify or withdraw specific commitments in its Schedule. In order to do so at least three years must have elapsed from the date of the entry into force of that commitment. At the request of any Member affected by a proposed modification or withdrawal, the Member seeking to modify its commitment must enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment. In any such negotiations, the objective is *“to maintain a general level of mutually advantageous commitments not less favourable to trade than that provided for in the Schedules of specific commitments prior to such negotiations”*. Any compensatory adjustments agreed through negotiation with affected Members must be made on an MFN (most favoured nation) basis; other Members are entitled to similar benefits.

If an agreement cannot be reached between the modifying Member and the affected Members, the matter may be referred to arbitration. Where arbitration has been requested by an affected Member, the modifying Member must make compensatory adjustments in conformity with the findings of the arbitration before taking action to modify or withdraw its commitment. If the modifying Member does not comply with the arbitration’s findings, any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits in conformity with the findings.

These provisions are discussed in some detail here in order to emphasize how international agreements strike a balance between obligations entered into by states, and their subsequent decisions to alter these ‘in the public interest’. This is typical of all legal orders based on the rule of law. These very same principles are found in the South African Constitution and its Administrative Law. Executive action and legislative changes based on policy ‘adjustment’ have to be justified, be rational and must comply with legality, transparency and fairness requirements. The ‘public interest’ is not a blank cheque for the executive branch of government.

The SADC Finance and Investment Protocol (which has entered into force and which South Africa has ratified) is another relevant international legal instrument. It inter alia protects foreign investment. This Protocol does not have to be analysed in any detail (refer to the previous Discussion by JB Cronje, details above) but the original spirit behind the SADC regional integration endeavour needs to be recalled. Article 4 of the SADC Treaty mentions respect for democracy, human rights and the rule of law as the basic principles of the organization. The Member States undertake *“to adopt adequate measures to promote the achievement of the objectives of SADC, and shall refrain from taking any measure likely to jeopardise the sustenance of its principles, the achievement of its objectives and the implementation of the provisions of this Treaty”*<sup>[3]</sup>. They *“shall take all necessary steps to accord this Treaty the force of national law”* and *“shall co-operate with and assist institutions of SADC in the performance of their duties.”* In case of violations sanctions may be imposed: *“Sanctions may be imposed against any Member State that persistently fails, without good reason, to fulfil obligations assumed under this Treaty....”*<sup>[4]</sup>

It is true that SADC has not lived up to its own ideals. That is part of another problem. However, South Africa should set an example of how to respect the rule of law when it comes to doing business across borders. One of the reasons why this is very necessary is because of the reciprocal disrespect which violations of accepted commitments may invite. Others may follow suit and discover ‘public interest’ justifications for treating successful South African firms in the same manner now contemplated for foreign owned security companies doing business in South Africa. The result will be a downward spiral towards unpredictable and illegal action on many fronts. Africa’s integration plans require a different basis.

**Ends**

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### ***Are foreign-owned private security companies a threat to South Africa's national security?***

The South African Minister of Police is on record as saying that foreign ownership of private security companies is a threat to national security. However, to date there has been no substantive explanation to show how this may be the case.

The idea that foreign-owned private security companies are a threat to national security emerged in a debate over the recently adopted Private Security Industry Regulation Amendment Bill. Indeed, the private security industry faces various shortcomings. These include the non-registration of personnel and businesses, poor training, inadequate vetting and background checks, the issuing of firearms to persons who are not competent to use them and the failure to pursue criminal or disciplinary action against security personnel who break the law. These are all credible and legitimate reasons for improving regulation.

Currently, there are 445 000 registered active private security ‘guards’ in South Africa. This means that private security officials far outnumber the 270 000 public security officers, a number that includes those working for the South African Police Service (SAPS) and the South African National Defence Force (SANDF). Given the large number of people that the private security industry employs – many of whom are armed – it is important that it should be well regulated.

**“Less than 10% of the local private security industry is foreign owned”**

The minister also argued that the growth of the private security industry in South Africa ‘has outstripped other countries.’ However, according to a 2011 report by the United Nations Office on



[Drugs and Crime \(UNODC\)](#) that compares civilian private security services internationally, South Africa is not that different to many other countries. In fact, South Africa's ratio of private security officers to police officers did not differ much from that of developed countries, and compares favourably to other middle-income or developing countries, as can be seen below:

- South Africa 2,87:1
- USA 2,26:1
- Australia 2,19:1
- Honduras 4,88:1
- Guatemala 6,01:1
- India 4,98:1

The 2013 draft Green Paper on Policing referred to another threat when it expressed concerns about the private security industry's 'ability' to 'destabilise any security situation' in South Africa. This was ostensibly due to the involvement of 'former military and police officers at management level,' and the deployment of 'highly trained, legally armed operatives' within this industry. However, most of these former security officials are South African citizens, which therefore does little to support concerns relating to *foreign* ownership.

The Green Paper also alleged that the private security industry is 'increasingly performing functions which used to be the sole preserve of the police.' However, the growth of the private security industry is directly linked to high levels of crime and violence, along with public perceptions that police officers are unable to provide adequate security. The Green Paper also contradicts itself by pointing out that private security companies have no special powers beyond those of private citizens. It is therefore difficult to see how these companies can be seen to undermine the state's law enforcement power.

[“Many businesses in SA have foreign ownership, so why single out private security?”](#)

Once again – as has been the case with the Protection of State Information Bill and the [security ministers' attempted cover-up](#) of the exorbitant amount of [public money spent on the president's private Nkandla homestead](#) – the term 'national security' is being used to justify government decisions or behaviour that cannot be properly explained. It is for this reason that Barry Buzan, in his 1991 book titled *People, states and fear*, says that elites in weak states more readily view various threats as 'national security threats' – especially when they seem to have negative implications for the power of those elites.

Similarly, much of what the current administration refers to as national security threats, appears to have more to do with removing the duty to account for political decisions, rather than any real danger to South African sovereignty.

Craig Snyder, in his 1999 book titled *Contemporary security and strategy*, says that 'national security' should be about freeing people from constraints such as poverty, poor education, political oppression and war. This is why, both internationally and locally, there has been a move away from the term 'state security,' which often narrowly equated a nation's security with 'regime security.'

Indeed, South African policy has largely been in line with progressive understandings of 'national security.' For example, the [South African White Paper on Defence \(1996\)](#), states that (in the absence of any external or military threat), 'the greatest threats to the South African people are socio-economic problems like poverty and unemployment ... as well as the high level of crime and violence.'

National security, therefore, can best be described as freedom from external and internal threats, which may manifest as military, political, economic, societal and environmental threats, crime and violence and the threat of anarchy.

It is therefore difficult to see how foreign ownership or majority shareholding of private security companies by foreigners can be a threat to South Africa's national security. Many businesses operating in South Africa have foreign ownership, including those in the field of information technology, which could be perceived as a potential threat. So why single out the private security industry?

Less than 10% of the local private security industry is foreign owned, and the 445 407 security officers that are registered as active are all South African citizens or have permanent resident status. They do not constitute a coherent, well-organised semi-military force ready for deployment against a particular target. Rather, they're spread across 9 031 registered businesses, providing more than 20 different categories of security and services as locksmiths, car guards, body guards and armed reaction teams. So, where is the threat?

Surely, limiting foreign investment and the jobs it may bring is more of a threat to our national security than the mere foreign ownership of a small number of companies. Most of these companies are listed on stock exchanges and are therefore subject to rigorous oversight. Unfortunately, given the absence of a rational, evidence-based argument to explain why foreign ownership of security companies is a threat to national security, questions now arise as to the real reason behind the controversial clause in the Private Security Industry Regulation Amendment Bill.

*Johan Burger, Senior Researcher, and Gareth Newham, Head, Governance, Crime and Justice Division, ISS Pretoria (082 822 0962)*

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## **Business Day, 26 March**

### **SA in for a bumpy ride over changes at WTO**

Kholofelo Kugler

<http://www.bdlive.co.za/opinion/2015/03/24/reforms-to-private-security-industry-laws-are-justifiable>

### **Amending SA's Gats schedule could be a protracted and politically intricate procedure, writes Kholofelo Kugler**

IN THE light of the Private Security Industry Regulation Amendment Bill, which has been awaiting President Jacob Zuma's signature for the past year, Police Minister Nkosinathi Nhleko wrote on this page this week that SA would start talks at the World Trade Organisation (WTO) to amend its commitments to the private security sector under the General Agreement on Trade in Services (Gats).

If the government decides a 49% cap on foreign ownership in the private security industry is a legitimate policy objective, according to Gats, WTO members have a fundamental right to amend their schedules of commitments.

In modifying its own schedule, SA must first notify the WTO's Council for Trade in Services at least three months before the date of implementation of the measure. Any WTO member that is affected by the proposed change can request negotiations into which SA must enter with a view to reaching agreement on compensation within three months. The foreign ownership cap is likely to affect countries such as Switzerland, the UK and Sweden on behalf of companies such as Tyco International's ADT Security, G4S and Securitas.

The key is that the level of the settlement cannot be any less favourable than the status quo and compensatory adjustments must be extended to all WTO members. So not only will the negotiated



settlements benefit the countries directly affected by the ownership limitation, all WTO members will benefit from SA's concessions.

Should SA and its trade partners fail to reach agreement in the allotted time, the affected members can refer the matter for arbitration at the WTO. SA is prohibited from enacting the bill in its present form before the arbitral decision is handed down and is obliged to implement the findings of the arbitration body. Should SA fail to implement the award, each affected member is entitled to implement "substantially equivalent" countermeasures or retaliate against SA in respect of any industry, also known as cross-retaliation.

So far, the only WTO member to modify its Gats schedule is the US, after what it considered an unsatisfactory outcome in an anti-online gambling case against Antigua. After a panel was established in March 2007 because the US had failed to comply with the ruling of the WTO's Dispute Settlement Body (DSB) after the case, the US said it would not comply with the ruling but was modifying its schedule.

Reports show seven affected members joined Antigua in notifying the US of their intent to seek compensation and the US reached agreements with Australia, Canada, the European Union and Japan by making additional market access commitments in certain services sectors. However, no agreement on compensatory adjustment was reached with Antigua.

In June 2007, Antigua instituted arbitration proceedings at the WTO to authorise retaliatory measures up to an amount of \$3.44bn. In December 2007, the arbitrator determined that Antigua was entitled to annual retaliation of \$21m against the US's exports and could request to cross-retaliate under various sections of the WTO's intellectual property agreement, the Agreement on Trade-Related Aspects of Intellectual Property Rights (Trips).

Five years later, on April 24 2012, Antigua informed the DSB that the US was still not in compliance with the rulings and, on January 28 2013, the DSB granted Antigua authorisation to cross-retaliate under Trips. To this day, the US has still not complied with the rulings and Antigua has also not cross-retaliated, presumably due to the potential fallout from a David taking on Goliath scenario.

Amending SA's Gats schedule could be a protracted and politically intricate procedure. If SA wishes to proceed with the foreign ownership limitation in the private security industry, it must brace itself for a bumpy ride. Luckily, SA can discontinue the process at any time and its commitments under Gats will revert to their original form.

- *Kugler is an international trade and investment specialist working in Geneva*

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PRIVATE SECURITY

## New law sets off alarm

Government has promised better regulation of the private security industry through its new Private Security Industry Regulation Amendment Bill, but this has failed to allay the fears of some companies in the sector.

The bill is awaiting President Jacob Zuma's signature before it can be promulgated. But the Security Industry Alliance (SIA), an association of private security companies, has urged Zuma to send it back to parliament.

Section 20 of the bill stipulates that private security companies that operate in SA be at least 51% locally owned.

The alliance says this would force companies to sell shares at "fire sale" prices, and would undermine job creation and foreign investment.

Foreign companies involved in the security sector in its most narrow definition (manned security, guarding, cash-in-transit and so on) make up 10% of the sector in SA, which has about 8 000 companies.

However, the broad definition of a security company in the bill means that locksmiths, camera manufacturers and communication device producers would also have to relinquish 51% to locals.

Those opposing the bill have indicated an intention to challenge it in the constitutional court if it is signed into law, on the grounds of arbitrary deprivation of property.

The bill has been proposed in the interests of national security, as well as employment issues. Security guards in SA outnumber police officers and it is believed they possess more firearms. Government also appears to be worried that security companies are involved in gathering intelligence.

There are provisions for exemptions from the bill. Police minister Nathi Nhleko says an advisory committee will be established to help his ministry adjudicate applications for exemption from the ownership limit. "The minister may contemplate a different percentage for companies seeking an exemption," Nhleko says.

The advisory committee will include members of the Private Security Industry Regulatory Authority, as well as officials from the state security agency, police and home affairs departments.

Whether the bill will cause disinvestment from SA is a point of debate, Nhleko says, but "national security" is paramount.

Amichand Soman, director of liaison at the civilian secretariat for police, says it is important to link the bill and the Firearms

“  
[LOCAL OWNERSHIP OF SECURITY FIRMS] IS A NORM APPLIED ACROSS THE WORLD  
BONGANI MABIZELA

Control Act. "The registrar of firearms must submit a list of all firearms in possession of a company to the authority."

Soman says the bill is necessary because norms and standards that govern firearms and wages are flouted frequently.

The industry believes Nhleko's exemptions will further complicate the contested piece of legislation.

Costa Diavastos of the SIA says provisions for exemptions are "nebulous, unclear and impractical". He says it is not clear how the regulations will be applied to different companies.

The SIA believes that most, if not all, foreign companies are largely compliant with SA's laws and regulations. Thus, the compliant companies are the ones that will be most "hurt" by the bill, in the sense of giving up ownership.

"[The industry is] not involved in intelligence gathering and supplying intelligence to mercenaries. What the private security industry focuses on is a distinct and complementary function to state functions and this bill will not address government's concerns over national security," Diavastos says.

However, Black Business Council member Bongani Mabizela supports the bill, saying countries such as the US and the UK would never allow foreigners to hold a 75% stake in a security company that operates there.

"We are still, to a great extent, untransformed in this sector. We seem to

be dwelling too much on the issue of the 51%."

Mabizela says his firm operates in other countries, which have insisted that he go in with a local partner. "It's a norm applied across the world," he says.

Rhodes University professor and deputy dean of the law faculty Laurence Juma says the constitutionality of the bill is "very contestable" and that a number of its assertions may be found to be problematic if challenged in court.

Critics have also said the bill would be a violation of bilateral trade agreements. Nhleko says SA will engage with affected countries that are signatories to the World Trade Organisation's General Agreement on Trade in Services (Gats), because SA cannot uphold Gats commitments that clash with national security concerns.

If the bill is adopted, SA may have to compensate WTO member states affected by it, and may be expected to make other commitments under Gats on tariff reductions in other services sectors, according to Trade Law Centre senior researcher JB Cronje.

Mandela Institute research director Azwimpheli Langelanga adds that ambiguity in the provisions for exemption from the 51% local ownership clause creates room for "wheeling and dealing".

"If there is a suggestion that this bill applies fully to one company and not fully to another, it is likely to be thought that one company did not lobby government behind the scenes, and this kind of perception creates problems," Langelanga says.

Khulekani Magubane  
magubane@bdfm.co.za



**Business Day, 30 March 2015**

## **Police minister Nhleko gets on the wrong side of international law**

Peter Leon and Ben Winks

**It seems remarkable that the president did not announce the global investment policy shift after saying at Davos SA is open for business, write Peter Leon and Ben Winks**

POLICE Minister Nathi Nhleko did more than raise the collective eyebrows of the global investment community recently, when he warned that SA "intends to withdraw from its commitments" under its international trade and investment treaties in order to enact a bill that would effectively indigenise the ownership of SA's private security industry.

It seems remarkable that such a far-reaching announcement should come not from the president, who promised the World Economic Forum in Davos in January that "SA remains fully open for business", nor from the Cabinet's economic cluster, but from the police minister. What makes this more anomalous is the lack of proper justification for this departure from SA's international economic protocols.

The apparent motive behind his statement is to secure President Jacob Zuma's assent to the Private Security Regulatory Authority Amendment Bill, which includes a provision restricting foreign "ownership and control" of private security companies to 49%. This clause was dropped from the bill soon after its introduction, over concerns by the Department of Trade and Industry that it "required significantly more research and would have to be linked to properly understanding and addressing (SA's) international agreements".

A year later, the clause was reinserted by the parliamentary portfolio committee on police, without addressing the department's concerns, while the bill was passed by Parliament last month. This relapse was defended by reliance on a "briefing note" prepared by the South African Police Service, a summary of which appeared under Nhleko's name on this page last Tuesday. It said the growth of the private security industry carries the "potential to compromise national security", so foreign influence in security firms must be restricted to minority participation. This measure has been heavily criticised, mainly on the grounds that it will discourage foreign investment; contravene the constitution; violate SA's trade and investment treaty commitments; and not actually enhance national security. Nhleko rebuffs these concerns and insists that "the government will be ready for any legal challenge to the bill once it becomes law ... be it at the international or domestic level".

Nhleko's justifications, however, reveal that the government is far from ready for a legal challenge. First, his interpretation of the constitution is incorrect and incomplete. He cites section 199(3), which says that, other than the national defence, police and intelligence services, armed organisations may be established only "in terms of national legislation". But he omits to mention the governing principle in section 198(d): "National security must be pursued in compliance with the law, including international law." In any event, a country's national law can never excuse it from failing to adhere to its international law obligations. What is more, the bill would apply not only to "armed organisations", but to a vast array of service providers, including manufacturers, importers, distributors and marketers of "monitoring devices".

Nhleko also observes that the constitutional right to freedom of trade and occupation is accorded only to citizens, and that the equality clause permits discrimination against non-citizens when there is good reason. Indeed, the Constitutional Court has already accepted that requiring all registered security guards to be citizens or permanent residents is not unfair discrimination, as public safety demands that people permitted to provide private security should be susceptible to thorough vetting. Nhleko fails to acknowledge, however, that, for this reason, foreigners are already prohibited by law from participation in private security firms as directors, managers or officers.

Most important, Nhleko fails to explain precisely what threat the remaining form of foreign participation — capital investment — poses to "national security", let alone how imposing a cap of 49% would eradicate such a threat. Yet the constitution demands that every exercise of public power must be justified. What is more, when such exercise cuts into a constitutional right, it must be rationally and proportionally related to a public purpose.

Protecting national security is indeed a legitimate public purpose but, tellingly, Nhleko admits that the measure is aimed at addressing not "existing threats", but "potential future threats". This is not good enough. The Constitutional Court has long held that the state must present evidence, not speculation or conjecture, to justify an infringement of rights. Nhleko has not revealed any such evidence.

Even further removed from his remit is the management of SA's foreign investment and trade relations. Nhleko's assumption that the government may summarily withdraw from its international trade commitments is misconceived. As a member of the World Trade Organisation and a party to the General Agreement on Trade in Services, SA has undertaken not to impose any foreign capital restrictions on private security companies. Modifying this commitment is not simply a matter of notice and negotiation, as Nhleko imagines, but a complex, costly and lengthy exercise, after which SA will have to make compensatory adjustments to the member states affected or face their withdrawal of equivalent benefits.

As the bill has direct implications for SA's international trade law obligations, it should fall within the domain of the Department of Trade and Industry, rather than the police. The department is engaged in sensitive negotiations with the US to ensure that South African exports continue to qualify for duty-free access under the Africa Growth and Opportunity Act (Agoa) when it comes up for renewal by the US Congress in September. The US's concerns about the bill, which in effect expropriates the investments of US security firms in SA, appear to have made little impression on Nhleko, further complicating the department's task.

Zuma can avoid a protracted international trade dispute, and spare SA the risk that Congress excludes it from the renewal of Agoa, if the bill is returned to Parliament for reconsideration on the grounds of its manifest unconstitutionality. This would subject the bill to much-needed insight and oversight by the department, and hopefully result in a law more consistent with SA's trade and investment goals.

- Leon is a partner and Winks an associate at Webber Wentzel attorneys.

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## News release from Grant Thornton

### SA Business optimism plummets to a record low as the uncertain business environment increasingly impacts growth prospects

*Rising crime, increased energy costs, exchange rate fluctuations, lack of skills, over regulation and economic uncertainty constrains local business*

6 May 2015

New Grant Thornton research highlights that South African businesses grow more pessimistic about the future outlook of the nation's economy with local business optimism levels plummeting by 30% since 2013, to reach record lows.

When SA business executives were asked how optimistic they were about the outlook of the country's economy over the next 12 months, Grant Thornton's International Business Report (IBR), reveals a dismal 9% total optimism, compared to the more buoyant 39% recorded by South African businesses in 2013.

Grant Thornton's International Business Report (IBR) provides tracker insights from around the world on a quarterly basis. These findings are from the IBR's first quarter tracker data for 2015, revealing findings from business executives to 31 March 2015. The IBR survey specifically presents perceptions into the views and expectations of over 10000 C-Suite interviews in total per year across 36 economies on an annual basis (2500 interviews per quarter).

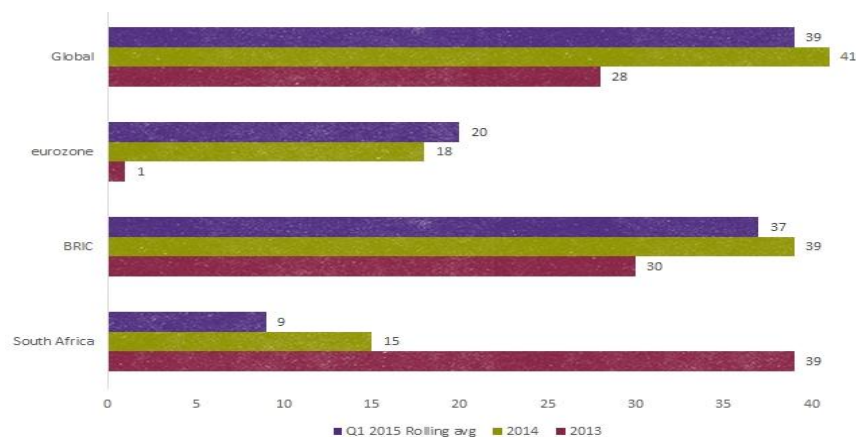
The Report also highlights regional and national perceptions of privately held businesses regarding crime, service delivery and political climate of 400 South African business owners annually (100 business executives per quarter).

"We seem to be in a post election lull as increased bureaucracy and economic uncertainty fuel the fires of pessimism. Business confidence is in a downward spiral," says Andrew Hannington, CEO of Grant Thornton Johannesburg.

In contrast, global data from the Grant Thornton IBR reveals positive business expectations overall as the eurozone jumped for the first quarter of 2015 from 1% in 2013 to 20% for Q1 2015.

"Many of the economies hardest hit by the financial crisis, such as Ireland and Spain, are increasingly optimistic about their growth prospects although our local picture here in South Africa is downtrodden, with business prospects falling to an all-time low," continues Hannington.

## Business optimism



The Q1 IBR data to end March 2015 also highlighted that a torrent of factors are constraining business growth with a massive 55% of South African businesses lamenting rising energy costs, 42% frustrated by exchange rate fluctuations, 39% expressing concern regarding economic uncertainty, 37% struggling with a lack of availability of a skilled workforce, and 36% stating that over-regulation and red tape are restricting business expansion.

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**Attachment B**

**LEGAL OPINION**

for

**SECURITY INDUSTRY ALLIANCE**

by

**WEBBER WENTZEL**

Ref: P Leon / B Winks

on

**PRIVATE SECURITY INDUSTRY REGULATION AMENDMENT BILL, 2012:  
ISSUES IN INTERNATIONAL TRADE LAW AND INVESTMENT LAW**

dated

**2 MARCH 2015**

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**WEBBER WENTZEL**

in alliance with > **Linklaters**



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## EXECUTIVE SUMMARY

1. Clause 20 of the Private Security Industry Regulation Bill, 2012 ("**the Bill**"), now awaiting Presidential assent, requires that a private security business may not be registered unless "*at least 51% of the ownership and control is exercised by South African citizens*" ("**Clause 20**"). Having been removed from the Bill by the National Assembly's Portfolio Committee on Police in November 2012, the same clause was unexpectedly reinserted when that Committee reconvened in November 2013, purportedly on the grounds that it was necessary to protect South Africa's national security. Unresponsive to submissions from foreign diplomats, Parliament passed the Bill in March 2014.

### *International trade law*

2. As a member of the World Trade Organisation ("**WTO**"), South Africa maintains a Schedule of Specific Commitments under the General Agreement on Trade in Services, 1994 ("**GATS**"), which stipulates that no limitations will be imposed on foreign suppliers' entitlement to full "*market access*" and "*national treatment*" in South Africa's private security services sector. By restricting foreign ownership and control of private security businesses, Clause 20 contravenes both of these obligations. A complaint to the WTO by an affected country would likely result in a ruling that South Africa must repeal Clause 20, as China was ordered to do in 2009 after introducing a 49 per cent restriction on the foreign ownership of businesses distributing electronic sound recordings.
3. Clause 20 does not fall within the "*governmental services*" exclusion from the scope of GATS, nor within the "*public policy*" or "*essential security*" exceptions, as it is not reasonably "*necessary*" for the protection of those interests, in terms of WTO jurisprudence. The test is objective and South Africa bears the onus of meeting it. In any event, these exceptions cannot apply to any measure that is considered "*arbitrary*", which Clause 20 would be, given the absence of any



evidence that it is rationally related to its stated purpose - the government has not explained how foreign ownership and control of private security business poses a threat to national security, nor how limiting such ownership and control to 49 per cent would undermine this threat.

4. The way in which Clause 20 was hurriedly reinserted into the Bill, shortly before it was passed, fell short of the standard of "*transparency*" required by GATS, as neither the WTO nor its members were appropriately informed, with any clarity or consistency, of the rationale, contents and consequences of Clause 20.
5. South Africa may not modify or withdraw its Schedule of Specific Commitments without first negotiating "*compensatory adjustments*" with any affected states, failing which they may subject South Africa to arbitration and obtain authority to impose retaliatory trade restrictions, even beyond the private security sector.

#### *International investment law*

6. South Africa is party to several bilateral investment treaties ("**BITs**") (with the United Kingdom and Sweden, among others), free trade agreements ("**FTAs**") (with the European Union and the European Free Trade Association), and the Southern African Development Community Protocol on Finance and Investment, 2006 ("**SADC Investment Protocol**"), each of which affords rights to foreign investors.
7. Clause 20 contravenes investors' right to "*fair and equitable treatment*", as it is arbitrary and ambiguous (failing to define how foreign "*ownership and control*" must be measured), and as it was adopted by a procedure that lacked clarity, consistency, transparency and predictability. Clause 20 also contravenes the right to "*national treatment*", by directly discriminating against foreign investors on no basis other than nationality, as well as "*most-favoured-nation treatment*", by empowering the Minister of Police directly or indirectly to discriminate among different foreign investors when granting exemptions from Clause 20.

8. Clause 20 constitutes an indirect expropriation under international law, as it permanently neutralises the economic value of those shares a foreign investor holds in excess of the 49 per cent restriction. The expropriation is unlawful, as it is not rationally related to a public purpose, it is discriminatory, and it does not provide for adequate compensation (given that the forced nature of the sale diminishes the market value of the shares).
9. A foreign investor from a country with which South Africa has concluded a BIT (including a terminated BIT which still applies to pre-existing investments for a certain sunset period) may enforce any affected rights under that BIT by direct recourse to international arbitration before an independent arbitral tribunal, whose award will be enforceable almost anywhere in the world. By virtue of the SADC Investment Protocol, even a foreign investor who is not protected by any BIT may enforce its rights under international arbitration, after exhausting all available remedies in South Africa's domestic dispute resolution system.

A.

INTRODUCTION

1. We are requested to advise on the international trade law and international investment law issues implicated by the Private Security Industry Regulation Amendment Bill, 2012 ("**the Bill**"), specifically clause 20, which would amend section 20 of the Private Security Industry Regulation Act, 2001 ("**the Act**"), *inter alia*, by the addition of a requirement that a security business may only be registered as a security service provider "*if at least 51% of the ownership and control is exercised by South African citizens*" ("**Clause 20**").
2. This advice accordingly examines the following:
  - 2.1 the background to the Bill, to the extent necessary for a contextual legal assessment of Clause 20 - the scope of services to which it would apply, the substance of the scheme surrounding Clause 20, and the procedure by which it was adopted;
  - 2.2 the issues of scope, substance and procedure implicated by Clause 20 in international trade law; and
  - 2.3 the issues of scope, substance and procedure implicated by Clause 20 in international investment law.
3. Our opinion does not examine any of the issues implicated by Clause 20 in South African domestic law, including constitutional law, although we note that the international law issues identified would have constitutional implications.<sup>1</sup>

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<sup>1</sup> See *Glenister v President of the Republic of South Africa and Others* 2011 (3) SA 347 (CC), as well as the following recent academic articles about the constitutional implications of international obligations, in Stuart Woolman *et al* (eds.), *Constitutional Court Review V*, Juta, 2014, 399 *et seq*: Bonita Meyersfeld, "Domesticating International Standards: The Direction of International Human Rights Law in South Africa"; Franziska Sucker, "Approval of an International Treaty in Parliament: How Does Section 231(2) 'Bind the Republic'?"; Juha Tuovinen, "What to Do with International Law? Three Flaws in *Glenister*".

## B. BACKGROUND TO THE BILL

### 1. Scope

1.1 The Act applies to a broad spectrum of "security services", which may not be lawfully rendered for reward in South Africa by any security business that is not registered as a "security service provider" under the Act.<sup>2</sup>

These include: protecting or safeguarding persons or property in any manner; ensuring order and safety on recreational premises; manufacturing, importing, distributing or advertising monitoring devices; private investigation; installing, servicing or repairing security equipment; monitoring signals or transmissions from electronic security equipment; locksmith services; as well as advising, training, managing or brokering any of these services, or indeed even "creating the impression, in any manner, that one or more of [these services] are rendered".<sup>3</sup>

1.2 It is worth emphasising that the Act applies broadly enough to include the supply of "monitoring devices", which could cover an extensive range of commercially available audio and video recording equipment.<sup>4</sup> The Bill would augment its application to include the "manufacturing, assembling, possessing, selling, purchasing, or advertising" of "any electronic, electro-magnetic, acoustic, mechanical or other instrument, device or equipment, the design of which renders it primarily useful for purposes of the interception of communications", as identified by the Minister of Justice and Correctional Services.<sup>5</sup>

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<sup>2</sup> Section 20(1)(a) of the Act.

<sup>3</sup> See Section 1 *sv* "security service" para (m) of the Act.

<sup>4</sup> Although the Act does not define "monitoring devices", section 1 of the Regulation of Interception of Communications and Provision of Communication-related Information Act, 2002 ("RICA"), defines them as "any electronic, mechanical or other instrument, device, equipment or apparatus which is used or can be used, whether by itself or in combination with any other instrument, device, equipment or apparatus, to listen to or record any communication".

<sup>5</sup> Clause 1(k) of the Bill, read with sections 1 and 44 of RICA.

- 1.3 The implications of the Act's wide definition of "security service" are far-reaching. This is because, among other things, the Act:
- 1.3.1 defines a "security business" as "*any person who renders a security service to another for remuneration, reward, fee or benefit*";<sup>6</sup>
- 1.3.2 prohibits any person from doing so "*unless such a person is registered as a security service provider*";<sup>7</sup> and
- 1.3.3 provides that a security business "*may only be registered as a security service provider*" if it satisfies certain qualifications.<sup>8</sup>
- 1.4 Clause 20 adds another mandatory qualification for registration as a security service provider, namely that "*at least 51 per cent of the ownership and control is exercised by South African citizens*".<sup>9</sup> The Minister of Police ("**the Minister**") is mandated to "*prescribe by regulation the verification of ownership and control of security businesses*",<sup>10</sup> and empowered to exempt any person from any provision of the Act "*as long as it does not prejudice the achievement of the objects of this Act*".<sup>11</sup>
- 1.5 Consequently, upon the Bill becoming law, any company having foreign ownership or control exceeding 49 per cent would be prohibited from "*manufacturing, assembling, possessing, selling, purchasing or advertising*" a broad range of audio and video recording equipment.

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<sup>6</sup> See section 1 of the Act.

<sup>7</sup> Section 20(1)(a) of the Act. Section 38(3)(a) makes this a criminal offence.

<sup>8</sup> Section 20(2) of the Act:

- (a) *if all the persons performing executive or managing functions in respect of such security business are registered as security service providers, unless such person is exempted in terms of this Act; and*
- (b) *in the case of a security business which is a company, close corporation, partnership, business trust or foundation, if every director of the company, every member of the close corporation, every partner of the partnership, every trustee of the business trust, and every administrator of the foundation, as the case may be, is registered as a security service provider.*

<sup>9</sup> Clause 20(d) of the Bill.

<sup>10</sup> Clause 20(e) of the Bill.

<sup>11</sup> Clause 20(f) of the Bill.

Clause 20 thus stands to have a considerable impact upon businesses well beyond those who would ordinarily be considered, or consider themselves to be, private security companies.

## 2. Substance

2.1 The precise content of Clause 20 is unclear, as it is not known how the "ownership and control" of a business might be measured, nor how many corporate veils might be pierced to identify the citizens ultimately exercising such "ownership and control". For the purposes of this opinion, however, we assume that Clause 20 would - at least - disqualify from the private security industry any company that has more than 49 per cent of its shares owned or controlled by persons domiciled or incorporated outside South Africa.

2.2 It is important to understand that restricting foreign participation in the private security industry is part of the fabric of the Act - the Constitutional Court has already held that it is, in principle, not arbitrary for the Act to distinguish between citizens and permanent residents on one hand, and foreigners on the other. Justifying the exclusion of refugees from eligibility for registration as private security officers, the Court held as follows:<sup>12</sup>

*The private security industry is a very particular environment. At stake is the safety and security of the public at large. Section 12 of the Constitution guarantees everyone the right to freedom and security of the person, which includes the right to be free from all forms of violence from either public or private sources. In a society marred by violent crime, the importance of protecting this right cannot be overstated.*

*That is not to say that foreign nationals, including refugees, are inherently less trustworthy than South Africans. In a country where xenophobia is causing increasing suffering, it is important to stress this. It is not that the Authority does not trust refugees. Rather, it requires everyone to prove his/her trustworthiness. The reality is*

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<sup>12</sup> See *Union of Refugee Women and Others v Director, Private Security Industry Regulatory Authority and Others* 2007 (4) BCLR 339 (CC), paras 37-42.

*that citizens and permanent residents will be more easily able to prove their trustworthiness in terms of the Security Act.*

*The Security Act is designed to limit eligibility for registration to people whose trustworthiness can be objectively verified. ...*

*Differentiating between citizens and permanent residents on the one hand, and all other foreigners on the other, therefore has a rational foundation and serves a legitimate governmental purpose.*

2.3 It is vital to appreciate, however, that this judgment was addressing the eligibility of persons who would be directly engaged in the physical work of private security, and accordingly whom public safety demands be adequately vetted. Clause 20's restriction on the "*ownership and control*" of private security businesses does not benefit from the same rationale, as it excludes permanent residents from participation and as it does not concern the physical work of private security. Accordingly, we do not believe this judgment would assist the government in justifying Clause 20.

2.4 The repeated rationale for Clause 20 is that foreign ownership or control of private security companies poses a threat to national security. Apparently to foreshadow this concern, the Bill would insert the following considerations into the Preamble of the Act:<sup>13</sup>

**WHEREAS** *national security is paramount and needs to be approached in a holistic and pro-active manner;*

**AND WHEREAS** *it is essential that the private security industry operates in a manner that contributes to the safety and security of communities and in particular consumers of private security services, but also in a manner that does not prejudice or threaten national security...*

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<sup>13</sup> See clause 42(a) of the Bill.

- 2.5 The official memorandum on the objects of the Bill purports to establish a nexus between national security and indigenised ownership and control of private security companies, in the following terms:<sup>14</sup>

*[G]iven the increasingly complex national security challenges post the 11 September 2001 events in the United States of America, as well as the changing nature of the private security industry globally and developments that could impact on the security of states, concerns have been raised about the potential or capability of elements operating in the private security industry to access sensitive information or threaten national security through access to firearms and information technology. As a developmental state, South Africa, in looking at its national security from a long-term perspective, needs a legislative framework that will also address such a potential or capability in a pro-active manner by, amongst others, limiting the extent of foreign participation. The control by South African citizens of security companies is therefore necessary to this end, in addition to advancing the empowerment of South African citizens in the private security industry.*

- 2.6 Commenting on Clause 20 specifically, the memorandum explains the restriction on foreign ownership as follows:<sup>15</sup>

*The clause further deals with the issue of foreign ownership in the private security industry. The clause further provides for a limitation on the extent of foreign participation in a private security business in South Africa. Item 15 of the transitional provisions in this Bill will address the existing rights of foreign participants who exceed the proposed statutory limitation on shareholding in a private security business in South Africa. All new applications for registration as a security service provider will, however, be required to comply with the provisions of this clause once it becomes law.*

- 2.7 The "transitional provisions" mentioned above refer to a new section 44A which the Bill would insert into the Act,<sup>16</sup> including the following subsection 44A(15):

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<sup>14</sup> See the Memorandum on the Objects of the Private Security Industry Regulation Amendment Bill, B27D of 2012, para 1.1.

<sup>15</sup> *Ibid*, para 2.2.20.

<sup>16</sup> Clause 38 of the Bill.



*The implementation of section 20(2)(c) with regard to a security business that is registered as a security service provider at the commencement of the Amendment Act must be done in accordance with legislation promoting and protecting investment in the Republic and the Republic's international trade obligations.*

2.8 It is not clear how the above subsection "*will address the existing rights of foreign participants*" as the memorandum expects. We cannot discern any way that it would. The subsection does, however, concede that Clause 20 will have implications for South Africa's international trade law obligations, which are discussed below.

2.9 The subsection's reliance on "*legislation promoting and protecting investment*" is unhelpful, for at least three reasons. First, it is superfluous to say that government must act in accordance with any legislation, for the government could not lawfully act in any other way. Second, no such specific legislation exists; a draft Promotion and Protection of Investment Bill was prepared by the Department of Trade and Industry ("**DTI**") in 2013 but is yet to be introduced to Parliament.<sup>17</sup> Third, that draft would, if enacted, drastically derogate from the "*existing rights of foreign participants*" under international law, rather than insulating them in any way from the impact of Clause 20.<sup>18</sup>

### 3. Procedure

3.1 The Bill was introduced by the Minister in the National Assembly on 6 September 2012, including the clause restricting foreign "*ownership and control*" of private security businesses to 49 per cent.<sup>19</sup> On 13 November 2012, however, the National Assembly's Portfolio Committee on Police ("**the Committee**") decided to remove the clause completely, as it "*would*

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<sup>17</sup> Invitation for the public to comment on the Promotion and Protection of Investment Bill, 2013, Government Notice 1087, Government Gazette 36995, 1 November 2013.

<sup>18</sup> See Peter Leon and Ben Winks, "Promotion and Protection of Investment Bill: A reversion to diplomatic protection?", *Without Prejudice*, November 2014, 14-15. A detailed analysis of the draft Bill falls outside the scope of this opinion.

<sup>19</sup> In that version of the Bill (B27 of 2012), the 49 per cent restriction of foreign ownership and control was contained in clause 9.

*require additional involvement of different departments, renegotiation of international treaties, more detail and better processes".*<sup>20</sup> This decision followed input from the DTI, which had not been consulted on the Bill before its introduction, and felt that the clause *"required significantly more research and would have to be linked to properly understanding and addressing [South Africa's] international agreements".*<sup>21</sup>

3.2 When the Committee reconvened a year later, however, the clause had been re-introduced in identical terms,<sup>22</sup> and was adopted by a majority,<sup>23</sup> apparently without any deliberation.<sup>24</sup> Despite submissions on behalf of the United States of America ("US") and the United Kingdom ("UK"),<sup>25</sup> the Bill was passed by the National Assembly, with Clause 20 untouched, on 25 February 2014 and, despite a further round of entreaties from senior foreign diplomats,<sup>26</sup> it was passed by National Council of Provinces on 5 March 2014.

3.3 The reintroduction of Clause 20 was defended, after the fact,<sup>27</sup> by reliance on a *"Briefing Note"* prepared by the South African Police Service

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<sup>20</sup> Minutes of the Portfolio Committee on Police, 13 November 2012. The Chairperson noted that, after completion of such processes, a restriction of foreign ownership *"could be brought back"* at a later stage.

<sup>21</sup> *Ibid.*

<sup>22</sup> Bill 27B of 2012.

<sup>23</sup> Bill 27D of 2012; Minutes of the Portfolio Committee on Police, 5 November 2013.

<sup>24</sup> See Unrevised Hansard, *Proceedings of the National Assembly*, 25 February 2014, 203-205. The working drafts of the Bill considered by the Committee on 24, 29 and 30 October 2013 did not contain any reference to a restriction of foreign ownership.

<sup>25</sup> Letters were addressed to Parliament by US Ambassador Patrick Gaspard on 8 November 2013 and by British High Commissioner Judith MacGregor on 13 November 2013.

<sup>26</sup> See the letter from US Ambassador Patrick Gaspard on 28 February 2014 and the emails from European Union Trade Delegate Axel Pugin de la Maisonneuve on 28 February 2014, UK Trade Commissioner Andrew Henderson on 1 March 2014 and Swedish Economic Counsellor Sara Aulin on 3 March 2014.

<sup>27</sup> See Unrevised Hansard, *Proceedings of the National Assembly*, 25 February 2014, 193-194: justifying the reintroduction of Clause 20 during the second reading of the Bill, the Chairperson of the Committee argued as follows: *"You are going to be told here... that the provision was sneaked in and that the need for it was never proved - this despite a 21-page document that was presented to the committee to show the need for this change in the Bill."*

("SAPS"),<sup>28</sup> which apparently purports to demonstrate that majority foreign shareholding in private security companies poses a threat to national security, and that South Africa's international trade obligations are not an obstacle to imposing a restriction on such ownership. Parliament's reliance on the SAPS Briefing Note was, in our view, misplaced, for at least the following reasons:

3.3.1 It is unsubstantiated, speculative and vague. It claims "*there are examples for foreign owned companies registered in South Africa which provide military services in various parts of the world*",<sup>29</sup> but does not identify any of these examples. It alludes to "*links*" between South African security companies and "*foreign companies with questionable human rights records, as well as with foreign states*", and concludes that they thus "*pose a national security threat to South Africa*",<sup>30</sup> but it neither identifies these "*links*" nor explains how they could jeopardise national security. It claims that private security companies are "*increasingly used in the field of human intelligence*", which involves "*supplying former intelligence agents as actual bodies on the ground in sensitive locations*",<sup>31</sup> but it provides no evidence of this.

3.3.2 It fails to demonstrate any nexus at all between foreign "*ownership and control*" of private security companies and threats to national security. It further fails to explain how limiting such ownership and control to 49 per cent would address these perceived threats. It contains no research regarding the current proportion of foreign

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<sup>28</sup> SAPS Legal Services, *Briefing Note - Private Security Industry Regulation Amendment Bill: Provision on Restriction on Foreign Involvement - Section 20(2)(c)*, 5 February 2014 ("**SAPS Briefing Note**"). This document was apparently authored by Major-General Philip Jacobs, whose expertise and experience in international trade law is unknown.

<sup>29</sup> *Ibid*, 3.

<sup>30</sup> *Ibid*.

<sup>31</sup> *Ibid*, 4.

ownership and control in South African security companies.<sup>32</sup> It also fails to acknowledge that private security companies are already required to be managed and staffed only by South African citizens and permanent residents. Finally, it fails to address the argument that a private security company wholly owned by South African citizens who are hostile to the incumbent government would pose a clearer threat to national security than one owned by an array of foreign investors.

3.3.3 The "*comparative studies*" cited in the SAPS Briefing Note do not suggest rigorous research. Indeed, several of these "*studies*" reveal a misreading or misrepresentation of the relevant provisions. For example, Botswana is described as maintaining a "*total prohibition*" on foreign shareholding, but the only law cited is a 2008 bill which has apparently been abandoned.<sup>33</sup> The cited "*total prohibition*" laws in Antigua and Barbuda, Djibouti, Senegal and Switzerland address not shareholding at all, but management and staffing.<sup>34</sup>

3.3.4 The SAPS Briefing Note's assessment of the workings of GATS reveals a very limited understanding of international trade law. It does not engage at all with the requirement of compensatory adjustments, but recites the provision on modification of trade commitments and comments as follows:<sup>35</sup>

*For South Africa to withdraw from its commitments under GATS or BITs, there must be a sound basis for entering into*

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<sup>32</sup> See Institute for Security Studies, *Are foreign-owned private security companies a threat to South Africa's national security?*, 15 April 2014: "Less than 10% of the local private security industry is foreign owned, and the 445 407 security officers that are registered as active are all South African citizens or have permanent resident status. They do not constitute a coherent, well-organised semi-military force ready for deployment against a particular target. Rather, they're spread across 9 031 registered businesses, providing more than 20 different categories of security and services as locksmiths, car guards, body guards and armed reaction teams."

<sup>33</sup> SAPS Briefing Note, 11-12. Similarly, the reference to a "*restriction on shareholding*" in Kenyan law (at 12-13) is also to a bill that has apparently not been enacted.

<sup>34</sup> *Ibid*, 12, 14 and 17-18.

<sup>35</sup> *Ibid*, 21.

*negotiations with the other parties. A sound justification for this to happen must exist. Grounds for justification could be for South Africa to entrench its national security, particularly as a development state and in the broader African Union context, the potential for private security companies to use its might, knowledge and weapons to destabilize the State, or be used by other agencies or States towards this end.*

- 3.4 The contents of the SAPS Briefing Note suggest that the DTI was not consulted or involved in its preparation, nor in its presentation to the Committee. Given the delicacies and intricacies of international trade, and the DTI's specially assigned responsibility and capacity to deal with them, any decision to reintroduce Clause 20 could not have been rational without the involvement of the DTI.
- 3.5 Having been passed by Parliament almost a year ago, the Bill is awaiting assent by the President before it can become law. The President has no power to veto legislation, but he does bear a special power to refer a bill back to Parliament if he has reservations about its constitutionality.<sup>36</sup> In that event, Parliament must reconsider the Bill in light of the President's reservations and revise it where necessary. In such a process, Parliament is strictly confined to the specific reservations expressed by the President and is not empowered to revisit any other aspects of the Bill.<sup>37</sup> It is thus essential that the President expresses his reservations clearly and completely. If Parliament does not fully accommodate the President's reservations, he may refer it to the Constitutional Court.<sup>38</sup>
- 3.6 It is possible that the President might hold reservations regarding the constitutionality of Clause 20, considering that he recently referred the Mineral and Petroleum Resources Development Amendment Bill, 2013, back to Parliament on the grounds that its beneficiation provisions "*appear to be inconsistent with South Africa's obligations under the General*

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<sup>36</sup> Section 79(1) of the Constitution.

<sup>37</sup> See *Ex Parte President of the Republic of South Africa: In re Constitutionality of the Liquor Bill* 2000 (1) SA 732 (CC).

<sup>38</sup> Section 79(4) of the Constitution.

*Agreement on Trade and Tariffs (GATT) and the Trade, Development and Cooperation Agreement (TDCA) insofar as they appear to impose quantitative restrictions on exports".*<sup>39</sup> The President thus apparently adheres to the doctrine that a breach of international treaty obligations may render a statute unconstitutional.<sup>40</sup> In this light, there is a reasonable prospect that the President might refer the Bill back to Parliament with reservations that Clause 20 would render South Africa in breach of its obligations under international trade law and international investment law.

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<sup>39</sup> See the letter from President Jacob Zuma to the Speaker of the National Assembly, 16 January 2015, para (b).

<sup>40</sup> See *Glenister v President of the Republic of South Africa and Others* 2011 (3) SA 347 (CC).

## C. INTERNATIONAL TRADE LAW

### 1. Scope

#### 1.1 trade in services

1.1.1 South Africa is a founding Member of the World Trade Organization ("**WTO**"), which was established with effect from 1 January 1995,<sup>41</sup> in order to standardise and modernise the application of the 1947 General Agreement on Tariffs and Trade ("**GATT**"), of which South Africa was also a founding member.<sup>42</sup> All of South Africa's major trading partners are also WTO Members, including the US, the UK and Sweden, which (among others) are home states to companies that control majority shareholdings in several private security companies in South Africa.

1.1.2 As the private security industry is engaged primarily in the supply of services rather than goods, the relevant source of South Africa's international trade obligations, for present purposes, is not GATT but the General Agreement on Trade in Services "**GATS**".<sup>43</sup> Under the applicable international classification under GATS, "*investigation and security services*" include private investigation, advice on security systems, monitoring and maintaining alarm systems, collection and delivery of goods by armoured car; security guard and bodyguard services, among others.<sup>44</sup>

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<sup>41</sup> See the Marrakesh Agreement Establishing the World Trade Organization ("**WTO Agreement**"), signed on 15 April 1994, ratified by South Africa on 2 December 1994, and entered into force on 1 January 1995.

<sup>42</sup> South Africa signed and joined GATT on 13 June 1948. Since 1994, GATT has been repackaged as Annex 1A to the WTO Agreement.

<sup>43</sup> GATS appears as Annex 1B to the WTO Agreement.

<sup>44</sup> United Nations Statistical Office, *Statistical Papers, Series M, No 77: Provisional Central Product Classification*, 1991, 73-74.

1.1.3 GATS is the most significant international agreement applicable to trade in services. It establishes a framework for the progressive liberalisation of trade in services, with a view to ensuring that states open their domestic markets to foreign service suppliers on a non-discriminatory basis. GATS provides for WTO Members to stipulate, in a "*Schedule of Specific Commitments*", which service sectors and subsectors will be liberalised and to what extent. As an integral part of the WTO Agreement, GATS has been binding on South Africa since 1 January 1995, and South Africa submitted its Schedule of Specific Commitments on 15 April 1994, the date on which it signed the WTO Agreement.<sup>45</sup> According to this Schedule, South Africa undertook not to impose any trade restrictions on the foreign supply of private security services, apart from ordinary immigration regulations applicable to foreign nationals.<sup>46</sup>

1.1.4 In addition to GATS, in 1999 South Africa concluded a Trade, Development and Cooperation Agreement with the European Union ("**TDCA**"),<sup>47</sup> and is party to a Free Trade Agreement between the European Free Trade Association and the Southern African Customs Union ("**EFTA-SACU FTA**").<sup>48</sup> In each of those agreements, the parties "*underline the importance of strict observance*" of GATS,<sup>49</sup> and commit themselves to "*further liberalising trade in services*".<sup>50</sup> As a member of the Southern African Development Community

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<sup>45</sup> South Africa has supplemented its Schedule of Commitments on three occasions - 28 July 1995, 11 April 1997 and 26 February 1998 - but none of these supplements is relevant to this opinion.

<sup>46</sup> *South Africa: Schedule of Specific Commitments*, GATS/SC/78, 15 April 1994, 12.

<sup>47</sup> See the Agreement on Trade, Development and Cooperation between the European Community and its Member States, and the Republic of South Africa, signed on 11 October 1999 and entered into force on 1 May 2004.

<sup>48</sup> See the Free Trade Agreement between the EFTA States (the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway and the Swiss Confederation) and the SACU States (the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland, together forming the Southern African Customs Union) ("**EFTA-SACU FTA**"), signed on 1 July 2006 and entered into force on 1 May 2008.

<sup>49</sup> See TDCA, article 29(1); EFTA-SACU FTA, article 27(1).

<sup>50</sup> See TDCA, article 30(1); EFTA-SACU FTA, article 27(2).



("SADC"), South Africa is also party to the 1996 SADC Protocol on Trade<sup>51</sup> in which it undertook to "*adopt policies and implement measures in accordance with their obligations in terms of [GATS]*",<sup>52</sup> as well as the 2012 SADC Protocol on Trade in Services,<sup>53</sup> in which it reaffirmed the obligations under GATS and amplified its application within SADC.<sup>54</sup> Accordingly, considering that each of these treaties requires adherence to GATS, any breach of South Africa's obligations under GATS would, in principle, also constitute a contravention of each of these treaties.

1.1.5 For the purposes of this opinion, we focus our analysis on the relevant provisions of GATS, although a contravention of GATS would necessarily also constitute breaches of these agreements.

1.1.6 GATS "*applies to measures by Members affecting trade in services*",<sup>55</sup> which are defined widely, and include "*measures in respect of... the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member*".<sup>56</sup> More specifically:

1.1.6.1 'measure' means "*any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form*";<sup>57</sup>

1.1.6.2 'trade in services' includes "*the supply of a service... by a service supplier of one Member, through commercial presence in the territory of any other Member*";<sup>58</sup>

<sup>51</sup> SADC Protocol on Trade, signed on 1 August 1996 and entered into force on 25 January 2001.

<sup>52</sup> SADC Protocol on Trade, article 23(2).

<sup>53</sup> SADC Protocol on Trade in Services, which was signed on 18 August 2012, was ratified by South Africa on 13 September 2013, and has yet to enter into force.

<sup>54</sup> SADC Protocol on Trade in Services, article 2.

<sup>55</sup> GATS, article I:1.

<sup>56</sup> GATS, article XXVIII:(c)(iii).

<sup>57</sup> GATS, article XXVIII:(a).

1.1.6.3 'supply of a service', in turn, "*includes the production, distribution, marketing, sale and delivery of a service*";<sup>59</sup> and

1.1.6.4 'commercial presence' means "*any type of business or professional establishment, including through: (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office, within the territory of a Member for the purpose of supplying a service*".<sup>60</sup>

1.1.7 The latter definition is significant, as it, in principle, embraces both "*entities that have established a commercial presence in the host Member and/or entities that seek to establish in the host Member*".<sup>61</sup> Thus, a complaint of non-compliance with GATS could be instituted not only by Members whose nationals are already invested in South Africa's private security industry but also by any Member whose nationals might seek to invest in the industry in future.

1.1.8 Crucially, the WTO Appellate Body has held that the term "*affecting*", which is the key touchstone of GATS's application, should be interpreted expansively.<sup>62</sup>

*In our view, the use of the term 'affecting' reflects the intent of the drafters to give a broad reach to the GATS. The ordinary*

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<sup>58</sup> GATS, article I:2(c).

<sup>59</sup> GATS, article XXVIII:(b).

<sup>60</sup> GATS, article XXVIII:(d). See Peter van den Bossche and Werner Zdouc, *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, Cambridge University Press, 3<sup>rd</sup> edition, 2013, 46: "*It is clear from the third mode of supply (i.e. commercial presence) that the GATS also covers measures relating to foreign investment by suppliers of services.*"

<sup>61</sup> *China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products ("China - Publications and Audiovisual Products")*, Panel Report, WT/DS363/R, 19 January 2010, DSR 2010:II 261, para 7.974.

<sup>62</sup> *European Communities - Regime for the Importation, Sale and Distribution of Bananas ("EC - Bananas III")*, Appellate Body Report, WT/DS27/AB/R, 25 September 1997, DSR 1997:II 591, para 220. See also *United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services ("US - Gambling")*, Panel Report, WT/DS285/R, 20 April 2005, DSR 2005:XII 5797, para 6.251; and *China - Publications and Audiovisual Products*, Panel Report, para 7.971.

*meaning of the word 'affecting' implies a measure that has 'an effect on', which indicates a broad scope of application.*

- 1.1.9 Clause 20 would impose a restriction on the "ownership and control" of security businesses, and would thus clearly "affect" the "commercial presence" of such businesses in South Africa.

## 1.2 public services exclusion

- 1.2.1 Explicitly excluded from the scope of GATS are "services supplied in the exercise of governmental authority",<sup>63</sup> which means "any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers".<sup>64</sup> As this would typically include "police protection and penitentiary services",<sup>65</sup> it may be anticipated that the South African government might argue that at least some private security services are "supplied in the exercise of government authority" and are thus excluded from the scope of GATS. However, this would contradict South Africa's Schedule of Commitments, which explicitly recognises the full range of private security services as being bound by GATS.<sup>66</sup>
- 1.2.2 Moreover, while there is no WTO jurisprudence on the "government authority" exclusion under GATS, the European Court of Justice ("ECJ") has, on two separate occasions (in 2001 and in 2007), firmly rejected an argument by the government of Italy that private security

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<sup>63</sup> GATS, article I:3(b).

<sup>64</sup> GATS, article I:3(c).

<sup>65</sup> Van den Bossche and Zdouc, *op cit*, 339.

<sup>66</sup> It would also contradict the previous Minister's comments during the National Assembly's second reading debate before the Bill was passed: "While it is true that private security does and can fill certain vacuums, private security can never replace the public police. In fact, they have different objectives. Public police aims to protect the public, while private security has a profit motive and has as its main objective the protection of its client's interests. The interests of private clients and those of the state and the public are not always the same." (Unrevised Hansard, *Proceedings of the National Assembly*, 25 February 2014, 186).

services concerned "*the exercise of official authority*",<sup>67</sup> falling outside the scope of its non-discrimination obligations under the Treaty Establishing the European Community ("**EC Treaty**").<sup>68</sup> The 2001 case concerned a law requiring all private security firms and guards to hold Italian nationality.<sup>69</sup> The 2007 case concerned a subsequent law requiring private security guards to swear an oath of allegiance to the Italian Republic.<sup>70</sup> In both cases, the ECJ held that "*security services are not normally directly and specifically connected with the exercise of official authority*" and the Italian government had proffered no evidence to the contrary.<sup>71</sup> The ECJ's findings, though not dispositive, provide an indication that private security services would not qualify for the 'governmental authority' exclusion from the application of GATS.<sup>72</sup>

### 1.3 public policy exceptions

1.3.1 The GATS does not preclude measures that are strictly "*necessary*" for the protection of public morals, order, health and safety, as well as for consumer protection and privacy.<sup>73</sup> These so-called "*general exceptions*" are, however, subject to the proviso that their application does not result in "*arbitrary or unjustifiable discrimination between*

<sup>67</sup> See *Commission v Italy* [2001] ECR I-4363 ("**Italy [2001]**"), para 9; *Commission v Italy* [2007] ECR I-11095 ("**Italy [2007]**"), para 22.

<sup>68</sup> This agreement was originally the Rome Treaty Establishing the European Economic Community, 1957, but was eventually repackaged as the Treaty Establishing the European Community (after the Maastricht Treaty, 1993), and then as the Treaty on the Functioning of the European Union (after the Lisbon Treaty, 2009).

<sup>69</sup> See *Italy* [2001], paras 2-5.

<sup>70</sup> See *Italy* [2007], paras 2-11.

<sup>71</sup> See *Italy* [2001], paras 20-21; *Italy* [2007], paras 33-43; *Commission v Spain* [1998] ECR I-6717, para 35; and *Commission v Belgium* [2000] ECR I-1221, paras 25-26;

<sup>72</sup> See Lindsey Cameron and Vincent Chetail, *Privatizing War: Private Military and Security Companies under Public International Law*, Cambridge University Press, 2013, pp 183-184: "*since general security services, including patrolling surveillance, static security and close protection services (i.e. bodyguarding) can be provided to the public (and often are) on a competitive and commercial basis, one can imagine that they would not be exempt from the application of the GATS, although policing powers for the state would be an excluded public service.*"

<sup>73</sup> GATS, article XIV:(a), (b) and (c).

*countries where like conditions prevail, or a disguised restriction on trade in services".*

- 1.3.2 Invocation of any of these exceptions "*requires that the challenged measure address the particular interest specified in that paragraph and that there be a sufficient nexus between the measure and the interest protected*".<sup>74</sup> This is an objective standard,<sup>75</sup> which the challenged Member bears the burden of meeting,<sup>76</sup> by showing that it has "*explored and exhausted reasonably available WTO-consistent alternatives*".<sup>77</sup> This involves a process of "*weighing and balancing*" the public interests protected against the trade interests affected:<sup>78</sup>

*One factor is the contribution of the measure to the realization of the ends pursued by it; the other factor is the restrictive impact of the measure on international commerce. A comparison between the challenged measure and possible alternatives should then be undertaken, and the results of such comparison should be considered in the light of the importance of the interests at issue. It is on the basis of this 'weighing and balancing' and comparison of measures, taking into account the interests or values at stake, that a panel determines whether a measure is 'necessary' or, alternatively, whether another, WTO-consistent measure is 'reasonably available'.*

- 1.3.3 Determining whether a measure meets the threshold of necessity is thus a complex contextual task, which will be resolved in favour of the Member defending it only if it can show that the measure stands "*significantly closer to the pole of 'indispensable' than to the opposite*

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<sup>74</sup> *US - Gambling*, Appellate Body Report, WT/DS285/AB/R, 20 April 2005, DSR 2005:XII, 5663, para 292.

<sup>75</sup> *Ibid*, para 304.

<sup>76</sup> *Ibid*, paras 309-310: "*It is well-established that a responding party invoking an affirmative defence bears the burden of demonstrating that its measure, found to be WTO-inconsistent, satisfies the requirements of the invoked defence.*"

<sup>77</sup> See *US - Gambling*, Panel Report, para 6.528.

<sup>78</sup> *US - Gambling*, Appellate Body Report, paras 306-307, citing *Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Appellate Body Report, WT/DS161/AB/R & WT/DS169/AB/R, 10 January 2001, DSR 2001:I 5, paras 164-166.

*pole of simply 'making a contribution to' the public interests it seeks to protect.*<sup>79</sup>

1.3.4 It may be expected that the South African government might seek to place Clause 20 within one of these exceptions, most likely "*public order*".<sup>80</sup> GATS prescribes a strict interpretation of this exception, stating that it "*may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society*".<sup>81</sup> While the government may have little difficulty showing that national security is "*one of the fundamental interests of society*",<sup>82</sup> it would have to present *evidence* demonstrating that foreign ownership of private security companies poses "*a genuine and sufficiently serious threat*" to national security. In our view, it has not done so, and is not in any apparent position to do so.

1.3.5 Indeed, an analogous "*public order*" exception was invoked by Italy when its private security laws were challenged before the ECJ in 2007. The ECJ held that the exception "*must be narrowly construed*",<sup>83</sup> and found that it was unavailable in that case.<sup>84</sup>

*It cannot be held that private security undertakings, established in Member States other than the Italian Republic, could create a genuine and serious threat affecting one of the fundamental interests of society by exercising their right to freedom of establishment and freedom to provide services and by using staff who have not sworn allegiance to the Italian Republic and the Head of State.*

1.3.6 In a previous complaint against a Belgian law requiring private security firms to have their place of business in Belgian territory, the

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<sup>79</sup> *Ibid*, paras 309-310.

<sup>80</sup> GATS, article XIV:(a).

<sup>81</sup> GATS, footnote 5.

<sup>82</sup> See *US - Gambling*, Panel Report, para 6.467: "*These fundamental interests can relate, inter alia, to standards of law, security and morality.*"

<sup>83</sup> See *Italy* [2007], para 49.

<sup>84</sup> *Ibid*, para 50.

ECJ found that "*the Belgian Government's argument that any security firm is capable of constituting a genuine and sufficiently serious threat to public policy and public security is obviously unfounded and, in any event, unproven*".<sup>85</sup>

1.3.7           It is important to note that, although the standard under GATS is an objective one, the Member's subjective sense of necessity is a significant factor to be taken into account.<sup>86</sup>

*We note, at the outset, that the standard of 'necessity' provided for in the general exceptions provision is an objective standard. To be sure, a Member's characterization of a measure's objectives and of the effectiveness of its regulatory approach - as evidenced, for example, by texts of statutes, legislative history, and pronouncements of government agencies or officials - will be relevant in determining whether the measure is, objectively, 'necessary'. A panel is not bound by these characterizations, however, and may also find guidance in the structure and operation of the measure and in contrary evidence proffered by the complaining party. In any event, a panel must, on the basis of the evidence in the record, independently and objectively assess the 'necessity' of the measure before it.*

1.3.8           In respect of Clause 20, however, the government's "*characterization of [the] measure's objectives and of the effectiveness of its regulatory approach*" is far from clear. Firstly, the executive has admitted that Clause 20 is not aimed exclusively at safeguarding national security but also at "*transforming*" the industry. Concluding the National Assembly's debate on the second reading of the Bill in February 2014, the Minister spoke as follows:<sup>87</sup>

*Speaker, this industry is going to be transformed. [Interjections.] Firstly, regarding the threat, we said here that if the collection of intelligence information by the security*

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<sup>85</sup> See *Commission v Belgium* [2000] ECR I-1221, para 30.

<sup>86</sup> *US - Gambling*, Appellate Body Report, para 304.

<sup>87</sup> Unrevised Hansard, *Proceedings of the National Assembly*, 238-240. See the similar comments by the Chair of the Committee, Ms A van Wyk MP (at 196) and Mr JK Moepeng MP (at 234-235). The Memorandum on the Objects of the Bill, para 1.1, also cites this motive.



*companies, the evidence of criminality and criminal activities by some of them and the allegations of mercenary activities in other countries from here in South Africa do not constitute a threat to security, I do not know what does. ...*

*Now, regarding the 51% that we are talking about, you cannot say that you need to transform this industry and talk about everything else, except for ownership. You cannot do this. The countries that have their security industries here, mainly the United States and the United Kingdom, do not restrict this industry in their countries for foreigners, they outlawed them! They outlawed them! In fact, the last one involved the British government challenging the European Union on that, because they are very clear on it being outlawed. And we are not even outlawing them! All we are saying is that ownership must be transformed. South Africans must have a stake in the ownership of this. We are not going to be apologetic about that. [Applause.] We will ensure that that will happen at the end of the day.*

1.3.9            Moreover, the government has never placed on record any evidence demonstrating a "*sufficient nexus between the measure and the interest protected*", such as would place it "*significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'*" national security.<sup>88</sup> The SAPS Briefing Paper does not demonstrate any such nexus, as it shows neither how foreign ownership of private security companies jeopardises national security, nor how restricting foreign ownership to 49% would contribute at all - let alone indispensably - to eradicating such risk.

#### 1.4            **security exceptions**

1.4.1            GATS also affords a Member the space to take "*any action which it considers necessary for the protection of its essential security interests*", as far as they pertain to military establishments, nuclear programmes or wartime emergencies,<sup>89</sup> as well as "*any action in pursuance of its obligations under the United Nations Charter for the*

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<sup>88</sup> US - Gambling, Appellate Body Report, paras 309-310.

<sup>89</sup> GATS, article XIVbis:1(b).



*maintenance of international peace and security*".<sup>90</sup> These provisions of GATS have never undergone dispute resolution, and the few disputes arising under the corresponding provisions of the GATT have never resulted in any definitive rulings.<sup>91</sup> It is instructive to note, however, that they all concerned targeted trade embargoes imposed upon specific enemy regimes,<sup>92</sup> rather than blanket restrictions directed at foreign nations generally.

1.4.2 Based on the government's stated suspicions about "*the line between private security companies and private military companies ... becoming increasingly blurred*",<sup>93</sup> it might argue that Clause 20 is an "*action which it considers necessary for the protection of its essential security interests... relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment*".<sup>94</sup>

1.4.3 For this exception to apply, however, the government would, in our view, need to show: (a) which military establishment is at issue; (b) which services are being supplied "*for the purpose*" of that military establishment; and (c) how and why Clause 20 is "*necessary*" to protect essential security interests from such supply. The same stringent test for "*necessity*" would require the government to have "*explored and exhausted reasonably available WTO-consistent alternatives*", which it has not done. Moreover, even if evidence were available in respect of (a) and (b) (and we are aware of none),

<sup>90</sup> GATS, article XIVbis:1(c).

<sup>91</sup> Van den Bossche and Zdouc, *op cit*, 595-600; Roger Alford, "The Self-Judging WTO Security Exception", *Utah Law Review*, 2011, volume 3, 697-759.

<sup>92</sup> See, for example, Request for Consultations by the European Communities, *United States - The Cuban Liberty and Democratic Solidarity Act*, WT/DS38/1, 13 May 1996.

<sup>93</sup> SAPS Briefing Note, 2. See also Unrevised Hansard, *Proceedings of the National Assembly*, 188; and Unrevised Hansard, *Proceedings of the National Council of Provinces*, 5 March 2014 - during the second reading of the Bill, the Chair of the Select Committee on Security and Constitutional Development stated that "*the majority of delegates were satisfied with the department's responses that [GATS] allows for certain exceptions, which include national security considerations*".

<sup>94</sup> GATS, article XIVbis:1(b)(i).

Clause 20 would undoubtedly be overbroad, and thus not "*necessary*", as it would in principle apply to *all* private security services, irrespective of nature, purpose, supplier or consumer.

## 2. Substance

### 2.1 most-favoured-nation treatment

2.1.1 GATS requires that "*each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country*".<sup>95</sup> This classic obligation of 'most-favoured-nation treatment' aims to ensure that no preferential or prejudicial treatment is accorded to any particular

Member or Members. The standard prohibits differential treatment whether it manifests directly or indirectly, as it is "*interpreted to include de facto, as well as de jure, discrimination*".<sup>96</sup> Although there is provision for a Member to obtain temporary exemption from this obligation in respect of certain sectors,<sup>97</sup> South Africa's list of exemptions concerns only road transportation and financial services within the Southern African region.<sup>98</sup>

2.1.2 Clause 20, on its face, does not appear to fall foul of the most-favoured-nation treatment standard, as Clause 20(2)(c) imposes a blanket restriction on foreign capital for all private security companies across the board. The power of the Minister, under Clause 20(2), to "*prescribe by regulation a different percentage of ownership and control in respect of different categories of the security business*" would also, in principle, not contravene the standard, as the listed categories are based on service types rather

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<sup>95</sup> GATS, article II:1.

<sup>96</sup> See *EC - Bananas III*, Appellate Body Report, paras 231-234.

<sup>97</sup> GATS, article II:2.

<sup>98</sup> *South Africa: Final List of Article II Exemptions*, GATS/EL/78, 15 April 1994.

than sources, and would thus meet GATS' qualification of "*like services and service suppliers*".<sup>99</sup>

2.1.3 However, Clause 20(5) empowers the Minister to exempt any private security service provider from any provision of the Act, "*as long as it does not prejudice the achievement of the objects of this Act*". This provision may contravene the most-favoured-nation standard, as it creates scope for the Minister to favour investors from one state over those from another. This would manifest directly if the Minister persists with the government's national security rationale and accordingly grants exemption to suppliers from South Africa's diplomatic or economic allies. It could also manifest indirectly. For example, if the Minister were to relax the restriction on foreign investment for Company A (owned by US nationals), this would result in less favourable treatment for Company B (owned by UK nationals) and Company C (owned by Swedish nationals). Thus, in order to comply with the most-favoured-nation standard, the Minister would have to grant the same exemption to all foreign-owned companies or to none. This would render the exemption power effectively inapplicable to the cap on foreign ownership.

## 2.2 market access

2.2.1 GATS provides for each Member to stipulate specific commitments to liberalise access to its domestic market in respect of different service sectors, subject strictly to the "*terms, limitations and conditions agreed and specified in its Schedule*".<sup>100</sup> More specifically, GATS prescribes that, "*unless otherwise specified in its Schedule*", a Member "*shall not maintain or adopt*", among other

<sup>99</sup> Clause 23 would insert a new section 21A, prescribing the following closed list of categories: "(a) guarding; (b) close protection; (c) response security; (d) assets in transit; (e) event security; (f) manufacturers, importers and distributors of listed equipment defined in [RICA]; (g) private investigators; (h) security training; (i) electronic security; (j) locksmiths; or (k) security advisers".

<sup>100</sup> GATS, article XVI:1.

measures, "*limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment*".<sup>101</sup>

2.2.2 In 2009, China was found by the WTO Appellate Body to have breached this obligation, by adopting regulations which, among other things, restricted the licenced distribution of electronic sound recordings to companies with a maximum foreign shareholding of 49 per cent, whereas it had stipulated no such limitation on market access in its Schedule of Specific Commitments.<sup>102</sup> China was ordered to bring its regulations into conformity with its Schedule, and in April 2012, China reported that it had repealed the measure.<sup>103</sup>

2.2.3 South Africa's Schedule stipulates no limitations on market access through "*commercial presence*" in the "*investigation and security*" sector.<sup>104</sup> Accordingly, in the same way as it did for China, the market access obligation under GATS completely prohibits South Africa from introducing any limit on foreign shareholding in private security companies. Clause 20 self-evidently constitutes a clear breach of this obligation.

## 2.3 national treatment

2.3.1 Each Member also commits itself, "*subject to any conditions and qualifications*" set out in its Schedule, to "*accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers*".<sup>105</sup>

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<sup>101</sup> GATS, article XVI:2(f).

<sup>102</sup> *China - Publications and Audiovisual Products*, Panel Report, paras 7.1395-1396 and 8.2.3(c)(i); and Appellate Body Report, WT/DS363/AB/R, 19 January 2010, DSR 2010:I, 3, para 416(b).

<sup>103</sup> *China - Publications and Audiovisual Products*, Status Report by China, WT/DS363/17/Add.15, 13 April 2012.

<sup>104</sup> *South Africa: Schedule of Specific Commitments*, GATS/SC/78, 15 April 1994, 12.

<sup>105</sup> GATS, article XVII:1.

Whether it is formally identical or different, treatment is deemed "*less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member*".<sup>106</sup>

2.3.2           The national treatment obligation is a classic international norm of non-discrimination, which is breached when "*origin is the only factor on which a measure bases a difference of treatment between domestic service suppliers and foreign suppliers, ... provided there will, or can, be domestic and foreign suppliers that under the measure are the same in all material respects except for origin*".<sup>107</sup>

2.3.3           In understanding the impact of discriminatory measures in the private security context, it is useful to have regard again to the jurisprudence of the ECJ. In the 2001 case against Italy, the ban on foreign firms supplying private security services was overtly discriminatory on no basis other than nationality, and thus it was found to be "*an unjustified restriction on freedom of establishment and freedom to provide services*".<sup>108</sup> In 2007, however, the ECJ found that these freedoms were infringed even by the indirect measure of requiring all security guards (irrespective of nationality) to swear an oath of allegiance to the Italian Republic:

*[E]ven though that rule applies to operators from other Member States wishing to pursue their activities in Italy in exactly the same way as it applies to operators established in Italy, it none the less constitutes, for any operator not established in Italy, an impediment to the pursuit of its activities in that Member State, which impairs its access to the market.*

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<sup>106</sup> GATS, article XVII:3.

<sup>107</sup> *China - Publications and Audiovisual Products*, Panel Report, paras 7.975-976. See also *Canada - Measures Relating to Exports of Wheat and Treatment of Imported Grain*, Panel Report, WT/DS276/R, 27 September 2004, paras 6.164-167; *Argentina - Measures Affecting the Export of Bovine Hides and Import of Finished Leather*, Panel Report, WT/DS155/R, 16 February 2001, DSR 2001:V, 1779, paras 11.168-169.

<sup>108</sup> See *Italy* [2001], para 22.

*By comparison with operators from other Members States wishing to pursue their activities in Italy, it is easier for operators established in an Italian province to have staff available to them who will agree to swear the oath required under Italian legislation. It is obvious that, on account of its symbolic significance, such a solemn promise of allegiance to the Italian Republic and to the Head of State will be more acceptable to citizens of Italy or to people who are already installed in that State. As a result, foreign operators are placed at a disadvantage as compared with Italian operators established in Italy.*<sup>109</sup>

2.3.4            Clause 20, however, requires little nuanced analysis, as it is a blunt and sweeping measure, differentiating between foreign and domestic investors directly and exclusively on the basis of nationality. South Africa's Schedule of Specific Commitments does not stipulate any limitations at all on its national treatment obligation in respect of the "commercial presence" of suppliers in the "investigation and security" sector.<sup>110</sup> Accordingly, Clause 20 constitutes a clear breach of that obligation, which would be regarded by the WTO in the same way as China's 49 per cent cap on foreign participation in the distribution of electronic sound recordings.<sup>111</sup>

*In our view, a measure that prohibits foreign service suppliers from supplying a range of services that may, subject to satisfying certain conditions, be supplied by the like domestic supplier cannot constitute treatment "no less favourable", since it deprives the foreign service supplier of any opportunity to compete with like domestic suppliers. In terms of paragraph 3 of Article XVII, such treatment modifies conditions of competition in the most radical way, by eliminating all competition by the foreign service supplier with respect to the service at issue.*

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<sup>109</sup> *Italy* [2007], paras 46-47.

<sup>110</sup> *South Africa: Schedule of Specific Commitments*, GATS/SC/78, 15 April 1994, 12.

<sup>111</sup> *China - Publications and Audiovisual Products*, Panel Report, para 7.979.

### 3. Procedure

#### 3.1 transparency

3.1.1 GATS requires that each Member must "*promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments*".<sup>112</sup> Moreover, it must "*respond promptly to all requests by any other Member for specific information*" on such measures.<sup>113</sup> These obligations, although untested and often overlooked, are vital to effective trade in services, as "*lack of information, uncertainty and confusion with respect to the relevant laws and regulations applicable in actual or potential foreign markets are formidable barriers to trade*".<sup>114</sup>

3.1.2 As far as we can ascertain, Clause 20 has not been the subject of any communication by the South African government to the Council for Trade in Services, despite the fact that it will undoubtedly "*significantly affect trade in services covered by its specific commitments*". Moreover, there does not appear to be any public record of the government having responded, promptly or at all, to

those Members who have raised concerns regarding Clause 20.<sup>115</sup>

As far as we are aware, however, no Member has issued South Africa with a formal request for consultation under GATS.<sup>116</sup>

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<sup>112</sup> GATS, article III:3.

<sup>113</sup> GATS, article III:4.

<sup>114</sup> See Van den Bossche and Zdouc, *op cit*, 532.

<sup>115</sup> See the letters from US Ambassador Patrick Gaspard and European Union Trade Delegate Axel Pougine de la Maisonneuve on 28 February 2014, UK Trade Commissioner Andrew Henderson on 1 March 2014, Swedish Economic Counsellor Sara Aulin on 3 March 2014, and US Senator Orrin Hatch on 23 June 2014.

<sup>116</sup> See GATS, article XXII, read with the WTO Agreement - Annex 2: Understanding on Rules and Procedures governing the Settlement of Disputes, article 4.



3.1.3 In any event, the limited information that the government has published regarding Clause 20 cannot approximate any meaningful standard of transparency, as it provides foreign suppliers with no clarity or predictability as to the precise motive of the measure, nor its intended implications. There is, for example, no indication of what metric might be used to measure the "*per cent*" value of foreign "*ownership and control*" of private security companies,<sup>117</sup> nor whether, on what basis and to what extent a particular company might be exempted from the requirement.<sup>118</sup>

### 3.2 modification of schedules

3.2.1 GATS makes provision for a Member to "*modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force*".<sup>119</sup> This is, however, not an easy exercise. The Member must give notice of the proposed modification or withdrawal, at least three months before its intended implementation, to the Council for Trade in Services,<sup>120</sup> which will distribute the notice to all Members and discuss it at its next meeting.<sup>121</sup>

3.2.2 Any other Member potentially affected by the proposed modification or withdrawal may object to it within 45 days of its circulation.<sup>122</sup>

<sup>117</sup> Clause 20(e), inserting a new section 20(2B), would leave this calculus solely to the Minister, who "*must prescribe by regulation the verification of ownership and control of security businesses*".

<sup>118</sup> Clause 20(e), inserting a new section 20(2A), provides opaquely that "*the Minister may, taking into account the security interests of the Republic, prescribe by regulation a different percentage of ownership and control in respect of different categories of the security business*"; Clause 20(f), amending section 20(5)(b), would empower the Minister to "*exempt any service, activity, practice, equipment, person or entity from any provision of this Act*".

<sup>119</sup> GATS, article XXI:1(a).

<sup>120</sup> GATS, article XXI:1(b).

<sup>121</sup> Council for Trade in Services, Procedures for the Implementation of Article XXI of the General Agreement on Trade in Services: Modification of Schedules, 19 July 1999 ("**GATS Modification Procedures**"), para 1.

<sup>122</sup> See GATS Modification Procedures, para 3.



Thereafter, the modifying Member must, within three months,<sup>123</sup> negotiate and agree upon a "*compensatory adjustment*" with all affected Members, in order to "*maintain a general level of mutually advantageous commitments not less favourable to trade*" than its Schedule previously provided.<sup>124</sup> The results of these negotiations are circulated to all Members.<sup>125</sup>

3.2.3 If no agreement is reached within three months, an affected Member may refer the matter to arbitration within the following 45 days.<sup>126</sup> Three arbitrators must be appointed within 30 days,<sup>127</sup> and they must complete their work within three months.<sup>128</sup> Their mandate is to "*examine the compensatory adjustments offered by [the modifying Member] or requested by [the affected Member(s)] and to find a resulting balance of rights and obligations which maintains a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to the negotiations*".<sup>129</sup> If the Member implements the proposed modification or withdrawal before receiving, or in conflict with, the arbitrators' findings, "*any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits in conformity with those findings*".<sup>130</sup>

3.2.4 If the negotiations are successful, or the arbitration is favourable, the Member must still submit a draft Schedule to the Council for Trade in Services, which will circulate it to all Members. There is then

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<sup>123</sup> See GATS Modification Procedures, para 4.

<sup>124</sup> GATS, article XXI:2(a). Any agreed adjustment would then apply generally, on a most-favoured-nation basis, not only in favour of the affected Member with whom the negotiation was concluded (GATS, article XXI:2(b)).

<sup>125</sup> See GATS Modification Procedures, para 5.

<sup>126</sup> See GATS, article XXI:3(a); GATS Modification Procedures, para 7.

<sup>127</sup> See GATS Modification Procedures, para 10.

<sup>128</sup> See GATS Modification Procedures, para 14.

<sup>129</sup> See GATS Modification Procedures, para 13.

<sup>130</sup> See GATS, article XXI:4; GATS Modification Procedures, paras 9 and 16.

another opportunity for any affected Member to object to the draft Schedule within a further 45 days, and to enter into consultations with the modifying Member to resolve the matter.<sup>131</sup> Any resulting changes to the draft Schedule are subject to another opportunity to object within a further 15 days, requiring further consultation.

3.2.5 Overall, this is a process that could potentially endure for several years. The only arbitration instituted under this provision to date, brought by Antigua against the US, is still unresolved after some seven years. The US had given notice in May 2007 (shortly after it was found to have breached the Panel Ruling against its restrictions on internet gambling)<sup>132</sup> that it would modify its schedule to exclude internet gambling from its market access commitments in the "*recreational services*" sub-sector.<sup>133</sup> The US reached agreement on compensatory adjustments with all affected Members except Antigua,<sup>134</sup> which immediately referred the matter to arbitration. In separate proceedings relating to the original breach, Antigua recently secured authorisation to take retaliatory measures against the US in the sphere of intellectual property rights.<sup>135</sup> The arbitration regarding the modification of the US' schedule may now proceed.

3.2.6 It is apparent from this that the modification or withdrawal of any commitment from South Africa's Schedule would be a complex and potentially very lengthy and costly exercise for the country. At the very least, the government would need to equip itself, in advance,

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<sup>131</sup> GATS Modification Procedures, paras 20-21.

<sup>132</sup> *US - Gambling: Recourse to Article 21.5 of the Dispute Settlement Understanding by Antigua and Barbuda*, Panel Report, WT/DS285/RW, 22 May 2007, DSR 2007:VIII, 3105.

<sup>133</sup> Van den Bossche and Zdouc, *op cit*, 531; Council for Trade in Services, *Notification from the United States Pursuant to Article XXI of the General Agreement on Trade in Services: Addendum*, S/SECRET/10/Add.1, para I.1.

<sup>134</sup> Australia, Canada, the European Union and Japan all accepted the US's offer to make additional market access commitments in respect of postal, warehousing, research and development, and technical testing services.

<sup>135</sup> See Van den Bossche and Zdouc, *op cit*, 531.

not only with a cogent case for implementing the modification or withdrawal, but also with a carefully considered menu of "*compensatory adjustments*" it is prepared to make in the interests of implementing Clause 20.

3.2.7           The SAPS Briefing Note seems to suggest that the South African government has not considered these needs, and has not fully appreciated the implications Clause 20 will have not only for trade in the private security sector, but potentially in other sectors that may be affected by compensatory adjustments - whether by agreement, arbitral award or unilateral retaliatory measures.<sup>136</sup> It also does not appear that the DTI has been involved or consulted in the SAPS's assessment of the trade law implications of Clause 20, yet the DTI would be the body responsible for negotiating and implementing any consequent compensatory adjustments.

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<sup>136</sup> See, for example, the op ed by Minister Nathi Mthethwa (during the final few days of his tenure) in *Business Day*, 20 May 2014, where he appears to assume that three months' notice is all that is required for withdrawal of GATS commitments, without any need for negotiation or arbitration.

## D. INTERNATIONAL INVESTMENT LAW

### 1. Scope

#### 1.1 investment agreements

1.1.1 International investment law refers to an extensive global network of legal instruments in which states have given certain substantive and procedural guarantees regarding the promotion and protection of foreign investments in their territories. While the instruments differ in detail, they bear common features that have lent themselves to the growth of a global body of jurisprudence for the interpretation of the rights and obligations they create. Classically, these guarantees are contained in bilateral investment treaties ("**BITs**") between two states, but they may also be found in the investment chapters of free trade agreements ("**FTAs**") among multiple states, or even in outward undertakings by states towards foreign investors generally.

1.1.2 A pertinent example of the latter is the SADC Investment Protocol,<sup>137</sup> which is binding on South Africa both in international law and in domestic constitutional law.<sup>138</sup> It was adopted in 2006 with the primary objective of "*creating a favourable investment climate within SADC with the aim of promoting and attracting investment in the Region*",<sup>139</sup> and its substantive and procedural protections are expressly extended to investors from any state in the world, not only from SADC. Thus, the SADC Investment Protocol contains mutual undertakings by SADC members towards one another, but also

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<sup>137</sup> SADC Protocol on Finance and Investment - Annex 1: Co-operation on Investment ("**SADC Investment Protocol**"), which was signed on 18 August 2006, was ratified by South Africa on 19 June 2008, and entered into force on 16 April 2010.

<sup>138</sup> See Section 231 of the Constitution; *Government of the Republic of Zimbabwe v Fick and Others* 2013 (5) SA 325 (CC), paras 27 and 69.

<sup>139</sup> Article 2(2)(a) of the SADC Protocol.

outward undertakings by SADC members towards the global investment community as a whole.

1.1.3 South Africa is party to 43 BITs and 10 other international investment agreements,<sup>140</sup> almost all concluded after the end of apartheid in 1994. South Africa has, however, never concluded a BIT with the US and is not a party to the Washington Convention,<sup>141</sup> the world's most widely ratified international investment agreement.<sup>142</sup>

Following a policy review in 2009,<sup>143</sup> South Africa gave notice to terminate several BITs: Belgium-Luxembourg on 7 September 2012; Spain on 23 June 2013; Germany on 23 October 2013; Switzerland on 30 October 2013; and The Netherlands on 1 November 2013. Despite the above policy review, the South Africa has not yet terminated its BITs with the UK<sup>144</sup> and Sweden<sup>145</sup> (among others), which are particularly relevant for present purposes, in light of the substantial extent of capital invested into South African private security companies by persons domiciled and incorporated in those two states.

1.1.4 Under the TDCA, South Africa bound itself towards the European Union "to establish a climate which favours and promotes mutually beneficial investment, both domestic and foreign, especially through

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<sup>140</sup> See United Nations Conference on Trade and Development ("UNCTAD"), *World Investment Report*, 2014, 225.

<sup>141</sup> Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("**Washington Convention**"), signed on 18 March 1965 and entered into force on 14 October 1966. The Washington Convention created a standing arbitral facility, the International Centre for the Settlement of Investment Disputes ("**ICSID**").

<sup>142</sup> The Washington Convention has been ratified by 158 states.

<sup>143</sup> DTI, *Bilateral Investment Treaty Policy Framework Review: Government Position Paper*, June 2009.

<sup>144</sup> Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa for the Promotion and Protection of Investments ("**SA-UK BIT**"), which was signed on 20 September 1994 and entered into force on 27 May 1998.

<sup>145</sup> Agreement between the Kingdom of Sweden and the Republic of South Africa on the Promotion and Reciprocal Protection of Investments ("**SA-Sweden BIT**"), which was signed on 25 May 1998 and entered into force on 1 January 1999.

*improved conditions for investment protection".*<sup>146</sup> Moreover, the EFTA-SACU FTA requires that South Africa "*shall endeavour to create and maintain a stable and transparent investment framework and shall not impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments*".<sup>147</sup>

## 1.2 protected investors

1.2.1 In principle, South Africa owes its investment protection obligations to any investor from a state with which South Africa maintains a BIT or similar instrument. Such an investor is typically defined as any natural person bearing the nationality of that state or any juristic person incorporated in that state.<sup>148</sup>

1.2.2 The SADC Investment Protocol, however, protects any investors from a "*third state*", which is "*any state that is not a State Party*" (i.e. any state outside SADC).<sup>149</sup> Accordingly, the protections in the SADC Investment Protocol may be invoked by any foreign investor, without demonstrating nationality of any particular state.

## 1.3 protected investments

1.3.1 The definition of "*investment*" is typically broad, encompassing most legally recognised forms of corporeal and incorporeal property. Most

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<sup>146</sup> See TDCA, article 52.

<sup>147</sup> See EFTA-SACU FTA, article 28(1).

<sup>148</sup> The SA-UK BIT protects UK "*nationals*" (article 1(c)(ii)) as well as "*companies*" incorporated in UK territory (article 1(d)(ii)). The SA-Sweden BIT, article 1(2), defines "*investor*" slightly more widely:

- (a) *any natural person who is a national of a Contracting Party in accordance with its laws;*
- (b) *any legal person constituted in the territory of a Contracting Party and having its seat in the territory of that Contracting Party; and*
- (c) *any legal person not established under the laws of a Contracting Party but effectively controlled by natural persons, as defined in (a) above, or by legal persons, as defined in (b) above.*

<sup>149</sup> SADC Investment Protocol, article 1 sv "third state".

relevant for present purposes, it invariably includes "*shares and other kinds of interest in companies*".<sup>150</sup>

## 2. Substance

### 2.1 fair and equitable treatment

2.1.1 The guarantee of fair and equitable treatment<sup>151</sup> is broad and encompasses a number of specific investment protection measures and general international law standards, both substantive and procedural in nature. These include a host state's obligation to act in good faith, consistently, transparently, reasonably, without ambiguity, arbitrariness or discrimination, in an even-handed manner, to ensure due process in decision-making as well as to respect investors' legitimate expectations.<sup>152</sup> An investor is entitled to expect the host state to act in accordance with its stated decisions, policies, rules and regulations which relate to its investments.<sup>153</sup>

2.1.2 Clause 20 is likely to contravene the fair and equitable treatment standard, as it is arbitrary, given that the government has not demonstrated any rational relationship between national security and restricting foreign ownership at all, let alone to the arbitrary ceiling of

<sup>150</sup> SA-Sweden BIT, article 1(1)(b); UK-SA BIT, article 1(a)(ii).

<sup>151</sup> SADC Investment Protocol, article 6(1); SA-UK BIT, article 2(2); SA-Sweden BIT, article 3(2).

<sup>152</sup> Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, Kluwer Law International, 2009, 279-280. The reference to *legitimate expectations* is to the expectations of the relevant investor arising from its reliance on specific host state conduct, usually oral or written representations or commitments, relating to an investment. In addition, a foreign investor may legitimately expect a relatively *stable and predictable* legal and administrative framework that meets certain *minimum standards*, including *transparency* and *consistency* in the host state's decision-making process, as well as the general expectation that the host state will treat foreign investments *fairly and equitably*.

<sup>153</sup> See the following leading authorities: *Tecnicas Medioambientales Tecmed SA v United Mexican States*, ICSID Case No ARB(AF)/00/2, Award, 29 May 2003 ("**Tecmed**"), para 154; *MTD Equity Sdn Bhd & MTD Chile SA v Republic of Chile*, ICSID Case No ARB/01/7, Award, 25 May 2004, para 114; *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, Award, 1 July 2004, para 185; *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No ARB/01/08, Award, 12 May 2005 ("**CMS**"), para 279; *LG&E v Argentine Republic*, ICSID Case No ARB/02/1, Award, 25 July 2007, para 127.

49 per cent.<sup>154</sup> It is also ambiguous, as the meaning of the crucial term "*ownership and control*" is left to Ministerial discretion, and its application is ultimately subject to Ministerial exemption. Finally, the manner of its introduction and particularly its re-introduction - being removed entirely in November 2012 and then reinserted without warning in November 2013 - cannot be said to have met any fair standard of consultation, consistency and transparency.<sup>155</sup>

## 2.2 non-discrimination

2.2.1 The international norm of non-discrimination precludes the host state from subjecting foreign investors or their investments to any treatment less favourable than that which it accords to its own nationals and their investments (national treatment), or those of any other state (most-favoured-nation treatment), in like circumstances.<sup>156</sup>

2.2.2 For the same reasons as set out in respect of South Africa's trade law obligations, Clause 20 clearly violates national treatment as it discriminates against foreign investors on no basis other than their nationality,<sup>157</sup> and will invariably breach most-favoured-nation treatment, as the exercise of the Minister's discretion to exempt foreign-owned company from the restriction will necessarily mean less favourable treatment towards the home states of the other foreign-owned companies.<sup>158</sup>

<sup>154</sup> See *Saluka Investments BV (The Netherlands) v The Czech Republic*, Partial Award, 17 March 2006, 458-460, where the Tribunal, referring to the International Court of Justice's decision in *Fisheries Jurisdiction (Spain v Canada)*, held that the host state must prove that its conduct "*bears a reasonable relationship to some rational policy*".

<sup>155</sup> See **A.3** above.

<sup>156</sup> Newcombe and Paradell, *op cit*, 159-163; SADC Investment Protocol, article 6(2); SA-UK BIT, article 3(1) and (2); SA-Sweden BIT, article 3(1).

<sup>157</sup> See **B.2.3** above.

<sup>158</sup> See **B.2.1** above.



## 2.3 expropriation

2.3.1 The SADC Investment Protocol precludes South Africa from expropriating any investment in its territory "*except for a public purpose, under due process of law, on a non-discriminatory basis and subject to the payment of prompt, adequate and effective compensation*".<sup>159</sup> South Africa's BITs with the UK and Sweden

contain similar guarantees.<sup>160</sup>  
that:<sup>161</sup>

The SA-UK BIT provides further

*Such compensation shall amount to the genuine value of the investment expropriated immediately before the expropriation or before the impending expropriation became public knowledge, whichever is earlier, shall include interest at a normal commercial rate until the date of payment, shall be made without delay, be effectively realizable and be freely transferable at the rate of exchange applicable on the date of the transfer pursuant to the exchange regulations in force.*

2.3.2 Protection from uncompensated expropriation is one of the classic cornerstones of international investment law. Subject to the terms of the instrument in question, it denotes protection from direct and total takings of property by the host state,<sup>162</sup> as well as from measures

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<sup>159</sup> SADC Investment Protocol, article 5.

<sup>160</sup> SA-UK BIT, article 5(1): "*Investments of nationals or companies of either Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation... in the territory of the other Contracting Party except for a public purpose related to the internal needs of that Party on a non-discriminatory basis and against prompt, adequate and effective compensation.*"

SA-Sweden BIT, article 4(1): "*Neither Contracting Party shall take any measures depriving, directly or indirectly, an investor of the other Contracting Party of an investment unless the following conditions are complied with: (a) the measures are taken in the public interest and under due process of law; (b) the measures are distinct and not discriminatory; and (c) the measures are accompanied by provisions for the payment of prompt, adequate and effective compensation, which shall be transferable without delay in a freely convertible currency.*"

<sup>161</sup> SA-UK BIT, article 5(1).

<sup>162</sup> UNCTAD, "Expropriation: A Sequel", *Issues in International Investment Agreements: Series II*, July 2012, 7. In *Amoco International Finance Corporation v Government of the Islamic Republic of Iran*, Partial Award No 310-56-3, 14 July 1987, 15 Iran-US CTR 189, 220, the Tribunal referred to a "*compulsory transfer of property rights*" as the measure of direct expropriation. In *Metalclad Corporation v United Mexican States*, ICSID Case No ARB(AF)/97/1 (NAFTA), Award, 30 August 2000 ("**Metalclad**"), para 103, the Tribunal described "*open, deliberate and acknowledged takings*

having an equivalent effect, such that they "*permanently destroy the economic value of the investment or deprive the owner of its ability to manage, use or control its property in a meaningful way*".<sup>163</sup> It is important to note that "*it is generally accepted in international law, that a case of expropriation exists not only when a state takes over private property, but also when the expropriating state transfers ownership to another legal or natural person*".<sup>164</sup>

2.3.3 Clause 20 envisages that any foreign investor must sell to "*citizens*" however many shares it owns or controls in excess of 49 per cent. In our view, this constitutes an expropriation (whether indirectly or by equivalent effect) of the 'excess' shares, as the foreign investor is compelled to choose either to relinquish the shares or to relinquish the company's right to operate as a private security service provider. This choice is no choice at all, and thus it effectively neutralises the economic value of the excess shares.

2.3.4 It is necessary, then, to assess whether such expropriation complies with the cumulative conditions set by international investment law. In our view, it does not, as Clause 20 would not be:

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*of property, such as outright seizure or formal or obligatory transfer of title in favour of the host, to the obvious benefit of the host state."*

<sup>163</sup> See UNCTAD, *ibid*, xi and 7-12. In *Tecmed*, para 114, the Tribunal held that indirect expropriation included "*where laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the Government*". In *Metalclad*, the Tribunal similarly held that indirect expropriation included "*covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state*". In *Tippets, Abbett, McCarthy, Stratton v TAMS-AFFA Consulting Engineers of Iran*, Award No 141-7-2, 29 June 1984, 6 Iran-US CTR 189, 225, the Tribunal held that "*a deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected*". In *CMS*, para 262, the Tribunal held that the effects of the instituted measure must be substantial to the extent that the investor's benefits in its property would be neutralised.

<sup>164</sup> See *Amco Asia Corporation v Republic of Indonesia*, ICSID Case No ARB/81/1, Award, 20 November 1984, 62. The leading South African judgment on expropriation, *Agri South Africa v Minister for Minerals and Energy* 2013 (4) SA 1 (CC), is inconsistent with international law in this respect and, in our view, was wrongly decided - see Ben Winks, "Expropriation - A Minefield?", *De Rebus*, July 2013, 44-46.

- 2.3.4.1 "for a public purpose", as there is no rational relationship between the measure (limiting foreign ownership) and the stated purpose (protecting national security);
- 2.3.4.2 "under due process of law", in light of the lack of transparency and consultation that marred its adoption by Parliament;
- 2.3.4.3 "on a non-discriminatory basis", as it manifestly discriminates against non-citizens on no basis other than their nationality; and
- 2.3.4.4 "subject to the payment of prompt, adequate and effective compensation", as the compulsory nature of the sale would invariably have the effect of diminishing the market value of the affected shares (considering that they would have to be sold at the same time and that the pool of potential buyers would then be restricted to citizens).

### 3. Procedure

#### 3.1 international arbitration

- 3.1.1 The defining feature of international investment law is that it is enforceable by independent investor-state dispute settlement.<sup>165</sup> Whereas international trade law is enforceable only by the home state against the host state (horizontally), international investment law is enforceable by the affected investor against the host state directly, not only through recourse to its domestic courts (vertically) but by referral to international arbitration (diagonally). An award by an international arbitral tribunal would be enforceable against South

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<sup>165</sup> See *Gas Natural SDG SA v Argentine Republic*, ICSID Case No ARB/03/10, Decision on Jurisdiction, 17 June 2005, para 29; *Eastern Sugar BV v The Czech Republic*, UNCITRAL, Partial Award, 27 March 2007, para 165; *Mafezzini v Kingdom of Spain*, ICSID Case No ARB/97/7, Decision on Objections to Jurisdiction, 25 January 2000, para 54; and *Suez, Sociedad General de Aguas de Barcelona SA and InterAguas Servicios Integrales del Agua SA v Argentine Republic*, ICSID Case No ARB/03/17, Decision on Jurisdiction, 16 May 2006, para 57.

Africa in the courts of any of the 154 countries that are party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958.<sup>166</sup>

3.1.2 BITs typically provide for direct investor-state arbitration of investment disputes under the auspices of ICSID or another arbitral institution. The SA-UK BIT permits an investor to submit a dispute, if not amicably settled within three months, to international arbitration before ICSID, the International Chamber of Commerce's Court of Arbitration, or an ad hoc arbitral tribunal under the rules of the United Nations Commission on International Trade Law ("**UNCITRAL**").<sup>167</sup>

The SA-Sweden BIT similarly entitles an investor to refer a dispute, if unsettled after six months, for arbitration before ICSID or an ad hoc tribunal under the UNCITRAL rules.<sup>168</sup>

3.1.3 The SADC Investment Protocol also entitles foreign investors to refer disputes to international arbitration, but only after exhausting domestic remedies.<sup>169</sup> In that event, the investor may refer the dispute to arbitration before ICSID or, if that forum is refused by the host state, to an ad hoc tribunal under the UNCITRAL rules.<sup>170</sup> Investors from states with which South Africa does not have a BIT would nonetheless be entitled to seek relief from an international arbitral tribunal, even if only after exhausting any available local remedies.

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<sup>166</sup> This Convention was adopted by a United Nations diplomatic conference on 10 June 1958 and entered into force on 7 June 1959. It was ratified by South Africa on 3 May 1976 and incorporated into domestic law through the Recognition and Enforcement of Foreign Arbitral Awards Act, 1977.

<sup>167</sup> SA-UK BIT, article 8(1) and (2).

<sup>168</sup> SA-Sweden BIT, article 7(2) and (3).

<sup>169</sup> SADC Investment Protocol, article 28(1).

<sup>170</sup> SADC Investment Protocol, article 28(2)(b)-(c) and (3). Article 28(2)(a) provides for referral to the SADC Tribunal, but that institution was suspended indefinitely by the SADC Summit during 2011 and has yet to be reconstituted.

3.1.4 Accordingly, to the extent that Clause 20 would contravene any of the substantive guarantees in an applicable investment instrument, an affected foreign investor would be entitled to refer the matter to international arbitration, and would in principle have considerable prospects of success. Clause 20 could thus expose South Africa to liability for compensation, and potentially legal costs, towards any foreign investor who is adversely affected by it.

### 3.2 **termination**

3.2.1 South Africa does, of course, retain the sovereign prerogative to withdraw from any international treaty, as long as it does so in conformity with the termination provisions of the treaty concerned. The termination of an investment treaty would, however, potentially have a chilling effect on foreign direct investment into South Africa, and would deprive South African investors of reciprocal protection in the territory of the other party to the terminated treaty.

3.2.2 As noted above, South Africa has given notice to terminate its BITs with Belgium-Luxembourg, Spain, Germany, Switzerland and The Netherlands.<sup>171</sup> This is pursuant to a DTI policy to terminate all of South Africa's BITs and to replace them with a single domestic statute.<sup>172</sup> The result is that investors from those states will enjoy BIT protection only in respect of investments made before the expiry of the notice period, and only for the duration of the sunset period prescribed by the BIT concerned.<sup>173</sup>

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<sup>171</sup> See **D.1.1.3** above.

<sup>172</sup> See Leon and Winks, *op cit*, note 18.

<sup>173</sup> The sunset periods of the already terminated BITs will expire as follows: Belgium-Luxembourg on 7 March 2023 (notice period of six months and sunset period of ten years); Spain on 23 January 2024 (notice period of six months and sunset period of ten years); Germany on 23 October 2034 (notice period of 12 months and sunset period of 20 years); Switzerland on 30 October 2034 (notice period of 12 months and sunset period of 20 years); and The Netherlands on 1 May 2029 (notice period of six months and sunset period of 15 years).

3.2.3 In September 2013, during the Bilateral Forum between the UK Foreign and Commonwealth Office and the South African Department of International Relations and Cooperation, the respective Ministers "*noted the intention of the South African Government after a series of consultations to terminate the [SA-UK BIT]*".<sup>174</sup> To date, however, South Africa has not yet issued formal notice to terminate the SA-UK BIT. Once it does so, the BIT will terminate after twelve months and the sunset period of protection will lapse twenty years thereafter.<sup>175</sup>

3.2.4 The SA-Sweden BIT is not yet susceptible to termination, as it is in force for an initial fixed term of twenty years,<sup>176</sup> which will end on 1 January 2019. Thereafter, it may be terminated on twelve months' notice, following which any pre-existing investments will enjoy protection for a further twenty years.<sup>177</sup>

3.2.5 The South African government has, to date, not publicly indicated any intention to withdraw from the SADC Investment Protocol, although its substantive similarities with BITs make it a significant impediment to the DTI's policy. If the government does indeed decide to withdraw from the SADC Investment Protocol, it may do so only on 12 months' notice to the SADC Secretariat,<sup>178</sup> whereupon South Africa will relinquish all rights and benefits under the Protocol immediately,<sup>179</sup> and will be released from its obligations under the Protocol only after a further sunset period of twelve months.<sup>180</sup>

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<sup>174</sup> *Joint Communiqué of the 10<sup>th</sup> Meeting of the United Kingdom - South Africa Bilateral Forum*, 10 September 2013, para 10. The next Bilateral Forum is due to be held during 2015.

<sup>175</sup> SA-UK BIT, article 14.

<sup>176</sup> SA-Sweden BIT, article 10(2).

<sup>177</sup> SA-Sweden BIT, article 10(3).

<sup>178</sup> SADC Investment Protocol, article 31(1).

<sup>179</sup> SADC Investment Protocol, article 31(2).

<sup>180</sup> SADC Investment Protocol, article 31(3).

- 3.2.6            Clause 20 will be susceptible to the substantive and procedural protections afforded by South Africa's BIT and the SADC Investment Protocol until the expiry of each treaty's post-termination sunset period. The prevailing risk of exposure to substantial compensation claims and legal costs should be borne in mind by those deciding when - or whether - Clause 20 should become law.

E.

**CONCLUSION**

1. In our assessment, Clause 20 exposes South Africa to considerable risk of compulsory participation in a series of lengthy, costly, complicated international legal processes arising out of its obligations under international trade law and international investment law.
2. Under international trade law, specifically GATS, any WTO Member affected by Clause 20 (in the sense that any of its nationals are affected by Clause 20) could lay a complaint against South Africa with the WTO, on the grounds that Clause 20:
  - 2.1 contravenes South Africa's Schedule of Specific Commitments, which stipulates that, in the private security services sector, no limitations will be imposed on foreign suppliers' entitlement to market access and national treatment;
  - 2.2 contravenes the non-derogable standard of most-favoured-nation treatment, in that it creates scope for Ministerial discretion, directly or indirectly, to favour certain Members over others;
  - 2.3 is not reasonably necessary to protect national security or any other public interest recognised under GATS;
  - 2.4 was passed without the required standard of transparency, in that neither the WTO nor its Members were kept informed, with any clarity or predictability, of its rationale, contents and consequences; and
  - 2.5 to the extent that it envisages modification or withdrawal of South Africa's Schedule of Specific Commitments, is not accompanied by any proffer of compensatory adjustments.



3. Under international investment law, any foreign investor forced to sell any stake in a South African private security business could institute international arbitration proceedings against South Africa (after exhausting local remedies, if it is not covered by a BIT permitting direct recourse), on the grounds that Clause 20:
  - 3.1 contravenes the international standard of fair and equitable treatment, in that it is ambiguous and arbitrary, and it was adopted in a manner that lacked any clarity, consistency, transparency or predictability;
  - 3.2 contravenes the guarantee of national treatment, in that it directly discriminates against foreign investors on no basis other than their nationality;
  - 3.3 contravenes the guarantee of most-favoured-nation treatment, in that it creates scope for a company to be exempted from the foreign ownership restriction, thereby according that company's foreign investor preferential treatment in relation to all others;
  - 3.4 constitutes an unlawful expropriation, in that it is not rationally related to a public purpose, it is discriminatory, and it does not provide for adequate compensation (as a forced sale of shares diminishes their market value); and
  - 3.5 cannot escape the application of these protections to existing investments until the expiry of the sunset period prescribed in the relevant investment agreement.

**WEBBER WENTZEL**

**Peter Leon Ben Winks**

**Johannesburg 2 March 2015**



DNA Economics

Impact of foreign ownership  
restrictions in the private security  
industry

March 2015

Clause 20(d) of the Private Security Industry Regulation  
Amendment Act, 2012

Research conducted for the Security Industry Alliance

## **AUTHOR**

Sarah Truen

Alex Constantinou

Andrew Sylvester



**DNA Economics**

3<sup>rd</sup> Floor, South Office Tower, Hatfield Plaza, 1122 Burnett Street, Hatfield, Pretoria, 0083, South Africa  
PO Box 95838, Waterkloof, 0145, South Africa

Tel +27 (0)12 362 0025 | Fax +27 (0)12 362 0210 | Email [contact@dnaeconomics.com](mailto:contact@dnaeconomics.com) | [www.dnaeconomics.com](http://www.dnaeconomics.com)

DNA Economics (Pty) Ltd

Company Registration: 2001/023453/07 | Directors: Amanda Jitsing, Elias Masilela, Matthew Stern, Truman Zuma

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## 1 INTRODUCTION

This paper provides an analysis of the likely costs associated with the implementation of Clause 20(d) of the Private Security Industry Regulation Amendment Act, 2012, which imposes restrictions on the ownership of private security firms in South Africa by international investors. This research was commissioned by the Security Industry Alliance.

At present, the South African private security industry includes four firms with majority foreign ownership, who would be affected by the proposed legislation. The table below indicates the relative size of these four firms, ranked by number of employees, as against the rest of the industry. As shown, all four are in the top fourteen firms by employee numbers.

**Table 1: Private security industry, ranked by number of employees, 2014**

Name of Firm	Number of employees	Foreign controlled?
Fidelity Security Services	26 551	
Protea Coin Group	17 500	
<b>G4S</b>	<b>14 302</b>	<b>Yes</b>
<b>ADT</b>	<b>10 516</b>	<b>Yes</b>
Bidvest Magnum	8 277	
Enforce	7 817	
Fidelity Springbok KZN	7 617	
IQP Africa	7 193	
Stallion Security	6 856	
Servest Security	5 549	
Afri Guard	3 865	
<b>Securitas</b>	<b>3 110</b>	<b>Yes</b>
Omega Risk Solutions	2 450	
<b>Chubb</b>	<b>2 358</b>	<b>Yes</b>

Source: Security Industry Alliance

The text of the Act imposes the following changes on foreign ownership. S20 of the Act, which imposes an obligation on all security service providers to be registered with the sector authority, will now include the following two provisions:

(d) by the addition of the following paragraph:

“(c) if at least 51 percent of the ownership and control is exercised by South African citizens.”;

(e) by the insertion after subsection (2) of the following subsections:

“(2A) Despite subsection (2)(c), the Minister may, taking into account the security interests of the Republic, prescribe by regulation a different percentage of ownership and control in respect of different categories of the security business contemplated in section 21A.

Policy changes such as that now envisaged typically have both costs and benefits, and it is important for government to fully understand such costs and benefits before implementing changes. It is not usually possible to costlessly “unscramble the egg” – once disinvestment has occurred, if the net

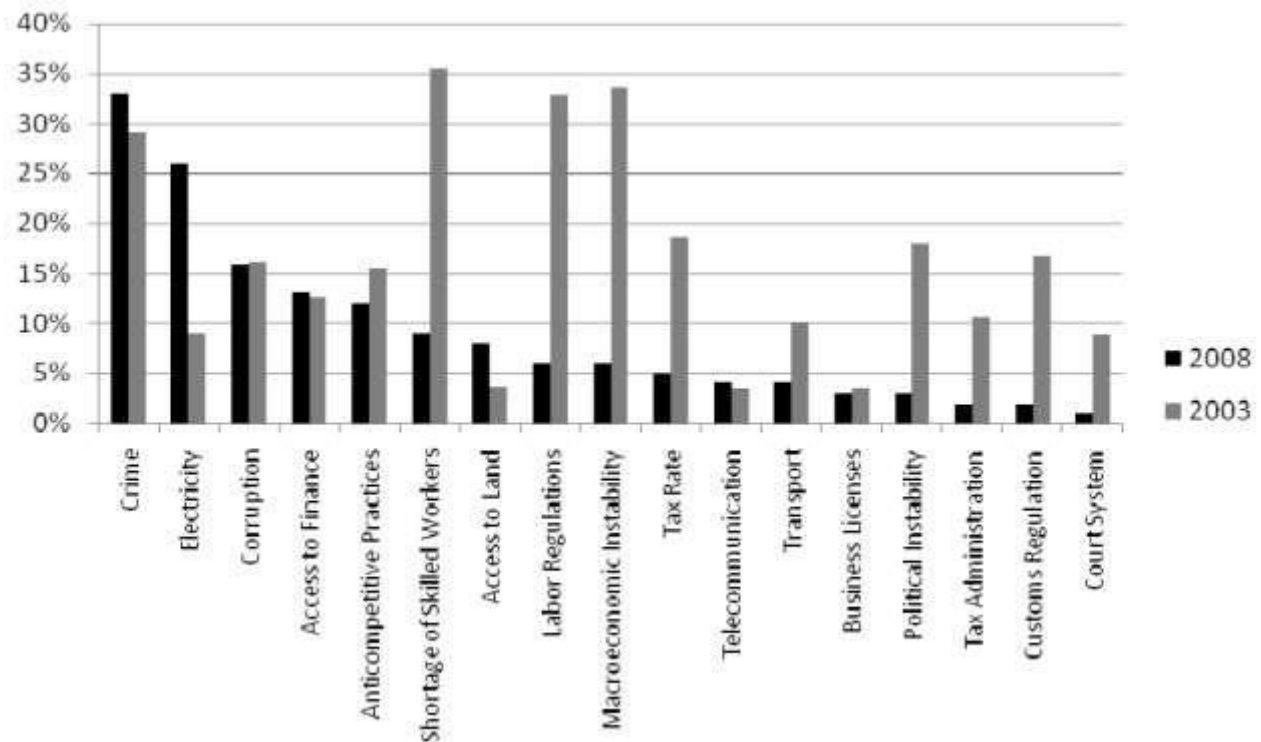
impact is not what was expected policymakers will either have to live with it, or undertake costly mitigation strategies. The goal of this paper is to provide additional detail on the likely source and size of such costs, before the first irreversible implementation process begins. The possible sources of costs associated with the proposed legislation are interrogated via the following three channels:

- The role that foreign owned private security plays in the wider South African security environment
- The likely impact from a trade in services perspective
- The impact on the equipment manufacturing industry

## 2 THE ROLE OF PRIVATE SECURITY IN THE SOUTH AFRICAN ECONOMY

Much of the long term health of any economy depends on how risky investors perceive it to be, which in turn is strongly influenced by the national crime level. The more risky an operating environment is, the fewer investments get made, and the fewer jobs are created. The level of crime in an economy is driven by a number of factors, one of which is the presence of an effective, well-established and regulated private security industry.

Research suggests that the total cost of crime to the South African economy is substantial. For example, Alda and Cuesta (2010) found that the total cost of crime in South Africa in 2007 was US\$22.1 billion, or 7.8% of 2007 GDP. Alternatively, Figure 1 below shows the results of a 2010 study using two surveys of managers conducted by the World Bank, the first in 2003 and the second in 2008. The results of the study identify the severity of various constraints on doing business in South Africa. Of the four major constraints identified by managers in 2003, only crime was still identified as a major constraint by 2008.

**Figure 1: Firms ranking constraints as major or severe (%) – 2003 vs. 2008**

Source: Figure 2, *The World Bank Group, (2010) South Africa: Second Investment Climate Assessment*

Publications and research such as this World Bank report are used by investors when making country investment decisions, and several emphasize the level of crime as a concern. For example, the *Doing Business in South Africa – 2011 Country Commercial Guide for U.S. Companies* stated that “U.S. firms should be aware that crime against business and individuals is a concern and should be addressed in market planning.”<sup>1</sup> Alongside research based publications such as those by the World Bank, investors are also made well aware of the problem crime poses to business in South Africa through the wider media.

A Harvard Centre for International Development study of South Africa condenses the many concerns linking security and macroeconomic performance into two general hypotheses:

1. “Theft, fraud, corruption, destruction of property, and violent attacks against staff impose direct and indirect costs on businesses that reduce profits, deter new investment, and increase business failures.

<sup>1</sup> Page 2 of *Doing Business in South Africa – 2011 Country Commercial Guide for U.S. Companies*



2. The perception that violent crime is high and beyond the control of government leads South Africans to restrict their work and leisure activities, restrains investment, and reduces tourism—all of which slow economic growth.”<sup>2</sup>

These two hypotheses address the cost that crime has on the economy. They can equally be used to understand the mechanisms by which a reduction in security levels will impact on the wider economy. The first mechanism is through actual costs: crime increases costs and reduces profitability. For this reason there are more business failures increasing the riskiness of investment in the South African economy. Given the increased risk exposure on investment, investors would require a higher expected return on their capital ultimately reducing the number of investment opportunities which meet the required levels of return. Reduced levels of security thus increase costs to existing firms, and reduced incentives to enter and expand in markets by new and existing firms respectively.

The second mechanism relates to perceptions about security rather than to actual levels of security. Individuals are, rightly so, risk averse when it comes to considering personal safety. Thus, where there is any uncertainty over the actual level of security, perceptions can be very important drivers of decision making. This applies both to individuals making individual decisions about when and where to work or vacation, however, also to individuals in business when making decisions about where to operate. A perceived reduction in security would thus impose a number of potential costs on the economy including a reinforcement of the diminished incentive to invest.

The logic of these two mechanisms on the reduced incentive to invest apply equally irrespective of the location of the individual or business. Thus the reduced incentive to invest due to the higher required return by investors will reduce the flows of foreign investment entering the country, however, and perhaps equally worrying, is that it will reduce the incentive of South African individuals and firms to invest in South Africa as well. The likely consequence of this second observation is that South African individuals and firms will divert funds which would have previously been invested locally and invest it internationally. These two consequences together have the potential to harm growth in the long run and undermine the stability of the national current accounts in the short term depending on the actual and perceived implications of the amendments on security levels in South Africa.

Small business development is a key driver of economic growth and redistribution in developing countries such as South Africa. In a study comparing a low crime area (Madina outside Accra in Ghana) and a high crime area (Mamelodi outside Pretoria in South Africa) it was observed that crime influenced decisions by small business operators resulting in earlier closure times, lost value from theft, businesses needing to be indoors and often behind screens, shorter tenures, and a higher response that doing business was not worth the risk given low margins.<sup>3</sup>

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<sup>2</sup> C. Stone, (2006), *Crime, Justice, and Growth in South Africa: Toward a Plausible Contribution from Criminal Justice to Economic Growth*, Centre for International Development at Harvard University

<sup>3</sup> See Chapter 5 of C. Stone, (2006), *Crime, Justice, and Growth in South Africa: Toward a Plausible Contribution from Criminal Justice to Economic Growth*, Centre for International Development at Harvard University

When it comes to reducing the level and cost of crime, private security firms typically play a very different role from the police. Private security officers do not have the legal powers that police officers have to conduct investigations, inspect premises and make arrests, and thus the role that private security plays in investigating and resolving violent crime in particular is usually very limited. However, the police force does not have the resources available to provide long-term guarding solutions to businesses and individuals, and does not have the skills set to assist businesses in making profit-maximising security decisions. In these areas of the market, only private security services meet security needs, and the police force is not able to fill any holes that may be left in the market (nor would it typically be appropriate to require them to do so).

In the private security market, moreover, private firms with international shareholders are likely to have particular skills sets that local firms cannot easily duplicate. For example, a firm with international experience on how best to reduce wastage levels associated with pilfering in a retail environment has access to international best practice and innovation in the skills and technological solutions likely to best manage client's costs. The manner in which best practice international knowledge transfers from international shareholders, and the benefits associated with this, are dealt with in greater detail in section 3.

As has been established, crime imposes substantial costs on the South African economy, and the private security industry is an important part of the system that prevents and mitigates against the effects of crime. Foreign owned firms help to keep the South African industry in line with international best practices, and thus help ensure that the private security business is optimally placed to mitigate against the effects of crime as much as possible. The proposed legislation is likely to undermine this relationship, and thus to reduce the deterrence effect of the private security industry on crime levels.

## **2.1 The cash-in-transit business**

A specific area where foreign ownership has played a substantive role on the ability of the private security industry to mitigate against the impact of crime is the cash-in-transit business. This effect has been felt both because of the transfer of international best practice from international shareholders, and also because of the enhanced ability of large multinationals to offer financial guarantees against losses.

G4S is currently the largest firm operating in the South African cash-in-transit business, and is also internationally owned. It is able to offer its customers guarantees against losses backed by the balance sheet of its much larger international parent company, and the size of its international operations has allowed it to offer bigger guarantees than its local competitors could match. It should be noted that the firm which offers the guarantee typically will only do so if it also has control over the operations of the cash-in-transit business, as operating practices have a strong impact on the risk of financial losses. Should G4S lose its controlling stake in its South African business, it is thus highly unlikely that it would continue to offer guarantees to customers of that business off its international balance sheet.

The cash-in-transit system is the means by which banks send and receive money from their retail clientele, and by which money for wages and social security payments is distributed to recipients. The level of risk in the cash-in-transit system thus has a direct feedback into the level of risk in the

financial system as a whole. A reduction in the ability of banks to access adequate guarantees against cash losses is likely to be a material effect of the proposed legislation.

## 2.2 Degree of competition in private security

The intensity of competitive rivalry between firms is one of the most important determinants of overall value derived by consumers, in terms of the combination of prices paid and quality received. Where competition is limited, consumers are often harmed by having to pay higher prices, receive lower quality, or a combination of both. In addition, higher prices may simply drive some consumers out of the market entirely, as they will no longer be able to afford the service in question.

At present, the private security market in South Africa displays a number of factors indicating intense rivalry, which suggests that competition is present at robust levels. In particular, there is evidence that it is easy for new competitors to enter the market (particularly in the value segment of the market) and for customers to switch between suppliers. In addition, the market displays a high degree of innovation in the technologies made available to customers, and a highly differentiated set of offerings which allow customers to opt for their desired level of security. While there are some large firms in the market, it seems that they have achieved their size from competition on the merits. Furthermore, they have to continue to perform because customers can easily switch and firms can easily enter. In other words, the current mechanism of rivalry looks to be functioning in a healthy manner.

Against this backdrop, the proposed amendments require that each firm in the security industry will now need to be majority owned by domestic citizens. There are two means by which this requirement will alter the competitive dynamics in the industry:

1. Who will majority stakes be sold to? If existing competitors are the acquirers rather than new investors, this will cause a reduction in levels of rivalry in the industry.
2. The impact on potential market entry by international firms.

If the legislation is implemented, the natural buyers of the stakes the firms will be forced to sell will be other companies who understand the business itself, and are well positioned to implement the required operational systems – in other words, the competitors of the international firms. There is thus a strong probability of some consolidation occurring in this industry, and economic theory suggests that firms with larger market shares are better placed to avoid competitive pressures. The full extent of this reduction in competitive rivalry is impossible to quantify at this time, and will depend on the extent of consolidation and the ability of small fringe competitors to grow and compete.

The second point arises from consultations with the international security firms who indicated a general unwillingness to be minority shareholders in the South African subsidiary of their firm. In other words, the implementation is likely to result in 100% divestment from South Africa for at least some of these firms. There were multiple reasons given for this by various firms including the following:

- Losing control over their local brand reputation, and not being willing to take the risk that the value of their international brand would be compromised;

- Increased difficulties in justifying the cost of bringing in expertise and know-how from their current international parent, which in turn would be likely to decrease the effectiveness of the local subsidiary;
- Lack of control leading potentially to a lack of consistency in financial reporting methods; and
- Greater potential for misalignment in business processes and ethics practices; all of which are designed by the foreign entity to control the fate and value of their own brand, and which they may face pressure by security regulators in the home country to retain control of.

One firm indicated that it was not so much that they were unwilling to be minority shareholders, but rather that it was not the correct time for such a change. Indeed, this firm indicated that it was already in their long term strategic plan to increase their domestic shareholding substantially, but that if this was done too soon this would undermine the growth prospects of the firm. All the international firms also currently have minority BBBEE shareholders, who arguably would also be prospective buyers of majority stakes. However, it should be noted that some of these BBBEE shareholders felt that the ownership relationship with the international firm greatly improved the prospects of the business, and thus that disinvestment would decrease the value of the equity they currently hold, and decrease the attractiveness of further investment in the business.

An unwillingness to be a minority shareholder is likely to be a feature both of the international firms who are currently invested in South Africa, as well as those who could potentially invest. In other words, the legislation will in effect translate into the erecting of an effective barrier to current and future international competition, thereby shielding domestic private security firms from an important source of rivalry.

In some sectors of the private security market this may not be a large problem because domestic firms compete effectively at all levels of the market. However, in the private security market, our engagement with stakeholders suggests that international firms have greater access to technology and expertise due to economies of scale across their international operations, and are thus better placed to serve the top end of the market – clients who are willing to pay for quality. Competition from domestic firms is stronger at the lower end of the market – customers who struggle to afford high quality services, or who are more sensitive about the cost than the quality of the service. The proposed legislation is thus particularly likely to decrease competition in the high value segments of the market, which will in turn tend to reduce competition on the basis of improvements in the quality of services, as well as potentially resulting in price increases.

Both industry consolidation and barriers to international competitors would act to reduce the degree of competition in the local private security market. This has the potential to result in higher than otherwise price increases as well as reduction in quality in the short to medium term. The domestic consolidation should be corrected in the long term because domestic firms can still enter and exit freely, however, the barrier to international competition is likely to have a permanent effect on the industry. This would only change if international firms were to become comfortable with owning minority stakes in subsidiaries wielding their brands.

## 2.3 Impact on PSiRA

The effective regulation of the private security industry is rightly considered to be a policy priority. While private security officers do not have the same legal privileges as police officers, they nevertheless fairly often carry weapons,<sup>4</sup> and are placed in positions of authority in sensitive situations such as household security. It is imperative that these individuals are properly screened, trained and monitored in order to prevent abuses.

The institution which currently carries out this regulatory function in South Africa is the Private Security Industry Regulatory Authority (PSiRA), which is the primary implementing body for the Private Security Industry Regulation Act. PSiRA is likely to be involved in the implementation of clause 20(d) of the Amendment Act, as the local ownership requirement is explicitly linked to the ability of a firm to register as a private security services provider with PSiRA. In effect, therefore, it is likely that PSiRA will need to issue non-compliance notices to the firms and threaten to deregister them if they do not sell a controlling stake to local shareholders. Should the international firms choose to utilise all legal options open to them in order to defend their local operations, this implies that it is possible that PSiRA will become involved in litigation on the matter.

A number of factors suggest that this would likely have a material impact on PSiRA's ability to act effectively as sector regulator. The regulatory task that PSiRA has to perform is resource intensive, as it requires actual inspections to ensure that licensees are compliant, and the number of potential inspection sites nationally is very large. Discussions with industry participants suggest that historically, PSiRA has struggled to fulfil its regulatory mandate, although some progress has been made in recent years, for example with an increase in the number of compliance inspections conducted from 3 583 in 2012/13 to 4 282 in 2013/14. However, the private security sector is still characterised by large numbers of "fly-by-night" operators, who are often unregistered and not compliant with security regulations around training, wages or the employment of South African citizens, for example.

The Chairperson of the Authority, Mr T.O. Bopela, has publicly acknowledged some of these challenges. For example, in PSiRA's 2013/14 annual financial report, he states that *"When I was appointed Chairperson of the Authority in 2010, I walked into an organisation that faced internal challenges such as lack of service delivery, corrupt officials and financial instability."* While progress has been made since this low point, PSiRA is by no means fully effective and stable at this point in time. Implementation challenges around clause 20(d) are likely to place unnecessary additional stress on the institution, and roll back some of the progress that has been made to date. The impact on the effectiveness of PSiRA in monitoring the industry will likely be much more significant for national security than clause 20(d).

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<sup>4</sup> It should be noted that, while private security officers often carry firearms, the proportion of weapons held by such individuals is quite small in contrast to the total number of registered firearms in the country as a whole. PSiRA 2015 statistics show private security companies hold 75 450 firearms, which is only 1.61% of all legal firearms in South Africa.

### 3 TRADE IN SERVICES IMPACT

The private security industry comprises one of South Africa's service industries. Services are an increasingly important part of the domestic economy, and have grown from 58% of value added in the domestic economy in 1990 to 68% in 2013. A substantial body of research has been conducted on the determinants of growth in the services sector, and a key driver of such growth has consistently been found to be the extent of trade liberalisation in the sector.

Trade in services occurs in very different ways from trade in goods, largely because providing a service typically requires there to be direct interaction between the supplier and consumer of the service.<sup>5</sup> The extent to which trade in services is permitted is thus measured largely in terms of the ability which service providers have to move between and invest in countries. Specifically, the General Agreement on Trade in Services (GATS) considers the following four modes of trade to be relevant when considering the extent of trade in services liberalisation:

- **Mode 1:** Cross-border supply, where the service provider is based in another country, but delivers services internationally.
- **Mode 2:** Consumption abroad, where both the consumer and producer of the service are from country A, but the service is delivered in country B
- **Mode 3:** Commercial presence, where the service provider establishes an outlet in another country
- **Mode 4:** Presence of a natural person, where the service is delivered by means of the service provider physically travelling to the country in question

The restrictions on foreign ownership envisaged in the Act represent a restriction on Mode 3 of trade in services, as they limit the ability of foreign firms to maintain a commercial presence in South Africa.

The liberalisation of trade in services, via Mode 3 in particular, is of wider economic benefit for a number of reasons. At the simplest level, firms tend to regard their insights into how best to service clients as commercially sensitive and confidential. They are prepared to share this knowledge with international subsidiaries they may establish, because they can benefit from the use of the information, and because they continue to exert control over a subsidiary. However, they typically will not share such information willingly with an unaffiliated firm. Investment in local subsidiaries is thus a primary means by which such international best practice filters into new markets.

In practice, therefore, a restriction on foreign control of private security firms is likely to substantially decrease the amount of international best practice learnings disseminated in the South African market. To illustrate, the type of knowledge involved could include nuts and bolts technological advances, such as the use of quick-setting foam in armoured cars; or managerial techniques, such as how best to manage the cash float at a commercial location to reduce risk and maximise operational efficiency. At present, there is substantial evidence of such knowledge transfer from the parent companies of the foreign-owned security firms in South Africa. For example, local staff at the

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<sup>5</sup> Warren & Findlay 1999



firms themselves and, in some cases, customer staff have been sent on international training courses. The experience of the international firm has also been leveraged in order to better understand the needs of given customer segments.

Liberalisation of trade in services not only tends to improve efficiency in the service sector, but in the wider economy as well. This effect is felt because of the role that service providers play in facilitating economic activity in the mining, agricultural, manufacturing and indeed all other sectors. Most productive activity requires services inputs, and private security services are an essential input to a number of particularly important sectors of the economy, notably the financial services sector. To illustrate, when a manufacturing company is able to reduce shop floor theft while reducing the cost of monitoring staff, or when a chain of petrol stations experiences fewer robberies, because the cash handling system at the station has become more effective, the operating costs of both firms reduce, and their operating efficiency increases. The transfer of skills and technological advances allowed by foreign investment, including foreign investment in private security services, thus play a role in improving the efficiency of the wider economy.<sup>6</sup>

The proposed legislation requires the foreign controlled private security firms to reduce the shareholding of their foreign parent company to a non-controlling stake. The larger the stake of the international parent company in the South African division, the more control it retains over the commercial know-how that it shares with its subsidiary, and the more directly it benefits from the commercial advantage that that knowledge imparts. The proposed legislative change thus goes directly to the heart of the motivation that foreign investors have to improve the efficiency of South African firms. It is likely to substantially reduce the flow of international best practice to South African private security firms, with a knock-on impact on the efficiency of both the sector and the wider economy.

As at 2006, Statistics South Africa estimated the total income generated from services rendered for investigation and security activities to be R9 802 million annually. If the sector is assumed to have grown at the same rate as the rest of the economy, this equates to total income of R18 834 million in 2013. A substantial amount of economic activity is thus directly exposed to a likely reduction in international knowledge transfer, and thus a likely resulting decrease in economic efficiency.

### **3.1 Value at risk: international investors**

The proposed legal amendment would require the four international firms to sell at least part of their shareholding. Where the firm already has substantial minority shareholding, the required sale in shareholding would be somewhat reduced. However, where the parent company is not comfortable with holding a minority share, which a number of the international firms have in fact indicated is the case, they would divest of their entire stake in the local firm. Thus the actual sale of shares caused by the amendments would likely be far greater than the minimum legally required.

The implementation of clause 20(d) would in effect result in G4S, ADT, Securitas, and Chubb all having to simultaneously go to the market to sell their business. In effect, the local market will be

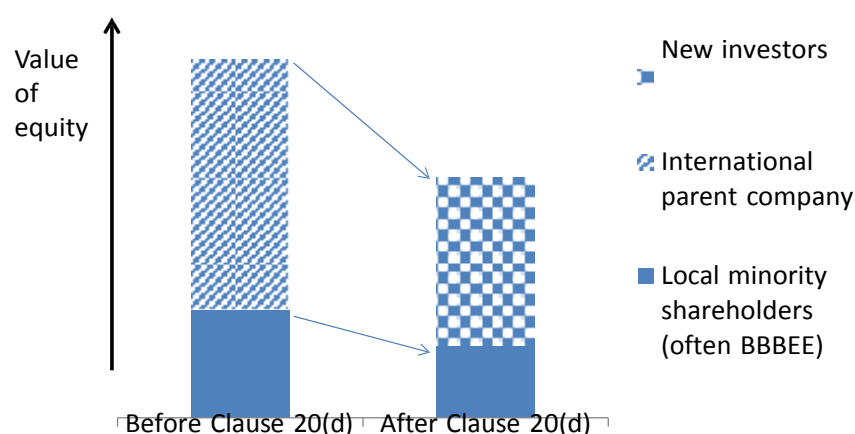
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<sup>6</sup> Tarr 2012, 4

flooded with private security assets, with local investors having the ability to shop around and drive the cost of assets down (and potential international investors would of course be excluded from bidding). In addition, because these four firms will either partially or entirely lose the technical, strategic and financial support of their parent company, they will also lose real value. Ultimately, the existing owners would be reasonable in expecting that they would have to sell their businesses at a discount to their true value.

This rush of sale of security assets on the market may benefit domestic individuals or institutions who acquire businesses at a steep discount. However, existing minority shareholders in such security firms will experience a decrease in the value of their minority shareholding as a result of losing the parent company support. Thus the process will produce winners (the new acquirers) and losers (existing minority shareholders and the international security firm owners). However, the net impact on society will be a decrease in the value of the economic assets concerned, due to the loss of commercially valuable parent company support, as well as a decrease in the efficiency of those assets, due to loss of access to international know-how. The resulting winners and losers are shown graphically below.

**Figure 2: Winners and losers in asset sale process**



Source: own extrapolation

This immediate cash flow would be from domestic investors to the current international security firms. Thus one of the direct consequences of the amendment would be an outflow on the national current account. The benefit to the current account is that there would not be dividend outflows each year, however, it would likely take many years for the once off loss to be recouped by the decrease in dividend outflows.<sup>7</sup>

While the direct consequences explained above are certainly not desirable outcomes in our economy, especially under the current economic conditions, the greater cost is likely to come in the form of reduced incentives to invest. The first set of investors with a reduced incentive to invest is

<sup>7</sup> To illustrate, if the price at which the assets are sold is a PE ratio of 10, then it would take 10 years before the benefit of no dividend outflows equals the cost of the once-off acquisition outflow (assuming earnings only increase with inflation).



international security firms. Stakeholders have presented several compelling reasons why international firms already present in the South African market would likely exit the market entirely rather than retain a minority shareholding. It follows from this that international security firms not present in South Africa would be unlikely to enter and invest in the country on a minority basis for the same reasons.

There is another set of investment concerns raised by the proposed amendment which is that international firms in other sectors will be deterred from investing out of fear of an increased risk of expropriation in the economy in general.

In South Africa the American Chamber of Commerce SA has expressed concerns about the perceived cumulative changes to legislation safeguarding US investments in South Africa. These legislative changes include the PSIRA Act as well as the Promotion and Protection of Investment Act, the intellectual property policy paper, and the Expropriation Act. Further compounding these concerns are proposed limitations on foreign ownership of land. It was reported in local press that the executive director of the American Chamber of Commerce SA, Carol O'Brien, stated that: *"It is one (piece of) legislation after another hitting you and you are beginning to wonder whether foreign investment is welcome in SA."*<sup>8</sup> Reporting on these issues, alongside others such as nationalisation of mining assets, has been increasing in the press substantially in recent months and years.

The point being made here is that the potential expropriation of investments in South Africa, by the state or by individuals, is a growing concern for investors. Currently the concern is limited to changes in policy and legislation, rather than actual expropriation events, but each piece of proposed legislation seems to be cumulatively affecting investor sentiment, and the position of the Private Security Industry Regulatory Amendment Act in the current legislative agenda has substantially increased its importance in the policy debate.

The growing investor concerns about expropriations would be dramatically compounded if international security firms are unable to realise a fair price on the sale of their South African businesses. Importantly, what is fair in this instance would be what foreign investors would perceive to be fair. Previously in this sub-section it was argued that, due to the rush of sale of these assets and the exclusion of international head office support for the businesses going forward, it would be expected that the businesses would have to be sold at a discount to fair value. The forced expropriation of assets along with the potential to not realise a fair value would be of great concern to both potential and current foreign investors.

Clause 20(d) in the amendments thus poses significant challenges to investment in the security industry specifically and, more worryingly, to the wider economy. The economic effect should not be viewed in isolation, but should take account of other proposed amendments and political views in understanding investor sentiment. Should this clause in the Act proceed, it may mark the start of a

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<sup>8</sup> Business Day, 20 February 2015, *Barrage of new laws alarms US firms in SA*, [www.bdlive.co.za](http://www.bdlive.co.za)

structural change in investment inflows, and potentially also outflows through the exit of current businesses.

### 3.2 Value at risk: international trade agreements

South Africa is currently party to a number of international trade agreements, some of which are likely to be affected by the proposed legislation. The structure of trade agreements, and thus the likely extent of retaliation from trade partners and size of economic impact, differs substantially. To illustrate, the possible impact of the legislation on AGOA, a preferential trade agreement offered unilaterally to African countries by the USA, and GATS, a bilateral international agreement, are now examined.

#### 3.2.1 AGOA (African Growth Opportunity Act)

The African Growth Opportunity Act was implemented by the United States in 2000. The Act comprises a unilateral decision by the United States to offer preferential trade treatment to African states, which was not contingent upon those African states making similar trade commitments to the US. However, the Act is designed to function as an instrument of US foreign policy, as its expressed purpose is to create “tangible incentives for African countries to continue their efforts to open their economies and build free markets.”<sup>9</sup> Changing policy positions which are not in accordance with this objective may thus be penalised by suspension from AGOA.

The United States has clearly indicated that it regards the proposed legislation as a contravention of the intent of AGOA. A letter from Senator Orrin Hatch to Ambassador Ebrahim Rasool, dated June 23, 2014, explicitly mentions the Private Security Industry Regulation Amendment Act, and states the opinion that “this legislation contravenes South Africa’s international trade commitments, and would negatively affect other companies’ future investment decisions.” Moreover, Senator Hatch opines that “the security services legislation appears to be part of a broader effort to deter international investment in South Africa,” which includes the 2013 Promotion and Protection of Investment Act, the Draft Intellectual Property Policy, and other issues. In conclusion, Senator Hatch states that:

*“Congress has begun work on renewal of the African Growth and Opportunity Act, an effort I strongly support. South Africa’s recent movement away from participation in the global economy and violations of its international trade commitments severely complicates that task. As you are aware, many members of Congress have questioned why unilateral preference programs that seek to encourage greater participation in the global economy should continue for countries that take domestic measures to disrupt international trade and investment.”<sup>10</sup>*

In this excerpt, Senator Hatch makes a clear connection between the security industry legislation and South Africa’s continued participation in AGOA. The manner in which AGOA is implemented,

<sup>9</sup> US Department of State, <http://www.state.gov/p/af/rt/agoa/>, accessed 9 March 2015

<sup>10</sup> Letter from Senator Orrin Hatch, United States Senate Committee on Finance, to South African Ambassador Ebrahim Rasool, dated June 23, 2014. Downloaded 13 February 2015, available at <http://www.siaonline.org/SiteAssets/GovernmentRelations/Letters%20To%20Con/2014-06-23%20Hatch%20South%20Africa%20Letter.pdf>

via a unilateral decision of the US government, implies that they do in fact have considerable discretion to use access to AGOA as a bargaining chip in this way.

Considerable research has been conducted by the Department of Trade and Industry on the estimated value of AGOA to the South African economy, and thus it is relatively easy to quantify the amount of value at risk. Vickers, 2013 estimates that 27% of South African goods exported to the US enter duty free under AGOA. In 2010, this was estimated to add 2.78% to South African manufacturing GDP, and 11% to manufacturing employment. Given the size of these impacts, the DTI rightly regards AGOA as “an essential component of growth and development to address poverty and inequality in SA,” and it is thus troubling that continued access to AGOA is under threat from security industry legislation.

### 3.2.2 General Agreement on Trade in Services (GATS)

The primary agreement governing international trade in services is the General Agreement on Trade in Services (GATS), which is administered by the World Trade Organisation. The GATS is almost entirely a multilateral system, where trade commitments made apply equally to all member states (although the trade negotiations themselves often occur on a bilateral basis). South Africa has made commitments to liberalise the private security sector in terms of the GATS, and thus the proposed security sector legislation represents a breach of our GATS commitments. It should be noted that this view has also been expressed by, among others, Axel Pougine de la Maisonneuve, the head of economics and trade at the EU delegation to South Africa, and the American ambassador to South Africa, Patrick Gaspard.<sup>11</sup>

In practice, only a country can take another country into a dispute process at the WTO, and thus the companies affected by the legislation do not have the ability to initiate litigation. The fact that the EU and the US have already formally expressed the view that the legislation breaches GATS must increase the risk that they are considering launching a dispute. It should be noted as well that evidence suggests that the US is particularly likely to pursue trade disputes at the WTO.<sup>12</sup> However, in practice it is still more likely that a simpler unilateral instrument like AGOA will be used to express disapproval rather than the more complex multilateral arrangements of the GATS.

If a complaint is pursued, the first step of the complaints process typically involves the complaining country requesting confidential diplomatic negotiations through the WTO. If the negotiations fail to resolve the problem, the process becomes more legal in nature, as a panel may then be established to hear the case. The recommendations of the panel require the losing party to bring their trade arrangements into compliance with GATS, and if compliance is not forthcoming, the losing country may then request GATS to impose sanctions (typically tariff surcharges) on the losing country. The entire process typically takes around 12-15 months to conclude.<sup>13</sup> Compensation for the damage

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<sup>11</sup> Lisa Steyn, 2014-04-10, *Private security Bill spells trouble*, Mail & Guardian. Available at <http://mg.co.za/article/20140410privatesecuritybillspellstrouble>

<sup>12</sup> Malawer 2014

<sup>13</sup> Malawer 2014

done through non-compliance can form part of the conclusion of a WTO case. Not all trade disputes proceed through all the stages outlined above.

Given this background, what then is then likely to happen in the case of the private security industry? As has been mentioned, with both the EU and the US formally indicating displeasure at the legislation, and linking it to concerns over the protection of investor rights in the wider South African policy space, it is highly likely that the trade conflict process will be initiated, beginning with confidential diplomatic negotiations and possibly escalating from there if agreement is not reached. This will impose a burden on South Africa's diplomatic corps and also on the trade negotiating team at the DTI. The likely cost to South Africa of the process is however difficult to ascertain, as it will depend on the course of negotiations, and the nature of the bargaining concessions that may or may not be made. The greatest potential cost of the process remains simply the loss of the economic gains associated with trade liberalisation, which are detailed in section 2.

## 4 EQUIPMENT MANUFACTURERS

The proposed amendments to PSIRA clearly also affect foreign-owned private security equipment manufacturers operating and active within the jurisdiction of the Republic of South Africa. This is based on the way the amended definition of "security service" in the Act will read. For ease of reference the relevant parts of this proposed definition are set out below with own emphasis added:

*1 Definitions:*

*[...]*

**'security services'** means a person who renders a security service to another for remuneration, reward, fee or benefit and includes such a person who is not registered as required in terms of this Act:

*[...]*

**(e) manufacturing, assembling, possessing, selling, purchasing, or advertising of listed equipment contemplated in section 1 of the Regulation of Interception of Communications and Provision of Communication-related Information Act, 2002 (Act no. 70 of 2002), authorised by the Minister of Justice and Constitutional Development under section 45(2);**

**(f) performing the functions of a private investigator;**

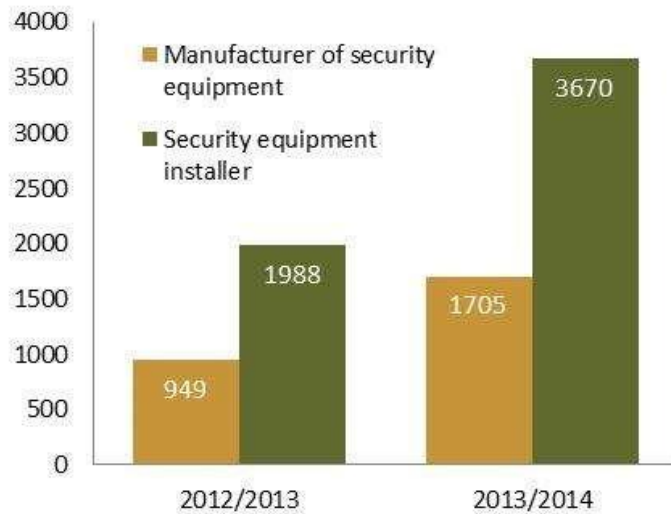
**(g) providing security training or instruction to a security service provider or prospective security service provider;**

**(h) installing, servicing or repairing security equipment;**

**(i) monitoring signals or transmissions from electronic security equipment;**

*[...]*

The private security equipment sector is characterised by a large number of registered businesses, and the number of equipment firms registered with PSIRA has grown in number significantly from 2012 to 2014, as shown in the figure below.

**Figure 3: Number of registered security equipment firms in SA**

Source: PSIRA Annual Reports 2012/2013 and 2013/2014

Within this particular part of the security industry value chain, there exist both locally-owned as well as foreign-owned market participants. Some examples of foreign-owned firms in this space that could be affected include, but are not limited to, the likes of ADI International, Johnson Controls, Bosch Security Systems and Siemens Security Solutions. However, 'security equipment' includes satellite tracking devices which may implicate other products such as Garmin and TomTom. Additionally, the South African Chamber of Commerce and Industry (SACCI) are of the belief that other foreign-owned firms such as Apple and Panasonic will be affected as well, presumably on the grounds of the type of equipment they produce and sell. An extract from a SACCI statement reads:

*"The broad definition of a security company in the proposed Private Security Industry Regulation Amendment Act will force multinational electronic companies like Apple, Sony, Samsung and Panasonic to sell 51% of their ownership to domestic shareholders."<sup>14</sup>*

The security equipment manufacturers' market deals in the manufacture, import, marketing, distribution, installation and after-market customer service solutions of security equipment, including *inter alia*, access panels, alarm equipment, CCTV cameras, and other security monitoring devices. Regarding foreign-owned equipment suppliers, products are typically researched, developed and manufactured abroad, following which they are imported into South Africa and then sold onwards to local clients. The local customer base is typically provided with an after-sales service in which maintenance, support calls, and customisation of equipment follows the sale and installation of security equipment.

What's important to note is that foreign-owned equipment suppliers provide after-sales service and support for their own products, upon which foreign-owned brand equity is built locally in South Africa. Foreign-owned products and services in this regard have the benefit and backing of international

<sup>14</sup> SACCI statement, 1 April 2014, available here. [Last accessed 2/3/2015.]

research and development, typically by multinational firms with deep pockets. This is a significant indirect benefit to the South African market and South African consumers.

Discussions with stakeholders in the equipment manufacturing space uniformly suggest that it is unlikely that control of the local operating unit of their brand would be sold to South African citizens. Instead, firms are more likely to either shed the product lines concerned, if they form only a small proportion of the product lines sold locally; or strip the brand from the assets and sell them off at a discount, to recoup some of their investment. Branded products might continue to be imported by independent distributors, but without the service offering which the original manufacturer would also offer. The reasoning is that the multinational firms have built up brand equity that transcends the borders of South Africa, and is an extremely valuable asset. Ceding control of this brand to a South African investor, which could behave in ways that are not aligned with the interests of the original owner, is thus an unacceptable operating risk.

These views are to some extent predicted by the economic literature around vertically integrated firms (a firm which both manufactures and distributes its own product, for example, is regarded as vertically integrated). For example, Motta (2004) argues that “... *not allowing a manufacturer to protect the image of its good ... might be harmful not only to itself but also to consumers.*”<sup>15</sup> In essence, an independent distributor will never be as highly motivated as the manufacturer of a good to properly service customer needs and provide product support, because doing so builds brand value, and only the manufacturer benefits from this. Corsten and Kumar (2005) point out that non-vertically integrated firms could have these kinds of contradictory objectives, resulting in conflict.<sup>16</sup>

In the event that the current version of amendments envisioned in the Act are implemented in full, equipment manufacturers are likely to disinvest, which would mean that their role in providing client service in the market would fall away. They would be unable to honour the current stock of installed equipment and service contracts, which would result in an immediate decrease in the level of client support provided. In addition, customers would face a reduced ability to customise equipment to suit their specific needs, and the availability of spare parts and system expansions would likely be significantly decreased, as independent distributors would again have less incentive to hold costly inventory locally to improve customer service levels. The customer would more often need to wait for an import of a specific part to be processed.

Ultimately, it is clear that foreign-owned security equipment manufacturers in South Africa will be affected by the proposed amendments. On a balance of probabilities, we believe that the impact is likely going to negatively impact on the overall health of the equipment manufacturer sector through a reduction in import competition, loss of jobs as well as FDI; possibly amplified by the broad definitions in the Act which may include a whole host of other foreign-owned entities active in South Africa including, but not limited to Bosch, Sony, Apple, Samsung and Panasonic.

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<sup>15</sup> Motta (2004). Competition Policy: Theory and Practice. Cambridge University. pp 334.

<sup>16</sup> In Schramm-Klein, Morschett and Swoboda (2008). Verticalization: The Impact of Channel Strategy on Product Brand Loyalty and the Role of Involvement in the Fashion Industry.



## 5 CONCLUSIONS

The process of developing policy and legislation can introduce significant uncertainties into the economic environment. It is essential that the costs and benefits of a legislative change are examined before they are implemented, as unintended consequences can have disastrous impacts on economic outcomes, which often cannot be easily unravelled. This paper examines a number of likely unanticipated negative consequences of the implementation of clause 20(d) of the Private Security Industry Regulation Amendment Act, 2012, which are of material size, and which should be carefully considered before proceeding.

It should be noted that the sources of these costs are substantial, and arise in a number of areas. Some of the most likely and possibly also most substantial of these costs would be triggered by a destabilisation of our relationships with important trading partners, namely the United States and the European Union, and the trade litigation and loss of trade in services liberalisation benefits which would result. It is difficult to see how the proposed amendment could generate benefits sufficient to outweigh these costs, particularly given the strict regulations on the *employment* of foreign nationals in private security that are already in place.

In contrast, the removal of clause 20(d) would send an important signal to our trading partners that South Africa intends to honour its trade commitments, and remains supportive of the private property rights of international investors. Our international trade position is of importance both to the achievement of South Africa's longer term growth objectives, and as a short term priority given the current deterioration in our trade position. The removal of clause 20(d) would thus be the correct strategic decision for the wider economy as well as the sector.

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