STABILIZATION CLAUSES IN NATURAL RESOURCE EXTRACTION CONTRACTS: LEGAL, ECONOMIC AND SOCIAL IMPLICATIONS FOR DEVELOPING COUNTRIES

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I. INTRODUCTION

Developing countries endowed with natural mineral resources have a number of common features. These countries often lack the technological expertise and the financial power necessary for the exploitation of natural resources. Thus, for the most part, developing countries rely on foreign companies, usually transnational corporations (TNCs), for the exploration and exploitation of their mineral resources. In addition, many of these countries are politically unstable, ruled in the main by autocratic and unresponsive governments. Furthermore, the legal and judicial processes in many of these countries are deficient. These conditions pose certain investment risks for foreign investors in the extractive industries, including the risk that the legal and fiscal regimes governing a resource extraction project could be amended or changed by the host government mid-way through the life circle of the project. There is also the risk of expropriation and nationalization of investment projects. Investments in the extractive industries are particularly prone to these risks because of the long period of time it takes to accomplish natural resource extraction projects.

To forestall these risks, foreign investors in the extractive industries usually require host developing countries to issue guarantees on the stability of the legal and fiscal regimes governing investment projects. This objective may be achieved either by enshrining such guarantees in natural resource concession contracts or by enacting statutes containing such guarantees. Known commonly as "stabilization clauses", these contractual and statutory guarantees are aimed at preserving "the law of the host country as it applies to the investment at the time the State contract is concluded" and ensuring that "future changes to the law of the host country are inapplicable to the foreign

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investment contract."[1] The idea is to insulate foreign investors in the extractive industries from future changes to the host country's laws.[2]

While stabilization clauses may be beneficial to investors in the sense that they assure, at least on paper, a stable and predictable investment climate, there are questions as to whether these clauses are of any benefit to developing countries. As argued in this paper, stabilization clauses may be counter-productive to the development aspirations of developing countries because they constrain the fiscal policy options available to host developing countries. In addition, stabilization clauses have the potential to impede the capacity of the host country to regulate the activities of foreign corporations particularly as they relate to human rights and environmental protection.

II. NATURE OF STABILIZATION CLAUSES

Early variants of stabilization clauses were intended to 'freeze', in whole or in part, the legal and fiscal regimes governing extractive projects. This objective was attained by inserting clauses in resource extraction contracts that provided that the law governing the project shall be the law of the host country as of the date of execution of the contract. The 'freezing' stabilization clause, as this type of clause is often referred to, may enjoin the host State from amending or changing unilaterally the legal and fiscal regimes governing the project.[3] For example, the erstwhile Petroleum Concession agreement between the government of Libya and the Libyan American Oil Company provided that:

> The Government of Libya … will take all steps necessary to ensure that the Company enjoys all the rights conferred by this Concession. The contractual rights expressly created by this

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[1] United Nations Conference on Trade and Development, *State Contracts: UNCTAD Series on Issues in International Investment Agreements* (New York & Geneva: United Nations, 2004) at 26, online: UNCTAD <http://www.unctad.org/en/docs/iteiit200411_en.pdf>.

[2] Roland Brown, "The Relationship Between the State and the Multinational Corporation in the Exploitation of Resources" (1984) 33 I.C.L.Q. 218 at 222-223.

[3] See Peter D. Cameron, "Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors" at 28 (Final Report 5 July 2006, prepared for the Association of International Petroleum Negotiators), online: <http://www.lba.legis.state.ak.us/sga/doc_log/2006-07-05_aipn_stabilization-Cameron_final.pdf>; Christopher T. Curtis, "The Legal Security of Economic Development Agreements" (1988) 29 Harv. Int'l L.J. 317 at 346.

> Concession shall not be altered except by mutual consent of the parties.
> (2) This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the Agreement of Amendment by which this paragraph (2) was incorporated into this Concession Agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent.[4]

Although freezing stabilization clauses were common in the 1960s and 1970s, they are infrequently inserted in modern concession contracts because of the recognition that these clauses are of limited utility. As argued below, while they attempt to prevent host States from making changes to the legal and fiscal regimes governing a project, freezing stabilization clauses cannot, in law, prevent host States from amending or changing their legal and fiscal regimes. However, freezing stabilization clauses remain prominent in the extractive industries particularly in Africa, Asia and southern Europe.[5] For example, Mauritania's model production sharing contract provides:

> The Contractor shall not be subject to any legislative provision which would give rise to an aggravation, whether directly or indirectly, in the charges and obligations arising from this Contract and from the legislation and regulations in force on the date of signing this Contract, unless as mutually agreed upon by the Parties.[6]

In some instances, a stabilization clause may provide "partial stability" in the sense that it freezes certain aspects of the host country's legal and fiscal regimes such as taxes and royalties.[7] For example, the Mineral Development Agreement between Liberia and Mittal Steel provides that:

> The GOVERNMENT hereby undertakes and affirms that at no time shall the rights (and the full and peaceful enjoyment

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[4] See *Libyan American Oil Co. (LIAMCO) v. The Government of the Libyan Arab Republic,* 20 I.L.M. 1 at 31 (1981).
[5] See Andrea Shemberg, "Stabilization Clauses and Human Rights" (11 March 2008) at 17, online: <http://www.ifc-srsg_stabilization_final[1].pdf>.
[6] See Islamic Republic of Mauritania, *Production Sharing Contract 1994*, art. 27.3 [unofficial English translation], online: <http://resources.revenuewatch.org/sites/default/files/MauritaniaContracttypeAngl.pdf>.
[7] Cameron, *supra* note 3 at 30.

> thereof) granted by it under Article 19 (Income Taxation), Article 20 (Royalty) and Article 22 (Other Payments to the GOVERNMENT) of this Agreement be derogated from or otherwise prejudiced by any Law or the action or inaction of the GOVERNMENT, or any official thereof, or any other Person whose actions or inactions are subject to the control of the GOVERNMENT….[8]

Similarly, erstwhile Development Agreements between the government of Zambia and several mining TNCs provided in identical terms that, the government "undertakes that it will not for the Stability Period: (a) increase corporate income tax or withholding tax rates applicable to the Company … from those prevailing at the date hereof …; (b) otherwise amend the [Value Added Tax] and corporate Tax regimes applicable to the Company …; (c) impose new taxes or fiscal imposts" on the company; increase the rates of royalty, import duty and export from the levels set out in the agreement.[9] As well, Bolivia's Model Production Sharing Contract provides that "the system of royalties and permits [applicable] to this Contract shall remain fixed throughout its term".[10]

However, the nature of contractual stabilization clauses has evolved in the last few decades, culminating in a variant of stabilization clauses that attempts to maintain economic equilibrium between the parties. Unlike the 'freezing' stabilization clause, the 'economic equilibrium clause' does not prohibit changes to the legal and fiscal regimes governing a project. Rather, it envisages that where such changes occur, the contracting parties shall be restored to the position they occupied prior to the changes. For example, the Model Production Sharing Contract recently issued by the autonomous Kurdistan Region of Iraq provides that:

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[8] *An Act Ratifying the Amendment to the Mineral Development Agreement (MDA) Dated August 17, 2005 Between the Government of the Republic of Liberia (The Government) and Mittal Steel Holding A.G. and Mittal Steel (Liberia) Holdings Limited (The Concessionaire)*, art. 16(E), online: <http://www.leiti.org.lr/doc/ms.pdf>.

[9] See *The Government of the Republic of Zambia and Mopani Copper Mines Plc: Mufulira Mine, Smelter and Refinery and Nkana Mines, Concentrator and Colbalt Plant Development Agreement*, (31 March 2000) art. 16, online: <http://www.minewatchzambia.com/reports/MOPANI.pdf> [*Mopani Copper Mines Development Agreement*]; *The Government of the Republic of Zambia and Konkola Copper Mines Plc: Amended and Restated Development Agreement*, art. 15, online: <http://www.minewatchzambia.com/reports/KCM2004.pdf> [*Konkola Copper Mines Development Agreement*].

[10] *Model Production Sharing Contract* [Bolivia] 1997, Article 12, cited in Cameron, *supra* note 3 at 30.

> The obligations of the CONTRACTOR in respect of this Contract shall not be changed by the GOVERNMENT and the general and overall equilibrium between the Parties under this Contract shall not be affected in a substantial and lasting manner.
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> The GOVERNMENT guarantees to the CONTRACTOR, for the entire duration of this Contract, that it will maintain the stability of the legal, fiscal and economic conditions of this Contract, as they result from this Contract and as they result from the laws and regulations in force on the date of signature of this Contract. The CONTRACTOR has entered into this Contract on the basis of the legal, fiscal and economic framework prevailing at the Effective date. *If, at any time after the Effective Date, there is any change in the legal, fiscal and/or economic framework under the Kurdistan Region Law or other Law applicable in or to the Kurdistan Region which detrimentally affects the CONTRACTOR, the CONTRACTOR Entities or any other Person entitled to benefits under this Contract, the terms and conditions of the Contract shall be altered so as to restore the CONTRACTOR, the CONTRACTOR Entities and any other Person entitled to benefits under this Contract to the same overall economic position (taking into account home country taxes) as that which such Person would have been in, had no such change in the legal, fiscal and/or economic framework occurred.*[11]

Similarly, the West African Gas Pipeline Agreement provides that the contracting parties shall "endeavour in good faith to negotiate a solution which restores the Company and/or its shareholders to the same or an economically equivalent position it was or they were in prior to" a change to the legal and fiscal regimes governing the project.[12]

A stabilization clause could maintain economic equilibrium by providing that the host State shall pay compensation to the resource extraction company in the event that changes to the host State's laws or fiscal regimes adversely affect the economic interests of the company.

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[11] The Kurdistan Regional Government of Iraq, *Model Production Sharing Contract*, arts. 43.2, 43.3, online: <http://www.krg.org/uploads/documents/KRG%20Model%20PSC_2007_09_06_h14m3s46.pdf> [emphasis added] [Kurdistan, *Model Production Sharing Contract*].

[12] *West African Gas Pipeline Agreement: International Project Agreement*, 22 May 2003, Clause 36.2(a), cited in Cameron, *supra* note 3 at 44-45.

However, economic equilibrium may not involve direct payment of monetary sums to the company. Economic equilibrium could be achieved by defraying the costs of complying with the changes to the legal and/or fiscal regimes, or by adjusting the tariffs payable by the company, or through an extension of the lifespan of the concession or by reducing the taxes and royalties payable by the company to the host country.[13] Economic equilibrium may also be achieved by requiring the parties to the contract to negotiate in good faith an amendment to the contract in a manner that restores the economic equilibrium envisaged in the resource concession contract. For example, Article XIX of the model Concession Agreement for gas and crude oil exploration and exploitation in Egypt provides in part that:

> In case of changes in existing legislation or regulations applicable to the conduct of Exploration, Development and production of Petroleum, which take place after the Effective Date, and which significantly affect the economic interest of this Agreement to the detriment of CONTRACTOR or which imposes on CONTRACTOR an obligation to remit to the A.R.E. [Arab Republic of Egypt] the proceeds from sales of CONTRACTOR's Petroleum, CONTRACTOR shall notify EGPC [Egypt General Petroleum Corporation] of the subject legislative or regulatory measure and also the consequent effects upon issuing legislation or regulation which impact on the stabilization. In such case, the Parties shall negotiate possible modifications to this Agreement designed to restore the economic balance thereof which existed on the Effective Date.
> The Parties shall use their best efforts to agree on amendments to this Agreement within ninety (90) days from aforesaid notice.[14]

Where the parties are unable to agree on the measures that could restore the economic equilibrium, the matter may be referred to arbitration in accordance with the provisions of the concession contract.[15]

Finally, some stabilization clauses are hybrid in the sense that they encompass features of the 'freezing' clause and the 'economic

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[13] Shemberg, *supra* note 5 at 6; Cameron, *supra* note 3 at 31.

[14] Egypt, *Model Concession Agreement for Petroleum Exploration and Exploitation*, online: <http://www.egpc.com.eg/2006/Agreement_N.pdf>. See also The Kurdistan Regional Government of Iraq, *Model Production Sharing Contract*, *supra* note 11, art. 43.4.

[15] See Kurdistan, *Model Production Sharing Contract*, *ibid.* art. 43.4; Egypt, *Model Concession Agreement for Petroleum Exploration and Exploitation*, *ibid.*, art. XIX.

equilibrium' clause.[16] The hybrid clause may attempt to freeze the legal regimes governing a project, while also providing for the restoration of the economic equilibrium or the payment of compensation in the event that a change to the legal regimes adversely affects the economic interests of the resource extraction company.[17]

Although early stabilization clauses were, for the most part, contract-based, a number of developing countries now provide statutory backing or authorization for stabilization clauses. Statutory authorization is achieved in a number of ways. First, some countries adopt the direct approach by enshrining stabilization provisions in statutory enactments. For example, the statute establishing the Nigeria Liquefied Natural Gas Project (LNG Project) provides in part that:

> Without prejudice to any other provision contained herein, neither the company not its shareholders in their capacity as shareholders in the company shall in any way be subject to new laws, regulation and taxes, duties, imports or charges of whatever nature which are not applicable generally to companies incorporated in Nigeria or to shareholders in companies incorporated in Nigeria respectively."[18]
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> "The Government shall take such executive, legislative and other actions as may be necessary so as to effectively grant, fulfill, and perfect the guarantees, assurances and undertakings contained herein. In order to afford the degrees of security required to enable the company's investment to be made, the government further agrees to ensure that the said guarantees, assurances and undertakings shall not be suspended, modified or revoked during the life of the venture except with the mutual agreement of the government and the shareholders of the company.[19]

Other countries, such as Ghana and South Africa, have adopted what one might call the indirect approach by enacting legislation authorizing designated government officials to enter into resource concession contracts that contain stabilization clauses. In Ghana, for example, the

[16] Shemberg, *supra* note 5 at 9. 'Hybrid' stabilization clauses are envisaged under section 14 of South Africa's *Mineral and Petroleum Resources Royalty Act, 2008,* which is discussed below.
[17] Shemberg, *ibid.*
[18] *Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act No. 39 of 1990*, Second Schedule, para. 3 (as amended by the *Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) (Amendment) Act No. 113 of 1993*) [*Nigeria LNG*].
[19] *Ibid.* at Second Schedule, para. 6. .

Minister of Mines is authorized to enter into "stability agreements" for the purpose of ensuring that:

> "the holder of the mining lease will not, for a period not exceeding fifteen years from the date of the agreement,
> (a) be adversely affected by a new enactment, order, instrument or other action made under a new enactment or changes to an enactment, order, instrument that existed at the time of the stability agreement, or other action taken under these that have the effect or purport to have the effect of imposing obligations upon the holder or applicant of the mining lease.[20]

Stability agreements in Ghana may also contain provisions designed to ensure that mining companies are not adversely affected by subsequent changes to royalty, tax and import duty regimes.[21] Similarly, South Africa's Minister of Finance is statutorily empowered to enter into 'stabilization agreements' that could freeze the royalty regime prescribed in the *Mineral and Petroleum Resources Royalty Act, 2008* "for as long as the [resource] extractor holds the right (and for all participating interests subsequently held by the extractor in respect of the right)."[22]

III. THE VALIDITY OF STABILIZATION CLAUSES

Stabilization clauses that freeze the legal and fiscal regimes applicable to an investment project appear to constrain the sovereignty of host States. The constraining impact of freezing stabilization clauses on State sovereignty raises questions as to the validity of such clauses under both international law and domestic law. In terms of international law, some commentators argue that 'freezing' stabilization clauses are invalid and unenforceable because they fetter the sovereign power of host States to make laws.[23] They are equally said to offend the international doctrine of Permanent Sovereignty over Natural Resources, which recognizes "the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national

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[20] *Minerals and Mining Act 2006*, s. 48(1)(a).
[21] *Minerals and Mining Act 2006*, s. 48(1)(b).
[22] *Mineral and Petroleum Resources Royalty Act, 2008* (Act No. 28, 2008), s. 13.(1).
[23] See Thomas W. Waelde & George Ndi, "Stabilizing International Investment Commitments: International Law Versus Contract Interpretation" (1996) 31 Tex. Int'l L.J. 215; Yinka Omorogbe, "Law and Investor Protection in the Nigerian Natural Gas Industry" (1996) 14 Journal of Energy & Natural Resources Law 179.

interests."[24] According to critics, because the host State's right to natural resources is permanent and inalienable, the State cannot cede or alienate, by contractual clauses or statutory provisions, its right to natural resources. In the words of a former President of the International Court of Justice, the concept of permanent sovereignty "signifies that the territorial State never loses its legal capacity to change the status or the method of exploitation of [natural] resources, regardless of any arrangements that may have been made for their exploitation and administration."[25] Thus, critics argue, a stabilization clause that purports to alienate the State's legislative power is null, void, and unenforceable.

However, proponents of stabilization clauses argue that stabilization clauses do not fetter a State's sovereignty and that a State cannot rely on the doctrine of sovereignty as justification for its unilateral repudiation of a stabilization clause.[26] For example, Leo Kisamm and Edmond Leach argue that "[t]here is no legal or moral justification for a State, after solemnly committing itself to a contract with a foreign national, seeking to avoid its responsibilities thereunder on some outworn theory that sovereignty embraces privileges only, without correlative obligations."[27] According to these authors, "[n]othing inherent in sovereignty prevents the performance of contracts and the granting of irrevocable rights."[28] This view has, in fact, been received favourably by some arbitral tribunals. In *Texaco Overseas Petroleum Company / California Asiatic Oil Company v. Government of the Libyan Arab Republic,*[29] the tribunal ruled that stabilization provisions in a concession agreement, and in particular, provisions against

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[24] *Permanent Sovereignty over Natural Resources*, G.A. Res. 1803 (XVII), 17 U.N. GAOR Supp. (No.17) at 15, U.N. Doc. A/5217 (1962) at Preamble. See also, *Charter of Economic Rights and Duties of States*, G.A. Res. 3281, 29 U.N. GAOR, 29th Sess., Supp. (No. 31) 50, U.N. Doc. A/9631 (1974), art. 2.

[25] Eduardo Jiménez de Aréchaga, "State Responsibility for the Nationalization of Foreign Owned Property" (1978) 11 N.Y.U.J. Int'l L. & Pol. 179 at 179-180. See also Robin C.A. White, "Expropriation of the Libyan Oil Concessions - Two Conflicting International Arbitrations" (1981) 30 I.C.L.Q. 1 at 11-12 ("... the combined effect of General Assembly resolutions concerning natural resources and of the concept of sovereignty is to establish the competence of a State to exercise its sovereignty in respect of its natural resources at any time. ... international law will not recognise the fettering of sovereignty save perhaps under a treaty between States.")

[26] See Leo T. Kissam & Edmond K. Leach, "Sovereign Expropriation of Property and Abrogation of Concession Contracts" (1959) 28 Fordham L Rev. 177 at 204.

[27] *Ibid.*

[28] *Ibid.*

[29] *Texaco Overseas Petroleum Company / California Asiatic Oil Company v. Government of the Libyan Arab Republic*, (1978) 17 I.L.M. 1 [*Texaco v. Libya*].

nationalization of investment, do not offend the host State's permanent sovereignty over natural resources because, while these provisions may limit the State's exercise of its sovereignty, they do not prevent the State from enjoying its right to permanent sovereignty.[30] According to the tribunal,

> As regards the question of permanent sovereignty, a well-known distinction should be made as to enjoyment and exercise. The State granting the concession retains the permanent enjoyment of its sovereign rights; it cannot be deprived of the right in any way whatsoever; the contract which it entered into with a private company cannot be viewed as an alienation of such sovereignty but as a limitation, partial and limited in time, of the exercise of sovereignty. Accordingly, the State retains, within the areas which it has reserved, authority over the operations conducted by the concession holder, and the continuance of the exercise of its sovereignty is manifested, for example, by the various obligations imposed on its contracting party, which is in particular subjected to fiscal obligations that express unquestionably the sovereignty of the contracting State.[31]

Contractual limitations on the exercise of a State's sovereignty are juridically possible if the limitations are "expressly stipulated for, and … within the regulations governing the conclusion of State contracts", and "cover only a relatively limited period."[32] Moreover, because a stabilization clause protects only the contracting party from the host State's unilateral alteration of the legal and fiscal regimes, and because a stabilization clause does not prevent the State from altering its legal and fiscal regimes applicable to other investors, a stabilization clause cannot be said to fetter the legislative sovereignty of the State.[33] That being so, "a State cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and cannot, through measures belonging to its internal order, make null and void the rights of the contracting party which has performed its various obligations under the contract."[34]

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[30] *Ibid.* at 26.
[31] *Ibid.* at 26 para. 77.
[32] *Kuwait v. American Independent Oil Company (Aminoil)*, (1982) 21 I.L.M. 976 at 1023 para. 95 [*Kuwait v. Aminoil*].
[33] *Agip Company v. Popular Republic of the Congo*, (1982) 21 I.L.M. 726 at 735-736 para. 86 [*Agip v. Congo*].
[34] *Texaco v. Libya*, *supra* note 29 at 24 para. 68.

The argument that stabilization clauses are incompatible with State sovereignty appears weak, particularly in situations where the stabilization clauses are authorized expressly by statutory enactments, or where the stabilization provisions are contained in a statute validly enacted by the host State. Host States can, in exercise of their sovereignty, sign contractual provisions or enact legislative provisions which limit, for a specified period, the exercise of their sovereignty over specific natural resource projects. As noted earlier, developing countries such as South Africa and Ghana have enacted statutes authorizing designated agencies and officials to enter into stabilization agreements. These statutory enactments neither alienate the sovereignty of these countries nor deprive them of the right to enjoy their sovereignty over natural resources. To the contrary, the statutes are expressions of the sovereign will of host States. That said, stabilization clauses have certain negative impacts on the host State's ability to exercise its sovereignty over natural resources because, as will be noted shortly, such clauses limit the royalty and tax policy options available to the legislature.[35]

Although stabilization clauses are not incompatible with State sovereignty, and while a preponderance of academic and arbitral opinion holds that stabilization clauses are valid under international law,[36] the validity of 'freezing' stabilization clauses under the domestic laws of host developing countries is at least questionable. The Constitutions of some developing countries vest in the national legislature the power to make laws. For example, the Constitution of the Republic of South Africa vests in the National Assembly (that is, the legislature) the legislative authority of the national government including the power "to pass legislation with regard to any matter" on which the National Assembly has legislative competence.[37] Similarly, in Nigeria the National Assembly has power to make laws "with respect to any matter" falling within the areas listed in both the exclusive legislative list and the concurrent legislative list.[38] Arguably, a contractual or statutory stabilization clause is void and unconstitutional if it purports to limit the power of the legislature to make laws that change or amend the legal regimes governing an

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[35] International Monetary Fund, *Guide on Resource Revenue Transparency (2007)* at 24, online: International Monetary Fund <http://www.imf.org/external/np/pp/2007/eng/051507g.pdf> [*Guide on Resource Revenue Transparency*].

[36] See, e.g., Kissam & Leach, *supra* note 26 at 204; *Texaco v. Libya, supra* note 29; *Agip v. Congo, supra* note 33 at 735-736 para. 86.

[37] *Constitution of the Republic of South Africa, 1996*, ss. 43-44.

[38] *Constitution of the Federal Republic of Nigeria, 1999*, s. 4. See also the *Constitution of the Republic of Ghana*, s. 93(2) ("the legislative power of Ghana shall be vested in Parliament and shall be exercised in accordance with this Constitution").

investment project. This position was judicially validated in Nigeria recently when the Federal High Court held that the Second Schedule to the *Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act* [hereafter *"Nigeria LNG Act"*], which freezes the law applicable to the LNG Project, is unconstitutional because it fettered the power of the legislature to make laws. In addition, the court held that the stabilization provision is contrary to the tenets of the rule of law not only because it is "very wide", but also because it is inconsistent with the Nigerian Constitution, which empowers the legislature to make laws for the good of all Nigerians.[39]

The invalidity of statutory stabilization provisions under domestic law can impact negatively on the effectiveness of stabilization clauses entered pursuant to the invalid statutory provisions. If the domestic law authorizing a stabilization clause is unconstitutional and void because it fetters the power of the legislature, it follows that a stabilization clause signed by the government under the unconstitutional statute is itself void under domestic law. Similarly, a contractual stabilization clause is invalid under the domestic law of the host country if the clause is inconsistent with such domestic law. Peter Cameron argues this point persuasively when he notes that a stabilization provision "given by the host country government must be given in a form that is consistent with the country's legal and constitutional framework."[40]

III. LEGAL EFFECT AND UTILITY OF STABILIZATION CLAUSES

Assuming, for purposes of argument, that stabilization clauses are valid under international law and under domestic law, there is a further question as to the legal effect or utility of stabilization clauses that attempt to freeze the legal and fiscal regimes applicable to a project. In other words, are stabilization clauses effective in practice as to prevent host States from changing or amending the legal and fiscal regimes prescribed in the resource concession contract? This question has been the subject of a heated academic debate, particularly as it relates to international law. Although a consensus has yet to emerge, two opposing views are discernable. There is the view that stabilization clauses are effective in international law because "states can bind themselves by

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[39] *Niger Delta Development Commission v. Nigeria Liquefied Natural Gas Company Limited* (Suit Number FHC/PH/CS/313/2005, unreported judgment dated 11 July 2007) at 32. For analysis of this case, see Bayo Adaralegbe, "Stabilizing Fiscal Regimes in Long-Term Contracts: Recent Developments from Nigeria" (2008) 1:3 Journal of World Energy Law & Business 239.
[40] Cameron, *supra* note 3 at 13.

means of stabilized international contracts".[41] To paraphrase one arbitral tribunal, a stabilization clause binds the host State irrevocably.[42] More specifically, this view, which relies heavily on the doctrine of sanctity of contracts, that is, *pacta sunt servanda,*[43] holds that because stabilization clauses are binding on host States, they prevent host States from amending unilaterally the fiscal regimes envisaged in the concession agreement. Thus, in *Libyan American Oil Co. (LIAMCO) v. The Government of the Libyan Arab Republic,*[44] the tribunal held that a stabilization clause which provided that the "contractual rights expressly created by this Concession shall not be altered except by mutual consent of the parties" prevented the State of Libya from cancelling or modifying unilaterally the contents of the agreement.[45] According to the tribunal, Libya could not terminate or alter the concession unless it did so with the "[m]utual consent of the contracting parties, in compliance with the said principle of the sanctity of contracts and particularly with the explicit terms" of the stabilization clause.[46]

However, a subsequent arbitral decision casts doubt on the legal effect of stabilization clauses. In *Kuwait v. American Independent Oil Company (Aminoil),*[47] the arbitral tribunal ruled that a stabilization clause which provided that the host State "shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement", could not legally prevent Kuwait from enacting a subsequent statute which terminated and nationalized the concession granted to Aminoil. Although the majority of the tribunal members based their ruling partly on the fact that the stabilization clause did not, in their view, expressly prohibit nationalization of the concession,[48] and while the tribunal relied on "a change in the nature of the contract itself,

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[41] Curtis, *supra* note 3 at 350. See also Paul E. Comeaux & N. Stephen Kinsella, "Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance" (1994) 15 N.Y.L. Sch. J. Int'l & Comp. L. 1 at 25 ("International law upholds both the validity of stabilization clauses and the right of a sovereign nation to bind itself through the use of such clauses.")

[42] *Saudi Arabia v. Arabian American Oil Company (Aramco)*, (1963) 27 International Law Reports 117 at 168 [*Saudi Arabia v. Aramco*]

[43] See Kissam & Leach, *supra* note 26 at 207.

[44] *LIAMCO v. Libya, supra* note 4.

[45] *Ibid.* at 55. See also *Saudi Arabia v. Aramco, supra* note 42.

[46] *LIAMCO v. Libya, supra* note 4 at 62.

[47] *Kuwait v. Aminoil, supra* note 32. For insight on this case, see Martin Hunter & Anthony C. Sinclair, "*Aminoil* Revisited: Reflections on a Story of Changing Circumstances" in Todd Weiler, ed., *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May, 2005) 347-381.

[48] *Kuwait v. Aminoil, ibid.* at 1023 para. 94.

brought about by time, and the acquiescence or conduct of the parties”,[49] nonetheless their refusal to interpret this stabilization clause as fettering the legislative power of Kuwait is a telling commentary on the effect of stabilization clauses in international law. In specific terms the stabilization clause prohibited the government of Kuwait from enacting laws or taking administrative measures which could have the effect of terminating the concession granted to Aminoil.[50] The law enacted by Kuwait had this exact effect, yet the majority refused to give full legal effect to the stabilization clause. Had they done so, they would have concluded that the stabilization clause prevented Kuwait from enacting the law in question.

The refusal by the majority of arbitrators in *Kuwait v. American Independent Oil Company (Aminoil)* to give effect to a stabilization clause which prohibited the nationalization of the concession bolsters the position of critics who argue that, a stabilization clause is ineffective under international law (as well as under domestic law) to prevent a State from amending the legal and fiscal regimes prescribed in the resource concession agreement.[51] For example, Thomas Wealde and George Ndi argue very persuasively that, even in cases where the host country validly grants a stabilization clause, the legislature of the host country retains the right to alter the legal and fiscal regimes governing the project, subject to the payment of compensation for breach of the stabilization clause.[52] According to these authors, “the notion of sovereignty under municipal law means that the legislator can take what he has given” and “nothing would prevent the national legislature from retroactively canceling and revoking rights awarded, possibly subject to constitutional and other legal consequences (e.g., the duty to pay compensation under national law).”[53] Similarly, Yinka Omorogbe argues that stabilization clauses are at best “useless” and “legally valueless” because they “cannot bind the legislative body from enacting any other law which in any way alters or amends the terms contained therein.”[54] This view had earlier been projected by F.A. Mann when he argued that “the express exemption from the effects of future legislation is

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[49] *Kuwait v. Aminoil, ibid.* at 1024 para. 101.
[50] See the dissenting opinion of Sir Gerald Fitzmaurice in *Kuwait v. Aminoil, ibid.* at 1051 para. 24 (stating that the stabilization clause in this case is concerned with “any measure terminating the Concession before its time” and that the law enacted by Kuwait “was essentially an act of termination of the Concession”.)
[51] See Waelde & Ndi, *supra* note 23 at 238-240; Omorogbe, *supra* note 23 at 189.
[52] Waelde & Ndi, *ibid.*
[53] Waelde & Ndi, *ibid.* at 239. See also Cameron, *supra* note 3 at 13 (“… in every country the sovereign retains the power - in spite of any laws or contracts to the contrary - to enact laws that legally will ‘trump’ previous laws (and contracts)”).
[54] Omorogbe, *supra* note 23 at 189.

redundant" because "[s]uch exemption cannot and ought not to preclude the genuine exercise of the state's police power."[55]

In fact, notwithstanding a stabilization clause host States may amend the legal and fiscal regimes prescribed in resource concession contracts where the amendment is required in the public interest. In *BP Exploration Co. (Libya) Ltd. v. Government of the Libyan Arab Republic*,[56] for example, the arbitral tribunal recognized that although the stabilization clause in that case limited Libya's freedom to alter or amend unilaterally the terms of the concession, nonetheless Libya could do so if the amendment was in the public interest.[57] This position finds support in the fact that a statute enacted by the host State remains valid even if the statute contravenes the stabilization measures prescribed in prior concession agreements signed by the State.

Some authors argue that the legal effect of a stabilization clause depends on the scope and duration of the clause. Subrata Chowdhury argues, for example, that a stabilization clause is ineffective if it "ties the hands of the host State for a very long period".[58] Chowdhury's assertion finds support in *Kuwait v. American Independent Oil Company (Aminoil)*,[59] where the arbitral tribunal refused to read a stabilization clause as preventing the State of Kuwait from nationalizing a concession for "an especially long" period of 60 years.[60] If this view is correct, then it is arguable that contractual stabilization clauses and statutory stabilization provisions in some developing countries are at least ineffectual, given their wide scope and their unnecessarily long duration. For example, in South Africa a stabilization clause lasts "for as long the extractor holds the [mineral resource] right" to which the clause relates.[61] Similarly, the stabilization clauses under the *Nigeria LNG Act* are intended to be in force "so long as the Company or any successor thereto, is in existence and carrying on the business of liquefying and selling liquefied natural gas and natural gas liquids within and/or outside" Nigeria.[62] In fact, the stabilization provisions under the *Nigeria LNG Act* "shall not be

[55] F.A. Mann, "State Contracts and State Responsibility" (1960) 54 Am. J. Int'l L. 572 at 587-588.
[56] (1979) 53 International Law Reports 297.
[57] *Ibid.* at 318-321, 324, 327.
[58] Subrata Roy Chowdhury, "Permanent Sovereignty Over Natural Resources: Substratum of the Seoul Declaration" in Paul de Waart, Paul Peters & Erik Denters, eds., *International Law and Development* (The Hague: Martinus Nijhoff Publishers, 1988) 59 at 81.
[59] *Kuwait v. Aminoil, supra* note 32.
[60] *Ibid.* at 1023 para. 95.
[61] *Mineral and Petroleum Resources Royalty Act, 2008*, *supra* note 22, s. 13.(1).
[62] *Nigeria LNG, supra* note 18, Second Schedule, s. 4(a)).

suspended, modified or revoked during the life of the venture".[63] These provisions effectively tie the hands of the Nigerian government for the entire duration of the LNG Project.

While a 'freezing' stabilization clause may not prevent a host State from altering the legal and fiscal regimes stipulated in the concession agreement, in practice such a clause is functionally useful to foreign investors because its breach by the host government can create a cause of action for damages.[64] According to one author, stabilization clauses "reinforce the traditional rule that full compensation must be made for property rights taken by the state."[65] The amount of compensation payable by host States for breach of a stabilization clause depends primarily on two factors: the type of stabilization clause and the nature of the breach. Where the stabilization clause protects against expropriation and where the nature of the breach is such that it amounts to expropriation or 'regulatory taking' of the concession holder's property rights, compensation is determined on the basis of "all the circumstances relevant to the particular concrete case."[66] These circumstances include the "loss suffered" by the concession holder[67] and "the value of the [expropriated] corporeal property, including all assets, installations, and various expenses incurred" as a result of the breach.[68] In addition, arbitral tribunals may take into account the value of the mineral rights expropriated by the State.[69] And, depending on the terms of the contract and the applicable law, the legitimate expectations of the parties,[70] the anticipated profits from the mineral concession,[71] and the loss of profits resulting from the breach of contract by the host State may be taken into account in determining the amount of compensation.[72]

The amount of compensation may also be influenced by factors such as "the costs incurred by the investor because of the violation" of the stabilization clause by the host State and "the investor's legitimate

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[63] *Ibid.*
[64] See R. Doak Bishop, Sashe D. Dimitroff & Graig S. Miles, "Strategic Options Available when Catastrophe Strikes the Major International Energy Project" (2001) 36 Tex. Int'l L.J. 635 at 642. See also Comeaux & Kinsella, *supra* note 41 at 25.
[65] Curtis, *supra* note 3 at 349.
[66] *Kuwait v. Aminoil, supra* note 32 at para. 144.
[67] *Agip v. Congo*, *supra* note 33 at 737 para. 98.
[68] *LIAMCO v. Libya, supra* note 4 at 67. See also *Kuwait v. Aminoil*, s*upra* note 33 at 1038 para. 164.
[69] *LIAMCO v. Libya, ibid.* at 81.
[70] *Kuwait v. Aminoil, supra* note 33 at 1034 para. 148..
[71] *Ibid.* at 1034-5 para. 152-153.
[72] *Agip v. Congo*, *supra* note 33 at 737 para. 98..

expectations generated by the presence of a stabilization clause."[73] For example, in *Kuwait v. Aminoil* the arbitral tribunal held that stabilization clauses which "prohibited any measures that would have had a confiscatory character … created for the concessionaire a legitimate expectation" not only "as to the strength of the respect due to the contractual equilibrium", but also the expectation that the concessionaire would "obtain a reasonable rate of return" on its investment.[74] Thus, where an amendment to the host State's laws imposes additional or new regulatory obligations on a resource extraction company that is signatory to a prior stabilization clause, the host State may be liable to reimburse the company for the costs incurred in complying with the additional or new regulation. For economic equilibrium clauses, however, compensation is usually the restoration of the affected party to their position prior to the breach of contract by the host State. As mentioned earlier, economic equilibrium clauses usually provide a mechanism for restoring the status quo ante. Some clauses may require the mutual negotiation of compensation, while others may require the adoption of a formula that ensures that the amount of compensation is equal to the costs incurred by the company in complying with the new regulatory regime imposed by the host State. For example, in South Africa,

> [i]f the State fails to comply with the terms of an agreement contemplated in section 13.(1) and the failure has a material adverse economic impact on the determination of the royalty payable by the extractor that is party to that agreement, the extractor is entitled to compensation in respect of the increase in the royalty caused by the failure (and interest at the prescribed rate calculated on the compensation from the date of the failure) or to an alternative remedy that eliminates the full impact of the failure.[75]

V. ECONOMIC AND SOCIAL IMPLICATIONS OF STABILIZATION CLAUSES

As noted above, certain stabilization clauses in resource extraction contracts are intended to freeze the legal and fiscal regimes applicable to resource extraction projects. The freezing of legal and fiscal regimes

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[73] Lorenzo Cotula, "Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses" (2008) 1(2) J.W.E.L. & B. 158 at 166.
[74] *Kuwait v. Aminoil, supra* note 33 at 1037 para. 159-160.
[75] *Mineral and Petroleum Resources Royalty Act, 2008, supra* note 22, s. 14.(2).

governing extractive projects has economic and social implications for host countries. In the economic sense, stabilization clauses may lead to loss of revenues for host States. Zambia is a case in point. In the course of privatization of Zambia's mining industry in the 1990s, the Zambian government signed numerous Development Agreements with mining TNCs that not only granted very liberal and generous terms in favour of the TNCs,[76] but also prohibited the government from altering the fiscal regimes prescribed in the agreements. The Development Agreements fixed the royalty rate for copper at 0.6 percent of the gross revenues of the companies,[77] far below the statutory royalty rate of 3 percent of a company's gross revenues under the now repealed *Mines and Minerals Act* of 1995.[78] More significantly, the Development Agreements froze the fiscal regimes specified under the Agreements for 15 to 20 years.[79] Although there was a boom in copper price on the international market, the boom did not yield appreciable revenues for Zambia because of the low rate of royalty prescribed under the Development Agreements.[80] In fact, Zambia "incurred [financial] losses in tax revenues through the subsidies given to the private mining companies" under the 'Development Agreements.[81] Zambia realized a royalty of US$20 million from the combined gross proceeds of US$3.4 billion in 2007 because of the low royalty rate of 0.6 percent stipulated in the Development Agreements.[82]

Apart from their adverse impacts on resource revenues, stabilization clauses could limit the fiscal and tax policy options available to host States.[83] This is particularly so in countries where stabilization clauses are granted indiscriminately. In Zambia, the power to enter into

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[76] Christopher Adam & Anthony M. Simpasa, "Harnessing Resource Revenues for Prosperity in Zambia" (OxCarre Research Paper 36, Revised Draft) at 25-27, online: <http://www.oxcarre.ox.ac.uk/images/stories/papers/RevenueWatch/oxcarrerp201036.pdf>. Some of these Development Agreements are available at <http://www.minewatchzambia.com/agreements.html>.

[77] See, for example, *Mopani Copper Mines Development Agreement*, *supra* note 9, art. 16 read together with Schedule 8; *Konkola Copper Mines Development Agreement*, *supra* note 9, art. 15 read together with Schedule 6,.

[78] John Lungu, "Copper Mining Agreements in Zambia: Renegotiation or Law Reform?" (2008) 117 Review of African Political Economy 403 at 407.

[79] See *Mopani Copper Mines Development Agreement*, *supra* note 9, art. 16 read together with art. 1.

[80] See Adam & Simpasa, *supra* note 76 at 35-37.

[81] Lungu, *supra* note 78 at 409.

[82] Adam & Simpasa, *supra* note 76 at 36 (n. 27).

[83] See Thomas Baunsgaard, "A Primer on Mineral Taxation" (IMF Working Paper WP/01/139) at 18, online: <http://papers.ssrn.com/so13/papers.cfm?abstract_id=879929>; *Guide on Resource Revenue Transparency, supra* note 35 at 24.

'Development Agreements' was indiscriminately exercised by government officials in the 1990s such that, prior the recent termination of the 'Development Agreements', the government had signed about eleven 'Development Agreements' with mining companies.[84] Under these Development Agreements, the Zambian government undertook that it will not, for periods ranging from 15 to 20 years, increase corporate income tax or withholding tax rates applicable to resource extraction companies, or otherwise amend the Value Added Tax and corporate tax regimes, or impose new taxes or fiscal imposts, including new import or export duties or other new duties or new royalties that could have a material adverse effect on the company's distributable profits or dividends.[85] In addition, the agreements prohibited the government from increasing the royalty rates and the import duty rates applicable to resource extraction companies.[86] Given that the operations of most major mining companies in Zambia were governed by Development Agreements until recently, Zambia's ability to determine its tax and royalty policies was effectively constrained and limited by these agreements.

The adverse economic impacts of stabilization clauses in the host States are particularly acute because of the broad language and long duration of stabilization clauses. For example, the agreement relating to the West African Gas Pipeline Project contains stabilization clauses that "extend well beyond the fiscal regime" governing the project, including the freezing of "exchange controls, foreign investment rules and regulatory control over the pipeline".[87] And in Ghana, a 'stability agreement' can freeze a wide range of issues, including taxes, royalties, fees, exchange control, importation of goods and equipment, transfer of capital, and remittance of dividends.[88] In terms of duration, the recently-terminated Development Agreements between the government of Zambia and mining TNCs contained stabilization clauses which provided that, the fiscal regimes under the agreements shall be in force for periods ranging between 15 and 20 years.[89] A similar situation is found in Ghana where a 'stability agreement' can freeze the law applicable to a mining project for a period of 15 years.[90] Worse still, stabilization agreements in South Africa have effect "for as long the extractor holds the [mineral resource] right" to which the agreement relates.[91] Similarly, the

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[84] See Adam & Simpasa, *supra* note 76 at 40.
[85] See, for example, *Mopani Copper Mines Development Agreement*, *supra* note 9, art. 16; *Konkola Copper Development Agreement*, *supra* note 9, art. 15.
[86] See *ibid.*
[87] Cameron, *supra* note 3 at 44.
[88] *Minerals and Mining Act 2006*, *supra* note 20, s. 48.
[89] Adam & Simpasa, *supra* note 76 at 26.
[90] *Minerals and Mining Act 2006*, *supra* note 20, s. 48.
[91] *Mineral and Petroleum Resources Royalty Act, 2008 supra* note 22, s. 13.(1).

guarantees and assurances granted under the *Nigeria LNG Act* have effect "so long as the Company or any successor thereto, is in existence and carrying on the business of liquefying and selling liquefied natural gas and natural gas liquids within and/or outside" Nigeria.[92] In other words, the Nigerian government binds itself not to introduce changes to the legal and fiscal regimes governing the LNG Project for as long as the companies involved in the project are implementing the project.

Proponents of stabilization clauses may argue that these clauses are not so pervasive that they could negatively impact economic development in developing countries. This argument may hold true in countries where stabilization clauses are not rampant. The mere fact that a country has granted stabilization clauses to a few companies may not attract adverse economic consequences. The problem, however, is that stabilization clauses are often rampant in developing countries. TNCs often exert pressure on host developing countries to issue contractual and statutory guarantees on the fiscal regimes governing the extraction of natural resources. This is particularly so in Sub-Saharan Africa where freezing stabilization clauses are said to be most prevalent.[93] Where a country grants stabilization clauses in an indiscriminate manner, the adverse economic and social impacts associated with such clauses tend to magnify.[94] As noted earlier, such was the case in Zambia until very recently when the government unilaterally cancelled the Development Agreements.

On the social front, the freezing of the legal regimes governing resource extraction projects may have adverse consequences for human rights and environmental protection in the host country. This is because freezing stabilization clauses could restrict the State's ability to regulate the human rights and environmental practices of resource extractors. By freezing the legal regimes applicable to resource extraction projects stabilization clauses hinder the effective regulation of the social and environmental practices of resource extraction companies in developing countries. Regulatory authorities are, in effect, precluded from enforcing new laws and regulations against companies that are signatories to prior concession contracts containing stabilization clauses. Thus, stabilization clauses could promote social irresponsibility on the part of the companies. Amnesty International argues, for example, that stabilization clauses disregard human rights by holding back host governments from taking steps to improve human rights protection; by encouraging host governments to ignore their human rights obligations in relation to

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[92] *Nigeria LNG, supra* note 18, Second Schedule, s. 4(a)).
[93] Shemberg, *supra* note 5 at 22.
[94] Baunsgaard, *supra* note 83 at 18.

resource extraction; and by affording petroleum and mining companies an opportunity to frustrate efforts of the host States to fulfill their legal obligations to protect human rights.[95]

In fact, by entering into resource concession contracts that stipulate that the law governing a project shall be the law in force at the date of signing of the contract, host States may lose "the flexibility to introduce new regulations to promote and protect human rights", labour rights and the environment, at least in relation to the project.[96] This may be particularly so in countries where stabilization clauses are couched in broad language. For example, in Ghana the Minister of Mines could grant a development agreement that contains provisions "relating to environmental issues and obligations of the holder to safeguard the environment in accordance with this Act or another enactment".[97] Similarly, the erstwhile Development Agreement between Zambia and Konkola Copper Mines Plc prohibited the government of Zambia from effecting "any changes" to "legislation or regulations governing the terms and conditions of employment within Zambia" if the changes would prevent the company from:

a) operating on a seven (7) days a week, twenty-four (24) hours a day, three hundred and sixty five (365) days a year basis; or
b) negotiating with employees or relevant unions or engaging employees or terminating their contracts of employment in such a manner which would be likely to have a Material Adverse Economic Effect, individually or cumulatively.[98]

While this clause did not prevent the Zambian government from making changes to its labour law, those changes would be inapplicable to the Konkola Copper Mines plc if they adversely affect the smooth operations of the company. Conceivably, changes relating to work week, hours of work, workplace health and safety and termination of employment could adversely affect the operations of the company and hence, would be inapplicable to Konkola Copper Mines Plc.

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[95] Amnesty International, *Contracting Out of Human Rights: The Chad-Cameroon Pipeline Project* (September 2003) at 11-12, online: <http://www.amnesty.org/en/library/asset/POL34/012/2005/en/76f5b921-d4bf-11dd-8a23-d58a49c0d652/pol340122005en.pdf>.

[96] United Nations, Economic and Social Council, *Human Rights, Trade and Investment Report of the High Commission for Human Rights*, at 20 para. 31(d), online: UNESC <http://www.unhchr.ch/Huridocda/Huridoc.nsf/(Symbol)/E.CN.4.Sub.2.2003.9.En?Opendocument> [*Report of the High Commission for Human Rights*].

[97] *Minerals and Mining Act 2006*, *supra* note 20, s. 49(2)(d).

[98] *Konkola Copper Mines Development Agreement*, *supra* note 9, Arts. 13.1.4.

More significantly, freezing stabilization clauses essentially insulate resource extraction companies from complying with future changes to the human rights, labour rights and environmental protection regimes in host countries. For example, the original version of the Mineral Development Agreement between the Government of Liberia and Mittal Steel contained a stabilization that provided that:

> … any modifications that could be made in the future to the Law as in effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date.[99]

This provision not only shielded Mittal Steel from future changes to Liberian laws including laws relating to human rights and environmental protection, but also it allowed the company "to choose which new laws it will comply with."[100] This clause was particularly detrimental to social rights (that is, human rights, labour rights and environmental rights) in Liberia because it served as an incentive for Mittal Steel, a financially powerful TNC, to exert pressure on the Liberian government to enact laws that attenuated the environmental obligations of companies operating in Liberia. Happily, this stabilization clause was renegotiated and replaced with a new clause in 2007.[101]

Although freezing stabilization clauses could have negative impacts on human rights, labour rights and environmental protection, these impacts may be attenuated and, in some cases, eliminated by the legal and political dispensation in developing host countries. For example, the constitutions of many developing countries provide expressly that the constitution is supreme and that any statute or policy of government which is inconsistent with the constitution shall be null and void to the extent of the inconsistency. Because under these

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[99] Global Witness, *Heavy Mittal? A State Within a State: The Inequitable Mineral Development Agreement Between the Government of Liberia and Mittal Steel Holdings NV*, at 31, online: <http://www.globalwitness.org/media_library_detail.php/156/en/heavy_mittal> [*Heavy Mittal?*].

[100] *Ibid.*

[101] See *An Act Ratifying the Amendment to the Mineral Development Agreement (MDA) Dated August 17, 2005 Between the Government of the Federal Republic of Liberia (The Government) and Mittal Steel Holding A.G. and Mittal Steel (Liberia) Holdings Limited (The Concessionaire)*, art. 16(E), online: <http://www.leiti.org.lr/doc/ms.pdf>.

constitutions the legislature is vested with power to make law, it is arguable that freezing stabilization clauses are void to the extent that they prohibit or restrain the host country's legislature from changing the legal regimes governing a project. As noted earlier, this position was upheld recently by Nigeria's Federal High Court when it held that the fiscal stabilization provisions in the *Nigeria LNG Act* are unconstitutional because they fettered the power of Nigerian legislators to make law.[102]
In addition, regional and international human rights instruments impose obligations on State parties to protect the human rights and environmental rights of their citizens. For example, the *African Charter on Human and Peoples Rights* (hereafter *African Charter*) obliges African states to "promote and protect human and people's rights and freedoms" including the rights to life and integrity of the human person; right to liberty and security; and the right to enjoy the best attainable state of physical and mental health.[103] In fact, the *African Charter* imposes an obligation on States not only to "recognize the rights, duties and freedoms enshrined in this Charter", but also to "undertake to adopt legislative or other measures to give effect to" the rights enshrined in the Charter.[104]

Other international institutions have taken a similar position on the duty of States to protect human rights. For example, the UN High Commissioner for Human Rights has noted that a State's obligation to respect the human rights of its citizens requires the State to prevent human rights violations by third parties; while the obligation to fulfill human rights requires the State "to take appropriate legislative, administrative, budgetary, judicial and other measures towards the full realization of" human rights.[105] The African Commission on Human and Peoples Rights has also held that the human rights obligations under the *African Charter* oblige African governments "to protect their citizens, not only through appropriate legislation and effective enforcement but also by protecting them from damaging acts that may be perpetrated by private parties."[106] Similarly, the European Court of Human Rights has

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[102] *Niger Delta Development Commission v. Nigeria Liquefied Natural Gas Company Limited,* Suit Number FHC/PH/CS/313/2005, unreported judgment dated 11 July 2007.

[103] *African Charter on Human and Peoples' Rights*, O.A.U. Doc. CAB/LEG/67/3/Rev.5, arts.4, 6, 16, reprinted in (1982) 21 I.L.M. 58 [*African Charter*].

[104] *Ibid.,* art. 1.

[105] *Report of the High Commission for Human Rights*, *supra* note 96 at 18.

[106] *The Social and Economic Rights Action Center & Center for Economic and Social Rights v. Nigeria*, Communication No. 155/96, African Commission on Human and Peoples' Rights, at para. 57, online:

held that a government that fails to regulate the activities of third parties breaches their human rights obligations under the *European Convention on Human Rights* where the third parties' activities interfere with the rights guaranteed under the Convention.[107] This being so, a stabilization clause that inhibits the ability of host States to prevent third parties, in this case, resource extraction companies, from infringing the human rights of others violates the State's human rights obligations under both domestic and international law. Likewise, a stabilization clause that prevents the host State from taking appropriate legislative or administrative measures towards the full realization of human rights contravenes the human rights obligations of the State.

Although as argued earlier stabilization clauses do not prevent host States from changing or amending the legal regimes governing resource extraction projects, they can dissuade host States from changing their legal regimes because such a change or amendment could amount to a breach of the stabilization clause which, in turn, attracts compensation. This is particularly so where the stabilization clause prohibits the government from amending or changing its laws or regulations in a manner that amounts to expropriation or nationalization of the company's investment. Given the broad and liberal interpretation of contractual and treaty provisions on "expropriation" by some arbitral tribunals, the enforcement of new laws or new regulations against a company that is signatory to a prior contract containing a stabilization clause may be viewed by arbitral tribunals as an indirect expropriation where the new law or regulation has a material adverse impact on the company's investment. For example, in interpreting the expropriation provisions in Article 1110 of the North American Free Trade Agreement (NAFTA), a tribunal has held that expropriation means

> [n]ot only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also 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.[108]

<http://www1.umn.edu/humanrts/africa/comcases/155-96b.html> [*SERAC & CESR v. Nigeria*].

[107] See, for example, *Hatton v. United Kingdom*, ECHR, 2 October 2001; *Lopez Ostra v. Spain*, ECHR, 9 December, 1994.

[108] *Metalclad Corporation and the United Mexican States*, Case No. ARB(AF)/97/1 (2000) at para.103.

Applying the logic of the NAFTA tribunal, a new law or regulation that imposes compliance costs on a company that is the beneficiary of a prior stabilization clause may amount to "incidental interference with the use" of the company's property. This is particularly so where the compliance costs associated with the new law or regulation diminish the company's profits or where they deprive the company of a "reasonably expected economic benefit" whether in whole or in part. In effect then, a host State that breaches a stabilization clause by way of the enactment of a law that changes the legal regimes governing an extractive project may in fact be guilty of expropriation where the law incidentally interferes with a company's reasonably expected economic benefits. Because the breach of a stabilization clause may amount to expropriation and, because the host State is liable to pay compensation for such expropriation, the host State may not want to enact or enforce new laws or regulations. Even in cases where the new law or regulation does not amount to expropriation, the host State may, nonetheless, refrain from enforcing the law against the company in order not to trigger the arbitration and compensation provisions in the contract. As noted earlier, modern concession contracts contain economic equilibrium clauses that enjoin host States to restore resource extraction companies to the position they occupied prior to the new laws or new regulations. Such restoration is usually achieved by payment of compensation or by granting other financial incentives to the companies.

VI. STABILIZATION CLAUSES IN THE CONTEXT OF BILATERAL INVESTMENT TREATIES

The significance of stabilization clauses in natural resource extraction contracts may be enhanced where there is a Bilateral Investment Treaty (BIT) between the host State and the home country of the resource extraction company. BITs often contain provisions on the mutual obligation of parties to provide "full protection and security" and to ensure "fair and equitable treatment" of investments. These provisions may confer treaty status on the stabilization clauses in an investment contract.[109] Thus a breach of the stabilization clauses may amount to a breach of the BIT.

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[109] Thomas J. Pate, "Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry" (2009) 40 U. Miami Inter-Am. L. Rev. 347 at 363-364.

Although a consensus has yet to emerge on the meaning of "full protection and security" of investments, two lines of interpretation have been adopted by arbitral tribunals. The conventional view is that "full protection and security" imposes an obligation on States to exercise due diligence to protect against physical damage or physical injury to foreign investment projects.[110] Other tribunals have taken a more expansive view by holding that the phrase 'full protection and security' imposes an obligation on States to protect foreign investors against both physical injury and non-physical injury including protection from legal and administrative measures capable of depriving investors of their investments. The 'full protection and security' clause under a BIT, according to one tribunal, implies that State parties to the BIT guarantee the stability of investment "in a secure environment, both physical, commercial and legal".[111] Thus the "host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment withdrawn or devalued".[112] If this latter view is correct, the host State's amendment of the legal regimes governing an extractive project would amount to a breach of the BIT where the amendment changes in some material respects the legal regimes prescribed in the resource extraction contract.

More significantly, such amendment could infringe on the 'fair and equitable treatment' clause under the BIT. Although the meaning or scope of the 'fair and equitable treatment' principle has been the subject of intense debate in international investment law,[113] it is generally

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110 See *Suez v. Argentine Republic* (ICSID Case No. ARB/03/17), Decision on Liability (30 July 2010) at paras. 167 & 173; *Saluka Investments B.V. v. Czech Republic* (UNCITRAL), Partial Award (17 March 2006) at para. 484. See also *Lauder v. Czech Republic* (UNCITRAL), Final Award (3 September 2001) at para. 308.

111 *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania* (ICSID Case No. ARB/05.22), Award (24 July 2008) at para. 729.

112 *CME Czech Republic BV (The Netherlands) v. Czech Republic* (UNCITRAL), Partial Award (13 September 2001) at para. 613. See also *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award (14 July 2006) at paras. 406-408.

113 See Peter Muchlinski, "Caveat Investor'?: The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard" (2006) 55 Int'l & Comp. L.Q. 527 at 530 ("[t]he fair and equitable treatment standard is still shrouded with considerable uncertainty"); Graham Mayeda, "International Investment Agreements Between Developed and Developing Countries: Dancing with the Devil? Case Comment on the *Vivendi*, *Sempra* and *Enron* Awards (2008) McGill Int'l J. Sust. Dev. L. & Pol'y 189 at 215 ("ICSID tribunals are unable to articulate a precise meaning of the principle of fair and equitable treatment"); Mark Kantor, "Fair and Equitable Treatment: Echoes of FDR's Court-Packing

thought that the principle enjoins host States to protect the reasonable expectations of foreign investors arising primarily from the terms of the State contract including "the conditions offered by the host State at the time of the investment".[114] As noted earlier, such conditions usually include contractual provisions guaranteeing the stability of the legal and fiscal regimes governing the investment. Thus, where the host State grants a stabilization clause relating to the legal regimes governing the investment project and the State subsequently amends the legal regimes, such an amendment not only breaches the stabilization clause but more importantly, it also breaches the 'fair and equitable treatment' principle under the BIT.[115] This is because the reasonable expectations of the investor include a stable legal regime having regards to the stabilization clause granted by the host State at the commencement of the investment.[116] In effect, the principle of fair and equitable treatment imposes an obligation on States "not to alter the legal and business environment in which the investment has been made."[117] It protects foreign investors against subsequent changes to the host State's laws to the extent that "the investor has relied on the laws at the time of the investment."[118] Thus in *Suez v. Argentine Republic,* the tribunal held that failure to implement the legal framework prescribed in a Concession contract amounted to a breach of the fair and equitable treatment

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Plan in the International Law Approach Towards Regulatory Expropriation" (2006) 5 Law & Prac. Int'l Cts. & Tribunals 231 at 238 ("arbitral awards do not demonstrate a consistent approach towards the scope of the [fair and equitable treatment] obligation"). See also Alireza Falsafi, "The International Minimum Standard of Treatment of Foreign Investors' Property: A Contingent Standard" (2007) 30 Suffolk Transnat'l L. Rev. 317 at 337.

[114] *LG&E Energy Corp. et al v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability (3 October 2006) at para. 130.

[115] See *LG&E Energy Corp. et al v. Argentine Republic*, *ibid.* at para. 124 (the "stability of the legal and business framework is an essential element of fair and equitable treatment"). See also *Occidental Exploration and Production Company v. Republic of Ecuador* (London Court of Int'l Arb., Case No. UN. 3467) (1 July 2004) at para. 183.

[116] *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador* (ICSID Case No. ARB/19), Award (18 August 2008) at para. 340 ("The stability of the legal and business environment is directly linked to the investor's justified expectations. … such expectations are an important element of fair and equitable treatment"); *LG&E Energy Corp. et al v. Argentine Republic*, *supra* note 114 at para. 131 (fair and equitable treatment "involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor").

[117] *Occidental Exploration and Production Company v. Republic of Ecuador, supra* note 115 at para. 191.

[118] "Fair and Equitable Treatment in International Law", Remarks by Rudolf Dolzer (2006) 100 Am. Soc'y Int'l L. Proc. 69 at 72.

principle under the Argentina-France BIT and the Argentina-Spain BIT because it deprived the claimants of their "legitimate expectation that the Argentine authorities would exercise [their] regulatory authority and discretion within the rules of the detailed legal framework that [had been] established for the Concession".[119]

The breach of the "full protection and security" and the "fair and equitable treatment" provisions under a BIT could have serious financial and legal consequences for host developing countries. Host developing countries are liable to pay damages for such breach. The amount of damages payable by host States may depend on the losses suffered by the investor as a result of the breach.[120] In appropriate cases, the fair market value of the investment may be adopted as the standard for determining the loss suffered by the investor.[121] The host State may be liable to pay damages for the breach of a BIT even where the legal or administrative action constituting the breach is legitimately undertaken by the State, unless of course the State is able to prove the defence of 'necessity' under international law. In the legal sense, because the principle of fair and equitable treatment of investment protects the reasonable expectations of investors arising from the Concession contract including the expectation that the legal regimes prescribed in the Concession contract would not be amended or changed, it could "limit the host state's ability to take legislative action promoting its sustainable development goals".[122]

Stabilization clauses and BITs are inimical to the interests of developing host countries in another sense. They diminish the host State's power and authority over foreign investors and in fact redistribute the host State's power and authority among several international investment participants including foreign investors and international arbitral tribunals.[123] Tai-Heng Cheng articulates this point when he argues that

> [a]lthough states are the loci of power and authority in classical international law, international investment law transfers some of this power and authority to other decision-makers, including

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[119] *Suez v. Argentine Republic, supra* note 110 at paras. 213-218, particularly at para. 217. See also *LG&E Energy Corp. et al v. Argentine Republic, supra* note 114 at paras. 134-138.

[120] *Sempra Energy International v. Argentine Republic* (ICSID Case No. ARB/02/16), Award (28 September 2007) at para. 401.

[121] *Sempra Energy International v. Argentine Republic, ibid.* at para. 404; *Azurix Corp. v. Argentine Republic, supra* note 112 at para. 424.

[122] Mayeda, *supra* note 113 at 212.

[123] Tai-Heng Cheng, "Power, Authority and International Investment Law" (2005) 20 Am.U.Int'l L.Rev. 465 at 466-495.

> investors, arbitral tribunals and foreign courts. Investment treaties and contracts contain express investment protections … [that] often demand compliance by host states even if these norms intrude upon areas of sovereign control, such as monetary policies or the exploitation of resources. If host states ignore these demands for compliance, control mechanisms are triggered. Arbitral tribunals may be constituted pursuant to dispute resolution provisions in investment agreements to restore the norms from which the host state deviated. International investment law then calls on foreign courts to enforce these arbitral decisions. When such control mechanisms are successful, participants adjust their behavior to avoid or minimize the costs of non-compliance ….[124]

The host State's adjustment of behaviour may include a refusal to enact new laws and regulations governing an investment project that is subject to a stabilization clause or a BIT. Where the State enacts new laws and regulations it may refuse to implement the laws for fear that their implementation could trigger the arbitration or compensation provisions under the resource concession contract and under the BIT. In sum, because host States are desirous of avoiding payment of compensation for breach of a stabilization clause, they may become reluctant to exercise their legislative or regulatory power over an investment project. While this shift in power and authority may promote certainty in international investment law, the downside is that it erodes the host State's power and authority to regulate the activities of foreign investors even where such activities run counter to the development aspirations of the host State.[125]

The negative impacts of stabilization clauses and BITs have prompted some developing countries to rethink their position on foreign investment. For example, Ecuador's National Assembly has reportedly approved the government's plan to terminate its BITs with Germany, the United Kingdom, and Northern Ireland,[126] while Georgia has amended its foreign investment law by deleting the provisions on international arbitration and legal stabilization.[127]

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[124] *Ibid.* at 466-7.

[125] Mayeda, *supra* note 113; Cheng, *ibid.*. at 481.

[126] See "Ecuador Assembly Agrees to End International Investment Pacts", The Wall Street Journal, September 15, 2010, online:<http://online.wsj.com/article/BT-CO-20100915-712932.html

[127] See "Georgia Amends Foreign Investment Law so as to Remove International Arbitration and Legal Stabilization; One Claim is Pending Under the Law", online:<http://www.iareporter.com/articles/20100711.

VII. TOWARDS AN EQUITABLE REGIME OF STABILIZATION CLAUSES

As noted above, stabilization clauses are often included in natural resource contracts and in statutory enactments because of the perceived need to protect foreign investors from the economic and political risks involved in the exploitation of natural resources in developing countries. However, the prevalence of stabilization clauses in resource extraction contracts is equally attributable to the power imbalance between foreign investors (usually TNCs) and host developing countries. TNCs in the extractive industries wield enormous power over developing countries not only because of the financial strength of the TNCs, but also because of their technological expertise. To the contrary, many developing countries do not possess the requisite financial and technological expertise to exploit their natural resources. The power and influence of extractive TNCs is particularly effective in those developing countries that rely on the extractive industries for their economic sustenance.

Interestingly, as noted above international investment law entrenches and promotes this power imbalance through certain investment protection mechanisms. As Cheng rightly argues, international investment law "transfers power and authority from states to investors" through investment mechanisms such as multilateral and bilateral investment treaties and international development agreements.[128] Given these domestic and international realities, stabilization clauses are likely to continue to be included in resource extraction contracts between TNCs and developing countries. However, as noted above stabilization clauses have adverse economic and social consequences for developing countries. Stabilization clauses could lead to loss of revenues for the host States and hinder the protection of human rights and environmental rights in developing countries. How then do we ensure that stabilization clauses in investment contracts do not lead to unintended adverse impacts in developing countries?

Stabilization clauses ought to take into account the interests of both investors and the host country. While it is no doubt appropriate for foreign investors to seek the protection of their investments through stabilization clauses and other mechanisms, the protection of investment ought not to be at the economic expense of developing host countries. Rather, the interests of investors should be protected in a manner that takes into account the economic and social development aspirations of the host countries.

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[128] Cheng, *supra* note 123 at 492.

It has been suggested that the adverse impacts of stabilization clauses on human rights and environmental protection may be ameliorated by limiting, whether explicitly or implicitly, the scope of stabilization clauses. Lorenzo Cotula argues, for example, that a "human rights exception" should be built into stabilization clauses such that, the "host state regulation to promote the full realization of human rights is outside the scope of the stabilization clause".[129] That is, stabilization clauses should not operate to prevent or prohibit the host State from enacting new laws or regulations designed to discharge the State's obligations under international law. Thus, developing countries should ensure that stabilization clauses are not open-ended. Rather, stabilization clauses should contain express provisions excepting human rights and environmental protection from the ambit of the stabilization clauses. However, it is unlikely that resource extraction companies would agree to such limitation on the ambit of stabilization clauses. This is because modern stabilization clauses are designed not only to protect against investment risks, but also to protect the investor's profits. Corporate profits would likely be diminished by the imposition of post-contract regulatory burdens or compliance costs on resource extraction companies. Besides, resource extraction companies may view such express human rights exception as an attempt to impose human rights obligations on companies, a position that would be contrary to extant international law. Regrettably, conventional international law refuses to impose human rights obligation on companies for the reason that they are not subjects of international law.[130]

A complementary strategy is to limit the duration of stabilization clauses to a relatively short period, say five years. For example, a stabilization clause may provide that changes to the host State's legal regimes are inapplicable to a resource extraction company that is signatory to the contract containing the stabilization clause for a period of five years. Such a provision would afford these companies enough time to adapt to the new legal regimes. However, the stabilization clause may be mutually renegotiated after the initial five years.[131] Even then, the renegotiated clause should aim at maintaining economic equilibrium between the host State and the resource extraction company, rather than freezing the legal regimes governing the resource extraction project. As I have argued elsewhere, the advantage in negotiating a stabilization

[129] Cotula, *supra* note 73 at 172.
[130] See Evaristus Oshionebo, *Regulating Transnational Corporations in Domestic and International Regimes: An African Case Study* (Toronto: University of Toronto Press, 2009) at 115-116.
[131] On the need for re-negotiation of stabilization clauses, see Samuel K.B. Asante, "Stability of Contractual Relations in the Transnational Investment Process" (1979) 28 I.C.L.Q. 401 at 412-418.

clause after the initial five year period is that the host State would have access to requisite information, such as the density and quality of natural resources discovered during the exploration stage.[132] Thus, the host State is better able to negotiate the terms of the stabilization clause. In fact, the density and quality of resources discovered during the initial five year period may be such that the entire agreement is rendered "patently inequitable" to one party.[133] And, where a significant reserve of natural resources is discovered within the initial five year period, the host country may choose not to "provide commitments on contract stability at all".[134]

Although the strategies suggested above cater to future natural resource investments, they do not address extant stabilization clauses in the extractive industries. In this regard, arbitral tribunals have been urged to adopt a "sustainable development" approach in interpreting extant investment contracts by striking a balance between the economic interests of investors and overall interest of host countries.[135] According to Graham Mayeda, the sustainable development approach "would require [arbitral tribunals] to see promoting investment not as an end in itself, but as part of a country's approach to important social issues, including promoting human rights, protecting the environment, and improving social welfare".[136] There is a clear need to promote foreign investments in developing countries given the lack of economic development in these countries. However, economic development may not be attained in the absence of social and political development. Hence, the protection of foreign investment ought to be pursued in a manner that takes into account the mutually reinforcing link between economic development and social development.

Adopting this expansive view, arbitral tribunals ought to interpret extant stabilization clauses as invalid to the extent that they limit or freeze the human rights obligations of States. Otherwise States would literally 'contract out' of their human rights obligations by inserting stabilization clauses into contractual agreements that freeze or prohibit the application of new laws and regulations to companies that are signatories to the contracts. More specifically, arbitral tribunals should refuse to grant compensation for breach of a stabilization clause where

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132 Evaristus Oshionebo, "Fiscal Regimes for Natural Resource Extraction: Implications for Africa's Development" in Francis Botchway ed., *Natural Resource Investment and Africa's Development* (Cheltenham, U.K.: Edward Elgar Publishing, forthcoming).
133 Asante, *supra* note 131 at 412.
134 Cameron, *supra* note 3 at 17.
135 Mayeda, *supra* note 113 at 199.
136 *Ibid.* at 199.

the action of the host State alleged to constitute the breach was taken in order to fulfill the domestic or international legal obligation of the State to protect human rights or the environment. For example, an African State that enacts human rights law or environmental protection measures should not be held liable in compensation to a resource extraction company for breach of a stabilization clause where the law is intended to meet the State's human rights or environmental protection obligations under the *African Charter*.[137] This is because the right to a clean environment under the *African Charter* imposes clear obligations on African governments "to take reasonable and other measures to prevent pollution and ecological degradation, to promote conservation, and to secure an ecologically sustainable development and use of natural resources."[138]

VIII. CONCLUSION

The practice of inserting stabilization clauses in international investment contracts is likely to continue because of the perceived utility of stabilization clauses. They offer functional stability of investment in the sense that their breach invites monetary compensation or the restoration of the economic equilibrium envisaged under the investment contract. However, stabilization clauses have certain adverse consequences for developing countries. As argued in this paper, stabilization clauses could lead to loss of revenues in host countries. As well, stabilization clauses could have adverse impacts on human rights and environmental protection because they could dissuade host countries from regulating the social and environmental practices of resource extraction companies. Given these realities, developing countries ought to exercise caution in granting stabilization clauses. As suggested in this paper, such caution could involve limiting the duration of stabilization clauses to a specified period, as opposed to the current practice of granting stabilization clauses for an inordinately long period. Even then, stabilization clauses should be constantly renegotiated to cater to changing economic and social realities in developing countries.

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137 See, for example, *African Charter, supra* note 103, art. 24.
138 *SERAC & CESR v. Nigeria, supra* note 106 at para. 54.