

THE IMPACT OF STABILIZATION CLAUSE IN INTERNATIONAL OIL COMPANIES AGREEMENT

By

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Abstract

The world's dependence on oil and gas is increasing as global economies and infrastructure continue to rely heavily on petroleum based products. All processes involved in the oil and gas industry are capital intensive from exploration to production to transportation on that note most underdeveloped countries cannot afford such huge amount so they seek help from multinational oil companies to invest in their country under a contractual arrangement. This paper will examine the various types of oil companies and the oil company agreement with particular reference to the ones operated in Nigeria, it further examines stabilization clause its origin and validity in international oil companies' agreement. The paper made use of doctrinal research approach in order to breakdown the title into topics and subtopics given a detailed explanation on the impact stabilization clause has in international oil companies' agreement. The paper submits that the inclusion of stabilization clause in oil company agreement fosters a harmonious relationship between the host country and the international oil company. It is therefore recommended that inclusion of stabilization clause in international oil company agreement is a necessity to safeguard the multinational companies and not an illusion.

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Introduction

It is a known fact that most oil and gas contracts are long-term agreements that have long time periods of validity. It comes as no surprise that a lot may change with time during the life-span of such contracts, especially in developing countries. Ownership and control of petroleum products are vested in the government of the nation.¹

Government may change their policy which might have a significant impact on the government and investor, or even directly interfere with the long-term agreements such as expropriation, the obsolescence bargain, and changes in circumstance. As a result, there is a need to offer government and investors some protection from future unforeseen circumstances and significant changes. Hence, the need for stabilization hardship, price review and force majeure clauses to ensure that both the investor and the government are protected from unforeseen situations and circumstances which may affect the performance and or continuous of such contracts.

It must be stated from the outset that the *raison d'etre* for the inclusion of stabilization clauses in international contracts, oil international contracts in particular, is to ensure that such contracts are not altered unnecessarily and will remain „stabilized“.² It could therefore be safe to submit that stabilization clauses“ primary objective is to preclude the application to an agreement of any subsequent legislative (statutory) or administrative (regulatory) act issued by the government or the administration that modifies the legal situation of the investor.³ This paper therefore attempts to examine stabilization clauses in international oil companies“ agreements with a viewing to knowing the history and development oil and gas exploration in Nigeria, the prevailing types of agreements entered into by the international oil companies and the contents of the oil and gas agreements with particular focus on stabilization clauses. Furthermore, the article would make an analysis of the merits and demerits of stabilization clauses with a view to determining its impact on oil and gas operations in host nations. Countries that have oil and gas resources wish to exploit them and use revenues accrued from this resources as a means of sustainable economic development. It is an established fact that oil and gas projects are long term and very capital intensive with large sunk costs. The main expenses usually occur in the initial stage of investment which includes exploration and development; the bulk of such expenses cannot be recovered if the economics of the project by one reason or other change at the time of production and commercialization because of changes in

¹ Petroleum Act 1969, s 1.

² W S Thaib and F Santiago, ‘Tax Stabilization Clause in Oil and Gas Industry’ [2018] (59) *Advances in Economics, Business and Management Research*, 360.

³ W Peter, *Stabilization Clauses in Arbitration and Renegotiation of International Investment Agreement* (2nd edn: Kluwer Law International, 1995).

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domestic laws.⁴ The concept of Change in Law has evolved to include (i) the introduction of new law, (ii) modification of existing law and or (iii) changes in the interpretation of law by any court, tribunal, governmental entity or other authority which has applicable jurisdiction or regulatory oversight with respect to the Project or the Project Company.⁵

Stabilization clauses therefore are the major and widely recognized ways of sharing risk between parties to a long-term contract to ensure contractual stability wherein a party called the host state concluded transaction with foreign investor and entrusted same with the task of administering the country's petroleum resources in the interest of the public usually expensive and for a long term duration.⁶ It is a known fact that there is strong relationship between stability and equity of investments. Stabilization clause plays fosters a solid legal relationship between host state and foreign investors. Stabilization clause, also widely recognized as stability clause are inserted in most petroleum contracts agreement entered into by the host state who owns the resources and a foreign investor to avert any party from taking independent decisions to alter, abrogate or terminate the contract entered into by both parties. It is safe to submit at this juncture that the rationale for the inclusion of stabilization clauses in international oil contracts is the assurance and confidence that the host states would respect the sanctity of contracts and maintain the status quo of the fiscal commitments under their investment agreements irrespective of the changes in governments and laws during and after the consummation of the contract leading to the project.

Political instability, incessant change in law and policies has always been the order of the day in developing countries of the world. These, over the years, have been clog in the wheel of the progressive performance of most of the contracts negotiated by the foreigner investors and the governments. Most governments in the developing countries tend to hide under the guise of the occurrence of uncertainties not to perform their contractual duties under such contracts which most cases are detrimental to the financial benefits of the investors as they don't have any option that play along with the dictates and caprices of the governments of the day. Notwithstanding global acceptance and recognition of the principle of *Pacta Sunt Servanda*, or strict sanctity of contract, there is no legal system in the world that its application is found to be absolute, and contractual rights can be expropriated.

⁴ M Mansour, and C Nakhle, *Fiscal Stabilization in Oil and Gas Contracts: Evidence and Implications* (Oxford Institute of Energy Studies, 2016) 37.

⁵ Power Africa, 'Understanding Power Purchase Agreements' <<http://go.usa.gov/FBzH>> accessed 7 February 2021.

⁶ T W Waelde and G Ndi, 'Stabilizing International Investment Commitments: International Law Versus Contract Interpretation' [1996] (31) *Texas International Law Journal*, 264.

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A stabilization clause, therefore, is a contractual risk-mitigating device to protect investments from variations in the legal environment. These risks include but not limited to: expropriation,⁷ political and regulatory change (policy change, government stability and energy regulatory framework), the obsolescence bargain, or any other change which the government might utilize in order to impose new requirements on investors.⁸ This paper attempts to fill the gap in the dearth of literature that examine the application of stabilization clause in the international oil contracts with a view to examining the concept of stabilization clauses, types and characteristic features of stabilization clauses.

Conceptual Framework

The notable concepts that are of great importance to this paper are as follows:

Contract/Agreement

A contract or agreement is a legally binding document between at least two parties that defines and governs the rights and duties of the parties to an agreement.⁹ A contract is legally enforceable because it meets the requirements and approval of the law. A contract typically involves the exchange of goods, service, money, or promise of any of those. "Breach of contract", means that the law will have to award the injured party either the access to legal remedies such as damages or cancellation.¹⁰

According to Salmond,¹¹ a contract is an agreement creating and defining obligation between two or more persons by which rights are acquired by one or more to acts or forbearance on the part of others. Pollack¹² sees it as every agreement and promise enforceable at law. Contracts usually must possess three basic components an offer, an acceptance and a consideration, in addition to being voluntary, legal, written and must be made by persons with proper capacity (both mental and legal.) For a legally enforceable contract to exist, such contract irrespective of the presence of the requirement of an offer and acceptance, must be consummated by a consideration. A consideration involves each party giving up something of value in exchange for a benefit. This requirement of consideration serves the purpose of protecting parties to the contract from acts of approbation and reprobation.

⁷ J V De Macedo 'From Tradition to Modernity: Not Necessarily an Evolution – The Case of Stabilization and Renegotiation Clauses' [2011] (9)(1) *Oil, Gas and Energy Law*.

⁸ J P Henrique, *Are Investment Protection Mechanisms Provided by Brazilian Law as Effective as Stabilization Clauses for Petroleum Investments?* (Centre for Energy Petroleum Mineral Law and Policy, University of Dundee 2011).

⁹ R Fergus, *Round Hall nutshells Contract Law* (Thomson Round Hall 2006) 1.

¹⁰ *Ibid*, 1.

¹¹ J Salmond, *Principles of the Law of Contract* (London: Sweet & Maxwell Ltd. 1945) 22. ¹²F Pollock, *Principles of Contract* (Stevens & Sons 1950) 10.

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Oil and Natural Gas

Oil and gas refer to petroleum or crude oil, and raw natural gas extracted from the ground by conventional means and methods.¹² These resources has lock up an important part in the human race, it encourages, national development. Oil and natural gas are formed from decaying plant and animal remains that became buried within layers of the earth and subjected to heat and pressure over millions of years. The term oil loosely refers to petroleum or crude oil that is naturally existing toxic, flammable liquid consisting of a complex mixture of hydrocarbons of various molecular weights, and other organic compounds that are found in geologic formation, beneath the earth's surface.¹⁴

Fiscal Agreements

Petroleum fiscal arrangement guides the operations and relationship between the host country and international oil company. It determines how the HC will be guided in the governance of petroleum exploration, development and production.¹³¹⁴ Onyeukwu pointed out that Fiscal arrangements are regarded as tools to allocate the production or revenue proceeds from oil and gas resources between the HC and IOC.¹⁵ Exploration of oil and gas is governed by fiscal arrangements and they are classified into concessionary and contractual arrangements.¹⁶

Concessionary

A concession is a grant extended by a government to permit a company to explore for and produce oil, gas or mineral resources within a strictly defined geographic area, typically beneath government-owned lands or lands in which the government owns the rights to produce oil, gas or minerals.¹⁷ Concession Agreement is the first contractual arrangement known all over the world and since the World War II it became the common known type in most of the countries, especially in the

¹² Energy Institute, 'Oil and Gas' <<https://www.energyinst.org/exploring-energy/topic/oil-and-gas>> accessed 28 April 2020. ¹⁴Energy Institute (n 13).

¹³ A M Mazeel 'Iraq Oil and Gas Papers Disserta Verlag 2011' <<https://www.researchgate.net/publication/>

¹⁴ [Iraq_Oil_and_Gas_Papers_2010_by_Muhammed_Abed_Mazeel/link/5873ca0d08ae8fce4924c8d4/download](https://www.researchgate.net/publication/5873ca0d08ae8fce4924c8d4/download)> accessed 29 January 2020.

¹⁵ H Onyeukwu, 'Fiscal Regimes In a Volatile Oil Price Era: What Options Exist for Balancing the Interests of the Resource Country and Investor Company?' International Oil and Gas Conference and Exhibition in China, Society of Petroleum Engineers 2010.

¹⁶ N Ponghiri, 'Partnership in Oil and Gas Production Sharing Contracts' [2004] (3)(1) *Oil and Gas Energy Law*, 1.

¹⁷ Schlumberger Oilfield Glossary <<https://www.glossary.oilfield.slb.com>> accessed 29 January 2020. ¹⁹ A J Blake and M C Roberts, 'Comparing Petroleum Fiscal Regime Under Oil Price Uncertainty' [2006] (31)(5) *Resource Policy Journal*, 95.

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industrialization ones. Under the concession type, IOC will be in control and ownership of oil and gas resources while the government receives revenues from rentals, royalties and taxes.¹⁹

Joint Venture Agreement (JVA)

A joint venture happens when two or more parties in the oil industries enter into a relationship with a view to making profit.¹⁸ It is important to draw a distinction between a business partnership and a joint venture. In a partnership, both parties involved operate jointly and share profits jointly. While in joint venture, there is a joint interest in joint operation, but profits are shared according to the level of participation and contribution to the joint operations. In addition, the liability of a joint venture is not joint unlike a partnership in which both parties are jointly responsible for the business liability. Joint Operating Agreement parties can sell their share of the petroleum separately to make profit. Therefore, in JOA, joint relationship means joint investment in production. It does not mean joint sharing of profit while profits and liability are shared equally in partnership business.¹⁹ Importantly, in Nigeria the JV's arrangement means joint ownership of license, shared capital and reward, joint funding obligations, risk and liability are split and above all, each party to the joint venture pay separate tax liabilities.

Production Sharing Contract (PSC)

Production sharing contract is deeply rooted in the Napoleonic era and the French legal concept of ownership of minerals wherein mineral wealth is not to be owned by individual but the state.²⁰ In Nigeria the term production sharing contract is defined in the section 17 of the deep offshore and inland basin production sharing contract act 2019 (as amended): „Production sharing contract means any agreement or arrangement made between corporations or the holder and any other petroleum exploration and production company or companies for the purpose of exploration and production of oil in the deep offshore and inland basins“.

Stabilization Clause

The term „stabilization“ refers to the attempt to avoid potential conflicts or risks with respect to the alteration of the regime in which the project takes place.²¹ The success of

¹⁸ S Style, 'Joint Operating Agreement' in G Gordon and Others, *Oil and Gas Law, Current Practice and Emerging Trends* (Dundee University Press 2012) 368.

¹⁹ B G Taverne, *Petroleum Industry Governments: A Global Study of the Involvement of Industry and Government in the Production and Use OF Petroleum* (3rd edn, Kluwer Law International 2013) 365.

²⁰ D Johnston, *The International Petroleum Fiscal System and Production Sharing Contracts* (Tulsa Oklahoma: Penwell Books 1994) 22

²¹ E Mustafa, *International Energy Investment Law: Stability through Contractual Clauses* (Walters, Kluwer Law & Business, 2010)

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such mechanisms has been mixed; if the relationship between host governments and investors deteriorates to the stage where the legal provisions are invoked, investors may well become disappointed with their effectiveness. They remain, however, a mechanism in contractual agreements, and in laws governing oil and gas activities, in many countries. A stabilization clause has further been defined as a “specific commitment by the foreign country not to alter the terms of the agreement, by legislation or other means, without the consent of the contracting „party”.²² In other words, they are clauses which are inserted in contracts between International Oil Companies (IOC) and Host States (HS) or the National Oil Company (NOC) that protects the interest of the investors from incessant and unjustified change in law of the Host State during the life time of the project.²³

Legal Framework for Stabilization Clause in International Oil Companies Agreement in Nigeria

The Legal Frameworks for Stabilization Clause in International Oil Companies Agreement in Nigeria are as follows:

Constitution of the Federal Republic of Nigeria, 1999 (as amended)

The Constitution of the Federal Republic of Nigeria (CFRN) 1999 as the grundnorm forms the foundation for all enactments of other laws aimed at regulating the affairs of the country. Its provisions are supreme and binding on all persons and authorities in Nigeria, including the government. Section 44(3) of the Constitution vests ownership of oil and gas in the government of Nigeria.

It states thus:

Notwithstanding the foregoing provisions of this section, the entire property in and control of all minerals, mineral oils and natural gas in under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the Federation and shall be managed in such manner as may be prescribed by the National Assembly.²⁴

Section 17(1) provides that the social order of the Nigerian State is founded on ideals of Freedom, Equality and Justice. While section 17(2)(a) provides that: In furtherance of the order – every citizen shall have equality of rights, obligations and opportunities before the law; the CFRN equally provides thus: Exploitation of human or natural resources in any form whatsoever for reasons, other than the good of the community,

²² C T Curtis, ‘The Legal Security of Economic Development Agreements’ [1988] (29) *Harvard International Law Journal*, 317-318

²³ M Mansour, and C Nakhle, *Fiscal Stabilization in Oil and Gas Contracts: Evidence and Implications* (Oxford Institute of Energy Studies, 2016) 12-13

²⁴ CFRN 1999 (as amended) s 44(3)

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Corporation will facilitate the discharge of the said duties under this Act”.³³The overall function of the NNPC is to drive the Nigerian economic and technical advancement while leveraging on the petroleum endowment of the country.

Oil Pipelines Act, Cap O7, LFN, 2004

The Oil Pipelines Act ³⁴ and its regulations guide oil activities (petroleum marginal field operations). The Act creates a civil liability on the person who owns or is in charge of an oil pipelines. The person would be liable to pay compensation to anyone who suffers physical or economic injury as a result of a break in his pipelines.³⁵ The Act also establishes that grant of licenses is subject to regulations concerning public safety and prevention of land and water pollution. ³⁶The above provisions of the Act are quite commendable as it protects the environment from any form of degradation makes anyone who suffers physical or economic injury as a result of a break in his pipelines to be entitled to compensation. However, the said Act has the challenge of enforcement.

Under the Oil Pipelines Act,³⁹ damage to surface goods (which is the basis of computation) includes crops, buildings and profitable trees. The value of the land is not taken into consideration by any of the aforementioned statutes when computing compensation claims in the oil and gas sector of Nigeria. The mineral or natural resources found in or upon the land “are viewed by the state as public goods and government”’s intervention in their exploitation becomes simply a case for public use.”³⁷The Act³⁸ made provisions for the grant of a permit to survey the route for an oil pipeline for the transport of mineral oil, natural gas or such other products.

Deep Offshore and Inland Basin Production Sharing Contract Act

This act gives incentives to oil companies operating in deep offshore and inland basin areas under product sharing contract. These incentives range from deduction of royalty rate to lower tax rate; this is done in order to attract investors to the country.

³³ *Ibid*,s 6(1)(c).

³⁴ Oil Pipeline Act Cap O7, LFN 2004.

³⁵ *Ibid*, s 11 (5).

³⁶ *Ibid*, s 17 (4). ³⁹*Ibid*, s 20.

³⁷ W Akpan, ‘Oil, People and the Environment: Understanding Land-Related Controversies in Nigeria’s Oil Region’ <<http://www.codesria.org/IMG/pdf/akpan.pdf>> accessed 10 March 2020.

³⁸ OPA, s 4 (1); F Emiri and G Deinduomo, *Law and Petroleum Industry in Nigeria* (Lagos: Malthouse Publication 2009) 56.

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The Impact of Stabilization Clauses in IOC Agreements Nature and Scope of Stabilization Clauses in Petroleum Agreements

Stabilization clauses are specific commitments by the Host State not to alter the terms of the International Petroleum Agreements by legislation or other means, without the consent of other contracting parties.³⁹ One commentator has traced the origin of stabilization clauses to the period between World War 1 and World War 2 when US companies began to include them in concessionary agreements because of nationalizations in Latin America.⁴⁰ The perception by many host states that International Oil Companies have reaped a windfall in the climate of high energy prices and unfairly benefited from the terms of their agreements coupled with the cycle of soaring oil and gas prices has driven many countries into repudiating or altering fiscal regimes.⁴¹ Often forgotten in the scramble is the colossal risk undertaken by the international oil companies in exploring new frontiers, the risks of a dry hole and unrecoverable costs not to mention the high volatility in the oil and gas prices.⁴²

International oil companies are keen to anchor the terms of their agreements with host states on the legal regime in effect at the time of the investment. A comprehensive stabilization clause would usually preclude the host state from applying an amended legislation that would impact negatively on the investment of IOC's. However, as we shall later discuss in this chapter, for certain reasons, modern day stabilization clauses do not restrain the Host State from applying amended legislation but rather outline the need for reinstatement to the prior balance of economic benefits in the event of adverse legislative changes. Stabilization clauses may extend to any law that affects the economic conditions of the contract. Hence, the scope of stabilization clauses may include: (i) property; (ii) fiscal regime; (iii) labour legislation; (iv) exportimport provisions; (v) free transferability; and (vi) the general legislative and contractual framework.

However, it is worthy of mention that, concerns have been raised that such clauses limit a state's ability to effectively legislate in line with their international human rights obligations. As a result, there may be carve-outs from the stabilization clause

³⁹ T B Margarita, 'Stabilisation Clauses in International Petroleum Transactions' [2003] (30) *Denver J. International Law and Policy*, 217.

⁴⁰ R D Bishop, 'International Arbitration of Petroleum Disputes: The Development of a Lex Petrolea' [2002] (18) *Rocky Mountain Mineral Law Foundation of International Energy and Minerals Arbitration Law Series*, 2-28.

⁴¹ J Emeka, 'Anchoring Stabilisation clauses in International Petroleum Contracts' [2008] (42) *Int'l Law*, 1317-1338.

⁴² S Andrea, 'Stabilisation Clauses: Human Rights' <<http://www.reportsand-materials.org>> accessed 28 March 2021.

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relating to employment, environmental or human rights laws - the areas where the state may not want to be constricted, and where it is harder for the investor to legitimately argue that amendments should not be introduced. These concerns shall be critically analysed in a subsequent subheading.

Examples of Stabilization Clauses

- “The tax regime, benefits, privileges and exemptions provided in any of the articles hereof, which shall be recorded in the special operation contract, shall remain invariable for the duration thereof.”⁴³
- “In case of modifications to the tax regime, including the creation of new taxes, or the labor participation, or its interpretation, that have consequences on the economics of this Contract, a corresponding factor will be included in the production share percentages to absorb the increase or decrease in the tax burden or in the labor participation of the previously indicated contractor. This correction factor will be calculated between the Parties and approved by the Ministry of Energy and Mines.”⁴⁴
- “Should the income of the state or the Contractor be materially altered as a result of new laws, orders or regulations then, in such an event, the Parties shall agree to make the necessary adjustments to the relevant provisions of this Contract, observing the principle that the affected Party shall be restored to substantially the same economic condition as it would have been in had such change in laws or regulations not occurred. The cost of such restoration to the other Party may not exceed the benefit received by such other Party as a result of such change.”⁴⁵

The Impact of Stabilization Clauses on the Domestic Laws of Host Countries

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.⁴⁶ 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.⁴⁷ 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

⁴³ Decree-Law 1089 of 1975, art.12 and 12.1 (Chile).

⁴⁴ Model PSC of October 2002, art.11.7.

⁴⁵ P Cameron, ‘The Pursuit of Stability’ (Unpublished Nigerian Agreement dated 1994)

⁴⁶ Constitution of the Republic of South Africa 1996, ss. 43-44.

⁴⁷ CFRN, 1999 (as amended) s. 4.

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change or amend the legal regimes governing an 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.⁴⁸

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. 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.”⁴⁹

Impact of Stabilization Clauses on the Economy

In the economic sense, stabilization clauses may lead to loss of revenues for host States. A typical example is the development agreement between the Government of Zambia and Mining Companies in the course of privatizing 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,⁵³ 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,⁵⁴ far below the statutory royalty rate of 3 percent of company’s gross revenues under the now repealed Mines and Minerals Act of 1995. More significantly; the Development Agreements froze the fiscal regimes specified under the Agreements for 15 to 20 years.⁵⁵

The impact of the terms of the agreement came to effect when there was a boom in copper price in the international market, the boom did not yield appreciable revenues

⁴⁸ *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.

⁴⁹ P D Cameron, ‘Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors’ (Final Report 5 July 2006, prepared for the Association of International Petroleum Negotiators)

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for Zambia because of the low rate of royalty prescribed under the Development Agreements.⁵⁶ In fact, Zambia “incurred [financial] losses in tax revenues through the subsidies given to the private mining companies” under the „Development Agreements. 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.⁵⁷

Impact of Stabilization Clauses 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.

Stabilization clauses have also been criticized by international human rights organization Amnesty International as placing a price tag on human rights because they may exempt either explicitly (through the freezing clauses) or implicitly (through economic equilibrium clauses by making it expensive for the government) foreign investors and their projects from complying with human rights laws.⁵⁸

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

⁵³ C Adam and A M Simpasa, ‘Harnessing Resource Revenues for Prosperity in Zambia’ (OxCarre Research Paper 36, Revised Draft) at 25-27 <http://www.oxcarre.ox.ac.uk/images/stories/papers/RevenueWatch/oxcarrerp_201036.pdf> accessed 28 February 2020.

⁵⁴The 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, <<http://www.minewatchzambia.com/reports/MOPANI.pdf>>accessed 28 February 2020.

⁵⁵J Lungu, ‘Copper Mining Agreements in Zambia: Renegotiation or Law Reform?’ [2008] (117) *Review of African Political Economy*, 403.

⁵⁶Lungu (n 57).

⁵⁷*Ibid*, 407.

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human rights obligations in relation to resource extraction and by affording petroleum and mining companies an opportunity to frustrate efforts of the host States to fulfil their legal obligations to protect human rights.⁵⁹ 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.⁶⁰

The Impact Stabilization Clauses on the Sovereignty of Host States

A pertinent question to ask is why international oil companies are willing to invest in developed countries that do not provide stabilisation clauses but are hesitant to do so in the developing countries in their absence. Governments in developed countries decline granting stabilisation clauses on the premise they cannot bind a future government to the policies of the current administration. On the other hand, the international oil companies demand for stabilisation clauses in the developing countries is premised on suggestions that rule of law is either not firmly entrenched or simply does not operate in the way they would expect. It is further suggested Latin America, Africa and Middle East are also laden with deep and long-lasting legacies of anti-colonialist sentiments or populist suspicion of foreign investment.⁵⁰ The petroleum sector is often a principal source of government revenue like in Nigeria petroleum provides 90% revenue to the state. Stabilization clauses that freeze the legal and fiscal regimes applicable to an investment project appear to constrain the sovereignty of host states. 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.⁵¹ 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

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IFC’s study on Stabilization Clauses and Human Rights (2009) <<https://www.oxfordenergy.org>> accessed 10 may 2021

⁵⁹ Amnesty International, ‘Contracting Out of Human Rights: The Chad-Cameroon Pipeline Project’<<http://www.amnesty.org/en/library/asset/POL34/012/2005/en/76f5b921-d4bf-11dd-8a23d58a49c0d652/pol340122005en.pdf>> accessed 28 May 2021.

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United Nations, Economic and Social Council, ‘Human Rights, Trade and Investment Report of the High Commission for Human Rights’ <[http://www.unhchr.ch/Huridocda/Huridoc.nsf/\(Symbol\)/E.CN.4.Sub.2.2003.9 .En?Opendocument](http://www.unhchr.ch/Huridocda/Huridoc.nsf/(Symbol)/E.CN.4.Sub.2.2003.9.En?Opendocument)> accessed 28 May 2021.

⁵⁰ P Cameron, ‘Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors’ (Association of International Petroleum Negotiators 2006)

⁵¹ T W Waelde and G Ndi, ‘Stabilizing International Investment Commitments: International Law Versus Contract Interpretation’ [1996] (31) *Tex. Int’l L.J.* 215; Y Omorogbe, ‘Law and Investor Protection in the Nigerian Natural Gas Industry’ [1996] (14) *Journal of Energy & Natural Resources Law*, 179.

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and resources in accordance with their national interests.”⁵² 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.”⁵³ Thus, critics argue, a stabilization clause that purports to alienate the State’s legislative power is null, void, and unenforceable.

Challenges in the Implementation of Stabilization Clauses

Despite the popularity of stabilization clauses, their practical value to oil and gas companies is questionable, particularly when the fairness of fiscal regimes is so often called into question. The granting of stability provisions that conflict with national laws do not receive the protection of international law.⁵⁴ Stabilization clauses are the major means of investment protection at the disposal of oil companies,⁵⁵ however, other authors like Dias believe that despite such mechanisms, host countries will still proceed with their nationalization policies, under the aegis of the permanent sovereignty over natural resources principle, and challenge their previous commitments if they find it lucrative to do so.⁵⁶ Whereas, De Macedo is of the view that, the use of stabilization clauses in state contracts should, in theory, restrain the host country from adopting unilateral measures of this sort (which have such detrimental consequences on the investors’ interests);⁵⁷ this, however, could not be further from the truth. A minority of the industry experts interviewed felt that companies would be unwise to place faith in such clauses, as governments could ignore them (and have ignored them in the past).

⁵² 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; 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.

⁵³ E J de Aréchaga, ‘State Responsibility for the Nationalization of Foreign Owned Property’ [1978] (11) *N.Y.U.J. Int’l L. & Pol.*, 179-180; R C A White, ‘Expropriation of the Libyan Oil Concessions – Two Conflicting International Arbitrations’ [1981] (30) *I.C.L.Q.*, 11-12

⁵⁴ D Philip and S Emil, ‘Contractual Assurances of Fiscal Stability’, in P Daniel and Others (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (IMF, Washington 2010)

⁵⁵ M H Tijjani, ‘The Role of Stability and Renegotiation in Transnational Petroleum Agreements’ [2012] (5)(1) *Journal of Politics and Law*, 33–42.

⁵⁶ D Dias, ‘Stability in International Contracts for Hydrocarbons Exploration and Some of the Associated General Principles of Law: From Myth to Reality’ [(2010) (8)(4) *OGEL*.

⁵⁷ J V De Macedo, ‘From Tradition to Modernity: Not Necessarily an Evolution – The Case of Stabilisation and Renegotiation Clauses’ [2011] (9)(1) *OGEL*.

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Cameron argues that the freezing clause has proved to be of little value in resisting expropriation, although it may have helped investors to secure an exit on better financial terms than they would have otherwise obtained.⁵⁸ The author further adds that the effectiveness of the more flexible modern clauses has not yet been the subject of review by arbitral tribunals. While Alexander brilliantly points out that, even if the IOC is successful and „wins“ an arbitral award, it may find it impossible to „execute“ an arbitral award against the host country.⁵⁹

In summary therefore, it is safe to conclude that the above Industry experts endorsed the idea that stability clauses had at least some worth, and further noted that while protection was not guaranteed, clauses were generally respected and might serve as a deterrent. Once such provisions are invoked, relations between the government and the company, or companies, in question deteriorate, perhaps irretrievably. Taking a government to court/international arbitration can mean that the company in question has little future in the country.

The Role of International Arbitration in Stabilization Clause Disputes

Under this heading, an examination of international oil concession contracts that degenerate into disputes and the subsequent decisions of the arbitral award shall be examined with a view to knowing the effect of failure to honour stabilization clause in any international oil contract and how same affect the relationship between the host state and the foreigner investor.

Sapphire International Petroleum Ltd. v. National Iranian Oil Co. (NIOC)⁶⁰

This is another notable early case on stabilization clause wherein a concession by the Iranian government contained a choice-of-law clause in which parties agreed to carry out the provisions in accordance with principles of good faith and good will.⁶¹ The stabilization clause stated inter-alia that “no general or statutory enactment, no administrative measure or decree of any kind, made either by the government or by any governmental authority in Iran (central or local), including NIOC, can cancel the agreement or affect or change its provisions, or prevent or hinder its performance. No cancellation, amendment or modification can take place except with the agreement of the two parties”.⁶² The arbitrator held first that “the agreements contained no express

⁵⁸ Cameron (n 60).

⁵⁹ A Frank ‘Security of Investment Considerations under PSCs and Other Government Petroleum Contracts’, Fraser Milner Casgrain LLP, prepared For: Legal Education Society of Alberta 43rd Annual Refresher Course – Business Law 2010.

⁶⁰ [1967] 35 (ILR) 136.

⁶¹ [1967] 35 (ILR) 140.

⁶² [1967] 35 (ILR) 140.

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choice of law provisions.”⁶³The tribunal held that “the agreement between the parties should be construed in light of the provisions currently stipulated to in other, similar Iranian agreements.”⁶⁴ He held further that “the legal security of the investments, responsibilities, and considerable risks of the foreign company, could not be guaranteed... by the outright application of Iranian law, which... is within the power of the Iranian state to change.”⁶⁵The arbitrator, however, failed to recognize the stabilization clause contained in the contract and refused to find that the State of Iran had violated the clause.⁷⁷

Lena Goldfields, Ltd v. U.S.S.R.⁶⁶

On February 12, 1930, an English company commenced an arbitral proceeding against a foreign state under an arbitration clause contained in a written concession agreement signed by both parties. ⁶⁷ Lena Goldfields was incorporated in 1908 to acquire seventy percent of the shares of the Russian Lena Goldfields Company, which was established in 1855 to develop gold mining along the river Lena and its tributaries in Siberia.⁶⁸The arrangement got soar in July 1918 when the new Soviet government nationalized all mining properties without compensation, including the Lena's Russian interests. Sometimes in 1925 and after unsuccessful negotiations between the Soviet government and Lena Goldfields, the company ratified a concession agreement which gave Lena Goldfields the exclusive right to mine gold and other metals in the Urals and parts of Siberia.⁶⁹ The concession period was to run for thirty years at the first instance and for fifty years at the second instance.⁷⁰ Lena Goldfields started operations on its concession sometimes in 1925.⁸³The Soviet government, however, adopted a number of policies that discouraged concessions agreements with foreign capitalists in 1929.⁸⁴Sequel to this, Lena Goldfields faced an increasingly hostile treatment which made it unable to meet up with the production requirement of the concession agreement⁷¹and this led to the referral of the matter to arbitration for

⁶³ [1967] 35 (ILR) 173.

⁶⁴ [1967] 35 (ILR) 174-175.

⁶⁵ F V Garcia-Amador, ‘State Responsibility in Case of Stabilization Clauses’ [1993] (2)(23) *Journal of Transnational Law & Policy*, 30. ⁷⁷T B Margarita, ‘Stabilisation Clauses in International Petroleum Transactions’ [2003] (30) *Denver J. International Law and Policy*, 228.

⁶⁶ Lena Goldfields Arbitration, Annual Digest of Public International Law Cases; A Nussbaum, ‘The Arbitration between the Lena Goldfields, Ltd. and the Soviet Government’ [1950-1951] (31) (42) *Cornell Law Quarterly*

⁶⁷ V V Veeder, ‘The Lena Goldfields Arbitration: the Historical Roots of Three Ideas’ [1998] (47) *International & Comparative Law Quarterly*, 747.

⁶⁸ *Ibid*, 757.

⁶⁹ *Ibid.*, 758.

⁷⁰ *Ibid.* ⁸³*Ibid*, 761

⁸⁴*Ibid.*

⁷¹ *Ibid*, 762.

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possible settlement under an arbitration clause within the concession agreement.⁷² The court of Arbitration held in that case that irrespective of the inclusion of the stabilization clause in the contract, based on the interaction between the clauses of the agreement, a contract between a private party and a sovereign state might be internationalized.⁷³ The tribunal held further that the agreement between Lena Goldfields and the Soviet Government, while governed by Russian law in respect to ordinary matters, was subject to the general principles of law insofar as the contractual provisions safeguarding the company's position were concerned.⁷⁴ The award laid down a precedent and the very first time arbitration panel held that other law, besides national law, could govern the contractual relationship between a foreign company and a private party.

Saudi Arabia v. Arabian American Oil Co. (Aramco) ⁷⁵

In 1954, the government of Saudi Arabia concluded an agreement with Saudi Arabian Maritime Tankers, Ltd and its owner, Aristotle Onassis and gave same right of priority for the transport of Saudi Arabian oil for a period of thirty year.⁷⁶ This concession was in conflicts with the exclusive right to transport oil given to the Arabian American Oil Company ("Aramco") by Saudi Arabia in 1933. This however led to a tussle of legal battle between Aramco and Saudi Arabian Maritime Tankers, Ltd which led to arbitration in 1955 held in Geneva under an ad hoc submission agreement.⁷⁷ There was a stabilization clause in the Aramco concession agreement.

The tribunal concluded that "by reason of its very sovereignty within its territorial domain, the State possess the legal powers to grant rights by which it forbids itself to withdraw before the end of the concession."⁷⁸ In 1958, the tribunal ruled in favor of Aramco to the effect that the government was bound by the dictate of its agreement with Aramco.⁷⁹ Therefore, the agreement with Onassis's company is in breach of that agreement. It must be stated at this juncture that this decision of the panel gave effect to the importance of the inclusion of stabilization clause in any oil and gas contract and recognize its validity under international law.

⁷² *Ibid*, 762-763.

⁷³ (n 76), 177.

⁷⁴ C Greenwood, 'State Contracts in International Law-The Libyan Oil Arbitrations' [1982] (53) (27) *British Year Book of International Law*, 41.

⁷⁵ *Saudi Arabia v Arabian American Oil Co. (Aramco)* [1963] 27 (ILR) 117.

⁷⁶ A Redfern and M Hunter, *Law and Practice of International Commercial Arbitration* (3rd edn, Sweet & Maxwell 1999) 373.

⁷⁷ *Ibid.*, 373.

⁷⁸ (n 77), 229.

⁷⁹ [1963] 27 (ILR) 169

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Conclusion

It is safe to conclude that freezing clause has proved to be of little value in resisting expropriation, although it may have helped investors to secure an exit on better financial terms than they would have otherwise obtained. It was also discovered that the inclusion or otherwise of a stabilization clause in international oil contract does not prevent a host state that seeks to attract investment into its petroleum sector as such a host state would do anything possible to respect the sanctity of the contract entered into religiously. Furthermore, it was observed that even if a stabilization clause is inserted in IOC, whether its contents would be fulfilled and respected still lies with the host state. It is has been pointed out by scholar that, even if the IOC is successful and „wins“ an arbitral award, it may find it impossible to „execute“ (monetize) an arbitral award against the host country.

Recommendations

This paper recommends as follows:

i) Inclusion of Exceptions to Limit the Adverse Impact of Stabilization Clauses

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”.⁸⁰ 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 IOC’s 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, IOC’s may view such express human rights exception as an attempt to impose human rights obligations on them, a position that would be contrary to extant international law.

⁸⁰ L 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.

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ii) **Shorter Duration for IOC Agreements**

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 an IOC 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.⁸¹ Even then, the renegotiated clause should aim at maintaining economic equilibrium between the host State and the IOC’s, rather than freezing the legal regimes governing the resource extraction project.

iii) **The Instrumentality of Arbitral Tribunals**

Although the strategies suggested above, cater to future investments, they do not address extant stabilization clauses in the IOC Agreements. 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.⁸² 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”.⁸³ 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.

⁸¹ K B Samuel, ‘Stability of Contractual Relations in the Transnational Investment Process’ [1979] (28) *I.C.L.Q.* 401.

⁸² G Mayeda, ‘International Investment Agreements Between Developed and Developing Countries: Dancing with the Devil? Case Comment on the Vivendi, Sempra and Enron Awards’ [2008] (1) *McGill Int’l J. Sust. Dev. L. & Pol’y*, 215.

⁸³ *Ibid.*

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