

OIL AND GAS LAW

IS THERE A LEGAL AND FUNCTIONAL VALUE FOR THE STABILISATION CLAUSE IN INTERNATIONAL PETROLEUM AGREEMENTS?

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Abstract: Stabilisation Clauses in International Petroleum Agreements are an attempt by the International Oil Company (IOC) to neutralise the Host State's power to unilaterally change the terms of an already concluded agreement. The shift in the balance of power from the side of the IOC to that of the Host State after investment has been made, demands that IOCs insist that contractual terms remain constant through-out the life of a project, or that any change would require agreement between both parties before it may be effected. There are conflicting views about the legal and functional value of stabilisation clauses in international petroleum agreements; however what cannot be escaped from is that they serve a useful function in such agreements as one of the best means utilised by the IOC to manage the political risk that petroleum projects face. This paper analyses the legal and functional value of stabilisation clauses in international petroleum agreements and concludes that their use is dependent on the confidence that the IOC has in conducting business with the Host State in question and how desperately it wants to access its petroleum resources.

List of Abbreviations

ARAMCO	Arabian American Oil Company
BP	British Petroleum
IOC	International Oil Company
NOC	National Oil Company
LIAMCO	Libyan American Oil Company
TOPCO	Texaco Overseas Oil Petroleum Company

1. INTRODUCTION

A stabilisation clause in an international petroleum agreement as its name suggests is utilised as a means of ensuring that the agreement concluded between a host state, or its agent¹ and the international oil company (IOC) will not be altered and its terms remain stable². The use of the stabilisation clauses in such agreements can be understood when one focuses on the inherent risks that IOC's are exposed to when they invest in foreign countries. The most dramatic of these risks were manifested last century with the large scale expropriations and nationalisations that took place in many oil producing countries, and resulted in many IOC's losing their investment in these countries³.

The world has changed significantly since the days of direct expropriation, and in light of the current trend of stiff competition for foreign direct investment among countries; it is questionable whether a host state government would attempt such action, without the realisation that it would probably spell the end of such investment⁴. In the modern era what is of concern to the IOC is not the threat of direct expropriation, as remedies for such action have been firmly established under international law⁵, it is the less drastic action taken by host states to change the fiscal and regulatory conditions that apply to particular projects. As a consequence the stabilisation clause today has become a tool of political risk management. This was clearly pointed out by one commentator

“Subsequent changes to the negotiated and established fiscal regime with a detrimental effect on the company's income and cash flow, as well as unexpected restriction on repatriation of foreign exchange

¹ The Host State's agent in an international petroleum project development is usually a National Oil Company (NOC) specifically set up to hold and manage the Host states interest in the project.

² Peter, W., Arbitration and Renegotiation of International Investment Agreements 214 (2nd ed. The Hague: Kluwer Law International, 1995).

³ Smith E., et al., International Petroleum Transactions 338 (3rd ed., Denver, Colorado: Rocky Mountains Mineral Foundation, 2000)

⁴ See Peter, supra note 2, at 392

⁵ It is clearly established under international law that the payment of full (i.e. prompt adequate and effective) compensation is a necessary precondition for the legality of foreign expropriation. See more detailed discussion on this point in, Ndi, G., Investment Policy Transformation In The Natural Resources Sector: Legal Implications As Regards The Tension Between International Property Rights And Sovereign Rights, 238 (Unpublished PHD Thesis, CEPMLP, University Of Dundee, 1994).

earnings, are perhaps the main cases of political risk. These occur far more frequently than outright nationalization”⁶

Stabilisation clauses are also important because the peculiarities of petroleum projects also demand stability. Typically such projects have long durations with each project phase lasting many years⁷. They are extremely capital intensive with exploration and development programmes costing from the tens to the hundreds of millions of dollars⁸. They pose acute project risks with only an estimated one in ten exploration ventures resulting in a commercial discovery⁹, and finally they are heavily reliant on loan finance from a number of different institutions that have strict repayment schedules¹⁰.

In light of this, any action by the host state to change already agreed fiscal and regulatory terms may have the effect of disrupting the profitability of the venture for the IOC, as well as impact on their ability to meet debt service obligations. From the point of view of the host state the enactment of new laws or the amendment of existing ones is an expression of their sovereignty and any expectation that a host state will not have the requirement to alter its laws is ludicrous. However what is at issue is the validity of such action when there has been formal agreement in the form of a stabilisation clause not to effect such change.

On the basis of conflicting perspectives this paper analyses the legal and functional value of the stabilisation clause in international petroleum agreements. Part II discusses the neutralising effect of the stabilisation clause on the host states powers Part III will outline the main types of stabilisation clauses and their implications. Part IV will outline the legal effect of the stabilisation clause. Part V will focus on the functional value of the clause and what they achieve, and part VI will be the conclusion of this paper with some general observations about the effectiveness of such clauses.

⁶ Walde, T., *Stabilising International Investment Commitments: International Law versus Contract Interpretation*, CEPMLP Professional Paper PP13, 21(1994).

⁷ *Id.*, at 14.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

2. NEUTRALISING THE HOST STATES POWERS

The emergence of a modern petroleum industry throughout the world has required the need for a close relationship between two parties that bring different bargaining chips to the negotiating table. On the one hand there is the host state or its agent which possesses the title to the petroleum resource, and on the other there is the IOC which possesses the requisite skill and capital essential for the exploitation of the petroleum resource.

During the concessionary era¹¹, the level of host state involvement in the exploitation of the petroleum resource was considerably less than it is today. In this period there was substantial investor superiority and it was during this time that the stabilisation clause seems to have emerged¹². In the modern era the arrangement for petroleum exploitation has evolved significantly and varies considerably from country to country, however there are four broad categories recognised internationally for achieving this purpose. They are the concession, the production sharing agreement, the participation agreement, and the service agreement¹³.

The inescapable fact that a petroleum project development requires a high level of co-operation between the host state and the IOC, each being dependent on the other to achieve their respective objectives, means that the amount of power that may be asserted by each party is dependent on their respective bargaining strength. Generally it has been said that

“a state which is desperate for investment is not going to be too assertive as it will scare away such investment, but a state which is perceived as a safe state from which profits can be made will use

¹¹ The concessionary era refers to the period where the only means through which petroleum exploitation could be conducted was through the host state granting a concession over certain tracts of land to the oil company, there was virtually no host state involvement in the process except in receiving fees and taxes from the oil company for the privilege. “A typical concession agreement grants the exclusive right to explore, search and drill for, produce, store, transport, and sell Petroleum within the designated concession acreage for a specified number of years”. See Comeaux, P., and Kinsella, S., Protecting Foreign Investment Under International Law : Legal Aspects of Political Risk 128 (New York: Oceana Publications Inc,1997).

¹² See Walde, *supra* note 6 at 8.

¹³ See Smith (et al) *supra* note 3 at 411.

techniques through which it could optimise benefits from foreign investment for itself while ensuring that the foreign investor has adequate incentives for him to remain and do business in that state.”¹⁴

Prior to the IOC making the decision to invest, the balance of power lies very heavily in its favour, because at this stage they are able to pick and choose where to commit their capital based on what the particular country has to offer. In the context of the petroleum industry the host states bargaining power is at its lowest, and that of the IOC as it’s highest at the pre-exploration stage of operations¹⁵. The reason for this is that at this point no commercial reserves of petroleum have been discovered, so the host state does not know whether it has anything to contribute to the proposed transaction. As a consequence, the IOC will be able to negotiate contractual terms that are most in its favour at this time because of the increased risk that it is being exposed to¹⁶.

After the discovery of commercial reserves of petroleum, this strong IOC position begins to diminish this is known as the concept of the “obsolescing bargain”¹⁷, which is premised on the fact that a shift in bargaining power will occur between the investor and the host state over time¹⁸. It is at this stage that the host state seeks to exploit this shift in bargaining power on the basis that there is a real or perceived change of circumstances, which requires remedial action¹⁹. Factors which often contribute to the host states desire to change the terms of a previously concluded agreement, include things such as, the petroleum discovered exceed expectation, the price of the commodity rises to unexpected levels, a change of government in the host state, and political pressure caused by anti foreign sentiment²⁰.

These factors pose significant political risks to the IOC, and not addressing them can have very grave consequences. Especially since any decision to alter the contractual terms for a project can have a hostage effect²¹ on the IOC, as it cannot simply walk

¹⁴ Sornarajah, M., The International Law on Foreign Investment 118 (Cambridge: Cambridge University Press,1994)

¹⁵ Hollis, S., and Berresford, J., *Structuring Legal Relationships in Oil and Gas Exploration and Development in Frontier Countries*, in Walde and Ndi (eds) International Oil and Gas Investment Moving Eastward 41 (London: Graham & Trotman,1994).

¹⁶ *Id.*

¹⁷ See Walde, *supra* note 6, at 11.

¹⁸ See Peter, *supra* note 2, at 392.

¹⁹ See Ndi, *supra* note 5, at 172.

²⁰ See Walde *supra* note 6, at 11.

²¹ See Ndi *supra* note 5, at 179.

away from a project after it has sunk millions of dollars into developing it. It is precisely for this reason that stabilisation clauses are incorporated into international petroleum agreements as a means of neutralising the host states powers, by alienating its right to unilaterally change the regime and rights relied upon by, and promised to, the IOC²².

3. MAIN TYPES OF STABILISATION CLAUSES

Stabilisation clauses may be divided into a number of broad categories based on their attributes. A traditional stabilisation clause²³ seeks to freeze the law of the host state as it stood at the time the agreement was signed between the parties²⁴. This action thereby prohibits the application of any law enacted subsequently by the host state to the terms of the already concluded agreement. A slight variation to this traditional approach is what is sometimes referred to as a “consistency clause”, which requires that any subsequently enacted law must be consistent with terms of the already concluded agreement²⁵. The aim of the traditional stabilisation clause is to render any change to the terms of an already concluded agreement ineffective, and by express agreement remove the host states power to effect such change.

A further type of clause, which is regarded by some as a stabilisation clause provides that the agreement concluded between the parties must be performed with good will or in good faith, Although a good will clause does not usually expressly curtail the host states right to enact new laws, it requires both parties to perform the agreement in good faith, thereby implicitly precluding the unilateral modification or termination of the agreement by either party²⁶. A final distinction is sometimes made between a strict stabilisation clause and what is called an intangibility clause, such a clause requires that any modification of the terms of the agreement requires the mutual consent of the

²² Comeaux, P., and Kinsella, S., *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilisation Clauses and MIGA& OPIC Investment Insurance*, 15 N.Y.LJ Int'l & Comp L.1,16 at 23 (1994).

²³ This has also been referred to as a stabilisation clause *stricto sensu*. See Curtis, C., *The Legal Security of Economic Development Agreements*, 29 Harv. Int'l L.J. 317 at 367-47

²⁴ See Ndi, *supra* note 5 at 179.

²⁵ *Id.*

²⁶ See Curtis, *supra* note 23 at 347.

parties²⁷. By its nature an intangibility clause is aimed at achieving a compromise in the event that a change of law affects the terms of an already concluded agreement²⁸. Unlike the traditional stabilisation clauses an intangibility clause contemplates that a host state may have the requirement to change the terms of an already concluded agreement but such alteration must not be done unilaterally.

3.1 IMPLICATIONS OF SPECIFIC TYPES OF STABILISATION CLAUSES

An example of a traditional stabilisation clause which attempts to freeze the law of the host state as it stood at the time the agreement was concluded, is the clause contained in a Concession Agreement of 1933 between the State of Iran and the Anglo Iranian Oil Company. It provided as follows

“Concession shall not be annulled by the Government and the terms therein contained shall not be altered either by general or special legislation in the future, or by administrative measures or any other acts whatever of the executive authorities.”²⁹

Stabilisation Clauses have evolved considerably since the above clause was drafted, and since petroleum project development is conducted under more advanced and complex arrangements than was previously the case, this fact is reflected in the manner that modern clauses are drafted

A modern adaptation of a stabilisation clause, which is designed for a production sharing, participation, or service agreement provides the following

“After the effective date of this agreement, if there is a change in the domestic law that results in a material adverse impact on the economic value derived from operations by the contractor, the state (NOC) will ensure that the

²⁷ Paasivirta, E., Participation of States in International Contracts and Arbitral Settlement of Disputes 162 (Helsinki: Lakimieslution Kustannus, 1990).

²⁸ See Ndi, *supra* note 5 at 181.

²⁹ See Paasivirta, *supra* note 27 at 162.

contractor will derive the same economic benefits as it would have derived if the change in law had not been affected”³⁰

The above clause has the effect of a consistency clause, but unlike a standard consistency clause, it does not say that the law has no application to the agreement because it is inconsistent with its terms, instead it puts the onus on the state national oil company (NOC) to restore the IOC to the position that it would have been in had the change in law not taken place. The question of whether a host state would be prepared to agree to such a clause primarily would depend on the bargaining strength and position of the host state. If the host state was desperate for investment it might agree, However if had a strong bargaining position it might seek to negotiate a clause that was more in its favour.

An example of a modern consistency clause, which may also be used to stabilise an international petroleum agreement, is as follows

“Nothing in this clause shall be read or construed as imposing any limitation or constraint on the scope, or due and proper enforcement, of legislation of general application that does not discriminate, or have the effect of discriminating against the Contractor, and provides in the interest of safety, health, welfare or protection of the environment...provided, however that the state will ensure that such measures are in accordance with the current international petroleum industry standards and are not unreasonable.”³¹

This clause is very different from the one above, because the expectations that the contractor has of the host state party is much less. It recognises the host state’s right to enact laws in the future so long as they are non discriminatory, are in line with recognised standards and reasonable. Such a clause obviously shows that the host state party to this agreement is in a much stronger position than the one in the preceding clause.

³⁰ O. Anderson, *Risk: Emphasising Political Risk*, CEPMLP Course Materials, Contracts Used in International Oil Industry Development, Slides p18-19 CEPMLP Jun 2003.

³¹ *Id.*

The final example is an adaptation of a traditional stabilisation clause and an intangibility clause, which may be used to achieve the same objective. It provides as follows

“This agreement shall be construed in accordance with the Petroleum and Tax Laws and related regulations in force on the date of execution. Any amendment to, or repeal of such laws or regulations, shall not affect the contract rights or obligations of the contractor without its consent”³²

This clause is peculiar because it incorporates attributes of a traditional stabilisation clause by limiting the application of laws to the agreement to only those in force at the date of its execution. However it also extends the consent requirement commonly found in intangibility clauses to the Contractor if they wish to be bound by any new laws. Such a clause would suggest that the bargaining strength of the IOC is quite good, because they ultimately have the right to decide whether any new laws enacted by the host state will bind them.

As can be seen in the modern era stabilisation clauses do not fit into strict categories. This is because lawyers and other contract drafters will choose the language that is considered most appropriate to mitigate risks that such projects face. This is also coupled with the fact that when these clauses are drafted reference is made to a number of other clauses used in previous agreements and these are utilised in the construction of the final clause.

We shall now consider the diverging views concerning the legal and effect validity of stabilisation clauses in international petroleum agreements.

4. THE LEGAL VALIDITY AND EFFECT OF STABILISATION CLAUSES

The process of ascertaining the legal validity and effect of stabilisation clauses contained in international petroleum agreements is a complex one, and has been described by one commentator as

³² *Id.*

“...one of the most complex issues in international economic law in view of the fact that strands of arguments from international law (state responsibility, law of treaties) of national law, of conflict of law (both international and national conflict of laws) and possibly of an “international *lex mercatoria*” come together and can be arguably applied.”³³

For our purposes an analysis will be conducted under domestic and international law, as well as a review of a number of arbitral awards.

4.1 UNDER DOMESTIC LAW

When considering the legal validity of the stabilisation clause under domestic law, one is confronted with the fact that a number of domestic legal systems have established legal principles that have the effect of invalidating a stabilisation clause and making it of no legal effect. One such principle is that Parliament or the executive powers of the state may not be fettered by a contract with a private individual or corporation³⁴. This is a principle of English common law³⁵ and is particularly applicable in many countries that have adopted the common law as part of their domestic law. Consequently if the domestic law of such a country is the governing law of the petroleum agreement it is highly likely that the local courts will interpret a stabilisation clause to be unenforceable and therefore have no binding effect on the host state³⁶.

In other domestic legal systems a similar situation exists, especially in Middle East and some French speaking African countries, which have modelled their laws on the French civil code³⁷. Under such a system mineral development agreements have acquired a public character and are therefore understood to depreciate the implications of the sanctity of contract doctrine³⁸. Therefore it is also arguable whether a

³³ See Walde, *supra* note 6 at 28.

³⁴ Walde, T., and Ndi, G., *Fiscal Regime Stability and Issues of State Sovereignty*, in J. Otto (ed) *Taxation of Mineral Enterprises* 75 (Otto, J., ed. London: Graham and Trotman, 1995).

³⁵ This principle is laid down in *Rederiaktiebolaget Amphitrite v. R [1921]*, 2 Kings Bench 500.

³⁶ See Walde and Ndi, *supra* note 34 at 76.

³⁷ *Id.*

³⁸ *Id.*

stabilisation clause would of any effect under these systems when domestic law governs the agreement.

In light of this discussion, it would clearly be in the host state's interest to insist that the governing law of the agreement was its domestic law, if it ever had the intention of breaching a stabilisation clause contained in an agreement. The problem for the host state is that most IOC's recognise this, and therefore seek to internationalise their agreements, by insisting that international law is the governing law of the contract, and that the dispute resolution mechanism require the use of an independent arbitrator in a neutral forum³⁹. By doing this, the IOC avoids the risk and effects of a domestic court possibly interpreting the stabilisation clause to be of no effect. As a consequence the majority of debate concerning the validity of stabilisation clauses is centred on whether they are valid under international law.

4.2 UNDER INTERNATIONAL LAW

An analysis of stabilisation clauses under international law is focused around two competing concepts, the doctrine of sanctity of contract and (*pacta sunt servanda*) versus the doctrine of permanent sovereignty over natural wealth and resources (*rebus sic stantibus*)⁴⁰. Under international law there is a considerable difference of opinion as to the legal validity and effect of such clauses, of which three main views have emerged.

The first view is based on the notion that once parties choose international law as the governing law of the contract, it automatically renders the contract applicable to certain legal principle of international law, namely the doctrine of sanctity of contract and *pacta sunt servanda* and any breach of a stabilisation clause in this circumstance is a breach of international law⁴¹. The crux of this argument is that any unilateral alteration of the stabilisation clause immediately and directly engages the responsibility of the state under international law, without the additional requirement of establishing that there was a breach of other customary international conditions.

³⁹ For more detailed discussion see Delaume, G., *Transnational Contracts: Applicable Law and Settlement of Disputes – Law and Practice*, Booklet I, Dobbs Ferry, New York 37 (1992).

⁴⁰ See Walde, *supra* note 6 at 32.

⁴¹ See Walde and Ndi, *supra* note 34 at 79. For further discussion about this view see also Kissam, L., and Leach, E., *Sovereign Expropriation of Property and abrogation of Concession Contracts* 28 *Fordham Law Review*, 177 (1959-60), and C. Greenwood, *State Contracts in International Law: The Libyan Oil Nationalisations*, 53 *Brit. Y.B. Int'l L.* 27, 41 (1982).

The second view is that a state has the right to permanent sovereignty over its natural resources and the proponents of this view find their justification in the pronouncements of the United Nations General Assembly⁴². The idea espoused here is that the principle of sovereignty does not limit the power of the host state to merely concluding agreements that create binding obligations; its sovereignty also allows the state the lawful basis to terminate such agreements⁴³. Therefore according to this school of thought the state is free to bind itself by a stabilisation clause, but it also has the right to revoke such an undertaking if the circumstances warrant it to do so.

There also exists a third more moderate view, which recognises that stabilisation clauses have an international effect but its proponents do not believe that they can offer the investor absolute protection⁴⁴. It is their belief that the freezing function of the stabilisation clause is only part of a wider picture, as economic, social and political factors must be taken into account when interpreting the validity of such a clause⁴⁵.

No dominant view has emerged as yet, what however has been useful is a number of arbitral awards that have taken place over the years.

4.3 ARBITRAL AWARDS

An early example of an arbitration that involved both a choice of law clause as well as a stabilisation clause was *Lena Goldfields v. USSR*⁴⁶. Although the case did not directly comment on the legality of the stabilisation clause, it was the first case to establish that a contract between a private party and a sovereign state might be

⁴² Resolution 1803 (XVII) of 14 December 1962, 3021 (S-VI) of 1974 (Declaration on the Establishment of a new Economic Order) and 3281 (XXIX) of 12 December 1974 Charter of Economic Rights and Duties of States

⁴³ See Walde and Ndi, *supra* note 34 at 80. For further discussion see Sornarajah, M., The Pursuit of Nationalised Property 1 (Dordrecht, The Netherlands: Martinus Nijhoff Publishers 1986) and E. Paasivirta, *supra* note 27 at p 182

⁴⁴ See Walde and Ndi, *supra* note 34 at 80.

⁴⁵ *Id.* See also R. Higgins, *Legal Preconditions for Foreign Investment*, IBA-SERL Seminar Proceedings, Matthew Bender, New York 233-235

⁴⁶ *Lena Goldfields* arbitration, Annual Digest of Public International Law Cases (H.Lauterpacht, 1929-930).

internationalised and not exclusively governed by domestic law⁴⁷. In *Sapphire International Petroleum Ltd v. National Iranian Oil Co*⁴⁸ a stabilisation clause precluded the government of Iran from cancelling, amending or modifying the terms of the agreement except with the consent of both parties. Again in this award the main decision revolved around the choice of law clause and the stabilisation clause was virtually ignored, except for a fleeting comment that where a concession is prematurely terminated there was a duty to compensate, in this award there was no finding that the stabilisation clause had been violated⁴⁹

An important award in the consideration of the legal effect of stabilisation clauses is *Saudi Arabia v. Arabian American Oil Company (Aramco)*⁵⁰. It involved a conflict between a transportation agreement granted to the Saudi Arabian Maritime Tankers Ltd to transport Saudi oil and a concession granted to Aramco giving it the exclusive right to transport the oil it extracted from the concession area. The tribunal concluded that it was the very sovereignty of the state that gave it the legal power to grant rights which it prohibits itself from breaching until the end of the concession period. This award without any reservation recognised the validity of stabilisation clauses under international law. This same line of argument was also followed in the more recent *AGIP v. Popular Republic of Congo*⁵¹. When the President of Congo nationalised the assets of AGIP in breach of a stabilisation clause in their concession agreement. AGIP filed an application for arbitration and the tribunal found that the existence of a stabilisation clause in an agreement did not affect the states sovereign or regulatory powers in relation to nationals or foreigners, accordingly the clause was valid and enforceable under international law⁵².

Although it appears that arbitral awards clearly recognise the validity of stabilisations clauses in international petroleum agreements a few number of awards have raised some questions about their effect. One basis for controversy arises from the Libyan

⁴⁷ M. Coale, *Stabilisation Clauses in International Petroleum Transactions*, 30 Den. J. Int'l L & Pol'y 217 at 227 (2002).

⁴⁸ 35 I.L.R 136 (1967).

⁴⁹ See Coale, *supra* note 47 at 228.

⁵⁰ 27 I.L.R 117.

⁵¹ 2 I.L.M 726 (1982).

⁵² See Walde and Ndi, *supra* note 34 at p 81.

nationalisation cases⁵³, where the Libyan government nationalised the interest and properties of foreign oil companies in Libya, though the awards were favourable to the companies⁵⁴. What was of concern was that "...the arbitrators in two out of the three awards seemed to have reached the conclusion that that stabilisation clauses cannot prevent unilateral change by government in the sense of restitution of the agreement to the *status quo ante* being required"⁵⁵. In addition the award in *Kuwait v. Aminoil*⁵⁶ has been described as depreciating the international legal value of the stabilisation as a protective device over the long term"⁵⁷. The tribunal was of the view that stabilisation clauses can only be effective for a limited period of time, because the concession agreement had been renegotiated a number of times in the past and had lost its absolute character⁵⁸.

There is still an element of confusion surrounding the legal character and effect of stabilisation clauses, especially under international law. Ultimately the validity of such clauses depends on the school of thought that the person conducting the analysis belongs to, What however cannot be escaped is that such clauses are an integral part of most international petroleum agreements. The final part of this paper will focus on the functional value of stabilisation clauses.

5. FUNCTIONAL VALUE OF STABILISATION CLAUSES

The functional value of stabilisation clauses in international petroleum agreements is a question that is also the subject of many views. Some believe that such clauses serve absolutely no function; on the basis that international law already prohibits arbitrary or unlawful interference by a host state in an international investment agreement⁵⁹. The reasoning being that an IOC cannot realistically expect that the freezing effect of a traditional stabilisation clause is capable of insulating it from outside influences

⁵³ These included *BP Exploration Company (Libya) Ltd v. Government of the Libyan Arab Republic* 53 I.L.R.297, *Texaco Overseas Oil Petroleum Co / California Asiatic Oil Co (TOPCO) v. Government of the Libyan Arab Republic* 53 I.L.R. 389 (1979), and *Libyan American Oil Co (LIAMCO) v. Government of the Libyan Arab Republic* 62 I.L.R 140 (1977)

⁵⁴ See Coale, *supra* note 47 at 231.

⁵⁵ See Walde and Ndi, *supra* note 34 at 82.

⁵⁶ 21. I.L.M 976 (1982)

⁵⁷ See Walde and Ndi *supra* note 34 at 82.

⁵⁸ See Coale, *supra* note 47 at 236.

⁵⁹ See Ndi, *supra* note 5 at 228. For further discussion see Higgins, *supra* note 45 at 243.

taking place in the real world, because international law will be sensitive to such changes.

Another view identifies the stabilisation clause as having a financial function for the IOC if it is breached⁶⁰. Here the view is that even if the clause is deemed not to have any effect on the host states right to unilaterally alter the terms of the already concluded agreement, breaching it would give the investor a special right of compensation which would be higher than any other form of contractual breach not involving a stabilisation clause⁶¹. Such compensation would extend to prospective gains, or lost profits (*lucrum cessans*), which are currently not recoverable⁶².

A final view is that is that such clauses may serve the function of a secondary protection mechanism; even in the case that international law already provides protection for any arbitrary interference by the host state⁶³. This view is that the function of the stabilisation clauses would be to give the investor additional protection against any *prima facie* lawful grounds which international law recognises for affecting changes to the concluded agreements.

From a practical standpoint, the function of the stabilisation clause is that it assists in attracting foreign direct investment. It serves a major risk management function for the IOC, in the form of an undertaking that no changes will be effected to the agreed terms of the agreement; it therefore raises the IOC's confidence in its proposed interaction with the host state⁶⁴. Even if there is wrangling about its legal function such argument is academic, because industry practice has developed that stabilisation clauses are considered an essential part of international petroleum agreements. So for the IOC and the host state its function is obvious, above all it provides a high level of

⁶⁰ *Id.*

⁶¹ Arechaga de, J., *International Law in the Past Third of a Century*, 159 *Recueil des Cours*, 307 (1978).

⁶² *See* Ndi, *supra* note 5 at 229

⁶³ *Id.*

⁶⁴ For instance it is argued that in developing countries stabilisation clauses help to create a secure and favourable legal regime that thereby encourages investment, an example of this is the Nigerian Liquefied Natural Gas Venture discussed by Rawding, *Protecting Investments under State Contracts; Some legal and Ethical Issues* 99 *Arbitration International* 341 cited in A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration*, Sweet and Maxwell.103 at footnote 10 (1999).

clarity as to the expectations that each party has of the agreement that they have concluded

The nature of the petroleum industry with its many risks means that stability is essential for all the parties involved in it to reach their respective objectives. The question of the legal and functional value of stabilisation clauses from a theoretical perspective is not as important as the purpose that the clause serves in the agreement. The inclusion of the stabilisation clause in an international petroleum agreement means that the IOC has addressed the risks that the project poses to it, and attempted to mitigate one of them. Not directing ones mind to the issue that the fiscal or regulatory stability of a project might be unilaterally altered by the host state would be negligent, because such a risk is a real one.

The controversy surrounding the legal validity of stabilisation clauses under international law should not be used to discount its ability to ensure a project's stability, because in many instances, a host state will honour the stabilisation clause and decide that new laws will not apply to project agreements concluded before the enactment of those laws. The reason being that the disruptive effect that breaching such a clause has for the host state in terms going to arbitration and a probable requirement for the payment of compensation, may be too much trouble. What cannot be escaped is that the bargaining strength of host state and the IOC is what will determine the type of stabilisation clause that is in the agreements and whether one is actually included at all. If the host state has enough petroleum, which may be extracted economically, it becomes solely a cost benefit analysis for the IOC. The specific means through which this may be done is always open to negotiation, and it would be wrong to believe that investment in a host state would be impossible without the inclusion of a stabilisation clause in the agreement. The problem for the host state is that today the level of competition for investment is intense, and IOC's usually invest where they feel most comfortable in terms of taking the least amount of risk, and stabilisation clauses form an essential part of an IOC's risk management measures.

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