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Validity and Efficacy of Stabilisation Clauses

Legal Protection vs. Functional Value

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I. INTRODUCTION

The involvement of the state as a contracting party in a petroleum contract always raises the possibility of unilateral change or premature termination by virtue of the state's sovereign legislative power. Against this backdrop, foreign investors in natural resource development projects have always sought stability guarantees as protection from the unilateral exercise of state power to change the terms of the contract by legislation or administrative discretion. Stabilisation clauses figure prominently as contractual mechanisms for the promotion and protection of foreign investment in the negotiation of modern petroleum contracts. Stabilisation clauses have generated much academic debate regarding their legal nature, efficacy and validity.

The aim of this article is to examine the legal nature of stabilisation clauses, to identify the scope and different categories of stabilisation clauses, to explore their purposes, and to examine their legal effect and validity in the light of arbitral jurisprudence and contract practice. In determining the validity and efficacy of stabilisation clauses, the article also explores the functional relationship between stabilisation clauses and applicable law.

Taking into consideration the developmental dimension of petroleum contracts, the article also focuses on political economy aspects of stabilisation clauses in order to explain the developing states' adherence to such contractual obligations despite their frequent opposition to the legal effect of such clauses.

II. DEFINING FEATURES OF STABILISATION CLAUSES

As risk-averse entities, foreign investors always seek a stable contractual relationship for the investment on the basis of the legal regime in effect at the time the investment was made. Given the necessity of a fair return on the investment and the uniqueness of petroleum contracts in terms of their legal nature, a mechanism is required to address much-needed concerns for stability in the contractual regime. The stabilisation clause is a contractual device developed in response to such concerns: it attempts to insulate petroleum contracts from changes in the legal environment surrounding them. The stabilisation clause is essentially a phenomenon of long-term state contracts, in contrast to private contracts, commercial contracts and short-term state contracts, which are not usually vulnerable to political or regulatory risk.[1]

The stabilisation clause is a form of governmental guarantee in a negotiated petroleum contract, which usually provides that the terms negotiated under the contract between a state and a foreign national will not be altered unilaterally or terminated by the state through the promulgation of legislation or regulation. In essence, stabilisation clauses aim at the prevention of legislative intervention in the negotiated contract regime. In the ultimate analysis, the stabilisation clause is a legal mechanism for the protection of foreign investors from state intervention in a petroleum and mineral resource development project through legislative or administrative measures.[2] In this sense, the stabilisation clause is different from the stability provision found in legislation and regulations, governmental orders, and decrees of the host states to attract foreign investment, in that it is a device to protect the property rights of specific foreign investors by constraining the host state's sovereign legislative power.

As petroleum contracts involve a long duration, the stabilisation clause is a sui generis approach to deal with the effect of the time element in the contractual relationship. As far as its legal nature is concerned, the stabilisation clause is substantive in nature, as it deals with the rights and obligations of the contracting parties, and its breach may substantially change the rights and obligations of the parties.

III. Scope of Stabilisation Clauses

Stabilisation clauses have both spatial and temporal dimensions. The scope of a stabilisation clause may be either comprehensive or limited. A stabilisation clause is comprehensive in scope when it encompasses a restriction upon a change of the whole range of legislative competences by the host state. A stabilisation clause of comprehensive scope attempts to insulate completely contractual undertakings from any change in the applicable law of a host state. A stabilisation clause may also be of limited scope, applicable to specific legislation such as tax laws, labour law or social welfare law, the law relating to repatriation of rights, stabilisation of export-import provisions, or free transferability of currency. This limited stabilisation clause tends to be more effective and is preferred by developing countries because it requires only a limited waiver of legislative power.

IV. Types of Stabilisation Clauses

The formulation of a particular stabilisation clause is the result of the bargaining process and relative strength of the parties, and reflects a balancing of their opposing

[1] For comprehensive analysis of the treatment of stability of investment contracts, *see* Thomas W. Waelde & George Ndi, *Stabilising International Investment Commitments: International Law versus Contract Interpretation*, 31 Tex. Int'l L.J. 215–67 (1996).

[2] A stabilisation clause has 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." Margarita T. B. Coale, *Stabilisation Clauses in International Petroleum Transactions*, 30 Denver J. Int'l L. & Policy 217 (2003).

interests. Stabilisation clauses may be broadly divided into three categories: stabilisation clauses in the strict sense; intangible clauses, and economic stabilisation clauses.

A. Stabilisation clause *stricto sensu*

A stabilisation clause *stricto sensu* intends to ensure that the law applicable to the petroleum contract will not change over the life of the project. This is a more traditional approach which tries to impose an absolute block on the legislative competence of the host states. Such clauses may take the following forms:

(a) a stabilisation clause that freezes the municipal law of the host state on the day the agreement is made, for the whole period of the contract. The broader implication of this type of stabilisation clause suggests that the host state promises that subsequent legislation will not apply to the relationship between the parties to the agreement. Thus, this kind of clause does not amount to a waiver of state sovereignty to legislate; it means rather that subsequent legislation will not apply to the contract;

(b) a stabilisation clause providing that in the event of any conflict between new legislation and the provisions of the agreement, the latter will prevail.

A stabilisation clause *stricto sensu* is consistent with the principle of non-retroactivity of laws.[3]

B. Intangible clause

In general, an intangible clause denotes that contracts will not be modified or abrogated except by the mutual consent of the contracting parties. The intangible clause is widely used in petroleum contracts. These clauses do not contain an explicit waiver of legislative sovereignty but rather seek to prevent unilateral modifications of contract by the host state. A typical example of an intangible clause is: "This contract shall not be annulled, amended or modified in any respect, except by the mutual consent in writing of the parties hereto."[4]

Such clauses are more consensual in nature, because the mutual consent of the parties is required in order to change the contractual obligations. The main difference between the stabilisation clause *stricto sensu* and an intangible clause is that while the former intends to protect investors from host state legislative intervention in the contract through changes in the applicable law or the enactment of new legislation, the latter aims

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[3] Libyan American Oil Co. (LIAMCO) (USA) v. Government of the Libyan Arab Republic, 20 I.L.M. 31 (1981), para. 60.

[4] Production Sharing Contract of Indonesia between Pertamina and Overseas Petroleum Investment Corp. and Treasure Bay Enterprise Ltd., 1995, Basic Oil Laws and Concession Contracts, Barrows Supplement (Asia and Australisia), Supp. No. 149, art. 17.2.

to protect them from the host state's exercise of administrative power to change or modify the contract unilaterally. A stabilisation clause *stricto sensu* limits the legislative competence of the state, whereas an intangible clause shields the investor against the exorbitant powers of the government acting as public authority to change the contract terms.[5] The requirement of mutual consent for modification of contract may also be implied where the contract in question is silent.[6] In such cases, a party's consent may be deemed to be given by subsequent conduct acquiescing in unilateral actions by the other party that have the effect of altering the contract terms.

C. Economic stabilisation clause

This kind of stabilisation clause requires that the host state will not enact any legislation or take any administrative measure which has the effect of aggravating the costs of the project, or provides that if subsequent legislation should adversely affect the foreign contractor's rights, the parties will consult to determine the economic consequences of such a change and the host state will restore the foreign contractor's economic loss. For example, article 43.1 of a 1997 Gabonese production sharing contract provides as follows:

> [T]he State guarantees to the Contractor, for the duration of the Contract, the stability of the financial and economic conditions insofar as these conditions result from the Contract and from the regulations in force on the Effective Date.
>
> The obligations resulting from the Contract shall not be aggravated, and the general and overall equilibrium of the Contract shall not be affected in an important and lasting manner for the entire period of validity hereof. However, adjustments and modification of these provisions may be agreed upon by mutual consent.[7]

An example of the second type of economic stabilisation clause is article 17.1 of the Vietnamese model production sharing contract of 2004:

> If after the effective date, existing laws and regulations are amended or annulled or new laws and regulations are introduced in Vietnam … in any case adversely affecting the economic rights or benefits expected by the contractor from this contract … the parties shall meet and consult promptly with each other and make such changes to this contract as are necessary both to maintain the Contractor's rights, benefits and interests hereunder and to ensure that any revenues or

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[5] P. Weil, *Les clauses de stabilisation ou d'intangibilité insérées dans les accords de développement économique*, *in* Melanges oferts a Charles Rousseau 301–44 (1974), *translated and cited in* A.Z. El Chiati, *Protection of Investment in the Context of Petroleum Agreement*, 204 Recueil Des Cours 115 (1987).

[6] A.F.M. Maniruzzaman, *Some Reflections on Stabilization Techniques in International Petroleum, Gas and Mineral Agreements*, Int'l Energy L. & Taxation Rev. 96, 98 (April 2005).

[7] Vanco Exploration Production Sharing Contract, May 27, 1997, between the Republic of Gabon & Vanco Gabon, Inc. (Astrid Maine), Basic Oil Laws and Concession Contracts, Barrows Supplement (South and Central Africa), Supp. No. 142, at 80. Another example of an economic stabilisation clause reads as follows: "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 from this Contract and from the legislation and regulation in force on the date of signing this contract, unless as mutually agreed upon by the Parties." Hardman/Elixir Production Sharing Contract, September 8, 1996, between Mauritania and Hardman Petroleum (Mauritania) Ply & Elixir Corp. Ply Ltd., art. 27.3, Basic Oil Laws and Concession Contracts, Barrows Supplement (South and Central Africa), Supp. No. 143, at 54.

> incomes or profits … derived or to be derived under this contract … shall not in any way be diminished as a result of such changes.[8]

The economic stabilisation clause of the second type is more popular than the first type and is increasingly being incorporated in petroleum laws or codes, investment laws and petroleum contracts.[9] Because this kind of economic stabilisation clause does not seek to prevent the enactment of subsequent legislation but tries to mitigate its adverse impact on the economic equilibrium of the contract, it is more compatible with the notion of the legislative freedom of the state.

V. Purpose of Stabilisation Clauses

Stabilisation clauses seek to (i) provide protection from political risk; (ii) ensure legal certainty; and (iii) encourage foreign investment.

A. Protection from political risk

The availability of legal protection against political risks in the host countries' law and contractual arrangements is considered to be one of the most significant factors taken into account by foreign investors in long-term, capital-intensive projects. The primary function of a stabilisation clause is to protect foreign investors from subsequent changes in the law of the host state which may result in a direct taking, such as nationalisation or expropriation, or indirect taking of property of the foreign investor.[10] These clauses aim to stabilise petroleum agreements by neutralising the effect of prerogatives of the host state that would otherwise allow it unilaterally to modify the legal environment of such agreements.[11]

Given that existing principles of international law are inadequate to protect foreign investors from a state's unilateral change, a foreign investor will usually insist on the contractual mechanisms of a stabilisation clause, arbitration clause, and choice of law

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[8] Vietnam Model Production Sharing Contract, 2004, art. 17.1, Basic Oil Laws and Concession Contracts, Barrows Supplement (Asia and Australasia), Supp. No. 164, at 130.

[9] For example, art. 17(2) of the Federal Law of Russia concerning production sharing agreements states: "In the event that, during the period of validity of the agreement, the legislation of the Russian Federation, the legislation of constituent entities of the Russian Federation and legal acts of local government bodies establish norms which deteriorate the commercial results of the investor under the agreement, amendments shall be made to the agreement which guarantee the investor the commercial results which it could have received under the legislation of the Russian Federation, the legislation of constituents entities of the Russian Federation and legal acts of local government bodies which were in force at the time of concluding the agreement. The procedure for making such amendments shall be defined by the agreement." Federal Law 225-FZ 1995 concerning production sharing agreements as amended by Law 19-FZ of January 7, 1999, Basic Oil Laws and Concession Contracts, Barrows Basic Oil Laws and Contracts (Russia and NIS Countries), Supp. No. 35, at 99–100.

[10] *See* Oscar Schachter, International Law in Theory and Practice 314 (1991); S.K. Chatterjee, *The Stabilisation Clause Myth in Investment Agreements*, 5 J. Int'l Arb. 97–111 (1988); Chiati, *supra* note 5, at 115. According to Delaume, the purpose of a stabilisation clause is "to reach a compromise between the sovereign prerogatives of the state involved and the legitimate quest of the private party for stability of status consistent with sound business judgement." G.R. Delaume, Transnational Contracts: Applicable Law and Settlement of Disputes, Booklet 8, 39 (July 1983).

[11] Bertrand Montembault, *The Stabilisation of State Contracts Using the Example of Oil Contracts: A Return of the Gods of Olympia?*, 6 Int'l Bus. L.J. 593, 599 (2003).

clause in order to deal with political risk. One of the main objectives of the stabilisation clause is to maintain the sanctity of contract. As the international law principle of *pacta sunt servanda* cannot be directly incorporated in state contracts, foreign investors insist on the contractual mechanism of a stabilisation clause. An extreme interpretation of the protectionist effect of a stabilisation clause may, however, fail to take into account dynamic changes that can occur in the lifetime of a contract, and the need to accommodate such changes through legal or regulatory measures. Thus, the stabilisation clause *stricto sensu* has only a limited role in protecting foreign investors from political risks, because norms of state contract are profoundly shaped by public policy considerations and as a result, legal and regulatory intervention to realise public policy considerations can become inevitable in the course of the contractual relationship.[12]

B. Legal certainty

Legal predictability and certainty is a core element of any effective legal system. The notion of legal certainty is derived from the general principle that law should be certain and predictable to a reasonable degree.[13] Legal predictability of the applicable law of long-term contracts, including petroleum agreements, has important significance in determining the legal rights and position of the parties. Legal certainty is an important factor because by eliminating speculation as to what the law is and avoiding the need for interpretation, clarification or explanation that arises from the lack of a clear rule, certainty promotes efficiency for the commercial and investment transaction.

Because the future behaviour of any government is uncertain, a stabilisation clauses aim at policing state behaviour.

C. Encouragement of foreign investment

The host state's interest in agreeing to a stabilisation clause stems from the need to encourage foreign investment. While arbitral practice shows that the legal protection function of stabilisation clauses is uncertain and questionable, their promotional function has come to the forefront. The presence of a stabilisation clause in a petroleum contract

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[12] *See* George Berman, *Contracts Between States and Foreign Nationals: A Reassessment*, *in* International Contracts 195 (Hans Smit, Ninian M. Galston & Serge L. Levitsky eds., 1981). The post regulatory intervention in the contract is also sometimes explained by the concept of the "obsolescing bargain," which suggests that changes in the level of bargaining power and increased knowledge of the host state can lead to an unstable contractual relationship. *See* Raymond Vernon, *Long-Run Trends in Concession Contract*, *in* Proceedings of the American Society of International Law 81–89 (1967).

[13] Certainty of rule and judicial decision are important factors in any legal system: "The maintenance of reasonable security of expectations has seemed so compelling as one of law's ends-in-view that there is a whole armory of legal ideas and legal institutions designed to provide it: constitutional provisions like the guarantee against ex post facto criminal laws, judicial policies like that embodied in the emerging doctrine of prospective operation of overruling decisions, and indeed, the principal of stare decisis with its special force, as you will have observed, in the 'reliance areas' of the law where it is realistic to assume that action was taken on the strength of known judicial precedents." Paul E. Loving, *The Justice of Certainty*, 73 Or. L. Rev. 743, 749 (1994); *see also* Harry W. Jones, *An Invitation to Jurisprudence*, 74 Colum. L. Rev. 1023 (1974).

can act as a psychological boost to give confidence to investors at the initial stage of the investment. It can act as an incentive to facilitate foreign investment in natural resources development which invariably involves huge capital outlays.

VI. Validity of Stabilisation Clauses

Although there is uncertainty as to the consequences of the violation of such a clause, there is a considerable authority to support the view that a stabilisation clause is valid under national and international law. First, since stabilisation clauses are concluded by mutual consent of the parties by virtue of their autonomy of will, the parties must intend them to be valid undertakings. Second, a state enters into petroleum contracts under the framework of its public law, by virtue of which it can renounce the exercise of other public law prerogatives. Thus, by undertaking the contractual obligations of a stabilisation clause, the state is acting *de jure imperii* in granting certain legislative immunity to a private contracting party.[14] Third, the legal validity of stabilisation clauses can also be premised on the principle of estoppel — a state should not be permitted to repudiate a position that it has assumed voluntarily and upon which the foreign investor has relied.

However, the legal validity of stabilisation clauses has been challenged as contravening two fundamental principles. First, it has been suggested that the stabilisation clause is invalid because it encumbers the host state's permanent sovereignty over natural resources.[15] The developing states argue that the principle of permanent sovereignty over natural resources has assumed the character of *jus cogens* — a customary norm from which no derogation is permissible. But the prevailing view suggests that stabilisation clauses are valid despite the invocation of the principle of permanent sovereignty over natural resources, because the state's freedom of contract remains intact (irrespective of whether the principle has assumed the status of *jus cogens*).[16]

Another argument for the validity of stabilisation clauses is that states continue to include them in petroleum contracts, even after the formulation of the principle of permanent sovereignty over natural resources. This indicates that there is no contradiction between the two principles, but rather that they can co-exist.[17]

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[14] Ahmed S. El-Kosheri & Tarek F. Riad, *The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process*, 1 ICSID Rev. 266 (1986).

[15] *See, e.g.*, M. Sornarajah, *The Myth of International Contract Law*, 15 J. World Trade L. 187 (1981). According to the principle of permanent sovereignty over natural resources, states own the natural resources within their territory and may dispose of those resources as they Sess., fit, including by nationalising natural resource concessions. *See* G.A. Res. 1803, U.N. GAOR, 17th Supp. Sess., No. 17, at 15, U.N. Doc. A/5217 (1962); G.A. Res. 3171, U.N. GAOR, 28th Sess., Supp. No. 30, at 52, U.N. Doc. A/9400 (1973).

[16] *See* Wolfgang Peter, Arbitration and Renegotiation of International Investment Agreements 222 (2d rev. ed. 1995). "A stabilised economic development agreement represents a judgement on the part of the contracting state that the cost of foregoing some degree of future regulatory flexibility is justified by the anticipated benefits of the investment. No rule of *jus cogens* should prevent states from implementing that judgment. When a state accepts obligations under a stabilised agreement, it is bound only by the rules it sets for itself based on its judgement of its own best interests." Christopher T. Curtis, *The Legal Security of Economic Development Agreements*, 29 Harv. Int'l L.J. 317, 361 (1988).

[17] *Id*. at 350–51. *See also* Moshe Hirsch, The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes 149 (1993).

Finally, permanent sovereignty over natural resources should not be understood as giving the state unfettered rights; these will always be limited by the principle of good faith, the obligation to respect other states' rights under international law; the obligation not to cause transboundary pollution, and the state's obligation to use its permanent sovereignty over the natural resources for the benefit of its population.[18]

A further argument against the validity of stabilisation clauses is that they limit state sovereignty and curtail the legislative power of the state, resulting in a shift of the balance of power to the private party to the detriment of the state.[19] Although this "sovereignty" argument has invariably been invoked in all petroleum arbitrations, the common view that has emerged from the arbitral awards is that a stabilisation clause cannot be declared invalid merely on the basis of state sovereignty.[20]

The sovereignty argument has been implicitly abandoned by UN resolutions. Neither the U.N. General Assembly resolution on permanent sovereignty over natural resources[21] or the Charter on Economic Rights and Duties of the States contains any language suggesting that a state, in the exercise of its sovereignty, may abandon contractual commitments voluntarily undertaken, and the resolution expressly requires that states observe in good faith foreign investment agreements entered into for the purpose of developing natural resources.[22]

Thus, the stabilisation clause should be treated as a self-imposed but temporary limitation on the sovereignty of host governments. However, even the stabilisation clause *stricto sensu* should not be construed as an absolute block on the legislative power of the state. A construction that the stabilisation clause *stricto sensu* merely means that any legislation subsequently enacted which may have particularly adverse impact upon the

[18] *See* Franz Xaver Perrez, Cooperative Sovereignty 97–107 (2000).

[19] *See* George R. Delaume, *The Proper Law of State Contracts Revisited*, 12 ICSID Rev. 24 (1997).

[20] In the *Texaco* award, the sole arbitrator Dupuy stated: "There is no need to dwell at any great length on the existence and value of the principle under which a State may within the framework of its sovereignty, undertake international commitments with respect to a private party. This results from the discretionary competency of the State in this area … The result is that 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." *Texaco award*, 17 I.L.M. 1, 23–24 (1978), paras. 66 and 68. The arbitral tribunal in *Revere Copper* also recognised that "in order to meet the aspirations of its people, the Government may for certain periods of time impose limits on the sovereign powers of the State, just as it does when it embarks on international financing by issuing long term government bonds on foreign markets." *Revere Copper*, 17 I.L.M. 1321, 1831 (1978). *See also* AGIP v. Popular Republic of the Congo, ICSID Case No. ARB/77/1, 21 I.L.M. 726 (1982), s. 86, where the tribunal held that "stabilisation clauses freely accepted by the Government do not affect the principle of its sovereign legislative and regulatory powers and that, in the present case, changes in the legislative and regulatory arrangements stipulated in the agreement simply cannot be invoked against the other contracting party."

[21] G.A. Res. 1803 (XVII), U.N. GAOR, 17th Sess., Supp. No. 17, at 15, U.N. Doc. A/5217 (1962).

[22] *Id.* para. 8. *See also* International Law Association, Declaration on the Progressive Development of Principles of Public International Law Relating to a New International Economic Order, 1986, which affirms the ability of states to bind themselves under international law by means of economic development agreements. The Declaration provides that while permanent sovereignty is inalienable, a state may accept obligations with regard to the exercise of such sovereignty, by treaty or by contract, freely entered into, and that a state's power to nationalise, expropriate, exercise eminent domain or otherwise transfer property or rights in property is "without prejudice to legal effects flowing from any contractual undertaking." International Law Association, Report of the Sixty-Second Conference 2, 6–7 (1987), para.5.2, *cited in* Curtis, *supra* note 16, at 354.

contract regime will not be applicable to it would be more compatible with the notion of the state's legislative freedom.

It must, however, be acknowledged that a state may disregard such a voluntary contractual undertaking in exceptional circumstances involving an overriding consideration of public interest, but in doing so, the state must not discriminate and must act in good faith.

VII. Legal Effect of Stabilisation Clauses

The legal effect of stabilisation clauses depends, to a great extent, upon the particular form of the clause.

A. Legal effect of stabilisation clause *stricto sensu*

The legal effect of a stabilisation clause *stricto sensu* centres on whether its presence in a petroleum contract can change the legal nature of such a contract to "enclave status," or whether nationalisation or expropriation of petroleum projects or a unilateral change or termination of contract containing a stabilisation clause by a host state should be treated as an unlawful act under national and international law.

1. *Prohibition of Nationalisation or Expropriation*

An important issue with respect to the legal effect of the stabilisation clause *stricto sensu* revolves around the question that plagued arbitral tribunals for a long time: whether the clause prohibits nationalisation and expropriation of a foreign contractual enterprise. An extreme interpretation, based on *pacta sunt servanda*, holds that a stabilisation clause prohibits otherwise lawful nationalisation by a state. Accordingly, nationalisation of a foreign-owned enterprise in breach of a stabilisation clause is a wrongful act which may be justified only by a fundamental change of circumstances.[23] This was the view endorsed by the arbitral tribunal in the *Texaco* arbitration,[24] in which the arbitrator decided that nationalisation by the Libyan government was in breach of the stabilisation clause and constituted an illegal act under international law.

This line of reasoning was discarded in subsequent arbitrations, in which it was held that nationalisation is always a lawful act and a stabilisation clause cannot abrogate a state's right to nationalise under international law. In the *Liamco* arbitration,[25] the tribunal found that nationalisation which is non-discriminatory and not accompanied by a wrongful act

[23] Pierre-Yves Tschanz, *The Contributions of the* Aminoil *Award to the Law of State Contracts*, 18 Int'l Lawyer 245, 278 (1984). *See also* Timothy B. Hansen, *The Legal Effect of Given Stabilisation Clauses in Economic Development Agreements*, 28 Va. J. Int'l L. 1015, 1035 (1987–88); Christopher Greenwood, *State Contracts in International Law: The Libyan Oil Arbitrations*, 53 Brit. Y.B. Int'l L. 63 (1982).

[24] Texas Overseas Petroleum Co. ("Texaco") and California Asiatic Oil Co. v. Government of the Libyan Arab Republic, 17 I.L.M. 3 (1978).

[25] *LIAMCO*, 20 I.L.M. 1 (1981), 62 I.L.R. 140 (1981).

or conduct is not a breach of a stabilisation clause. In the *Aminoil*[26] arbitration, the tribunal held that while a straightforward and direct reading of stabilisation clauses might lead to the conclusion that they prohibit any nationalisation, this assumption is erroneous. Accordingly, it held that the limitation of a state's right to nationalise is a "particularly serious undertaking" and cannot be presumed in the absence of express language.[27] The *Aminoil* award suggests that limitations on a sovereign's right to nationalise may be possible, but these would have to be explicit and reasonable. Finally, the *Aminoil* tribunal held that a stabilisation clause must be interpreted restrictively, and should be construed to provide protection only against measures having a confiscatory character. Thus, despite the form or wording of the particular stabilisation clause, it cannot prohibit lawful nationalisation, which is recognised as a state's inherent right under international law, as a contractual obligation cannot prevail over a general norm of international law.

Another implication that follows from the *Aminoil* award is that a stabilisation clause may be valid as a temporary limitation upon state sovereignty if it is limited to a relatively short period. On the other hand, a stabilisation clause for an unreasonably long period, such as sixty years, may justifiably be breached in the light of profound social and economic changes in the host country.[28] Thus, legal specificity of such a clause in terms of its duration and scope of application, and explicit mention of the legal consequences which may ensue from its breach, undeniably enhance its legal effect.

2. *Internationalisation of Contract*

According to the theory of the internationalisation of contract, the presence of a stabilisation clause has the legal effect of giving the contract containing it an international character. Consequently, the rights and obligations of the parties under the petroleum contract are to be governed by international law, and unilateral termination of the

[26] Art. 17 of the 1948 Concession Agreement reads as follows: "The Shaikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11. No alteration shall be made in the terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement." *AMINOIL*, 21 I.L.M. 976 (1982).

[27] The *AMINOIL* award had been criticised by many authors. Higgins finds the tribunal's interpretation of the stabilisation clauses "implausible as a matter of construction and unpersuasive as a matter of reasoning." Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 304 (1982-II); according to Tasan, "the tribunal rendered the stabilisation clauses superfluous by depriving them of any specific meaning. If the requirement that the nationalisation not be confiscatory is part of general international law, then the stabilisation clauses add nothing to what would be the usual legal situation." Fernando R. Tason, *State Contracts and Oil Expropriations: The Aminoil–Kuwait Arbitration*, 24 VA. J. INT'L L. 323, 344–45 (1984). *See* the separate opinion of Sir G. Fitzmaurice in the award. His main contentions are that stabilisation clauses do not need to be express to be effective; that this clause was express in any event; and that the character of the concession or of the stabilisation clause had not changed due to subsequent negotiations and amendments. *AMINOIL*, 21 I.L.M. 1051–53 (1982).

[28] *See* Report of the Secretary General of the United Nations on Permanent Sovereignty over Natural Resources, at 24, para 68, U.N. Doc E/C/119 (1981). "A recurrent provision, even in very recent contracts, is the freezing of the tax regime applicable at the time of the negotiation. Some of the freezing clauses negotiated at present tie the hands of the Government for a very long period. Long and comprehensive 'freezing' clauses seem to run counter to the principle of permanent sovereignty over natural resources, although it may be conceivable that provisions to stabilise the fiscal regime for a reasonable period, so as to assure loan repayment, for example, can be found acceptable under specific conditions."

contract constitutes an internationally wrongful act. Indeed, some arbitral tribunals have recognised the internationalisation effect of a stabilisation clause, and cited the presence of a stabilisation clause as an important indicator that the contract has been internationalised, thereby removing it from the purview of the municipal law of the host state, and subjecting it to principles of international law. In the *Texaco* award, Professor Dupuy found that the presence of a stabilisation clause changed the legal nature of the Libyan petroleum concessions and converted them into internationalised ones.[29] A similar position was upheld in the 1979 *AGIP* arbitration,[30] in which the tribunal found the nationalisation of an Italian company to be contrary to article 11 of a 1974 agreement guaranteeing the stability of the investor's status for a period of ninety-nine years. It was with regard to this stability provision that the tribunal decided that it was necessary to apply international law in conjunction with Congolese law.[31] The tribunal held that a stabilisation clause's applicability "results not from the automatic play of sovereignty of the contracting state but from the common will of the parties expressed at the level of international juridical order."[32]

Some commentators have taken the view that the very essence of a stabilisation clause prohibits a state from unilaterally modifying a state contract, and that international law supersedes the host state's law in governing the contract.[33] According to others, the mere presence of a stabilisation clause cannot fully internationalise the contract, absent an arbitration clause or applicable law clause providing for general principles of law or international law.[34] The genesis of the theory of internationalisation of contract can be found in the 1967 *Sapphire* arbitration, in which the tribunal held that "these concessions give the contract a particular character, which lies partly in public law and partly in private law" and "this contract has therefore a quasi-international character, which releases it from the sovereignty of a particular legal system."[35] The theory has been subject to criticism

[29] The stabilisation clause, clause 16(2) of the concession agreement, reads as follows: "This Concession shall throughout the period of 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. Professor Dupuy based the proposition of internationalisation of contract on the following grounds: (i) these agreements are not administrative contracts in nature; (ii) the UN General Assembly resolutions purporting to assert exclusive competence of the host state in matters of nationalisation are not positive international law; (iii) deeds of concession fall into the category of an economic development agreement." *Texaco*, 17 I.L.M. 3 (1978).

[30] *AGIP*, 21 I.L.M. 726, 727–28 (1982).

[31] *Id.* at 736.

[32] *Id.* at 735.

[33] Greenwood, *supra* note 23, at 53. *See also* Richard B. Lillich, *The Law Governing Disputes under Economic Development Agreements: Re-examining the Concept of Internationalisation*, *in* INTERNATIONAL ARBITRATION IN THE TWENTY FIRST CENTURY: TOWARDS "JUDICILIASATION" AND UNIFORMITY 100 (Richard B. Lillich & Charles N. Brower eds., 1994); Hansen, *supra* note 23.

[34] F.V. Garcia-Amador, *supra* note 15, at 33–34. *See also* Gunther Jaenicke, *Consequences of a Breach of an Investment Agreement Governed by International Law, by General Principles of Law or by Domestic Law of the Host State*, *in* FOREIGN INVESTMENT IN THE PRESENT AND NEW INTERNATIONAL ECONOMIC ORDER, vol. 1 (D.C. Dicke ed., 1987) (arguing that the stabilisation clause, in combination with a clause providing for international arbitration, is a strong indicator of the intention of the parties to insulate the investment agreement from the reach of the law of the host state, and that the host state thereby implicitly accepts the competence of an arbitral tribunal to rule on the validity — and on any alleged impairment — of the "stabilisation clause" by applying national as well as international legal standards).

[35] Saphire International Petroleum Ltd. v. National Iranian Oil Co., 35 I.L.R. 136, 171–73 (1967).

on both normative and technical grounds. From the viewpoint of the normative aspect of the theory, it has been claimed that those arbitral awards that articulate the theory reflect a doctrinal trend that started in the 1950s and is no longer currently valid.[36] The theory has also been criticised as essentially self-serving and designed to support a very partisan, capitalist approach to contractual disputes,[37] representing a norm of international law created largely by decisions of arbitral tribunals delivered during colonial times and not relevant at the present time.[38]

It has further been attacked on a number of technical grounds. First, it cannot be said that mere reference to international law or general principles of law as the governing law should elevate a contract to international treaty status, because multinational companies are yet to be fully recognised as subjects of international law and do not enjoy the same rights and obligations as a state.[39] Second, the absence of an applicable law clause or the choice of international law or general principles of law does not automatically internationalise the contract, because there is a strong presumption in favour of application of the law of the host state if there is no express choice of applicable law.[40] In the present context, internationalisation theory has lost its efficacy, as there has been an overwhelming shift in modern petroleum agreements towards "relocalisation" by expressly providing

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[36] A.A. Fatouros, *International Law and the Internationalised Contract*, 74 AM. J. INT'L L. 134–44 (1980).

[37] Derek William Bowett, *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 49 BRIT. Y.B. INT'L L. 49, 51–52 (1988).

[38] Sornarajah, *supra* note 15, at 190. According to Sornarajah, the weakness of these arbitral awards justifying internationalisation is that they were made during a climate of coercion, often to provide a legal cloak for what could have been achieved by coercion in the colonial period. The objective of the norms contained in these arbitral decisions is the maximisation of the protection to be given to private foreign investment through diplomatic intervention, economic coercion and other forms of sanction.

[39] Oscar Schachter, writes: "A clause stipulating that the proper law of the contract is international law or general principles of law does not transform the contract into an international agreement within the meaning of the Vienna Convention on the Law of Treaties. It goes no further than to authorise an arbitrator to have recourse to cognate rules of international law or general principles of law that may be applied to the contract. For example, reference might be made to the principle of *rebus sic stantibus* or the various rules on invalidity." Schachter, *supra* note 10, at 309. Amerasinghe draws a similar conclusion: "A mere choice of law (international law) cannot, therefore, convert a breach of such a contract by a State into a breach of international law vis-a-vis the alien's State." C.F. Amerasinghe, *State Breaches of Contracts with Aliens and International Law*, 58 AM. J. INT'L L. 881, 906 (1964). For instance, in the *ARAMCO* award, the tribunal rejected a contention made on behalf of the company that the concession agreement should be "assimilated to an international treaty governed by the law of Nations." Saudi Arabia v. ARAMCO, 27 I.L.R. 165–67 (1963). The tribunal held that the concession agreement should be governed by the law of Saudi Arabia because, according to the tribunal, "this is the law of the country with which the contract has the closest natural and effective connection, unless another law is designated by the conclusive conduct of the parties." *Id.* at 167.

[40] The Permanent Court of International Justice stated in the *Serbian Loans* case that: "any contract which is not a contract between states … is based on the municipal law of the same country." 1929 P.C.I.J. (ser. A) No. 20, at 41. In the *ARAMCO* award, the contract in dispute had no express provision on applicable law and, therefore, the arbitral tribunal considered the law applicable to the dispute and found that, because the subject matter of the agreement dealt with the exploitation of oil in Saudi Arabia and one of the parties to the agreement was the State of Saudi Arabia, the law to be applied to the agreement was the law of Saudi Arabia. *ARAMCO*, 27 I.L.R. 167 (1963). This assertion is further justified by the "objective theory" of the choice of law, according to which, in the absence of an express provision on applicable law, the law applicable to the contract should be that of the host state mainly because the principal place of performance of the contract is within the territory of the host state and it is the law of the host state with which the contract is mostly closely connected. In the objective determination of the applicable law, the forum of the contract, the nationality of the parties, the language used in the contract, the place where it is to be performed, the place of breach of contract, and the place where the subject matter of the contract is situated are generally taken into consideration, *see* M. SORNARAJAH, THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES 229–30 (2002).

for application of the legal system prevailing in the host state.[41] Moreover, petroleum contracts can never be completely internationalised, even when international law or general principles of law are designated as applicable. This is because many aspects of petroleum contracts, including the movement of expatriate staff, the employment of local labour, social legislation, and customs and exchange regulations are always governed by the law of the host state.[42]

Third, a provision for international arbitration in state contracts cannot assimilate them to international treaty status, because the primary purpose of providing for arbitral settlement of investment disputes is to remove them from the jurisdiction of the domestic courts of the host state in order to ensure neutrality and justice. A provision for international arbitration, or for applicability of international law or general principles of law, does not give a private party recourse to international law remedies based on the international law of state responsibility, except through diplomatic protection by the state of nationality.[43]

Finally, the argument that mere characterisation of petroleum contracts as economic development agreements converts them into internationalised contracts so as to provide protection to the private parties under international law, requires careful examination. The resolution of this issue depends upon the normative understanding of whether petroleum contracts can be identified as a form of "economic development agreement," a proposition that purports to afford investors such legal protection as *restitutio in integrum*, under international law. In fact, the value-laden characterisation, long used by commentators and arbitral tribunals, of natural resource agreements as "economic development agreements" is not universally accepted.[44] Thus, mere insertion of a stabilisation clause cannot internationalise the contract to the effect that breach of such stabilised contract amounts to violation of international obligations. The increasing use of economic stabilisation clauses in an effort to avoid uncertainty regarding the consequences of a breach of a traditional freezing clause also negates the thesis of internationalisation of contract.

3. *Payment of Compensation*

Because a stabilisation clause cannot prevent a state from exercising its inalienable right to legislate for an overriding public purpose, there is strong support for the argument that

[41] El-Kosheri & Riad, *supra* note 14, at 267.

[42] *See* Georges R. Delaume, *State Contracts and Transnational Arbitration*, 75 AM. J. INT'L L. 784, 796 (1981).

[43] Schachter, *supra* note 10, at 307–8.

[44] For instance, natural resource development agreements are sometimes referred to as "economic development agreements" by some authors and arbitral awards as, according to them, these agreements confer economic development on the host state. *See, e.g.*, Lord McNair, *The General Principles of Law Recognised by Civilised Nations*, 33 BRIT. Y.B. INT'L L. 1–4 (1957); James N. Hyde, *Economic Development Agreement*, RECUEIL DES COURS 282–83 (1962–I); Curtis, *supra* note 16, at 316; *Texaco* 17 I.L.M. 1–37 (1978). However, in view of the historical context of inequitable contractual arrangements in the past and both the state party's and company's economic interest involved in such contracts, some commentators describe them as state contracts, which is more value neutral. According to one commentator, "the growing practice of localising state contracts, together with substantial support for the doctrine of permanent sovereignty over natural resources, combined with the numerous arbitral awards rejecting the notion of long term development agreements as an internationalised form of state contract would seem to leave little scope for recognition of the concept of EDAs." Stephen I. Pogany, *Economic Development Agreements*, 7 ICSID REV. 1, 20 (No. 2, 1992). *See also* ESA PAASIVIRTA, PARTICIPATION OF STATES IN INTERNATIONAL CONTRACTS 104 (1990).

the main legal consequence of a breach of a stabilisation clause is an obligation to pay compensation. This proposition is equally applicable whether the contract is concluded with the state authority or a state enterprise. The *Aminoil* tribunal acknowledged this, stating that "these provisions are far from having lost all their value and efficacy on that account since, by impliedly requiring that nationalisation shall not have any confiscatory character, they reinforce the necessity for a proper indemnification as a condition of it."[45] There is consensus among authors that the relevance of a stabilisation clause is not that it will be specifically enforced, but rather that it ensures that damages — and in some cases, a higher amount of compensation — will be awarded.[46] However, it is difficult to determine such "higher amount of compensation," as contractual and arbitral practice do not provide any guidance. Some writers hold that specific performance or *restitutio in integrum* are a proper remedy for breach of a contract containing a stabilisation clause.[47] According to other commentators, the proper remedy for breach of a stabilisation clause is compensation for actual loss suffered, as well as lost profits or prospective gains (*lucrum cessans*).[48] But the determination of lost profit poses many practical difficulties.

Arbitral practice suggests that there is uncertainty in this. In the *Texaco* arbitration, the arbitrator ordered *restitutio in integrum*, citing the stabilisation clause as one of the factors justifying such compensation. In *Liamco v. Libya*,[49] however, the presence of a stabilisation clause was one of the factors leading to an award of "equitable compensation" by the tribunal. In *Aminoil*, although the tribunal rejected both the investor's claim for *restitutio in integrum*, and the host government's proposed net book value method, it acknowledged that the aim of the foreign investor must be to obtain a "reasonable rate of return" taking into consideration the legitimate expectation of the parties.[50] In this regard, the tribunal considered that the stabilisation clause was one of the factors that created for *Aminoil* "a legitimate expectation that must be taken into account."[51] The legal effect of a stabilisation clause insofar as compensation is concerned should depend on the legality of the measures taken by a state. In this regard, a distinction must be made between legal and illegal measures. If the legislative or regulatory measures taken by the state are non-discriminatory and for the public interest, but the stabilised contract is thereby breached, the compensation that becomes due is calculated on the basis of fair market value — a standard also accepted by arbitral case law. Moreover, fair market value automatically includes some discounted value for future earnings. If, however, the action taken by the state is illicit (e.g., not for a public purpose or discriminatory), the compensation

[45] *AMINOIL*, 21 I.L.M. 1023 (1982).

[46] *See* Eduardo Jimenez De Arechaga, *International Law in the Past Third of a Century*, RECUEIL DES COURS 307 (1979); Paul E. Comeaux & N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilisation Clauses and MIGA & OPIC Investment Insurance*, 15 N.Y.L. SCH. J. INT'L & COMP. L. 30–31 (1994). *See also* PAASIVIRTA, *supra* note 44, at 171; Garcia-Amador, *supra* note 15, at 49–50, Schachter, *supra* note 10, at 314–15.

[47] *See* Curtis, *supra* note 16, at 365; Jaenicke, *supra* note 34.

[48] Jimenez de Arechaga, *supra* note 46, at 307; Hansen, *supra* note 23, at 1040.

[49] *LIAMCO*, 62 I.L.R. 217–18 (1981).

[50] *Id*.

[51] *AMINOIL*, 21 I.L.M. 1037 (1982), para. 159.

due for breach of a stabilised contract should include both actual loss and future profits, as punitive measures.[52]

Many petroleum contracts which contain stabilisation clauses provide expressly for the provision of fair and equitable compensation in the event of nationalisation or expropriation. For example, article 43.2 of the Model PSC of Gabon of April 17, 1991 states: "Any nationalisation or total or partial expropriation of the contractor's right shall entail fair and equitable compensation in accordance with the internationally known standards and principles."[53]

B. Legal effect of intangible clause

The intangible clause restricts the administrative capacity of the host state to change the terms and conditions of a petroleum contract, but implicitly allows accommodation of changes of contract terms by mutual consent for the greater interest of the parties. Breach of an intangible clause will be treated as a breach of contract and, accordingly, compensation must be paid by the defaulting party to the affected one. However, the scope of rights and obligations, including the amount of compensation resulting from such a breach of contract, is generally to be determined by the arbitral tribunal, taking into consideration the intent of the parties, the terms and conditions of the contract which changed unilaterally, and the circumstances compelling the party to make such a change.

C. Legal effect of economic stabilisation clause

The economic stabilisation clause is remedial in nature, since it focuses on indemnification of the economic consequences of legislation, rather than preventing its enactment. This type of economic stabilisation clause seeks readjustment of the contractual relationship through indemnification of loss to the affected private party through payment of appropriate compensation. Economic stabilisation clauses are gaining popularity, because of their restrictive approach, and because they attempt to provide a compromise between the conflicting rights of the state's legislative freedom on the one hand, and the legitimate expectations of private investors on the other. Such stabilisation clauses do not necessarily exclude the possibility of new regulations that change the law applicable to the contract, but intend to remedy the negative impact of such regulation.

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[52] *See also* El Chiati, *supra* note 5, at 165.

[53] Model Production Sharing Contract of Gabon between the Republic of Gabon and International Companies, March 17, 1991, Basic Oil Laws and Concession Contracts, Barrows Supplement (South and Central Africa), Supp. No. 118, at 57. *See also* art. 8 of a petroleum contract of Niger which provides: "The State assures the company and its shareholders that it does not intend to nationalise the Company nor to dispossess it of any of its present or future property or profits. If through exceptional circumstances or a crisis situation, nationalisation measures become mandatory, the State agrees, in compliance with international law, to compensate any nationalisation measures by paying a fair and equitable indemnity without reflection of any reduction due to prior public notice or announcement, in freely convertible currency, within a reasonable period of time." Establishment Agreement between the Republic of Niger and Niger Hunt Oil Company, October 14, 1992, Basic Oil Laws and Concession Contracts, Barrows Supplement (South and Central Africa), Supp. No. 131, at 13.

The main objective of an economic stabilisation clause is to ensure the financial equilibrium of the contract as conceived at the time it was made. This "equilibrium" is based on various factors, including the definition of the term itself in the contract, the surrounding circumstances, and any adjustment made by the parties voluntarily in the course of the contractual relationship. The consequences for subsequent legislation affecting the economic equilibrium of the contract can be mitigated either by way of payment of compensation to the party or other equitable solution, including modification of the contract terms as may be agreed by the parties.

The traditional stabilisation clause, with its effect of freezing the applicable law, does not always safeguard the interests of the foreign investor, particularly when the host country adopts legislation favourable to foreign investors. In such circumstances, a stabilisation clause in the strict sense may work to the detriment of the foreign investor and tend to protect the interests of the host country.

Furthermore, the economic stabilisation clause is a more flexible device, representing a compromise between the state's exercise of legislative and regulatory power, and the viability and continuation through adjustment of the contractual relationship and by way of provision of compensation. This flexible approach also explains its increasing popularity among many developing countries and economies in transition. Moreover, the scope of an economic stabilisation clause is usually narrow, in the sense that it seeks to prevent the enactment of legislation that may have an adverse economic impact upon the contract equilibrium. This legal specificity of economic stabilisation limits the scope of the legal effect of such clauses to the obligation to pay compensation to the foreign investor in the event of its breach. The increasing acceptance of economic stabilisation clauses reflects the uncertainty associated with the amount of compensation payable in the event of a breach of a stabilisation clause *stricto sensu*. However, a delicate question arises as to how to assess the economic impact of new regulation. In this regard, it can be suggested that the criteria of economic equilibrium of contract can be used in assessing the negative impact of a new regulation, thereby avoiding the complicated process of determining compensation under international law, and helping parties avoid recourse to costly arbitration.

VIII. Relationship between Stabilisation Clause and Applicable Law Clause

A stabilisation clause cannot act in isolation; rather, it interacts closely with other contractual provisions, especially the applicable law clause. Indeed, a close connection exists between the stabilisation clause and the applicable law clause, because both deal with the law governing the contract, albeit in different ways. The legal effect of stabilisation clauses is shaped by the formulation of the applicable law. The applicable law can also have a great bearing upon the interpretation of a stabilisation clause by the international tribunal or municipal courts.

Much of the controversy about the legal effect and validity of stabilisation clauses relates to their relationship to the applicable law of the contract. The legal effect of a stabilisation clause will depend in large part on whether the law applicable to the contract is the domestic law of the state party. Indeed, three situations may arise in this regard: first, the contract may be governed by the national law of the host state, which is the general trend and generally preferred by host states. Second, the contract may be exclusively governed by international law, general principles of law, principles and practice of the petroleum industry, or principles of law common to more than one country. This practice has become rather rare. Third, a contract may be governed by domestic law, with recourse where necessary to international law, or by both municipal law and international law, decisions of international tribunals, or principles of petroleum industry practice.[54]

As a consequence of the application of the municipal law of the host state, any change of the applicable law by the host state could affect the contract by modifying contractual obligations. Thus, if the applicable law is that of the state party to the contract, the intended legal effect of stabilisation clauses *stricto sensu* would be negated if it were capable of being amended by the state in exercise of its sovereignty. In fact, the applicable law may be changed by the host state for various reasons, including constitutional challenge, inconsistency with peremptory norms of international law, or public policy concerns. If the contract is governed exclusively by the law of the host state, constitutional and legal constraints on the contractual capacity of that state may have significant legal implications for the validity and enforcement of the stabilisation clause. In addition, post-contract public policy considerations may lead the host state to amend the applicable law, which could significantly affect the efficacy of a stabilisation clause *stricto sensu*.

If the applicable law is non-municipal, such as international law, general principles of law, or principles and practice of the petroleum industry, the stability of the contract would appear to be enhanced, since the state cannot amend these laws or principles (which also tend to evolve more slowly than municipal law). This may explain the preference among international oil companies for this type of applicable law clause.

It should, however, be borne in mind that subjecting a state contract to non-municipal law is not by itself a complete guarantee of contractual stability, because international law recognises the host state's legislative and regulatory competence and its right to nationalise,

[54] *See, e.g.*, Model Production Sharing Contract of Turkmenistan, 1997, art. 29(1), which reads: "This Agreement shall be governed by, interpreted and construed in accordance with the law of Turkmenistan and as applicable, the principles of international law and the decisions of international tribunals and international treaties to which Turkmenistan is a party." *See also* Model Production Sharing Agreement of Ghana, 1995, art. 26.1, which reads "This Agreement and the relationship between the State and GNPC on the one hand and Contractor on the other shall be governed by and construed in accordance with the laws of the Republic of Ghana consistent with such rules of international law as may be applicable, including rules and principles as have been applied by international tribunals." Model Production Sharing Agreement of Ghana, 1995, between the Government, the Ghana National Petroleum Corp. and Contractor, BASIC OIL LAWS AND CONCESSION CONTRACTS, Barrows Supplement (South and Central Africa), Supp. No. 122, at 74. *See also* art. 28.1 of Shell-China Petroleum Contract which states: "For the purpose only of this Contract its validity, interpretation and implementation shall be governed by the laws of the People's Republic of China and such laws shall be publicly available. Failing such laws of the People's Republic of China, general international practice and principles shall be applicable." China-Shell Petroleum Contract, between China National Petroleum Corp. and Shell Exploration (China) Ltd. (Deep Horizon Qingshui Block, Liaohe, Bohai Bay Basin), August 9, 1996, BASIC OIL LAWS AND CONCESSION CONTRACTS, Barrows Supplement (Asia and Australasia), Supp. No. 142, at 64. Art. 34 of Mozambique Model Production Sharing Contract, 2000 (Bid Round), states that "this agreement shall be governed by and construed in accordance with the law of the Republic of Mozambique and such rules of International Law as may be applicable." BASIC OIL LAWS AND CONCESSION CONTRACTS, Barrows Supplement (Central and South Africa), Supp. No. 146.

notwithstanding any guarantees contained in the contract.[55] Moreover, even if the contract is governed by international law or general principles of law, it is always subject to overriding mandatory public law rules by virtue of which the state may interfere with the course of the contract when its vital interests are at stake.[56] Mandatory rules generally can cover wide-ranging issues involving protection of the public interest, such as conservation, pollution, import-export, foreign exchange, competition, taxation, embargo, blockade or boycott, expropriation, nationalisation and confiscation.[57] Conversely, the total exclusion of international law or general principles is neither possible nor desirable. Even in the absence of an express choice of non-municipal law, an international tribunal may take into consideration certain mandatory rules of public international law, such as the international minimum standard for the protection of foreign investors, or such general principles as the obligation to act in good faith or avoid a denial of justice.[58] When supranational law applies to supplement domestic law, it is assumed that the intent is to fill lacunae in the latter.

IX. Value of Stabilisation Clauses

While it is possible to conclude that stabilisation clauses *stricto sensu* are legally valid contractual undertakings, in practice, their efficacy can be severely eroded, since the state may exercise its inalienable sovereign power to enact such legislation as it deems appropriate in the public interest. This diminishes significantly the protection value of the stabilisation clause. But a clause that derives its legal validity from mutual consent must have some value. As already observed, the protective value of a stabilisation clause lies not in barring the state from exercising legislative power for immanent public interest, but in the fact that the presence of stabilisation clause may ensure compensation for any breach, and may result in a higher amount of compensation if the action of the state in question is not founded on good faith or is discriminatory. In this sense, the stabilisation clause has a deterrent effect. Furthermore, it should be conceded that in reality, only a few countries assert their unfettered right to exercise legislative competence to amend or abrogate stabilised contracts. There are very few contemporary instances of breach of a stabilised contractual relationship. Indeed, a stabilisation clause as a legal protection

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55 Greenwood, *supra* note 23, at 53.

56 Giuditta Cordero Moss, *Lectures on International Commercial Law*, 14 CEPMLP Internet J. 92 (2003), <http://www.cepmlp.org/journal>. On mandatory rules, Mayer states: "A mandatory rule is an imperative provision of law which must be applied to an international relationship irrespective of the law that governs the relationship. To put it another way: mandatory rules of law are a matter of public policy (*ordre public*) and moreover reflect a public policy so commanding that they must be applied even if the general body of law to which they belong is not competent by application of the relevant rule of conflict of laws … In matters of contract, the effect of a mandatory rule of the law of a given country is to create an obligation to apply such a rule, or indeed simply a possibility of so doing, despite the fact that the parties have expressly or impliedly subjected their contract to the law of another country." P. Mayer, *Mandatory Rules of Law in International Arbitration*, 2 Arb. Int'l 274–75 (1986).

57 *See* A.F.M. Maniruzzaman, *International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview*, 7 J. Int'l Arb. 53–64 (1990).

58 *See* Rosalyn Higgins, *The International Law Perspective*, *in* The Legal Character of Petroleum Licenses: A Comparative Study 35 (Terence Daintith ed., 1981).

mechanism seeks to give to the agreement more binding force, and adds emphasis, intensity, and strength to the petroleum contract.[59]

The stabilisation clause can also be used as an interpretative tool by both domestic courts and international tribunals in giving meaning to the contract, by defining the substantive rights and obligations of the parties. In fact, arbitral tribunals may interpret the legal implications of other contractual clauses in the light of the formulation of the stabilisation clause. Although the arbitral jurisprudence on stabilisation clauses is inconsistent and fraught with ideological conflicts, nevertheless, the interpretation of stabilisation clauses has helped to clarify other legal concepts associated with long-term state contracts.

Thus, denying any legal significance to the stabilisation clause would undermine the host government's credibility to undertake contractual commitments, which would, in turn, reduce the scope for long-term investment. Crediting the stabilisation commitment with some legal value would make the contractual relationship more efficient, since it would give the government a tool to enhance its credibility and reputation as a reliable contract partner.[60] Although a stabilisation clause cannot internationalise the contract, failure to respect it may amount to a breach of contract, which can lead the parties to dispute settlement. Recourse to arbitration before an international tribunal obviously has a negative impact on the host state's reputation, and may entail huge costs.

X. Political Economy of Stabilisation Clauses

Too much emphasis on the legal aspect of stabilisation clauses tends to ignore the underlying economic rationale behind the acceptance of stabilisation clauses by developing countries. This explains why so many developing countries accept stabilisation clauses despite their formal assertion that such clauses go against their sovereign legislative power and permanent sovereignty over natural resources. This seemingly paradoxical behaviour by many developing states may be explained in terms of their weak bargaining position at the initial phase of natural resources development, which compels them to accept such protective undertakings in order to develop scarce resources and accelerate economic development and public welfare. Adoption of stabilisation clauses can make a country with petroleum resources a much more attractive venue for investment in the petroleum sector. Indeed, many petroleum producing developing countries have adopted the stability requirement of an investment agreement as a part of their overall investment policy. Since the 1980s, many developing countries have adopted a liberal investment regime, which insists on the rule of law and the stability of the legal regime, based on a pre-existing set of rules. A liberal investment regime generally ensures the proper functioning of the market and provides adequate legal protection to foreign investments against political and regulatory risk. One of the yardsticks of effectiveness of a liberal investment regime is its emphasis on longevity of investment agreements in order to yield the expected benefits.

[59] Waelde & Ndi, *supra* note 1, at 236–37.
[60] *Id.* at 259–60.

Thus, much of the significance of stabilisation clauses lies in their instrumental value, as a means of encouraging foreign investment. In this sense, they have an important "market function" in developing countries.[61] Thus, developing countries accept stabilisation clauses in order to gain an economic advantage in attracting foreign investment in the petroleum sector by making their investment climate more competitive and favourable to the foreign investor.

XI. Conclusion

The contractual mechanism of the stabilisation clause remains one of the most significant legal guarantees of stability of contract and is preferred by foreign investors over legislative mechanisms. The long-term survival of a contractual relationship between host state and investor through a stabilisation clause always requires reconciliation of the tension between the legislative freedom and public interest of the state party. While the legal validity of a stabilisation clause must be acknowledged, its legal effect can be diminished by considerations of public interest.

The stabilising function of a stabilisation clause remains uncertain and questionable, because its legal validity is subject to states' constitutional limitations upon legislation and considerations of overriding public policy. Although the protective value of stabilisation as a means of investment security is disputed, its promotional role to attract foreign investment and its functional role of enhancing a legal culture of respect for property and contractual commitment has rightly been emphasised. As a means of promotion, the stabilisation clause is seen as an essential incentive to foreign investment. This has been manifested through the widespread use of stabilisation clauses, which indicates that the developing states are competing for petroleum investments. From a historical perspective, stabilisation clauses have undergone substantial transformation in their form and content, dictated not only by the changing expectations of the parties, but also by changes in the investment climate. One of the important aspects of this transformation is treatment of the stabilisation clause as an economic instrument for the preservation of equilibrium of contract, rather than a pure legal mechanism to prevent the host state's exercise of legislative power. The new generation of stabilisation clauses — also called economic stabilisation clauses — make the contractual framework flexible and dynamic throughout the duration of the contract. As the host country changes its laws and regulations, contractual equilibrium can be restored through renegotiation. The decline in the use of traditional freezing clauses demonstrates that they have lost much of their utility as an investment protection device but remain a promotional device. The intangible clause and the economic stabilisation clause are gaining ground both as protective and promotional mechanisms, and devices for mutability of contract. Thus, it can be argued that the economic stabilisation clause in conjunction with the intangible clause can better serve the purpose of stability.

[61] Paasivirta, *supra* note 44, at 171.