STABILISATION CLAUSES AND SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES

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Thesis submitted to the University of Nottingham

for the degree of Doctor of Philosophy

JULY 2014

ABSTRACT

This thesis examines the rationale and on-going purpose of stabilisation clauses and the ways in which the clauses undermine the pursuit of sustainable development in developing countries.

Two presumptions prevail in the literature on stabilisation clauses. The first is that developing countries compete for foreign investment on the basis of political risks. The second is that there are higher levels of political risks in developing countries. This thesis argues that neither presumption is true as such. The available evidence points to a more intense competition among foreign investors backed by their home governments for access to the extractive resources in developing countries. The political risks that stabilisation clauses are aimed at also exist, at least in equal measure, in developed countries. Nevertheless, stabilisation clauses are routinely recommended to developing countries as an 'essential' feature of an attractive investment climate. This recommendation is, however, not supported by any reliable evidence pointing to a link between stabilisation clauses and foreign investment inflow.

The literature on the potential adverse impacts of stabilisation clauses has evolved in a compartmentalised way, focusing on their impact on the ability of host governments to enact environmental and/or human rights laws. This approach and focus are misplaced because in practice, stabilisation clauses rarely limit the ability of host governments to enact human rights and environmental laws. Rather, they limit their ability to alter their fiscal and economic laws and policies in other to integrate such laws and policies with their social and environmental objectives. The main implication of this limitation is that such governments are unable to mobilise the maximum of available funds to finance their sustainable development measures including those specifically directed at eradicating poverty, improving the realisation of human rights and protecting the environment.

DEDICATION

This thesis is dedicated to my mother,

MRS FLORENCE FRANK NONJU
(1954 – 2013)

For the myriad of ways in which she inspired, encouraged, advised and sacrificially supported me in my determination to realise my potential.

Thanks mummy!

ACKNOWLEDGEMENTS

But the Comforter, *which is* the Holy Spirit, whom the Father will send in my name, he shall teach you all things, and bring all things to your remembrance, whatsoever I have said unto you. (John 14:26)

I must first acknowledge the Holy Spirit who teaches me all things and without whom I can do nothing. Thanks for all the brainwaves during the course of this Ph.D.

I remain grateful to my supervisors, Professor Mary Footer and Dr. Ed Goodwin, for the deft ways in which they supported and challenged me throughout the process. Their invaluable advice, support and guidance ensured that I finished well and quickly.

I gratefully acknowledge the financial support of the School of Law, the University of Nottingham. This Ph.D. was largely funded by the Postgraduate Research Studentship that they awarded me, without which I could not have completed this thesis.

I am grateful to 'my boss', Mr. Iniruo Wills, for his support and encouragement and for unwittingly sending me on this journey when, in 2006, he introduced me into the world of stabilisation clauses. I must also thank Dr. Youpele Banigo for inviting me to his doctoral graduation ceremony many years ago - an event that inspired me greatly.

I appreciate the efforts of my fellow postgraduate research students in the School of Law in promoting a stimulating and welcoming academic and social environment. Special mention must be made of Kubi Udofia, for his encouragement and active support at those times when it seemed difficult to continue.

This achievement would not have been possible without the full support of my family and my in-laws. Special thanks to my sisters, Caroline, Racheal and Franca, and their spouses, and to my cousin Eno. I also appreciate my father-in-law, Chief Moses Ofori, especially for his support and encouragement during those days when I found it difficult to continue following the death of my mum.

Finally, my special thanks must go to my wife, Gift, for her constant encouragement, support and quiet patience throughout the process and for subjecting me to a mock viva, and to my children, Itekena, Belema and Telema, for putting up with the discomforts and disruptions.

To God be all the glory.

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ABBREVIATIONS

AFDB	Africa Development Bank
AI	Amnesty International
AIPN	Association of International Petroleum Negotiators
BIT	Bilateral Investment Treaty
BTC	Baku-Tbilisi-Ceyhan
CEPMLP	Centre for Energy, Petroleum and Mineral Law and Policy
COTCO	Cameroon Oil Transportation Company
CPI	Corruption Perception Index
CRS	Congressional Research Service
DFID	Department for International Development
ECOWAS	Economic Community of West African States
EITI	Extractive Industry Transparency Initiative
EIU	Economic Intelligence Unit
ESMAP	Energy Sector Management Assistance Programme
EU	European Union
FDI	Foreign Direct Investment
GNI	Gross National Income
GDP	Gross Domestic Product
HGA	Host Government Agreement
IBLJ	International Business Law Journal
IBRD	International Bank for Reconstruction and Development
ICJ	International Court of Justice
ICSID	International Convention for the Settlement of Investment Disputes
IDA	International Development Association
IEA	International Energy Agency
IFC	International Finance Corporation
ILA	International Law Association
ILM	International Law Materials
ILR	International Law Review
IPA	International Project Agreement
ITN	Investment Treaty News
JENRL	Journal of Energy and Natural Resources Law
JWELB	Journal of World Energy Law and Business
LSA	Legal Stability Agreement
LCIA	London Court of International Arbitration
MDA	Mineral Development Agreement
MIGA	Multilateral Investment Guarantee Agency
NACE	National Advocacy Coalition on Extractives
NAFTA	North American Free Trade Agreement
NDDC	Niger Delta Development Commission
NGO	Non-Governmental Organisation
NLNG	Nigeria Liquefied Natural Gas

NNPC	Nigerian National Petroleum Company
OBT	Obsolescing Bargaining Theory
ODA	Overseas Development Assistance
OECD	Organisation for Economic Co-operation and Development
OGEL	Oil Gas and Energy Law
OHCHR	Office of the High Commissioner of Human Rights
OSISA	Open Society Institute of Southern Africa
PSA	Production Sharing Agreement
PSC	Production Sharing Contract
PSNR	Permanent Sovereignty over Natural resources
SCIA	Stabilisation Clauses Impact Assessment
TI	Transparency International
TOTCO	Tchad Oil Transportation Company
UK	United Kingdom
UKTI	United Kingdom Trade and Investment
UN	United Nations
UNCED	United Nations Conference on Environment and Development
UNCHE	UN Conference on the Human Environment
UNCITRAL	United Nations Commission on International Trade Law
UNCSD	United Nations Commission on Sustainable Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNECLAC	United Nations Economic Commission for Latin America and the Caribbean
UNEP	United Nations Environmental Programme
UNESCAP	United Nations Economic Commission for Asia and the Pacific
UNGA	United Nations General Assembly
US	United States
WAGP	West Africa Gas Gathering Project
WCED	World Commission on Environment and Development
WSSD	World Summit on Sustainable Development
WTO	World Trade Organisation
YBIEL	Year Book of International Environmental Law

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Aguaytía Energy, LLC v Peru, ICSID Case No ARB/06/13, Award of 11 December 2008)

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CHAPTER 1 - INTRODUCTION

1.1 BACKGROUND

Stabilisation clauses are provisions that protect foreign investors from the adverse effect of changes in the laws of host states. They may be found in investment contracts, national laws or in 'stability agreements' between host states and investors. Whichever technique a host state chooses, they achieve exactly the same objective, namely, to insulate the investor from the adverse effect of changes in the laws of the host state. This is achieved either by exempting the investor from the applicability of the changes or by stipulating that the investor will be compensated by the host state for any additional financial burden imposed by the changes in the law.

Concerns over stabilisation clauses began in earnest in 2003 following the publication of the legal documents governing the Baku-Tbilisi-Ceyhan (hereafter 'BTC') pipeline project, a cross-border project crossing Azerbaijan, Georgia, and Turkey.[1] Amnesty international then published a report claiming that the stabilisation clauses in the documents had the potential to limit the host states' ability to implement their human rights obligations under international law.[2] The report generated substantial interest and resulted in several academic articles on the potential impacts of stabilisation clauses on host states' regulatory ability. However, these studies have evolved in a compartmentalised way, focusing on the impact of the clause on environmental and/or social laws.

'Sustainable development' emerged as a result of the rejection of the 'unsustainable' approach whereby environmental protection, social development and economic growth are compartmentalised and treated as separate and distinct goals. It is based on the realisation that these goals are inseparable in terms of their causes and their resolution. The basic

[1] The documents were published on the website of BP- a key member of the consortium of the investors undertaking the project. BP Caspian, 'Legal Agreements' <http://www.bp.com/sectiongenericarticle.do?categoryId=9029334&contentId=7053632> accessed 16 April 2012.

[2] 'Human rights' is used as a surrogate for social and environmental laws in the report. Amnesty International, *Human Rights on the Line: The Baku-Tbilisi-Ceyhan Pipeline Project* (AI 2003).

premise of sustainable development, therefore, is that environmental protection, social development and economic growth are interdependent and mutually reinforcing. They must, therefore, be integrated in developmental decision-making to ensure a better quality of life for both the present and future generations.

Despite the foregoing, the literature on the impact of stabilisation clauses remains compartmentalised and largely silent on the economic pillar. Little effort is made to analyse the impact of the clause in an integrated way that includes an examination of its impact on host states' ability to enact and implement fiscal and economic laws and policies and how this might affect sustainable development.

One reason the impact of stabilisation clauses on the enactment of economic and fiscal policies is under-studied or considered low priority is because stabilisation clauses are widely portrayed as an essential tool that developing countries offer to attract foreign direct investment (hereafter 'FDI') to facilitate their sustainable development. However, this view is based on two presumptions. First, that developing countries compete to attract FDI into their extractive industries. Second, that there are higher political risks in developing countries. Stabilisation clauses are, therefore, presented in the literature as an 'essential' cure for these presumptions. Little effort is made to examine whether these presumptions are true. Similarly, little or no effort is made to consider the impact of the clause using a holistic approach in line with the concept of sustainable development. This is what this thesis seeks to do.

Although references may be made to stabilisation clauses granted in other sectors, especially in the discussion of the legal effect and validity of the clause, the focus of this thesis is on stabilisation clauses granted in the extractive sector. Specifically, it deals with stabilisation clauses granted in the oil, gas and mining sectors of developing countries. The focus on these sectors is reflective of their importance to many developing countries both in

terms of their size as a share of FDI and their huge economic, social, environmental, and political impacts. This is in addition to the fact that stabilisation clauses are mainly used in this sector, and proponents of the clauses usually focus on this sector.[3]

1.2 AIMS AND OBJECTIVES

This thesis examines stabilisation clauses and the way in which they undermine efforts by governments of developing countries to promote sustainable development. It, therefore, has two main aims or research questions. The first is to examine the rationale and on-going purpose of stabilisation clauses. The second is to examine the impact of the clauses on sustainable development in developing countries.

As indicated earlier, a supposed answer to the rationale and purpose of stabilisation clauses already exists in the legal literature. Proponents claim that stabilisation clauses are essential to attract FDI into developing countries especially in the extractive industries where investments are long term and capital intensive. However, as highlighted above, this view has hardly been supported by evidence. Rather, it is based on presumptions that have not had their veracity examined.

It is now over two decades since stabilisation clauses were re-introduced in several developing countries. It therefore makes little sense to still rely on presumptions, rather than evidence from the real world, to justify their claimed essentiality. It is for this reason that this thesis will rethink the rationale and on-going purpose of stabilisation clauses. This will be done in the light of the available evidence on current trends and future projections in the extractive industry, combined with an examination of whether a link indeed exists between stabilisation clauses and the inflow of FDI.

The second aim of this thesis is to examine the way in which stabilisation clauses affect sustainable development in developing countries. The vast literature on the impact of

[3] See, for example, UNCTAD, *Best Practices in Investment for Development Case Studies in FDI: How to attract and Benefit from FDI in Mining - Lessons from Canada and Chile* (UNCTAD 2011) 1.

the clause is compartmentalised and has focused on their impact on environmental and/or social laws. There is little or no published work that looks at the impact of stabilisation clauses in an integrated way in line with the concept of sustainable development. In particular, there is little or no published work that examines the impact of the clause on the ability of host governments to alter their fiscal and economic policies and how this affects their ability to eradicate poverty and improve human rights and environmental standards. This thesis seeks to fill this gap.

Analysing the impact of stabilisation clauses through this integrated approach is crucial, because in the real world, economic growth, environmental protection and social development are interdependent and mutually reinforcing. As a result, for an analysis of the impact of stabilisation clauses to have any semblance to reality, it must adopt the integrated approach promoted by the principle of sustainable development.

This thesis thus contributes to the on-going debate on what impact, if any, stabilisation clauses have on sustainable development, including on human rights and the environment. However, it does so from a different angle by first rethinking the rationale and purpose of stabilisation clauses rather than relying on presumptions. It also differs by rejecting the compartmentalised approach in favour of the integrated approach encapsulated in the concept of sustainable development. Finally, it does so with an explicit focus on developing countries where these clauses are used.

Such an approach helps to put stabilisation clauses in their proper context and deals holistically with the issues concerning the clauses thereby enhancing the understanding of their practical, rather than their potential, impact. In addition, it ensures that the recommendations that arise from the analysis are formulated with a solid understanding of the specific and different situation in developing countries. This in turn ensures that such

recommendations are aimed at the real life, rather than theoretical constraints posed by the clause.

1.3 OVERVIEW OF METHODOLOGY

This thesis is partly interdisciplinary but primarily doctrinal. Interdisciplinary research may be defined as research that combines research, concepts and theories from two or more disciplines to advance fundamental understanding or to solve problems whose solutions are beyond the scope of a single discipline.[4] The interdisciplinary research in this thesis draws mainly from research, concepts and theories from the social sciences. The interdisciplinary analysis is particularly beneficial to this thesis as the legal literature lacks some key information needed to properly answer the core research questions. For example, to properly examine the rationale and purpose of stabilisation clauses requires an understanding of the determinants of FDI and an application of the economic principle of demand and supply.

The doctrinal analysis in this thesis comprises of the use of interpretative methods mainly to discover and construct the legal protection offered by stabilisation clauses. The analysis identifies relevant legal provisions on stabilisation clauses, explains their current interpretation, and explores their potential interpretation. It is also used to clarify the legal status of the principle of sustainable development as there had been some debate about whether or not the principle has attained the status of a binding norm of customary international law. The doctrinal analysis in this regard relies particularly on primary international law sources and the academic literature to trace the evolution and legal status of the principle of sustainable development in international law.

[4] Committee on Facilitating Interdisciplinary Research and ors, *Facilitating Interdisciplinary Research* (NAP 2005) 188.

A purely doctrinal method, however, tends to separate law from society and as a result may ignore the reality of the law.[5] Accordingly, applying a purely doctrinal method to this research will reduce the scope for a contextual analysis of the rationale and purpose of stabilisation clauses and their impact on sustainable development in developing countries. Consequently, the doctrinal analysis is complemented by a socio-legal approach.

In broad terms, the socio-legal approach refers to the study of law in context i.e. how the law works in the real world.[6] The socio-legal approach in this thesis means that the analysis in the thesis is undertaken through the lens of the peculiar sustainable development challenges in developing countries.[7] In doing so, significant reliance is placed on documents that help put the analysis in context including, local press statements, local media reports, reports by local NGOs and civil societies, parliamentary hearings, political party manifestoes and national policy documents.

The socio-legal approach also includes the deliberate use of a significant number of real life examples in addition to two more detailed case studies showing how stabilisation clauses constrain sustainable development in Tanzania and Nigeria. While the two case studies may be not enough to establish the reliability and generality of the findings, it is possible for statistical inferences to be derived from their variables especially because they are supported by several other examples throughout the thesis. It is, therefore, a useful way to supplement the doctrinal analysis.

The choice of the selected case studies is motivated by several considerations. The stabilisation clauses are still in effect and the constraints that they impose still on-going. At the same time, enough time has passed since they were granted.[8] These, therefore, provide an

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[5] Maria Fox and Christine Bell, *Learning Legal Skills* (Blackstone 1999) 21

[6] Sally Wheeler and Phil Thomas, 'Socio-Legal Studies' in David Hayton (ed) *Law's Future(s)* (Hart 2002) 271; Reza Banakar and Max Travers, 'Law, Sociology and Method' in Reza Banakar and Max Travers (eds), *Theory and Method in Socio-Legal Research* (Hart 2005) xii.

[7] On the importance of context in legal research, see, Phillip C Kissam, 'The Evaluation of Legal Scholarship' (1988) 63 *Washington Law Review* 221, 225.

[8] The clauses were granted in the 1990s.

opportunity to re-assess the rationale that led to their introduction in the first place and relate them to their on-going purpose and the on-going constraints that they impose. Furthermore, the laws and relevant documents are either publicly available or easily obtainable. Finally, the laws and measures that the stabilisation clauses constrain highlight the relationship between economic growth, social development and environmental protection and how a constraint imposed by stabilisation clauses on one affects the others.

This thesis does not attempt to conduct a comprehensive comparative study, at least in the traditional sense, of stabilisation practices in developing countries. However, much of the analysis is not possible without an element of comparison. For example, it reviews stabilisation practices in several developing countries to search for commonalities and differences in order to properly examine the rationale and purpose of stabilisation clauses. Furthermore, in order to develop alternative approaches to maintaining regulatory stability without undermining host governments' sustainable development goals, the experiences of some developing countries are used as a reference point where relevant, as they may provide useful lessons for other countries. This inevitably assumes a certain degree of 'transferability' which is a key assumption of comparative law.

Finally, it must be emphasised that this thesis was not designed to review in detail the stabilisation practices of all developing countries. Such a study would have been impractical given the limited time and budget available to undertake a Ph.D. Furthermore, both the contractual processes and eventual contract terms in many developing countries continue to be shrouded in secrecy. This is in addition to the fact that not all investor-state contract disputes presented to international arbitration are published. This makes it difficult to ascertain whether they involve stabilisation clauses.

Consequently, in addition to a literature review, the examination of stabilisation practices in this thesis is based on the availability or relative ease of access to the contracts,

laws, arbitral awards and other information required to undertake the relevant analysis.[9] For this reason, this thesis makes no attempt to quantify some of the conclusions reached. However, despite these limitations, a significant number of stabilisation clauses have now either been published or leaked. The resultant increase in the availability of information sheds light on stabilisation practices and is useful in putting the doctrinal analysis in context and aid the answering of the core research questions.

1.4 OVERVIEW OF OUTLINE

This thesis is made up of 7 chapters. This chapter 1 provides a background to the research and explains the aims and objectives of the research. It also provides brief overviews of the methodology and structure of the thesis.

Chapter 2 provides an overview of stabilisation clauses. It examines the various techniques used to grant stabilisation clauses and the various types and scope of stabilisation clauses. The chapter concludes with an examination of the legal validity, effect and functional value of stabilisation clauses.

Chapters 3 and 4 rethink the context in which stabilisation clauses are negotiated and granted. Chapter 3 examines the presumptions upon which stabilisation clauses are rationalised in the legal literature. It uses evidence from previous empirical studies, data from other disciplines and an analysis of current stabilisation practices to challenge these presumptions and the view that stabilisation clauses are an essential requirement for developing countries.

Chapter 4 goes further to provide an alternative view of why stabilisation clauses are still popular in several developing countries despite the fact that the justifications for them are based on presumptions that can easily be rebutted by evidence from the real world. The chapter is divided into two sections. The first section examines the role of the World Bank in

[9] A list of these countries is provided in Appendix 3.

the re-introduction of stabilisation clauses into developing countries from the late 1980s. The second section examines the role of corruption and lack of transparency in determining whether a country grants stabilisation clauses, and the scope of the clauses so granted.

Chapters 5 and 6 are focused on the 'second part' of the research question i.e. the impact of stabilisation clauses on sustainable development in developing countries. Chapter 5 examines the concept of sustainable development and the effectiveness or otherwise of compartmentalising the debate on the impact of stabilisation clauses. It traces the evolution of sustainable development in international law and policy and examines its meaning and core elements. The legal relevance and implication of the concept is then examined. Finally, the chapter examines the focus on human rights and/or environmental laws in the literature dealing with the impact of stabilisation clauses and the possible reasons for this compartmentalisation.

Chapter 6 identifies the ways in which stabilisation clauses affect the ability of host states to pursue their legitimate sustainable development objectives. It highlights the *actual*, rather than *potential*, impact of stabilisation clauses on sustainable development in developing countries by identifying the real-life rather than mere theoretical constraints. In addition to relying on several examples where relevant, it will also rely on two more detailed cases studies to highlight the effect of stabilisation clauses on sustainable development.

Chapter 7, which is the concluding chapter, summarises the key findings of this thesis and some of their implications for current policies. After that, the chapter presents the recommendations of the thesis flowing from the findings in the previous chapters.

CHAPTER 2 - STABILISATION CLAUSES

2.1 INTRODUCTION

This chapter provides an overview of stabilisation clauses in order to set the scene for the analysis in subsequent chapters. The origin and evolution of stabilisation clauses will be traced. This is followed by a discussion of what a stabilisation clause is for purposes of this thesis. The various types of stabilisation clauses are then examined. The chapter will conclude with an examination of the legal validity, effect and functional value of stabilisation clauses.

2.2 THE ORIGIN OF STABILISATION CLAUSES

There is considerable agreement amongst commentators that stabilisation clauses can be traced to the period between the first and second world wars.[1] In his Separate Opinion in *Kuwait v Aminoil*, Sir Gerald Fitzmaurice pointed out that, during this period, there were increasing instances where foreign investors with concessionary contracts had their investments taken over by host governments, especially in Latin America.[2] He therefore explained:

> It was specifically in the light of those occurrences that stabilisation clauses began to be introduced into concessionary contracts, particularly by American companies in view of their Latin American experiences, and for the express purpose of ensuring that concessions would run their full term, except where the case was one for which the concession itself gave a right of earlier termination.[3]

[1] See, as examples, *Kuwait v American Independent Oil Company* (*Aminoil*), Ad hoc Arbitration, Award of 24 March 1982 (Separate Opinion by Sir G Fitzmaurice) fn 7 to [25]; Peter D Cameron, 'Stabilisation in investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors' (05 July 2006) 15 <http://lba.legis.state.ak.us/sga/doc_log/2006-07-05_aipn_stabilization-cameron_final.pdf> accessed 01 August 2011.
[2] Ibid.
[3] Ibid.

Stabilisation clauses, however, became popular from the late 1960s following several high profile international arbitrations triggered, in particular, by various acts of nationalisation and expropriation of petroleum industry assets by some oil producing nations who wanted to benefit from the rise in oil prices.[4] Subsequently, interest in the use of stabilisation clauses appeared to diminish substantially, with some commentators attributing this to a shift in attention towards investment treaties.[5] However, the more likely view is that given by other commentators that developing countries were influenced by some UN resolutions and scholarly writings in the 1970s that highlighted a possible conflict between stabilisation clauses and the principle of permanent sovereignty of states over their natural resources (PSNR).[6]

The principle of PSNR is a principle of international law that emerged in the 1950s mainly in response to the perception that during colonial rule, inequitable concessions were imposed on vulnerable host states.[7] Newly independent developing countries thus sought to obtain international recognition of their right to restructure these inequitable concessions and re-establish their sovereignty over their natural resources through nationalisation or similar means.[8] After several attempts to formulate the principle within the context of the UN, a compromise was finally agreed by the UN General Assembly in 1962.[9] The resolution recognised the right of states to 'permanent sovereignty over their natural wealth and

[4] Some of these cases are discussed in section 2.6.1.

[5] See, for example, Lorenzo Cotula, 'Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses' (2008) 1 JWELB 158, 159 – 160.

[6] See, for example, Thomas W Wälde and George Ndi, 'Stabilizing International Investment Commitments: International Law Versus Contract Interpretation' (1966) 31 *Texas Intl LJ* 215, 217 and 261. Note however that the claim of a conflict between stabilisation clauses and PSNR was subsequently overwhelmingly dismissed by several arbitral tribunals. See, for example, *Texaco Overseas Petroleum Company/California Asiatic Oil Company (TOPCO) v Libyan Arab Republic,* Ad hoc Arbitration, Award of 19 January 1977 [73] – [74]

[7] For an overview, see, Kamal Hossain, 'Introduction' in Kamal Hossain and Subrata Roy Chowdhury (eds) *Permanent Sovereignty over Natural Resources in International Law: Principle and Practice* (Francis Pinter 1984).

[8] Ibid.

[9] Permanent Sovereignty over Natural Resources, 14 December 1962, UN Doc A/Res/5217.

resources', which 'must be exercised in the interest of their national development' and well-being of their people.[10]

Having secured international recognition of their sovereign right over their natural resources, developing countries became reluctant to accept stabilisation clauses as that would impose a limitation on the exercise of this right.[11] Furthermore, several developing countries including Saudi Arabia, Nigeria and Indonesia considered it unnecessary to grant stabilisation clauses as they also believed their huge reserves offered sufficient incentives for foreign investors to bear the political risks associated with their investments.[12] In addition, the UN resolution also endorsed the right of states to nationalise and expropriate on grounds of 'public utility, security or the national interest' subject to the payment of 'appropriate compensation.'[13] As stabilisation clauses were originally developed to protect against these acts, the clauses became less relevant.

In the light of the above sentiments, predictions were made that even if stabilisation clauses were to be included in contracts, hosts states would no longer accept them.[14] These predictions were however short-lived. Following the mid-1980s catastrophic fall in mineral prices that significantly reduced the revenue developing countries received from their extractive industries, their governments were encouraged to enact policies to attract FDI as a means of obtaining more revenue.[15] Consequently, stabilisation clauses made an 'unexpected comeback' as they formed part of the new fiscal regime that several developing countries enacted with the support of the World Bank to attract FDI into their extractive industries.[16]

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[10] Ibid [1].
[11] Wälde and Ndi (n 6) 217, 261.
[12] Cameron (n 1) 17
[13] *PSNR* (n 9) para 4.
[14] See, as examples, Thomas Wälde, 'Revision of Transnational Investment Agreements in the Natural Resources Sector: Contractual Flexibility in Natural Resource Development (1978) 10 *Lawyer of the Americas*, 265; Juha Kuusi, *The Host State and the Transnational Corporation: An Analysis of Legal Relationship'* (Saxon 1979) 59 – 60.
[15] For an in-depth analysis of this point, see, Alfred Maizels, *Commodities in Crisis: The Commodity Crisis of the 1980s and the Political Economy of International Commodity Policies* (Clarendon 1992) 5 – 38.
[16] This issue is discussed in greater detail in section 4.2.

However, whilst the original clauses had been developed to guard against acts of nationalisation and expropriation at the time, the re-introduced stabilisation clauses were drafted to protect investors from the adverse effects of changes in the laws of the host state even if such changes fell short of expropriation or nationalisation. In other word, modern day stabilisation clauses may be drafted to allocate all the political risks associated with a project to the host states. For example, the scope of the stabilisation clause in the Host Government Agreement (HGA) covering the Azerbaijan part of the Baku-Tbilisi-Ceyhan (BTC) Pipeline project covers the following issues:

> The interpretation or application of Azerbaijan Law (whether by the courts, the executive or legislative authorities, or administrative or regulatory bodies), the decisions, policies or other similar actions of judicial bodies, tribunals and courts, the State Authorities, jurisdictional alterations, and the failure or refusal of judicial bodies, tribunals and courts, and/or the State Authorities to take action, exercise authority or enforce Azerbaijan Law.[17]

2.3 WHAT IS A STABILISATION CLAUSE?

Stabilisation clauses can encompass all mechanisms aimed at insulating a foreign investor from the effect of laws enacted subsequent to a contract. The scope of protection that it offers may be full, covering changes made to all laws, or limited, covering changes made to particular laws.[18] However, regardless of the scope of guarantee the host state may wish to give, several legal techniques are used to achieve stability. In most cases, this is in the form of a clause in the contract between the host state and the investor.[19] In other cases,

[17] BTC HGA between and among the Government of the Azerbaijan Republic and State Oil Company of the Azerbaijan Republic and BP Exploration (Azerbaijan) Limited & ors (2002) art 7(Vi)(X) <Http://Subsites.Bp.Com/Caspian/Sha/Eng/Hga/Host%20government%20agreement%20azerbaijan%20%28english%29.Pdf > accessed 28 July 2011.
[18] Cameron (n 1) 16.
[19] For example, the BTC HGA (n 17).

the host state may enact a separate national law which contains stability guarantees for the specified investor(s).[20]

Another legal technique is for the host state to enter into a separate agreement with the investor whereby it guarantees the stability of some or all aspects of its laws for a specified period or for the entire duration of the contract.[21] Such agreements are usually entered into with specific investors who meet the eligibility criteria laid down in the national legislation authorising the government to enter into such agreements.[22] These so-called 'Legal Stability Agreements' (LSAs) are popular in several Latin American countries including, Chile, Colombia and Peru.

Although different countries lay down different eligibility requirements for such agreements, once such agreements are entered into, they achieve the same objective as other stabilisation techniques.[23] As such, references to stabilisation clauses in this thesis, include LSAs. Accordingly, for the purposes of this thesis a stabilisation clause includes any provision contained in an investment contract, national legislation or in a separate agreement between the state and an investor which is aimed at insulating the investor from the effect of changes in the laws of the host state.[24] This could be by making the new laws inapplicable to the investor or by stipulating that the investor will be compensated for the additional financial burden imposed by the new law.

2.4 TYPES OF STABILISATION CLAUSES

The point needs to be made that stabilisation clauses may not fit into strict categories because, in practice, a particular clause may be drafted to ensure stability in different ways.

[20] See, for example, Nigeria LNG (Fiscal incentives, Guarantee and Assurances) (Amendment) Act 1993.
[21] For a useful overview of stability agreements, see, DE Vielleville and BS Vasani 'Sovereignty over Natural Resources Versus Rights under Investment Contracts: Which One Prevails?'(2008) 5 TDM 1, 13 - 21; UNCTAD, *Investment Policy Review: Peru* (UNCTAD 2000) 20 – 21.
[22] See, as examples, Minerals Law of Mongolia 2006, art 21; Mines and Minerals Law 2006 (Ghana), art 48.
[23] See decision in *Sergei Paushok and ors v Mongolia*, UNCITRAL, Award on Jurisdiction and Liability of April 28 2011) [97]
[24] See also definition in UNCTAD, *State Contracts* (UNCTAD 2004) 26.

That said, some commentators have found it useful to divide stabilisation clauses into different categories according to the way in which they aim to achieve stability.[25] This thesis adopts a similar approach and divides stabilisation clauses into three broad categories: freezing clauses, economic equilibrium clauses and hybrid clauses. However, a distinction first needs to be made between earlier stabilisation clauses (also referred to in the literature as 'intangibility clauses') and modern day stabilisation clauses which are the main focus of this thesis.

Intangibility clauses are generally aimed at preventing host states from unilaterally amending or modifying the terms of the contract.[26] They are therefore mainly concerned with preventing host governments from unilaterally changing the terms of a contract in order to expropriate or nationalise the investment.[27] An example of an intangibility clause can be cited from a Production Sharing Contract (PSC) that provides: 'This Contract shall not be annulled, amended or modified in any respect except by the mutual consent in writing of the Parties hereto.'[28]

Intangibility clauses were the earliest form of stabilisation clauses. As a result, virtually all the claims brought against host governments' acts of nationalisation and expropriation around the 1970s, largely relied on breaches of intangibility clauses.[29] The resulting awards in these cases raised doubts about their effectiveness in limiting the power of states to expropriate or nationalise the assets of investors.[30] However, despite these

[25] See, for example, Bertrand Montembault, `The Stabilisation of State Contracts using the Example of Petroleum Contracts: A Return to the Gods of Olympia?' (2003) 7 RDAI/IBLJ 593, 599 – 600; Cameron (n 1) 28 – 35.

[26] Prosper Weil, 'Les Clauses De Stabilisation Ou D'intangibilité Insérées Dans Les Accords De Développement Économique' In Melanges Oferts a Charles Rousseau (1974)307. Relevant text translated and cited in Az El Chiati, *Protection of Investment in the Context of Petroleum Agreements* in (*Recueil Des Course* vol 204, Martinus Nijhoff 1987) 115.

[27] Some formulations of intangibility clauses do explicitly prohibit expropriation and nationalisation. See, for example, Ertsberg Agreement Between Indonesia And Freeport Indonesia Inc (07 April 1967) art 14 (c).

[28] Production Sharing Contract (PSC) between Pertamina and AGIP Spa (10 October 1968) art xvi 1.2.

[29] Although the *Revere's* award was based on a tax stabilisation clause, the amount of tax was so high that the tribunal held that it amounted to expropriation. *Revere Copper & Brass, Inc v Overseas Private Investment Corporation* (OPIC), American Arbitration Association, Award of 24 August 1978 [25]

[30] See discussion on legal validity of stabilisation clauses at section 2.6 below.

questions, intangibility clauses are still in use today either alone or in combination with other types of stabilisation clauses.[31]

Notwithstanding the continued use of such intangibility clauses, the phase of outright nationalisations has generally passed, while direct expropriations targeted at individual properties and enterprises have become a 'rare phenomenon.'[32] Of course, there have been some recent acts of nationalisation, especially in several Latin America countries and in Russia.[33] For example, in the last decade, Venezuela enacted a new hydrocarbon law, which brought several major private oil projects under state control while Bolivia and Ecuador carried out similar acts.[34] However, prior to these, the Libyan nationalisation of US oil companies in 1973 was the last major example. In any event, even if it is accepted that large scale nationalisations may reoccur in the future, such acts are now widely accepted under international law provided it is based on grounds or reasons of public utility, security or the national interest, and appropriate compensation is paid.[35] Indeed, in practice, even when parties purport to prohibit nationalisation or expropriation, they often end up recognising the power of the host government to do so.[36] The on-going use of intangibility clauses thus appears to be an attempt to reinforce the conditions stipulated by general international law.

Based on the foregoing, it is argued that intangibility clauses are now generally less significant, at least for the purposes of this thesis. Indeed, strictly speaking, intangibility clauses do not qualify as stabilisation clauses even if they are so called. This is because such clauses merely seek to preserve the duration and terms of the contract rather than insulate the

[31] See, as examples, Model Production Sharing Agreement (PSA) of East Timor 2007, art 22.5; Model PSA of Bangladesh 2008, art 35.2.
[32] UNCTAD, *Taking of Property* (UNCTAD 2000) 5-6.
[33] For an up to date review, see Sergei Guriev, Anton Kolotilin & Konstantin Sonin, 'Determinants of Nationalization in the Oil Sector: A Theory and Evidence from Panel Data' (2010) 1 *J of L, Economics and Organization* 1.
[34] Vlado Vivoda, 'Resource Nationalism, Bargaining and International Oil Companies: Challenges and Change in the New Millennium' (2009) 14 *New Political Economy* 517, 520 -521.
[35] UNGA, *Permanent Sovereignty* (n 9) para 4.
[36] See, for example, Azerbaijan's BTC HGA (n15) art 1(e) of Appendix V.

investors from changes in the law.[37] Thus, a contract can contain an intangibility clause and still provide that the investor shall comply with any law in force.[38] Where this is the case, the intangibility clause cannot insulate the contract from adverse changes in the law of the state in the way a stabilisation clause is intended to operate.

Accordingly, while references may be made to the principles established in the legal interpretation of intangibility clauses, such references are made simply for the purposes of analogy. The focus of this thesis is on those types of stabilisation clauses that make new laws (or amendments to existing laws) inapplicable to the investor or ensure that they are compensated for the additional costs imposed by the changes even where such laws fall short of expropriation or nationalisation. These clauses, which can be divided into three broad categories, are considered next.

2.4.1 Freezing Clauses

Freezing clauses are also known as stabilisation clauses *stricto sensu* in the literature. They are so named because they 'freeze' the laws of the host state as they stood at the time of entering into the contract thereby making new laws inapplicable to the contract.[39] They are thus primarily aimed at limiting the legislative competence of the state to prevent it from enacting laws and regulations to the detriment of the investor.

In practice, different drafting techniques are employed to ensure stability through freezing clauses even if the clauses are not so named. One technique is to use the choice of law provisions in the contract. Although such provisions are primarily used to specify the applicable or governing law of the contract, they can also be used to freeze the laws of the

[37] This distinction between stabilisation clauses and intangibility clauses has long been proposed by Prosper Weil (n 26).
[38] See, for example, *Bangladesh PSA* (n 31) art 35.2 (Intangibility Clause), arts 10.3 and 19.3 (investor to comply with law in force from time to time).
[39] Andrea Shemberg, 'Stabilization Clauses and Human Rights (2009) Report, paras 23 – 25 <http://www.ifc.org/ifcext/sustainability.nsf/content/publications_lessonslearned> accessed 16 April 2013; Christopher T Curtis, 'The Legal Security of Economic Development Agreements' (1988) 29 *Harvard Intl LJ* 346 – 347.

host state. This is achieved by simply stating that the law applicable to the contract shall be the laws of the host state on the date the contract is executed or on a specified date. This effectively makes laws enacted subsequent to the contract to be inapplicable to the contract. For example, a 'governing law' clause in a Model PSC provides as follows:

> This Contract is executed between the Parties in accordance with the laws and regulations in force at the date of its signing and on the basis of the provisions of said laws and regulations, as regards, inter alia, the economic, fiscal and financial provisions of this Contract.[40]

Although, like most governing law clauses, the above provision did not explicitly make new laws inapplicable, it does exempt the investor from complying with new laws by stipulating that the governing law shall be the laws and regulations 'in force at the date of its signing.'

Another technique of freezing the laws of the host state is through the inconsistency rule. This is achieved by stipulating that any inconsistent or contrary legislation enacted by the host government after the agreement has been entered into shall not apply to the contract. For example, a 1989 Model PSC provides as follows:

> The Contractor shall be subject to the provisions of this Contract as well as to all laws and regulations duly enacted by the Granting Authority and which are not incompatible or conflicting with the Convention and/or this Agreement. It is also agreed that no new regulations, modifications or interpretation which could be conflicting or incompatible with the provisions of this Agreement and/or the Convention shall be applicable[41]

[40] Model PSC of Saharawi Arab Democratic Republic 2005, art 36.
[41] Model PSC of Tunisia 1989, art 24.1.

While the above clause appears at first sight to merely prevent the application of inconsistent legislation, any subsequent law having an adverse effect on the economic position of the investor is likely to qualify as being inconsistent with the contract thus making the investor exempt from complying with it. For example, where a contract specifies the rate payable as tax by the investor, any subsequent amendment of the tax laws of the host state that has the effect of increasing the tax burden of the investor, would be deemed to be inconsistent with the provisions of the contract thereby activating the protection offered by the clause.

However, the most common way of freezing the laws of the host state is to explicitly 'freeze' the laws as they apply to the investors. Such a clause can be full or limited (comprehensive or partial).[42] A full freezing clause purports to freeze all laws of the host state by making all subsequent laws inapplicable to the investors, either for the entire duration of the contract or a specified period. This is regardless of whether such laws are fiscal (such as tax laws) or non-fiscal (such as environmental laws). An example of a full freezing clause can be cited from a 2008 PSA providing that:

> ...the "DRC" guaranties to the "Contracting Party" throughout the duration of this Contract the stability of the general legal, financial, petroleum, tax, customs and economic conditions under which each entity exercises its activities, as such condition results from the legislation and regulation in force at the date of the signature of the Contract.[43]

[42] Shemberg (n 39) paras 23 - 24; Cameron (n 1) 28 - 30.
[43] PSA with respect of Block 1 of the DRC Albert Graben between the Democratic Republic of Congo and Divine Inspiration Consortium Group (Pty) Ltd (21 January 2008) art 28.

A limited or partial freezing clause, on the other hand, aims to insulate the investment from a limited range of legislative action by the host state.[44] This could be because the host government agrees to provide stabilisation guarantees only for certain aspects of the agreement. In practice, a limited freezing clause is usually used to insulate the investment from a change in the laws that directly affect the fiscal regime, such as tax laws. In such a case, the stabilisation clause may be drafted to freeze the targeted regime either by listing the aspects of the host government's laws or the taxes that are stabilised or by referring directly to such legislation. An example can be cited from a recent Mineral Development Agreement (MDA) from Liberia which provides:

> For the avoidance of doubt, any amendments, additions, revisions, modifications or other changes to the Revenue Code (or any similar Law) made after the Effective Date shall not be applicable to the Concessionaire except as this Agreement specifically provides for the matter to be governed by applicable Law. Furthermore, any future amendment, additions, revisions, modifications or other changes to any Law (other than the Revenue Code or any similar Law) applicable to the Concessionaire or the Operations that would have the effect of imposing an additional or higher tax, duty, custom, royalty or similar charge on the Concessionaire shall not apply to the Concessionaire to the extent it would require the Concessionaire to pay such additional tax, duty, royalty or charge.[45]

Limited freezing clauses are also used where parties intend to freeze the entire regulatory framework but agree that certain laws be excluded from the ambit of the clause.

[44] Shemberg (n 39) paras 23 - 24; Cameron (n 1) 28 – 30.

[45] MDA between Liberia and China Union Investment (19 January 2009). See also Investment Agreement between Mongolia, Ivanhoe Mines Inc LLC, Ivanhoe mines Ltd and Rio Tinto International Holdings Limited (06 October 2009) arts 2.1 – 2.4.

In other words, the investor would be exempt from all new laws that adversely affect its economic position except those laws that have been specifically excluded from the ambit of the clause. For example, an Azerbaijan investment legislation exempts investors from new laws enacted within 10 years of their investment but excludes legislative changes 'concerning defense, national security and public order, environmental protection, credits and finances, public morals and public health.'[46]

2.4.2 Economic Equilibrium Clauses

Unlike freezing clauses, an economic equilibrium clause does not aim to freeze the law but aims to maintain the economic equilibrium of the project.[47] Thus, where the government enacts a new law, the investor would comply with the law. However, the investor would receive compensation from the government to defray the cost of complying with the law in order to maintain the economic equilibrium of the contract. In other words, the cost of complying with the change in the law is borne by the host state.

An economic equilibrium clause can also be full or limited. A full economic equilibrium clause entitles the investor to be compensated for the cost of complying with changes in all types of laws by the host government. An example can be cited from the Model Production Sharing Agreement (PSA) of Angola 2004 which provides:

> Without prejudice to other rights and obligations of the Parties under the Agreement, in the event that any change in the provisions of any Law, decree or regulation in force in the Republic of Angola occurs subsequent to the signing of this Agreement which adversely affects the obligations, rights and benefits hereunder, then the Parties shall agree on amendments to the Agreement to be

[46] Law of the Azerbaijan Republic about Protection of Foreign Investments 1993, art 10.
[47] Mohamed Al Faruque, 'Typologies, Efficacy and Political Economy of Stabilization Clauses: A Critical Appraisal' (2007) 4 OGEL 1; Shemberg (n 39) para 22.

> submitted to the competent authorities for approval, so as to restore such rights, obligations and forecasted benefits.[48]

Under a limited economic equilibrium clause, the host government is only obliged to restore the equilibrium of the contract where the investor incurs additional costs due to the application of specific laws as nominated in the contract.[49] An example of such a clause, here limited to laws that modify the tax system, provides:

> In the event of a modification to the tax system or the creation or elimination of new taxes not foreseen in this Contract or of the employment contribution, in force at the time of the execution of this Contract and as set out in this Clause, which have an impact on the economy of this Contract, a correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax or in the employment contribution burden.[50]

An examination of the literature and samples of economic equilibrium clauses reveals that while their aim is to protect the economic position of the investor in the event of a change in the law, many variations are found and different formulae employed to achieve the economic equilibrium. While practice varies from country to country and sector to sector, these clauses can be categorised according to their provisions governing the restoration of equilibrium.[51]

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[48] Article 37 (2).

[49] The study by Shemberg found that limited economic equilibrium clauses are mainly used in the few OECD countries that grant stabilisation clauses. Shemberg (n 39) paras, 26 – 28, 72 - 73.

[50] PSA for Block 7 between Burlington Resources Inc and Ecuador, art 11.12 as translated by the tribunal in *Burlington Resources Inc v Ecuador*, ICSID No ARB/08/5, Decision on Liability of 14 December 2012) [22]

[51] For a detailed discussion of this point, see generally AFM Maniruzzaman, 'International Energy Contracts and Cross-Border Pipeline Projects: Stabilization, Renegotiation and Economic Balancing in Changed Circumstances - Some Recent Trends (2006) 4 OGEL, 1.

In a few cases, an economic equilibrium clause may be drafted to require the parties to negotiate in good faith towards restoring the economic equilibrium of the original agreement in the event of an adverse change in the law. An example is contained in the Model PSC of Nigeria/Sao Tome JDA which provides:

> If at any time or from time to time, there is a change in legislation or regulations which materially affect the commercial benefit afforded the Contractor under this Contract, the parties will consult each other and shall agree to such amendments to this contract as are necessary to restore as near as practicable such commercial benefits which existed under the contract as of the effective date.[52]

Such formulations do not automatically entitle the investor to compensation in the event of an adverse change in the law.[53] However, they impose a duty on the parties to negotiate in good faith and readjust the contract in a way that restores its economic equilibrium and thus puts the investor in the position that he was in prior to changes in the law.[54]

Other formulations of economic equilibrium clauses directly stipulate that the host government will compensate the investor if it subsequently adopts regulatory measures which have the effect of reducing the investor's economic benefits from the project. Such a clause may or may not specify how the compensation should be calculated and what form it should take. In practice, however, notable forms of compensation include, tax rebates, monetary compensation, adjusted tariffs, and an extension of the concession.

For example, the clause in the PSA between Burlington and Ecuador stipulates that, in the event of a change in the tax law, a 'correction factor will be included in the production sharing percentages to absorb the impact of the increase or decrease in the tax on the

[52] Model PSC of the Nigeria/Sao Tome and Principe Joint Development Authority 2004, art 26(3).
[53] *Burlington Award* (n 50) [321] – [334]
[54] Ibid.

employment contribution burden.'[55] Where, as in this example, the clause explicitly stipulates the procedure or method for adjusting the economic equilibrium of the contract, such a contract is to be automatically amended in line with that procedure to maintain the economic equilibrium in the event of an adverse change in the law.[56]

In a few cases, economic equilibrium clauses may stipulate a threshold that must be crossed before an investor will be compensated and may provide guidance to be used in determining this threshold.[57] While this practice is to be welcomed, doubts remain as to its practical usefulness. This is because, in most of these clauses, the threshold is framed in general terms. For example, the clause may simply provide that the economic equilibrium is deemed to have been affected where the change in the law has a 'material' or 'significant' adverse effect on the investor.[58] As argued by AFM Maniruzzaman, the simple use of such words is open to conflicting interpretations in different contexts, especially where the matter is left to the discretion of the tribunal concerned.[59] Accordingly, in the absence of detailed or specific contractual provisions to ascertain the point at which the economic equilibrium of the contract has been affected, its practical benefit to the host state remains unclear.[60] What is, however, clear is that even where a threshold is set, the level at which it is set is usually significantly lower than that established by the 'regulatory takings doctrine' in general international law.[61]

Before moving on to the next type of stabilisation clause, it is useful to mention that there is agreement among commentators and practitioners that trends in contractual practice

[55] *PSA* (*Burlington*) (n 50) art 11.12.
[56] *Burlington Award* (n 50) [321] – [322]
[57] See AFM Maniruzzaman, 'The Pursuit of Stability in International Energy Contracts: A Critical Appraisal of the Emerging Trends' (2008) 1 JWELB 121, 129 – 132.
[58] See, as examples, Development Agreement between Zambia and Konkola Copper Mines Plc (31 March 2000) art 13.1.2 ('material adverse economic effect'); Indian Model PSC 2007, art 16.7 ('significantly affect').
[59] Maniruzzaman, *Pursuit* (n 57) 121 – 132.
[60] From the clauses reviewed, only the India Model National Highway Authority Concession Agreements and the resulting contracts stipulate a specific amount of 10 million Rupees beyond which the economic equilibrium would be deemed to have been affected. See, for example National Highway Authority Concession Agreements, Jaipur–Kishangarh Highway, (11 October 2010) art 36 <Http://Www.Nhai.Org/Fvb.Pdf> accessed 01 August 2011.
[61] This point is discussed in greater detail in section 2.7.2.

show a shift away from freezing clauses towards a greater use of economic equilibrium clauses.[62] A few commentators have attributed this to the advent of privately financed infrastructure/public–private partnership projects.[63] According to this view, it is relatively straightforward to negotiate economic equilibrium clauses in this sector as the costs of changes in the law can easily be passed on to the host state or, in some cases, the end users through tariff increases.[64] However, as this thesis deals with the extractive industry, the following reason given by other commentators is more relevant.

Several other commentators have attributed the rise in the use of economic equilibrium clauses to questions about the legality and enforceability of freezing clauses.[65] They argue that under many domestic laws, freezing clauses would be unconstitutional and thus difficult to enforce in the event of a breach.[66] Economic equilibrium clauses are therefore most likely to be enforceable because they are perceived to be the least obstructive to host states' legislative powers.[67] For this reason, it has been suggested that economic equilibrium clauses should be used in place of freezing clauses.[68] Those who make these suggestions argue that economic equilibrium clauses provide a 'win-win' situation by preserving the sovereign power of the host state to change its laws while still protecting the investor from the adverse effects of these changes.[69] However, such claims will be deconstructed later in this thesis.[70]

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[62] See, as examples, Cameron (n 1) 4; Waelde and Ndi (n 6) 218 – 219; Shemberg (n 39) para 25; Al Faruque (n 47) 31 – 33.
[63] For example, Audley Sheppard and Antony Crockett, 'Are Stabilization Clauses a Threat to Sustainable Development?' in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law 2011) 341 – 342.
[64] Ibid.
[65] Shemberg *(*n 39) para 5; Cameron (n 1) 4; Herbert Smith, 'Stabilisation Clauses - Issues and Trends' (2010) 36 Infrastructure and Mining Newsletter, 1-2.
[66] Ibid.
[67] Ibid.
[68] Talal AQ Al-Emadi, 'Stabilization Clauses in International Joint Venture Agreements' (2010) 3 *Intl Energy L Rev* 54, 57; Cotula, *Reconciling* (n 5) 178
[69] Ibid.
[70] See section 7.2.2.

2.4.3 Hybrid Clauses

Hybrid clauses are so named because they combine some characteristics of freezing and economic equilibrium clauses.[71] Thus, a freezing clause becomes a hybrid clause if it goes further to provide that in the event that the changes in the law are made applicable to investors, the investors will be restored to the same economic position that they were prior to the changes. Similarly, an economic equilibrium clause becomes a hybrid clause if it includes exemption from the changes in the law (freezing technique) as one of the options that may be applied to restore the economic equilibrium.

An example of this type of hybrid clause can be cited from the BTC HGAs where the host government committed to 'restore the Economic Equilibrium' of the project in the event of changes in the law and further agreed that the obligation to restore the economic equilibrium 'shall include the obligation to take all appropriate measures to resolve promptly by whatever means may be necessary, including by way of exemption....'[72] Such a clause, therefore, gives the investor the opportunity to either request that it is exempted from complying with the new law or demand that adjustments are made to the contract to accommodate the cost of complying with the law.

2.5 STABILISATION CLAUSES AS A ONE-EDGED SWORD

Before concluding the discussion on the types of stabilisation clauses, it is useful to comment briefly on the kind of stability most stabilisation clauses aim to achieve as this may be relevant in an examination of the impact they might have on sustainable development. First, it is acknowledged that it is possible to draft stabilisation clauses, and in particular economic equilibrium clauses, in a way that protects the interest of both the investor and the host government in the event of a change in the law. For example, the 1999 infrastructure

[71] Shemberg (n 39) paras 6 - 8.
[72] Azerbaijan, *BTC HGA* (n 16) art 7 (x).

concession in India also contains this corresponding provision in favour of the host government:

> If as a result of Change in Law, the Concessionaire enjoys a reduction in costs or increase in net after tax return or other financial benefit, the aggregate financial effect of which exceeds Rs.10 million (Rupees ten million) in any Accounting Year, NHAI may so notify the Concessionaire and propose amendments to this Agreement so as to put the Concessionaire in the same financial position as it would have occupied had there been no such Change in Law resulting in such decreased cost, increase in return or other financial benefit as aforesaid....[73]

However such an approach is rare especially in the extractive industry.[74] In the majority of cases, stabilisation clauses are drafted to insulate the investor from adverse effects of a change in the law without a corresponding benefit to the government where the law has a positive effect on the investor.[75] Some formulations even explicitly entitle the investor to claim any benefit that accrues from favourable changes in law. For example, the stabilisation clause in the PSA from DRC that was cited earlier went further to provide: 'it has been understood however that each entity making up the "Contracting Party" could benefit from any favourable measure with respect to the regime defined above.'[76]

Some formulations go even further to give investors the choice to switch back and forth between current laws and the stabilised laws according to the regime that they consider to be more beneficial. In other words, investors can elect to be bound by new laws where such laws are beneficial. However, where such laws are later amended and are no longer

[73] *Highway Agreement* (n 60) art 36.2.
[74] The few examples include Model PSC of India 2007, art 16.7 and the Law Concerning PSA 2005 (Kazakhstan) art 25.2.
[75] For recommendations on how host states can grant mutually beneficial stabilisation clauses, see section 7.3.3.
[76] *Divine Inspiration* (n 43) art 28

beneficial, they can switch back to the stabilised legal regime. For example, a 1995 Azerbaijan investment law exempts foreign investors from adverse changes in its laws but went further to provide that investors may:

> at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date. Provided further legislation of the Azerbaijan Republic deteriorates conditions of investment depositing, the legislation in force at the moment of investment is applied for the period, specified in the contract about investment activity.[77]

The practice of allowing investors to benefit from favourable laws, and in some cases being able to switch back and forth between legal regimes, raises questions about the true purpose of stabilisation clauses. In theory, stabilisation clauses are intended to ensure a stable regulatory framework in order to maintain the economic equilibrium of the contract. If this is true, then it is reasonable to assume that if an unexpected event, such as an unexpected geological breakthrough or rise in oil prices, affects the economic equilibrium of the project in a significantly positive way, the government should be entitled to benefit from the unexpected additional profits. However, from the way most stabilisation clauses are drafted as shown above, this is not the case. Indeed, as will be seen in later chapters, several 'windfall profit' taxes have been challenged on the basis of stabilisation clauses.[78]

Furthermore, in the case of changes in the law, it is also reasonable to expect that where an investor benefits from a freezing clause, then the investor should also be exempt from benefiting from favourable changes in the host states' laws. Similarly, where the investor benefits from an economic equilibrium clause, there should also be adjustments to

[77] Azerbaijan Law about Investment Activity 1995, art 18 (2). See also *Ivanhoe Agreement* (n 45) art 15.24(1) (2).
[78] See especially discussion in section 6.3.2.

the contract to rebalance the economic equilibrium where a change in the law improves the financial position of the investor. However, the findings of this thesis are that stabilisation clauses are rarely drafted or applied in this way. Rather, they are generally drafted to insulate the investor from adverse changes without any corresponding benefit for the host state where the changes are favourable to the investor.

In this sense, stabilisation clauses appear to be a one-edged sword, used to allocate the risks of changes in law to the host state while also allocating the benefits that may accrue to the investors. This raises the question as to whether governments of developing countries are acting rationally when they accept these clauses. However, before going into that, it is useful to first understand the legal implication and value of stabilisation clauses.

2.6 LEGAL VALIDITY AND EFFECT OF STABILISATION CLAUSES

The legal validity and effect of stabilisation clauses had been the subject of debate in scholarly writings especially in the light of the claimed conflict between the clause and the principle of permanent sovereignty of states over their natural resources.[79] In addition, until very recently, arbitral jurisprudence on stabilisation clauses was mainly based on intangibility clauses. As such, the views of commentators on the validity and legality of modern day stabilisation clauses were largely speculative. This was because they reviewed the awards on intangibility clauses and then proceeded by way of analogy.[80]

However, in recent years, several arbitral tribunals have provided further guidance on the legal status and effect of stabilisation clauses. Accordingly, for the purposes of clarity, the discussion of the arbitral jurisprudence on stabilisation clauses is divided, rather crudely, into three categories. The first category covers the arbitral awards in the 1970s and 1980s which mainly dealt with intangibility clauses. While as noted above, these cases were based

[79] For a useful summary of the debate, see Wälde and Ndi (n 6) 243 -246.
[80] See, as examples, Cameron, (n 6) 58; Cotula, *Reconciling* (n 5) 162 – 164; Maniruzzaman, *Pursuit* (n 57) 139 – 141.

on acts of nationalisation and expropriation, the principles applied in these cases still serve as a useful guide to the legal effect of stabilisation clauses.

The second category covers some cases based on alleged expropriations and breach of host states' obligations to provide fair and equitable treatment standard. These cases are based on Bilateral Investment Treaties (BITs) rather than on contracts. However, they are relevant to the present discussion because the arbitrators made comments on the possible effect of stabilisation clauses on the cases had they been included in the contracts between the parties. The last category covers the few, recently reported, cases that deal extensively with stabilisation clauses.

2.6.1 Arbitral Jurisprudence on 'Intangibility' Clauses

As already noted, stabilisation clauses were made popular from the 1960s by several high profile arbitrations based on acts of nationalisation and expropriation by host states.[81] In determining these cases, arbitral tribunals had to resolve the question of whether a state could lawfully nationalise or expropriate assets of a foreign investor contrary to the provisions of a stabilisation clause. This meant that they also had to determine the legal validity and effect of stabilisation clauses especially in the light of the sovereign right of states over their natural resources. The dominant view from the resulting (and rather conflicting) awards was that stabilisation clauses were valid and are legally binding on host states. However, they did not invalidate acts of nationalisation and expropriation. Rather, they ensured that the affected investor was compensated.

In *AGIP Co v Peoples' Republic of Congo*, the Concession contained a provision that the government would not apply 'any other subsequent law or decree that aims to alter the Company's status as a limited liability corporation in private law.'[82] The subsequent nationalisation of the Company was held to have 'represented a repudiation' of the

[81] See section 2.2.
[82] ICSID Case No ARB/77/1, Award of 30 November 1979 [69] – [70]

stabilisation clause and made the government liable to pay compensation.[83] Similarly, in the *Revere* award the tribunal noted that the stabilisation clause in the contract between the parties was 'internationally binding' and any action contrary to it constituted a breach.[84]

Other tribunals were, however, reluctant to uphold stabilisation clauses over acts of nationalisation and expropriation. For example, in *Libyan American Oil Co (LIAMCO) v Libyan Arab Republic,* the sole arbitrator held that acts of nationalisation which are in line with public policy and are non-discriminatory do not constitute a breach of the stabilisation clause.[85] Rather, they constituted a 'source of liability to compensate' the investor.[86] However, before arriving at this conclusion, the arbitrator confirmed the legal validity of stabilisation clauses by stating that a state has a binding obligation to respect all of its contractual undertakings, including stabilisation clauses.[87] Similarly, in *Liberian Eastern Timber Corporation (LETCO) v Liberia,* the tribunal, while emphasising that stabilisation clauses 'must be respected', held that a breach of a stabilisation clauses clause 'could only be justified by nationalization.'[88]

The above cases reveal a lack of a clear consensus amongst arbitrators on the question of whether nationalisation and expropriation constitute a breach of stabilisation clauses. While some arbitral tribunals agreed that nationalisation amounts to a breach of a stabilisation clause, others held that the right of a state to nationalise is absolute and prevails over stabilisation clauses. However, the dominant view arising from these awards is that stabilisation clauses are valid and legally binding under international law. This is because even in the cases where the arbitrators upheld nationalisation over stabilisation clauses, they acknowledged the binding nature of the clause. Their decision to uphold the acts of

[83] Ibid [85] – [88]
[84] *Revere* (n 29) [1345] See also *TOPCO v Libya* (n 6) [83]; *Kuwait v Aminoil* (n 1) [1023] – [1024]
[85] Ad hoc Arbitration, Award of 12 April 1977 [61]
[86] Ibid [88]
[87] Ibid [61]
[88] ICSID No ARB/83/2, Award of 31 March 1986 [666] – [667]

nationalisation was based on the fact that international law recognises nationalisation and expropriation provided certain conditions are met, including the payment of compensation.[89] Thus although they held that the stabilisation clauses could not prevent lawful nationalisation or expropriation, they agreed that they imposed an obligation on the host state to compensate the investor.

It is therefore safe to assume that if the principles established in these cases are applied to legislative acts falling short of nationalisation or expropriation, such acts would be held to constitute a breach of stabilisation clauses. This is especially true in the light of the statement by the tribunal in *LETCO v Liberia* that legislative action in breach of stabilisation clauses 'could only be justified by nationalisation.'[90]

2.6.2 Arbitral Jurisprudence arising from Treaty-Based Claims

Until the mid-2000s, there appeared to be no published arbitral award dealing with breaches of stabilisation clauses arising from enactments of new laws that adversely affected investor's economic positions but which fell short of expropriation and nationalisation. However, from the mid-2000s, stabilisation clauses began to appear in arbitral jurisprudence in claims arising out of alleged breach of investor protection standards in treaties. The main claims in these cases were that the regulatory measures by the host governments were in breach of their obligations to provide fair and equitable treatment thereby frustrating the investors' legitimate expectations of a stable legal framework. While these claims were based on treaty obligations of the host states, the arbitrators made very useful comments on the legal validity and effect of stabilisation clauses.

In *Methanex Corporation v USA*, the tribunal had to resolve the question of whether a regulatory measure by the State of California amounted to expropriation under the North

[89] As the arbitrator in *TOPCO v Libya* noted 'the right to nationalise is unquestionable today' (n 6) [73]
[90] (n 88) [666] – [677]

American Free Trade Agreement (NAFTA).[91] It concluded that 'from the standpoint of international law, it was lawful regulation and not expropriation.'[92] To reach this conclusion, the tribunal made the following comments which help explain the legal effect of stabilisation clauses:

> But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[93]

Similarly, in *EnCana v Ecuador*, the arbitrators unanimously rejected the investor's claim for indirect expropriation.[94] According to the tribunal, the investor had 'neither the right nor any legitimate expectation' that tax laws will not change during the period of the investment 'in the absence of a specific commitment from the host state.'[95]

Although both the *Methanex* and *Encana* tribunals did not directly mention stabilisation clauses, the clause must be assumed to be a 'specific commitment' within the contemplation of the tribunal. This is because stabilisation clauses are specific commitments by host states that all or some of the laws governing an investment will not be altered to the detriment of the investor for the duration of the investment or a specified period.[96] As a confirmation of

[91] UNCITRAL, Final Award on Jurisdiction and Merits of August 7, 2005
[92] Ibid Part IV, Chapter D [15]
[93] Ibid [7]
[94] LCIA UN3481, Award of 03 February 2006
[95] Ibid [173]
[96] See section 2.3.

this view, later tribunals faced with similar issues went further to mention stabilisation clauses as being one of such specific commitments.

For example, in *AES Summit Generation Ltd v Hungary*, the tribunal observed that Hungary did not give any 'specific commitments...that could limit its sovereign right to change its law (such as a stability clause) or that could legitimately have made the investor believe that no change in the law would occur.'[97] In *Parkerings–Compagniet AS v Lithuania*, the tribunal had to resolve the question of whether Parkerings had any legitimate expectation of a stable legal system and whether that expectation has been frustrated.[98] In resolving these questions, the tribunal held that 'save for the existence of an agreement, in the form of a *stabilisation* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.'[99]

Similar conclusions were also reached in the more recent *Paushok* award where the investors' claimed that Mongolia's 2006 windfall profit tax on gold frustrated its legitimate expectation of a stable tax environment.[100] In rejecting the claim, the tribunal noted that, in the absence of a stability agreement, the investor has failed to establish that they had 'legitimate expectations that they would not be exposed to significant tax increases in the future.'[101] According to the tribunal, the 'proper way' for an investor to protect itself against the adverse effects of changes in law is through a stability agreement.[102]

In the above cases, stabilisation clauses were not present in the contracts between the parties.[103] However, the arbitrators made it clear that stabilisation clauses were legally valid,

[97] ICSID Case No ARB07/22, Award of 23 September 2010 [9.3.31]. See also [9.3.25], [9.3.34]
[98] ICSID Case No ARB/05/8, Award of 11 September 2007
[99] Ibid [332] [Emphasis original]
[100] *Paushok* (n 23)
[101] Ibid [370]
[102] Ibid.
[103] Although the contract in *Impregilo SpA v Argentina*, ICSID Case No ARB/07/17, Award of 21 June 2011 contained a stabilisation clause, the tribunal held that its jurisdiction was limited to the alleged breach of the treaty.

binding and would have been effective in protecting the investors from the adverse effect of the regulatory measures by the host states if they had been obtained by the investors.

2.6.3 Arbitral Jurisprudence on Stabilisation Clauses

The opportunity for arbitrators to examine stabilisation clauses in greater detail and to pronounce on their legal validity and effect finally arrived in claims brought against Peru and Ecuador.[104] In *Aguaytía Energy LLC v Peru,* the investor claimed that Peru had breached the obligation to guarantee the stability of the right to non-discrimination contained in the Legal Stability Agreement (LSA) between the parties.[105] The investor had argued that the clause not only included stability of the right to non-discrimination but also a substantive right to non-discrimination. This interpretation was rejected by the tribunal, and the claim was dismissed in the absence of any change in the stabilised legal framework. However, before dismissing the claim, the tribunal pronounced on the legal effect of the stabilisation clause:

> It freezes the laws, rules and regulations applicable to it, as they were in existence at the time the Agreement was concluded. This means that no new law may be passed which would state that certain rules regarding non-discrimination would no longer apply to the Claimant [106]

However, the most far-reaching pronouncement on freezing clauses comes from *Duke Energy International Peru Investments No. 1, Ltd v Peru.*[107] A key issue in this case was whether the interpretation of existing legislation by the Peruvian tax authorities was in breach of the LSA which guaranteed the stability of the country's tax laws. The tribunal

[104] These cases appear to be the only published awards dealing extensively on stabilisation clauses.
[105] ICSID Case No ARB/06/13, Award of 11 December 2008
[106] Ibid [95]
[107] ICSID Case No ARB/03/28, Award of 18 August 2008

while upholding the validity of the stabilisation clause explained that the effect of the clause was that:

> (a) laws or regulations that form part of the tax regime at the time the LSA is executed will not be amended or modified to the detriment of the investor, (b) a stable interpretation or application that is in place at the time the LSA is executed will not be changed to the detriment of the investor, and (c) even in the absence of (a) and (b), stabilized laws will not be interpreted or applied in a patently unreasonable or arbitrary manner.[108]

An important aspect of this decision is the expansion of the scope of stabilisation clauses to cover not only the formal text of the laws but also their interpretation or application. Thus by the interpretation of the tribunal, a stabilisation clause also commits the host government not to change its interpretation of the law where a foreign investor had relied on a prior interpretation to invest in the country.[109] Thus where a new interpretation or application of an existing law is so unreasonable that it violates the very stability that was granted, it would be a breach of the clause.[110]

In the more recent *Burlington* award, the arbitral tribunal also clarified the legal effect and binding nature of a tax economic equilibrium clause.[111] In determining the question whether a windfall profit tax imposed by Ecuador without taking steps to restore the economic equilibrium of the contract was expropriatory, the tribunal first had to determine the legal effect of the economic equilibrium clause in the PSC between the parties. The

[108] Ibid [227]
[109] This view was upheld in the subsequent annulment proceedings. *Duke Energy International Peru Investments No. 1, Ltd v Peru,* ICSID No ARB/03/28, Decision on Annulment Proceedings of 01 March 2011 [218] – [223]
[110] *Duke* (n 107) [228]
[111] *Burlington Award* (n 50)

tribunal decided that the clause imposes a duty on Ecuador to apply a 'correction factor' to the PSCs when a new tax affects the economy of the PSCs.[112] In the words of the tribunal, 'the correction factor must be of such extent as to wipe out the effects of the tax on the economy of the PSC. Otherwise stated, the correction factor must restore the economy of the PSC to its pre-tax level.'[113] It should be added that the tribunal emphasised that the clause imposed a mandatory, as opposed to an optional duty on Ecuador to restore the economy of the PSC once there is a modification to the tax system which impacts on the economy of the contract.[114]

2.7 LEGAL AND FUNCTIONAL VALUE OF STABILISATION CLAUSES

2.7.1 Stabilisation Clauses and Compensation

The previous sections concluded that based on arbitral jurisprudence, stabilisation clauses are legally valid and binding irrespective of the sovereign power of states to change their laws. Clearly, however, the existence of such disputes indicate that host states have enacted laws and enforced them on the investors contrary to the clause. Thus, most commentators agree that the mere inclusion of a stabilisation clause in a contract is not a guarantee that the host state would indeed 'stabilise' its laws in favour of the investor.[115]

Furthermore, although arbitrators do have the power to order specific performance, it is rarely granted with regards to stabilisation clauses largely because it is hard to conceive how such laws will be enforced against an unwilling state. The only relevant case where specific performance was ordered is in the *TOPCO* award.[116] However, the order was difficult to enforce in the face of opposition from the government.[117] Thus even where an investor successfully brings a claim for a breach of stabilisation clause, it is unlikely that an

[112] Ibid [321] – [334]
[113] Ibid [334]
[114] Ibid [321] – [334]
[115] See, for example, Cotula, *Reconciling* (n 5); Maniruzzaman, *Pursuit* (n 57) 126.
[116] *TOPCO* (n 6).
[117] Cotula, *Reconciling* (n 5) 165 – 166.

arbitral tribunal can prevent a state from applying the changes in its law to the investor. However, this does not mean that stabilisation clauses, especially the freezing types, are legally ineffective, useless and unable to prevent a host state from doing as it pleases, as some commentators have suggested.[118] They have a legal and functional value.

Drawing on the arbitral jurisprudence on intangibility clauses, most commentators agree that the main legal consequence of a breach of a stabilisation clause is the payment of compensation.[119] This approach was followed by the tribunal in *Duke v Peru* as it did not order Peru to revert to the prior interpretation of the law.[120] Rather, it ordered Peru to pay compensation to the investor for the financial loss suffered as a result of the change in the 'stable' interpretation of the law.[121] The investor was thus restored to the same financial position it would have been in if the change had not occurred.

Thus, the value of a stabilisation clause to the investor is not that it will be specifically enforced. Rather it is that it serves as an important factor to ensure that compensation would be awarded, and in some cases, a higher amount of compensation.[122] In the *Duke* award, for example, the tribunal accepted the computation made by the investor's expert witness and awarded the entire amount as compensation for damages.[123] For an investor concerned with the adverse financial implications of a change in the law, this is a fair outcome. It is, therefore, immaterial that the clause did not guarantee the inapplicability of the law.

However, the point needs to be made that although a stabilisation clause may not practically prevent a host state from changing its law if it so wishes, in most cases, it does

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[118] For examples of those who hold this view, see: Peter Wolfgang, *Arbitration and Renegotiation of International Investment Agreements*, (2nd edn, Kluwer Law 1995) 227; Yinka Omoregbe, 'Law and investor Protection in the Nigerian Natural Gas Industry' (1996) 14 JENRL, 179, 189; M Sornarajah, *The International Law on Foreign Investment* (2nd edn CUP 2004) 408.
[119] See, for example, AFM Maniruzzaman, 'Damages for Breach of Stabilisation Clauses in International Investment Law: Where Do We Stand Today?' (2007) IELTR 246; Wälde and Ndi (n 6) 246.
[120] *Duke* (n 107).
[121] Ibid [460] – [485].
[122] Maniruzzaman, *Pursuit* (n 57) 126; Wolfgang (n 118) 886.
[123] *Duke (*n 107) [460] – [485].

serve its purpose of making changes in the law inapplicable to the investor. This is because the threat of paying huge compensation and the negative impact of international arbitration may have on the host state's reputation, serve as a deterrent.[124] Thus in practice, investors frequently rely on stabilisation clauses to avoid complying with new laws.[125] In other cases, the clause becomes a valuable tool which an investor uses to obtain a lower level of compliance or to delay the new law's applicability to it.[126]

It is, therefore, surely incorrect to refer to stabilisation clauses as 'useless' and ineffective to stop a host state from 'doing as it pleases.' The availability of only a few arbitral awards arising from stabilisation clauses, and the decisions of arbitral panels in awarding compensation for breaches indicate that the clause must be achieving at least some of its objective in protecting investors against the effects of changes in laws of host states. As James Otto and John Cordes aptly note, the effect of stabilisation clauses 'may be more a psychological deterrent than a legal one.'[127]

2.7.2 Stabilisation Clauses, 'Regulatory Takings' and Legitimate Expectations

Another legal and functional value of stabilisation clauses is the role that they play in determining whether regulatory acts of host states amount to 'regulatory taking' and whether they breach the legitimate expectations of investors. This finding is especially important in treaty-based claims as they help determine whether investors should be entitled to compensation for the adverse effect of the regulatory measure.

Under the 'police powers' doctrine of general international law, a state is not liable to pay compensation to foreign investors for *bona fide* regulatory measures enacted for a public

[124] Wälde and Ndi, *Stabilizing* (n 6) 236 – 237.
[125] See chapter 6.
[126] Ibid.
[127] James Otto and John Cordes, *The Regulation Of Mineral Enterprises: A Global Perspective on Economics, Law and Policy*. (RMMLF 2002) IV-26.

purpose in a non-discriminatory manner.[128] However, where the regulatory measures are arbitrary and discriminatory, the 'regulatory takings' doctrine requires host states to compensate foreign investors as such measures are deemed to constitute a 'taking' under international law. [129]

The question of whether a regulatory measure falls within the ''police powers' of the state or whether they constitute 'regulatory taking' depends on the circumstance of each case. Arbitrators thus have to examine the circumstance of each case, including the effect of the law and the political, socio-economic, cultural and historical conditions leading to the regulatory measures.[130] As there is yet no 'bright and easily distinguishable line' between regulations that fall within the police powers of a state and those that constitute regulatory takings, it is left to an arbitral tribunal to determine whether a regulatory measure has crossed the line.[131]

Several tribunals have laid down certain conditions that the regulatory measure must meet in order for it to constitute a regulatory taking. In *CMS Gas Transmission Co v Argentina*, the arbitral tribunal held that the measures must lead to 'substantial deprivation' of the investor's fundamental rights of ownership.[132] In the *EnCana* award, the tribunal held that a tax law can only constitute regulatory taking if it is 'extraordinary, punitive in amount or arbitrary in its incidence.' [133]

However, the arbitral jurisprudence suggests that where a state gives a specific commitment in the form of a stabilisation clause, it cannot successfully argue that the

[128] *Saluka Investments BV (The Netherlands) v The Czech Republic*, UNCITRAL, Partial Award of 17 March 2006) [255]; *Methanex* (n 91) Part IV, Chapter D [15]
[129] Emma Aisbett, Larry Karp & Carol McAusland, 'Regulatory Takings and Environmental Regulation in NAFTA's Chapter 11' (20 February 2006) <http://are.berkeley.edu/~karp/iiasubmitfeb06.pdf> accessed 25 August 2011
[130] *Impregilo* (n 103) [290]
[131] *Saluka* (n 138) [263] – [264]
[132] ICSID Case No ARB/01/8, Award of 12 May 2005 [262 – 264]
[133] (n 94) [175]

regulatory measure falls within its police powers and hence is not compensable.[134] Equally, an investor is more likely to succeed in a treaty-based claim for indirect expropriation or regulatory taking where the regulatory measure is contrary to a stabilisation clause.[135] This is because a breach of a freezing clause requires payment of compensation for regulatory change regardless of its impact while a breach of an economic equilibrium clause requires payment of compensation as long as the equilibrium of the investment has been affected.[136]

Accordingly, except where the particular stabilisation clause specifies otherwise, the impact of the measure on the investor and whether it is discriminatory becomes insignificant to the tribunal. In other words, the tribunal is only concerned with whether the regulatory measure was in breach of the stabilization clause. An indication of this approach was given by the tribunal in the *Duke* award when the arbitrators stated that they were not concerned with the correctness of the interpretation of the law 'but only determines' whether the interpretation 'represents a change from' the interpretation prior to the LSA.[137]

A closely related value of stabilisation clauses arising from arbitral jurisprudence is that they could also be used to support a treaty-based claim by an investor that the host state has frustrated its legitimate expectation of a stable legal framework.[138] The concept of legitimate expectation is usually treated as part of a host state's obligation to provide fair and equitable treatment under an investment treaty.[139] In other words, the fair and equitable treatment standard is violated when the investor is deprived of its legitimate expectation that the conditions existing at the time of the contract will remain unchanged for the duration of the contract.

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[134] See section 2.6.2.
[135] In cases of direct expropriation, the presence of a stabilisation clause is 'a relevant, although by no means decisive, consideration for purposes of the expropriation analysis.' *Burlington* (n 50) [419]
[136] See section 2.6.2 and *Burlington* (n 50) [414]
[137] *Duke* (n 107) [216]
[138] See Shemberg (n 39) 128; Maniruzzaman, *Pursuit* (n 57) 150 – 151.
[139] Maniruzzaman, *Pursuit* (n 57) 151; *Saluka* (n 128) [301]

However, the dominant view arising from arbitral jurisprudence is that, under general international law, an investor cannot legitimately expect that the legal framework will not change, perhaps to their detriment for the duration of the investment.[140] However, going by the comments of several arbitral tribunals, an investor can legitimately expect a stable legal framework if there is a specific commitment in the form of a stabilisation clause or otherwise in the contract between the parties.[141]

These comments by arbitrators suggest that stabilisation clauses create a legitimate expectation, recognisable under international law that the laws of the host state will not change to the detriment of the investor. As such, an investor's claim that the host state frustrated its legitimate expectation of a stable legal regime under an applicable treaty is likely to be successful where the investor benefits from a stabilisation clause. More importantly, the comments of arbitrators indicate that this legitimate expectation is to be protected regardless of any other circumstances surrounding the enactment of the law.[142]

2.8 CONCLUSIONS

Stabilisation clauses can encompass all mechanisms aimed at insulating a foreign investor from the effect of laws enacted subsequent to a contract. They were originally developed as a tool to protect investors against acts of nationalisation and expropriation, but their scope has now broadened and they may be drafted to mitigate the adverse effect of any type of changes in the laws of host states.

A freezing clause exempts investors from the applicability of changes in the law, while an economic equilibrium clause entitles the investors to be compensated for the cost of complying with the new laws. The presence of a stabilisation clause in the legal regime

[140] See section 2.6.2.
[141] *Parkerings* (n 98) [336]; *AES* (n 97) [9.3.31] – [9.3.34]; *Paushok* (n 6) [360] – [370]; *EnCana* (n 94) [173]
[142] See especially *Impregilo* (n 103) [290] where the tribunal noted that 'fair and equitable treatment cannot be designed to ensure the immutability of the legal order, the economic world and the social universe and play the role assumed by stabilization clauses...'

governing an investment may not guarantee that the host government would indeed 'stabilise' its laws in favour of the investor. However, the fact that the clauses have been held to be legally valid and binding by arbitral tribunals and compensation usually awarded for their breach serve as a financial disincentive for governments to act contrary to the clause.

The fact that there are arbitral awards over breaches of stabilisation clauses suggest that the clauses may be preventing at least some host governments from enacting and implementing certain laws that they desired. The question that, therefore, arises is why were the clauses granted in the first place? In other words, on what basis have stabilisation clauses been justified? This is the question that the next chapter attempts to answer.

CHAPTER 3 - STABILISATION CLAUSES AND FOREIGN DIRECT INVESTMENT: PERCEPTIONS VERSUS REALITIES

3.1 INTRODUCTION

Stabilisation clauses are widely portrayed as an essential tool which developing countries use to attract FDI. This claim is, however, mainly based on two presumptions promoted in the legal literature, by the extractive industry and some international organisations.[1] The first is that there is a competition among developing countries to attract FDI. The second is that there are higher levels of political risks in developing countries. This chapter challenges this view. It examines both presumptions and argues that neither presumption is true as such. The chapter concludes by examining the claim that stabilisation clauses are an essential investment attraction tool. It will argue that the evidence that does exist indicate that stabilisation clauses do not significantly influence investment decisions.

3.2 THE PRESUMPTION TO COMPETE FOR FDI

3.2.1 Rationale for FDI

Before proceeding to discuss the presumption of the need to compete for FDI, it is important to first restate the rationale for FDI. This is because proponents of stabilisation clauses often base their arguments on the assumption that foreign investors invest in developing countries to aid the latter's economic development. This assumption is particularly common with those writing from a legal perspective.[2] For example, Christopher Curtis justified the use of stabilisation clauses on the basis that 'investing in the economic future of developing countries involves many uncertainties.'[3] Similarly, Paul Comeaux and Stephan Kinsella were of the view that 'Western investors seek to benefit themselves and the

[1] The view that the promotion of stabilisation clauses have been based on presumptions is now also shared by Howard Mann, 'Stabilization in Investment Contracts: Rethinking the Context, Reformulating the Result' (*ITN*, 07 October 2011) <http://www.iisd.org/itn/2011/10/07/stabilization-in-investment-contracts-rethinking-the-context-reformulating-the-result/> accessed 22 March 2012.

[2] On the contrary, as will be seen throughout this chapter, most economic analyses of FDI present a more realistic view of the rationale for FDI.

[3] Christopher T Curtis, 'The Legal Security of Economic Development Agreements' (1988) 29 *Harvard Intl LJ* 317, 365.

populace of developing countries by investing needed capital to finance production and economic growth.'[4]

The available evidence in the economic literature and analyses by economists show that, in reality, FDI is driven not only by the interest of host governments, but also by the interests of foreign investors and their home governments.[5] For home governments, the outflow of FDI helps to increase their own productivity and competitiveness.[6] For example, the subsequent inflow of repatriated profits can drive re-investment in the home country. It is for this reason that most developed countries, and in recent times some emerging countries, actively pursue 'home country measures' (HCMs) to encourage outward FDI.[7]

On the other hand, countries seek to attract FDI based on the belief that in addition to the inflow of financial resources, the often superior knowledge and technology of foreign firms will have a positive spill-over effect on domestic firms.[8] This spill-over is then expected to lead to increased productivity and output, and improve the international competitiveness of domestic firms and the general economic performance of the host country.[9] These benefits apply regardless of the level of development of the host country.[10] It is for these reasons that policies and strategies to attract FDI have become a standard feature in many developing, as well as developed, countries.[11]

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[4] Paul E Comeaux and N Stephan Kinsella 'Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance' (1994) *15 New York Law School J of Intl Comp L* 1, 35.

[5] See, for example, EIU, *World Investment Prospect to 2011: Foreign Direct Investment and the Challenge of Political Risk* (EIU 2007) 67.

[6] The benefits of outward FDI are well documented. See, for example, Ari Kokko, 'The Home Country Effects of FDI in Developed Economies' (2006) European Institute of Japanese Studies Working Paper 225 <http://swopec.hhs.se/eijswp/papers/eijswp0225.pdf> accessed 22 March 2012.

[7] Such measures include the signing of BITs and double taxation agreements with host governments. For a detailed discussion, see UNCTAD, *Home Country Measures* (UNCTAD 2001).

[8] The benefits of FDI are well documents in the literature. See, for example, OECD, *Foreign Direct Investment for Development, Maximising Benefits, Minimising Costs* (OECD 2002).

[9] Ibid.

[10] See, as examples, US Department for Commerce International Trade Administration, *Assessing Trends and Policies of Foreign Direct Investment in the United States* (USDCITA 2008)1; Andrew Sharpe and Meghna Banerjee, *Assessing Canada's Ability to Compete for Foreign Direct Investment* (CSLS 2008); UKTI, *Britain Open For Business :Growth though International Trade and Investment* (UKTI 2011) 5.

[11] Ibid.

The desire of home countries to encourage outward investment and of host countries to attract FDI is matched by the desire of foreign firms to invest abroad. The reason behind this desire is aptly summed up by the Economic Intelligence Unit (hereafter 'EIU'):

> All firms are subject to the pressures of globalisation. As a result of the liberalisation of international economic transactions in recent decades and improved communication technologies, global competition has intensified. This puts considerable pressure on firms to internationalise, including through FDI. MNCs are motivated to establish a portfolio of locational assets to secure competitive advantage. They are driven to invest abroad to have better access to resources (including skills and technology) and to be close to their markets.[12]

It is therefore submitted that foreign firms' rationale for investing abroad is to obtain the highest return on their investment. As aptly summarised by UNCTAD: 'corporate objectives have remained unchanged: to maximize profits, minimize risk and recover investments as early as possible.'[13] It is therefore incorrect to suggest that foreign investors invest in developing countries because they are concerned about the host country's 'economic future' or are desirous of benefiting the local populace. While this may be an outcome of their investment, it is not an objective of the foreign investor. Rather it is an objective of the host government. This point was finely made by Rainer Geiger some decades ago when he stated as follows:

[12] EIU, *WIP* (n 5) 67.
[13] UNCTAD, *Economic Development in Africa: Rethinking the Role of Foreign Direct Investment* (UNCTAD 2005) 44.

> Undoubtedly the interests of the foreign investor and the host government coincide as to the success and profitability of the undertaking. In other aspects the interests of the parties may be opposite. The company naturally tries to obtain a maximum of return and security of its investment and as much freedom from government interference as possible. The host government, on the other hand may wish to induce the integration of the foreign enterprise into the national economy, control its future operations and share its profits.[14]

This distinction between the seemingly conflicting objectives of the host state and foreign investors is particularly relevant to this thesis. This is because it means that if FDI is to bring the expected benefits, hosts states must balance the profit-making objectives of foreign investors with their own development objectives. Investors should be able to earn profits commensurate with the risks while host states should be able to benefit in terms of long-term sustainable development objectives.[15] The crucial question therefore is whether stabilisation clauses facilitate or undermine this balance. This question is considered in chapter 6. For now, having clarified the rationale for FDI, the next section examines the view that developing countries grant stabilisation clauses because of a need to compete for FDI.

3.2.2 The Presumption to Compete: Rhetoric v Reality in the Extractive Sector

It is important to initially acknowledge that the extent to which FDI impacts upon many developing countries may be higher than that of developed countries. This is because the financial and technological constraints in many developing countries mean they may need to rely more on FDI to stimulate their economic growth. Furthermore, many developing

[14] Rainer Geiger, 'The Unilateral Change of Economic Development Agreements' (1974) 23 ICLQ 73, 75 – 76.
[15] EIU, *WIP* (n 5) 82; UNCTAD, *Economic Development* (n 13) 44 – 46.

countries are in general net importers of FDI.[16] Thus, in the context of FDI, their primary focus is on issues relating to their ability to attract inward FDI and to benefit from it.[17]

That said, it is also true, as noted previously, that strategies and policies to attract FDI is standard in most countries, irrespective of their level of development, geographical location, or industrial structure.[18] In fact, each member of the OECD now maintains an investment promotion agency to attract FDI.[19] Thus, if there is competition to attract FDI, the competitors include developing and developed nations. Accordingly, if this claimed competition for FDI is by itself a justification for the use of stabilisation clauses, then the clause should also be a standard feature of FDI attraction policies in developed countries. However, this does not appear to be the case.[20] In fact, most proponents of the clause recommend it for 'policy-makers in mineral–rich developing countries.'[21] This suggests that the competition for FDI is more intense in the extractive industry of developing countries. However, as the following analysis will show, such a view diverges dramatically from reality.

Much has been written on the current trends and future projections in the extractive industry.[22] However, for the purposes of this thesis, it is useful to briefly restate them here, especially as the information is found mainly in literature external to the legal discipline.

All available evidence points to an increasing competition for oil, gas, and other minerals in developing countries.[23] The reason for this is simple. First, continuous

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[16] A notable exception is China.
[17] UNCTAD, *The Development Dimension of Foreign Direct Investment: Policies to Enhance the Role of FDI, In the National and International Context: Policy Issues to Consider* (UNCTAD 2002) 4.
[18] See section 3.2.1.
[19] See also OECD, *Guiding Principles for Policies toward Attracting Foreign Direct Investment* (OECD 2003).
[20] Neither this thesis nor previous empirical studies found stabilisation clauses being used in a developed country.
[21] UNCTAD, *Best Practices in Investment for Development Case Studies in FDI: How to Attract and Benefit from FDI in Mining: Lessons from Canada and Chile* (UNCTAD 2011) 1.
[22] For an up to date analysis, see, Global Witness, *'Rigged: The Scramble for Africa's Oil, Gas and Minerals* (Global Witness 2012).
[23] The author is not unaware of the recent so-called 'shale gas revolution'. However, the possible commercial exploitation of shale gas does not affect the analysis under this heading in any substantial way as it is based on what is currently being used to justify stabilisation clauses.

industrialisation in developed countries and economic growth in many developing countries (particularly China and India), has led to an increasing global demand for oil, gas and other mineral resources thereby putting considerable strain on limited supplies.[24] Second, while reserves in most developed countries are declining and operating costs remain high, reserves in developing countries remain, in principle, 'large enough' and development costs 'low enough.'[25] As such, developing countries continue to play an ever-increasing role in energy supply and their investment decisions are of 'crucial importance' to global energy security.[26] For example, it is estimated that almost two-thirds of the $38 trillion investment required to meet global energy demand over the period 2011 to 2035 is needed in developing countries.[27]

Consequently, there is a 'scramble' among developed countries and the countries from the former BRIC economic group of developing countries (Brazil, Russia, India and China) for oil, gas and other mineral resources in developing countries.[28] Many of these countries have therefore put in place policies to secure control over supplies, preferably through investments by their own firms.[29] For example, in the US, the promotion of investment by American energy firms is a 'core element' of the country's engagement with 'major oil producers.'[30] Similarly, one of the objectives of the Energy Charter Treaty was to

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[24] For detailed analysis, see the following: John Deutch, 'Future United States Energy Security Concerns'(2004) MIt Joint Program on the Science and Policy of Global Change Report 115 <http://globalchange.mit.edu/files/document/MITJPSPGC_Rpt115.pdf> accessed 22 March 2012; Michael Klare and Daniel Volman, 'America, China and the Scramble for Africa's Oil (2006) 108 *Review of African Political Economy* 297.

[25] IEA, *World Energy Outlook 2008* (IEA 2008) 40.

[26] Ibid. See also Commission, 'The EU Energy Policy: Engaging with Partners beyond Our Borders' (Communication) COM/2011/539 final.

[27] IEA, *World Energy Outlook Factsheet'* (IEA 2011) 4.

[28] See, for example, COM/2011/539 (n 26)3 noting that 'The EU will increasingly compete with other importing countries and regions for energy supplies…' See also, Rowan Watt-Pringle, 'The BRICS scramble for Africa Resources: Plunder or Economic Blessing?' (*Mining Technology,* 15 September 2011) <http://www.mining-technology.com/features/feature129858/> accessed 22 March 2012.

[29] See, as examples, USA, *National Energy Policy: Report of the National Energy Policy Development Group* (US GPO 2001) <http://www.senate.gov/~foreign/testimony/2003/McManusTestimony031021.pdf> accessed 22 March 2012; Paul Belkin 'The European Union's Energy Security Challenges' (CRS Report for Congress, 2008) <https://www.fas.org/sgp/crs/row/RL33636.pdf> accessed 22 March 2012 .

[30] USA, *NEP* (n 29) ch 8 pg 6.

make Russia adopt the EU's principles of competition and to further open its energy sector to outside investors, preferably from the EU.[31] Other strategies include strengthening political relations and increasing investment in both production capacities and energy transit infrastructure in the EU's main supplier and transit countries.[32]

The strategy by China deserves a special mention as it is peculiar in terms of how it is devised, and significant in terms of how it affects the competition for the earth's remaining natural resources.[33] China's abundant coal resources have been insufficient to sustain all aspects of its rapid growth.[34] As a result, the country relies heavily on natural resources in other developing countries, particularly in Africa, to meet its demand. Chinese companies are state-owned and therefore operate as an arm of the government. With this status, they are able to offer 'no-strings attached' assistance to developing countries.[35] Such assistance is, however, linked to its strategic and economic objectives including, expanding access to natural resources and building of infrastructure that supports the transportation of these resources to China.[36] Although China does not generally release details of the amount of its aid, estimates show that it has increased dramatically in the last decade.[37] The Financial Times reported that in 2009 and 2010, China lent more money to developing countries than

[31] Belkin (n 29) 10 – 13.
[32] Ibid 8; COM/2011/539 (n 26) 5.
[33] For detailed analysis of the Chinese strategy, see, Jonathan Weston, Caitlin Campbell and Katherine Kileski, 'China's Foreign Assistance in Review: Implication for the United States' (2011) <http://www.uscc.gov/researchpapers/2011/9_1_%202011_ChinasForeignAssistanceinReview.pdf> accessed 22 March 2012; Denis M Tull, 'China's Engagement in Africa: Scope, Significance and Consequences' (2006) 44 *J of Modern African Studies* 459.
[34] China is currently the world's largest energy consumer and their consumption is projected to increase. IEA, *WEO 2011* (n 27) 2.
[35] 'No-strings attached' in that they do not impose conditions, such as the promotion of human rights, on the recipient countries. Weston, Campbell & Kileski (n 33) 2.
[36] Ibid.
[37] One report estimated that China's economic assistance increased from $51 million in 2002 to $25 billion in 2007. See: Thomas Lum, 'China's Assistance and Government – Sponsored Investment Activities in Africa, Latin America and Southeast Asia (CRS Report for Congress, 2009) <http://www.fas.org/sgp/crs/row/R40940.pdf> accessed 22 March 2012.

the World Bank, a finding which the paper sees as 'a stark indication of the scale of Beijing's economic reach and its drive to secure natural resources.'[38]

In the light of the foregoing, it is argued that the competition among foreign investors, backed by their home governments, for access to natural resources in developing countries is more acute than any competition which is claimed to exist among developing countries to attract FDI. The 'global bidding war' that clearly exists is among foreign investors, backed by their own governments for the natural resources in developing countries.[39] This is especially the case for Africa. In the words of one African leader: 'Since we discovered oil, agents of foreign interests have been running up and down urging us to produce as quickly as possible so that we export it to sustain the good life of outsiders.'[40] His view is supported by Michael Klare and Daniel Volman when they argued as follows:

> The African continent has now become a vital arena of strategic and geopolitical competition for not only the United States, but also for China, India, and other new emerging powers. The main reason for this is quite simple: Africa is the final frontier as far as the world's supplies of energy are concerned with global competition for both oil and natural gas (particularly the latter) becoming just as intense - if not even more so - than the former.[41]

It is conceded that many developing countries lack the financial and technical capacity to exploit these resources and may therefore need to create an investment climate

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[38] Geoff Dyer, Jamil Anderlini and Henny Sender, 'China's Lending New Heights' *Financial Times* (London, 17 January 2011) <http://www.ft.com/cms/s/0/488c60f4-2281-11e0-b6a2-00144feab49a.html#axzz1p7FKlngN> accessed 22 March 2012.
[39] Jim Jubak, 'A Global Bidding War for Oil (20 October 2011) <http://money.msn.com/investing/a-global-bidding-war-for-oil-jubak.aspx?page=2> accessed 22 March 2012.
[40] President Yoweri Museveni, 'Speech on Socio–Economic Transformation to the NRM MPs Retreat' (Kyankwanzi, 18 October 2011) <http://www.newvision.co.ug/news/18505-president-museveni-s-address-to-nrm-mps-in-full.html> accessed 22 March 2012.
[41] Klare and Volman (n 24) 297.

that attracts FDI. However, the fact that there is also a scramble for these resources by foreign investors for the reasons given above means that the benefits of any investment accrue not only to the host countries, but also to the foreign investors and their home governments. It is thus difficult to see why a stabilisation clause, which is not available in the home countries of the investors, is required to create a 'welcoming' environment for them in developing countries. It is even more difficult to understand why the broadest forms of the clauses are found in the extractive industry in Africa, which is also the 'final frontier' for the global competition for energy.[42] One is therefore not convinced that developing countries accept stabilisation clauses out of a need to compete for FDI. This leaves the other justification for the clause: the presumption that political risks are higher in developing countries. This presumption is considered next.

3.3 PRESUMPTION OF HIGHER POLITICAL RISKS IN DEVELOPING COUNTRIES

3.3.1 What are Political Risks

A review of the literature on political risks indicates that there are as yet, no strict boundaries to what constitutes the political risks of an investment.[43] Events that have been considered as a 'political risk' include breach of contract by governments, adverse regulatory changes, restrictions on currency transfer and convertibility, expropriation, war, insurrection and terrorism.[44]

Some authors have sought to distinguish the different types of political risks.[45] Daniel Wagner makes a distinction of particular relevance.[46] First, he makes a distinction between

[42] Previous studies and the findings of this thesis indicate that the broadest forms of stabilisation clauses are found in Africa's extractive industries. Andrea Shemberg, 'Stabilization Clauses and Human Rights (2009) Report, paras 53 – 56 <http://www.ifc.org/ifcext/sustainability.nsf/content/publications_lessonslearned> accessed 16 April 2013

[43] For a detailed discussion of political risks, see, Janice Monti-Belkaoui and Ahmed Riahi-Belkaoui, *The Nature, Estimation and Management of Political Risks* (Quorum Books 1998).

[44] See World Bank, *World Investment and Political Risks* (World Bank 2010) 17 – 19.

[45] For example, Monti-Belkaoui and Riahi-Belkaoui (n 43) 94 – 98

‘firm-specific’ political risks and ‘country-specific’ political risks.[47] He describes firm-specific political risks as those risks directed at a particular company and are, by nature, discriminatory while country-specific political risks are those whose effect is countrywide.[48] Secondly, he makes a distinction between ‘government risks’ and ‘instability risks.’[49] He described government risks as those risks that arise from the actions of governmental authorities such as tax hikes, regulatory changes and breach of contracts.[50] Instability risks, on the other hand, are those risks that arise from political power struggles or insecurity.[51] Included in this list are civil wars, urban riots, kidnappings, sabotage, and mass labour strikes.[52]

The second distinction is particularly relevant to this thesis as it provides some clarity on what constitutes the political risks that stabilisation clauses are intended to mitigate. The discussion in the previous chapter shows that stabilisation clauses are directed at ‘government risks’, i.e. the risks that arise from the actions of government such as detrimental changes in the law of host states. Accordingly, as this thesis deals with stabilisation clauses, a political risk is defined as the risk that the laws of the host state will change to the detriment of a foreign investor.

It is also important to make the point that most analyses on the level of political risk in a country are based on *perceived*, rather than, *actual* risk. Political risk analyses are thus largely subjective and are hardly reached based on realistic criteria.[53] As one commentator noted three decades ago ‘political investment risks do not lend themselves to easy

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[46]Daniel Wagner, ‘Defining Political Risks’ (*IRMI*, October 2000) <http://www.irmi.com/expert/articles/2000/wagner10.aspx> accessed 22 March 2012.
[47] Ibid.
[48] Ibid.
[49] Ibid.
[50] Ibid.
[51] Ibid.
[52] Ibid.
[53] See, for example, a World Bank report acknowledging that the assessment of what is perceived by a mining investor as a good place for investment (including considerations of political risk) is ‘somewhat subjective’. World Bank, *Zambia: What would it Take for Zambia’s Copper Mining Industry to achieve its Potential* (World Bank 2011) 28.

quantification based on objective data.'[54] As such 'the political risk analyses which some institutions in the United States sell at a rather high price hardly offer more than a "best guess."'[55]

Recent studies have confirmed that this view remains true. For example, Mirela Iluo and Sorin Ilou reviewed several empirical studies on political risk and concluded that investors' understandings of the concept of political risk in developing countries were 'subjective and superficial' and based on 'generalization and impressionistic knowledge of a developing nation.'[56] This view is also supported by a recent survey by the firm Ernst and Young which summarised investors' perceptions of political risks in Africa as follows:

> Unsurprisingly, perceptions of attractiveness are heavily influenced by the country of origin of the survey respondent, and often cultural or historical affinity. So for example, Morocco is regarded positively by many French respondents; South Africans tend to be more positive about Anglophone Africa countries (including, interestingly, being the most positive of all respondent about the attractiveness of Nigeria): Indians are positive about South Africa and Kenya, both of which have sizeable Indian minority populations and strong historical ties.[57]

Accordingly, if the argument that stabilisation clauses are required in developing countries due to high level of political risks is true, it assumes that the investment decisions

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[54] See also Jorgen Voss, 'The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies' (1982) 31 ICLQ 686, 691.
[55] Ibid.
[56] Mirela Iloiu and Sorin Iloiu, 'Political Risk and Investment Decision' (2008) VII *Fascicle of Management and Technological Engineering*, 2315, 2317 <http://imtuoradea.ro/auo.fmte/files-2008/MIE_files/ILOIU%20MIRELA%201.pdf> accessed 22 March 2012.
[57] Ernst and Young, *Africa Attractiveness Survey 2011: It's Time for Africa* (EYGM Limited 2011) 22 <http://www.ey.com/Publication/vwLUAssets/2011_Africa_Attractiveness_Survey/$FILE/11EDA187_attractiveness_africa_low_resolution_final.pdf> accessed 22 March 2012.

of foreign investors are significantly influenced by *perceived* political risks. If this is found not to be the case, then it assumes that the political risk levels are *actually* higher in developing countries. Whether these assumptions reflect reality then deserves some attention.

3.3.2 Investors' Perception of Risks and Investment Decisions

Investors everywhere (whether in developed or developing countries) want to minimise risks in order to maximise profit. However, this should not be interpreted as meaning that investors are influenced by *perceived* political risks when making *actual* investment decisions. On the contrary, the available empirical evidence suggests that investors' perceptions of political risks in developing countries have little or no influence in their actual investment decisions. Before highlighting the findings of some of these studies, it is important to briefly examine a contrary opinion expressed by the World Bank.[58]

According to the World Bank, 'there is little dispute that risk perceptions influence foreign investment.'[59] However, nowhere in the report was the basis for this view revealed. Rather, the report severally stated that 'the link between FDI and political risk is not straightforward.'[60] If this is so, then one is left to wonder how the report was able to draw a 'little disputed' line between FDI and risk perception. This is more so because the report admits that despite the high perception of political risks, investors in developing countries 'appear particularly bullish in their investment intentions.'[61] One must, therefore, dismiss this view of the World Bank, as expressed in the report, as incorrect and unreliable.

On the other hand, a significant number of studies confirm that there is a disconnection between investors' perception of risks and their actual investment decisions. This is particularly true in the extractive industry. For example, a survey by EIU found that

[58] World Bank, *WIPR 2010* (n 44).
[59] Ibid 36.
[60] Ibid 18, 21, 36.
[61] Ibid 7.

investors' perceive that political risks in developing countries and emerging markets will increase over the next 5 years.[62] However, the majority of the responding investors remained bullish about the investment outlook in these countries and planned to invest more over the same period.[63] The report, therefore, concluded that perceptions of political risks 'do not appear to have a significant impact on decision-making.'[64]

The Ernst and Young report also arrived at a similar conclusion.[65] The report compared the attractiveness of African countries with the actual distribution of FDI projects in Africa in 2010 and found a clear disconnect.[66] Furthermore, when the report analysed FDI inflow into Africa between 2003 and 2010, it also found that over 70% of the investment into Africa went to 10 countries that do not necessarily have the lowest perception of political risks.[67]

An examination of global distribution of FDI in recent years also fails to highlight a significant link between investors' perception of political risks and their investment decisions. In the last five years, the perception of political risk in developing countries has heightened due to so called 'resource nationalism.' However, developing countries experienced an increase in FDI within the same period such that by 2012, for the first time, developing countries attracted more FDI than developed countries, accounting for 52 per cent of global FDI flows.[68]

Several commentators and the empirical studies cited earlier have suggested reasons for the apparent disconnect between investors' perception of political risks and their actual

[62] EIU, *WIP* (n 5) 40.
[63] Ibid.
[64] Ibid.
[65] Ernst and Young (n 57).
[66] Ibid 22.
[67] Ibid 22. Excluding South Africa, all the other high FDI attracting nations, including Egypt, Morocco, Algeria, Tunisia, Nigeria, Angola and Libya do not have a low perception of risks even among Africa nations.
[68] UNCTAD, *World Investment Report 2013: Global Value Chains: Investment and Trade for Development* (UNCTAD 2013) 2.

investment decisions.[69] The summary of their suggestions is that while investors may have certain perceptions of political risks about countries, their decisions to invest in particular countries are is driven by economic reality, rather than political risk perception. It, therefore, does appear that political risks tend to concern lawyers more than the investors themselves. As Howard Mann and Konrad von Moltke argues, 'while lawyers focus their advice on risk and remedies, this does not make it the principal focus of the business investor itself.'[70] Other factors including, availability of resources, market potential, political stability, and physical infrastructure 'play a much larger role in these decisions.'[71] Similarly, the EIU explained this disconnect as follows:

> Contrary to popular belief, businesspeople and investors have traditionally paid little attention in their decision-making to most forms of political risk, compared with most other important drivers of investment decisions. Macroeconomic conditions, labour availability and costs, and the overall business and policy environment in a country have been far more important issues.[72]

Based on the foregoing, coupled with the discussion on the global competition for oil, gas and other mineral resources, it is argued that resource–seeking investors in developing countries are largely driven by economic factors, and in particular by the resource potential of the host country. Yet, proponents of stabilisation clauses argue that the clauses should be granted to these sorts of investors. This, they say, is because of the long

[69] EIU, *WIP* (n 5); Ernest and Young (n 57); Howard Mann and Konrad von Moltke, 'Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11 (Background Paper to the ILSD Tri-National Policy Workshops, 2011).
[70] Ibid fn 8 on pg 4.
[71] Ibid.
[72] EIU, *World Investment Prospect* (n 5) 40. When asked what would have the greatest influence on global FDI trends in the coming 5 years, respondents largely cited economic, rather than political, trends. Out of 14 factors, 6 of the top 7 were economic issues (geopolitical tensions were fifth).

term and capital intensive nature of the investments. If this is true, then the question that arises is why are stabilisation clauses not also used in the extractive industries of resource-rich developed countries? The usual answer in the literature is that the political risk in developed countries is lower. Whether this is true is the focus of the next section.

3.3.3 Challenging the Myth of Higher Political Risks in Developing Countries

The view that there are higher levels of political risks in developing countries has always been met with some criticism.[73] This view has come under further challenge in recent times. As one commentator puts it, 'all countries are risky. Emerging markets are those where this risk is priced in. Developed countries are where investors do not perceive their own risk.'[74] Similarly, Thomas Wälde and George Ndi argue that although investors' concerns for political risks in developed countries may be less acute, this 'may be wrong' and is 'perhaps due to cultural prejudices.'[75] They went on to suggest that 'a realistic analysis' in developed countries will usually reveal increases in taxation and changes in tax and environmental legislation to the detriment of investors.[76]

In 2008, a 'realistic analysis' was carried out by Peter Cameron and Graham Kellas on significant changes to fiscal terms in petroleum regimes around the world between 2002 and 2008.[77] Their findings show that these changes occurred not only in developing countries but also in developed countries including, Australia, Canada, UK and the US.[78] They therefore concluded that investors in the petroleum industry of developed countries are

[73] For example, John C Kinna, 'Investing in Developing Countries: Minimisation of Political Risk' (1983) 1 JENRL 89, 89 – 91, arguing that the political risk of detrimental changes in law exists in the extractive industry of both developed and developing countries.
[74] Jerome Booth as reported by Peter Apps, '"Political Risk Everywhere" Here to Stay' (*Reuters*, 24 June 2010) <http://in.reuters.com/article/2010/06/24/idINIndia-49610420100624> accessed 22 March 2012.
[75] Thomas W Wälde and George Ndi 'Stabilizing International Investment Commitments: International Law versus Contract Interpretation' (1996) 31 *Texas Intl LJ*, 215, 222 fn 26.
[76] Ibid.
[77] Peter Cameron and Graham Kellas, 'Contract and Fiscal Stability: Rhetoric and Reality' (*Wood Mackenzie and CEPMLP*, September 2008) <http://www.dundee.ac.uk/cepmlp/gateway/index.php?news=29422> accessed 22 March 2012.
[78] Ibid 4.

‘particularly vulnerable’ to adverse changes as governments of developed countries ‘appear just as likely to change fiscal terms as those in the developing world.’[79] The question that therefore arises is: what has been the basis for the view by some that developing countries have higher political risks?

Most commentators trace the basis for this view to the historical instances of nationalisation and expropriation in some developing countries especially between the 1960s and 1970s.[80] However, those who hold this view tend to overlook the fact, and often do not mention, that developed countries with significant extractive industry activity also carried out similar actions during that period.[81]

For example, several acts of nationalisation and expropriation by Canada in the 1970s culminated in the announcement of the National Energy Program in 1980. The stated aim of the program was to increase Canadian ownership and control of oil and gas production to a minimum of 50 per cent by 1990.[82] Pursuant to this program, the government enacted the Canadian Oil and Gas Act in 1981. The Act authorised inter alia; the government to acquire 25 per cent ‘Crown share’ in certain development, exploration and production interests in Canada.[83]

Similar acts of expropriation and nationalisation were also carried out by the UK during that period. For example, the Petroleum and Submarine Pipelines Act 1975 made major changes to the terms of existing production licenses, created a new form of petroleum taxation and gave shares to a newly established state oil company in all North Sea field

[79] Ibid 2.
[80] See, for example, Curtis (n 3) 319.
[81] This was in addition to acts of nationalisation in other sectors such as coal, transport and banks. For details, see: Konstantin Katzarov, *The Theory of Nationalization* (Martinus Nijhoff 1964) 42 – 53.
[82] For details, see, Cecil J Olmstead, Edward J Krauland and Diane F Orentlicher, ‘Expropriation in the Energy Industry: Canada’s Crown Share Provision as a Violation of International Law’ (1983 – 1984) 29 *McGill LJ* 439.
[83] Section 7.

developments.[84] However, unlike most developing countries, the licence terms contained neither stabilisation nor intangibility clauses and perhaps for this reason did not lead to any major legal challenge. Based on the foregoing, any claim that investors' perception of risk in developing countries is due to historical instances of expropriation and nationalisation must surely be incorrect.

A realistic analysis of political risks in developed countries can be taken further into the area of windfall profit taxes and increases in royalty rates. This is because the recent heightened perception of political risks in developing countries is often attributed to the attempts by their governments to seek a greater share of the profits of investors in the wake of rising commodity prices.[85] However, contrary to the perception created in most of the legal literature, these measures have not been the exclusive preserve of developing countries. They have also been undertaken by developed countries.[86]

For example, since 1973, the UK has imposed fiscal changes in the North Sea for an average of once every two years in a 'glistening example of fiscal volatility.'[87] More recently, since 2002, the fiscal regime governing the North Sea has been altered several times to impose or increase 'windfall profit' taxes on investors.[88] In 2002, a 10 per cent 'supplementary charge' was introduced on top of the standard corporation tax. The tax was doubled to 20 per cent in 2005 and further increased to 32 per cent in 2011.[89]

All the changes were justified by the need for the government to benefit from the steep rise in oil prices, and were introduced suddenly without any significant consultation

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[84] Peter D Cameron, *'Property Rights and Sovereign Rights: The Case of North Sea Oil'* (Academic Press 1983).
[85] World Bank, *WIPR 2010* (n 44) 19.
[86] See Appendix II
[87] Daniel Johnston, 'Changing Fiscal Landscape' (2008)1 JWELB 31, 44.
[88] For a detailed analysis of the changes in the North Sea see, Antony Seely, 'North Sea Oil Taxation' (House of Common Library, Standard Note SN00341, 2011) <http://www.parliament.uk/business/publications/research/briefing-papers/SN00341/taxation-of-north-sea-oil> accessed March 22 2013.
[89] HM Treasury, 'Pre-Budget Report 2005' (05 December 2005); HM Treasury, *Budget 2011* (March 2011) para 1.146.

with the industry.[90] As observed by the industry representative in its response to the 2011 changes, the increase followed 'a similar pattern' and was 'wholly unexpected.'[91] It therefore called for 'constructive discussions' between the government and the industry aimed at 'finding a cure for the chronic fiscal instability of the UK regime.'[92] It is however unlikely that this call will be heeded as the UK 'makes no pretensions about stability.'[93] As such, it has been argued that in terms of fiscal instability, 'the worst place to produce oil is not Russia or Venezuela, but Britain which is constantly tinkering with its tax rates.'[94]

Consequently, it is submitted that historical instances of nationalisation and expropriation, and modern day examples of changes in fiscal regimes to the detriment of investors can be found in developing countries, as well as developed countries. Investors therefore face similar political risks in all countries. However, that is not the end of the matter. Investors in developed countries also face a higher risk of protectionism, often disguised by governments as environmental regulation to avoid being ordered by arbitral tribunals to compensate the investors.[95] As Thomas Wälde and Abba Kolo argue:

> Given the political legitimacy of environmental causes, regulation that is in substance protectionist will be politically more acceptable if it appears on the scene clothed in environmental dress. All of the current batch of pertinent NAFTA awards and much of the discriminatory national regulation struck by enforcement of EU law involve acts of protectionism or mistreatment of unwary

[90] Ibid; Oil and Gas UK 'Budget 2011 Q&A' <http://www.oilandgasuk.co.uk/knowledgecentre/Budget2011QA.cfm> accessed 22 March 2012.
[91] Ibid
[92] Ibid
[93] Johnston (n 87) 45.
[94] The Economist, 'Energy and Nationalism: Barking Louder, Biting Less' (08 March 2007) <http://www.economist.com/node/8815008> accessed 22 March 2012.
[95] EIU, *Barriers to Entry Coping With Protectionism* (EIU/UKTI 2006).

> foreign investors, often blatant, but camouflaged in the much more palatable clothes of sacred environmental causes.[96]

Indeed, one can cite several cases to support the above views including, *Pope & Talbot Inc vs Canada*,[97] *SD Myers v Canada*,[98] *ADF v US*,[99] *Methanex v the US*,[100] and *Glamis Gold Ltd v US*.[101]

In the Glamis case, the investors had claimed, inter alia, that certain measures and actions by the federal government actions and the State of California resulted in the expropriation of their investments in violation of Article 1110 of NAFTA.[102] The tribunal however dismissed Glamis' claims because with the high price for gold, among other factors, the economic impact of the regulations was not high enough to constitute an indirect expropriation.[103] However, as Thomas Wälde argues, California imposed an 'intentionally prohibitive, novel and unexpected reclamation requirement' mainly 'with the express purpose of preventing the mine' but justified it as an 'environmental measures.'[104] He therefore concludes that:

> Developed economies cannot therefore necessarily claim to offer greater protection of acquired rights. To the contrary, they may offer a model of how to undo acquired rights by stealth through the deployment of regulation and tax rules, but also in the even better camouflaged ways of enforcement. Such regulatory and

[96] Thomas Wälde and Abba Kolo, 'Environmental Regulation, Investment Protection and Regulatory Taking in International Law' (2001) 50 ICLQ 811, 850.
[97] UNCITRAL (Ch 11 NAFTA Arbitration), Award on Merits Phase II of 10 April 2001
[98] UNCITRAL (Ch 11 NAFTA Arbitration), Partial Award of 13 November 2000
[99] ICSID Case No ARB(AF)/00/1, Award of 09 January 2003
[100] UNCITRAL (Ch 11 NAFTA Arbitration), Final Award of 03 August 2005
[101] UNCITRAL (Ch 11 NAFTA Arbitration), Award of 08 June 2009
[102] Ibid.
[103] Ibid [534] – [536]
[104] Thomas W Wälde 'Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law' (2008)1 JWELB 55, 76.

> administrative practices can, at face value, be made to appear innocuous and legitimate but achieve the same effect than the cruder instruments of confiscation, expropriation and nationalization used in the past primarily in developing countries.[105]

It is important to point out that in the majority of these cases; the investors' claims were dismissed. However, this was not because the investors did not suffer the adverse effects of the regulatory changes. Rather, it was largely because the investors had no specific commitment in the form of a stabilisation clause that could have protected them.[106] Thus as William Arnold puts it:

> It is ironic that countries such as Canada and the United States of America, where a request for a stability agreement would be regarded as a joke, have in fact been more unstable to the mining industry than many developing countries due to regulatory changes concerning the environment and health and safety issues.[107]

To conclude this section, the political risks that stabilisation clauses aim to minimise also exist in developed countries, especially those with significant extractive industry activity. However, while developing countries offer stabilisation clauses to minimise these risks, developed countries do not. Yet both developed and developing countries actively seek to attract FDI. The question that therefore arises is: are investors influenced, in a significant

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[105] Ibid 76-77.

[106] For example, the *Methanex* tribunal suggested that the actions of the Californian authorities may be classed as an expropriation if 'specific commitments' had been given by California government to Glamis that it would refrain from such regulation. See *Methanex* (n 100) Pt IV, ch D [7]

[107] William F Arnold, 'Mongolia Mining Sector Competitiveness and the Use of Stability Agreements' (2004) Report on Mongolia Economic Policy Reform and Competitiveness Project, 5 <http://www.eprc-chemonics.biz/documents/tech_reports/apr15_2004_mining_stability_en.pdf> accessed 22 March 2012.

way, by stabilisation clauses when making investment decisions? In other words, do stabilisation clauses attract FDI into developing countries? This question is examined next.

3.4 ARE STABILISATION CLAUSES EFFECTIVE IN ATTRACTING FDI?

Before proceeding to discuss whether stabilisation clauses influence investors' investment decisions, it is important to state that undertaking such an analysis poses several constraints. First, in most countries where stabilisation clauses are used, contracts containing the clause are classified as confidential and kept secretly. And since stabilisation practice varies from country to country, and sometimes even within a country, it becomes difficult to draw a general conclusion on the effectiveness of stabilisation clauses as a whole.

Second, although there is the option of surveying investors to discover to what extent they were or would be influenced by stabilisation clauses, this is not thought to be a viable option. This is because the disconnection between investors' perception and their investment decisions highlighted previously suggests that investors do not base their investment decisions on what is ideal.[108] Rather, investment decisions are based on economic reality. Furthermore, as will be discussed in more detail later, investors usually ask for stability guarantees, especially if they believe they can get it without much cost.[109] As such, while most investors may readily respond in a survey or interview that they consider stabilisation clauses as essential, they may still go ahead to invest without the clause where they are unable to get one.[110] In other words, what matters are the actions of the investors rather than what they say.

In any event, it is already established that investors' perceptions of political risks differ even in a particular country.[111] Thus while some investors may refrain from investing in a country due to the absence of stabilisation clauses, others may choose to invest without

[108] See section 3.3.2.
[109] See section 3.4.2 and 3.4.3.
[110] Ibid.
[111] See section 3.3.2.

the clause. Since the interest here is whether stabilisation clauses influence the overall inflow of FDI into a country, the divergent views of investors may therefore offer little clarity. This thesis thus seeks to answer the question whether stabilisation clauses influence the inflow of FDI to developing countries in a way that better reflects the *actual* investments decisions by investors. This will be done in three ways: First, an analogy will be drawn from the practice of using BITs and incentives and their effectiveness in attracting FDI. Second, the relevant findings of previous empirical studies on stabilisation clauses will be examined to see if any link can be drawn between stabilisation clauses and FDI inflow. This will then be followed by a review of recent trends in stabilisation practice amongst countries to see if any significant link can be found between stabilisation clauses and FDI inflow.

3.4.1 Lessons from Bilateral Investment Treaties and Investment Incentives

Stabilisation clauses share similar characteristics with bilateral investment treaties (BITs) and incentives. Like stabilisation clauses, BITs are portrayed as a tool which developing countries can use to create a favourable investment climate to attract FDI.[112] From an investors' perspective, BITs also share similar characteristics with stabilisation clauses as they can be relied upon by investors to mitigate, to a significant extent, the political risks that stabilisation clauses are aimed at. Incentives are also touted as tools that countries can use to attract FDI.[113] In this sense, a stabilisation clause may be seen as a regulatory incentive.

BITs and incentives also share another characteristic with stabilisation clauses. Like stabilisation clauses, they were routinely advocated for use, in primarily developing countries, without a proper examination of their effectiveness as an investment attraction tool.[114] This is despite the fact that, like stabilisation clauses, BITs and incentives impose

[112] The preambles of many BITs state that their purpose is to promote and attract FDI.
[113] UNCTAD, *Tax Incentives and Foreign Direct Investment: A Global Survey* (UNCTAD 2000).
[114] Mary Hallward–Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only A Bit…And They Could Bite' (2003) World Bank Policy Research Working Paper 3121, 1

significant obligations on host states while conferring strong rights on investors.[115] Thus for years their effectiveness and usefulness remained a subject of debate.

In the past decade however, several empirical studies have been undertaken on the issue.[116] The dominant view from these studies is that, at best, incentives and BITs play a minor role in attracting FDI to developing countries. For example, with regards incentives, Stefan van Parys and Sebastian James surveyed tax holidays granted by countries in the CFA Franc Zone between 1994 and 2006 and found 'no convincing evidence of the effectiveness of tax holidays on investment.'[117] Similarly Louis Wells and Nancy Allen, after finding no significant change in investment inflow to Indonesia after the country removed tax holidays in 1984, concluded that tax incentives do not determine location of FDI.[118]

In the case of BITs, Jason Yackee conducted a survey of in-house lawyers in large US corporations and found that majority do not view BITs as playing a major role in their companies' foreign investment decisions.[119] He therefore concluded that BITs are 'unlikely to significantly drive foreign investment.'[120] Similarly, Mary Hallward–Driemeier reviewed bilateral FDI outflows from 20 OECD countries to 31 developing countries between 1980 and 2000 and found 'little evidence that BITs have stimulated additional investment.'[121]

<http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3121> accessed 22 January 2014 ; Yolande Vamusse 'Tax Incentives and Exemptions not Necessary to Attract investment' (*Institute of Development Studies*, 20 December 2012) <http://www.ids.ac.uk/news/tax-incentives-and-exemptions-not-necessary-to-attract-investment> accessed 22 January 2014

[115] BITs usually contain investors' protection standards and the right to bring international arbitration.

[116] On BITs, see as examples, Jason Webb Yackee 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' (2010) 51 *Virginia J Intl L* 397; Hallward–Driemeier (n 114) 1 and 23. On Investment incentives, see as examples, Stefan van Parys and Sebastian James 'The Effectiveness of Tax Incentives in Attracting Investment: Panel Data Evidence from the CFA Franc Zone' (2010) 17 *Intl Tax Public Finance* 400; Louis T Wells and Nancy J Allen 'Tax Holidays to Attract Foreign Direct Investment: Lessons from Two Experiments' in Louis T Wells and ors (eds), *Using Tax Incentives to Compete for Foreign Investments* (IFC/World Bank 2001).

[117] van Parys and James (n 116).

[118] Wells and Allen (n 116). See also Magnus Blomström, Ari Kokko and Mario Zejan, *Foreign Direct Investment: Firm and Host Country Strategies* (Macmillan 2000).

[119] Yackee (n 116).

[120] Ibid.

[121] Hallward–Driemeier (n 114).

Although some debate still remains,[122] the view that BITs and incentives are largely insignificant in investment decisions appears more attractive. Indeed, as UNCTAD admits, 'there are many examples of countries with large FDI inflow and few, if any BITs.'[123] Similarly, unless key economic determinants are favourable, incentives (financial, fiscal, regulatory or otherwise) may only be 'an icing on the cake', especially for natural resource or market seeking investors.[124]

The above findings on BITs and incentives suggest that their continuous use is not by itself evidence of their effectiveness in attracting FDI. These findings can be applied by way of analogy to an analysis of the effectiveness of stabilisation clauses in attracting FDI (assuming stabilisation clauses to be a regulatory incentive). If this is done, the argument can be made that the grant of stabilisation clauses, and their continuous use by several developing countries, is not by itself evidence of their effectiveness in attracting FDI, contrary to the claims by some commentators.[125] For this to be so, it has to be shown that the investors were indeed swayed by the offer of stabilisation clauses to invest. This is more so because all the empirical studies on BITs and incentives affirm that the traditional factors, such as large market size, availability of natural resources, good infrastructural development, high skills level, and relative wealth and labour costs, remain more important determinants of FDI inflows.[126] Perhaps the empirical studies on stabilisation clauses themselves may offer some clarity.

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[122] For another study that finds some sort of link between BITs and FDI, see, Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties increase Foreign Direct Investment to Developing countries' (2005) 33 *World Development* 1567.

[123] UNCTAD, *Bilateral Investment Treaties in the mid–1990s* (UNCTAD 1998) 141. A notable example is Brazil.

[124] EIU, *WIP* (n 5) 68.

[125] See, for example, Curtis (n 3).

[126] See, for example, Yackee (n 116); Hallward–Driemeier (n 114); EIU *WIP* (n 5) 68; UNCTAD, *Economic Development* (n 13) 64 – 65.

3.4.2 Lessons from Empirical Studies on Stabilisation Clauses

The study by Andrea Shemberg is a good starting point in an analysis of whether stabilisation clauses attract FDI to developing countries as it remains the largest study of its kind.[127] The following comment in the report is particularly relevant as it is the closest the report came to explaining a possible link between stabilisation clauses and FDI:

> Investors and lawyers (including those representing states and investors) observe that states sometimes accept sweeping stabilization clauses, along with other terms that appear to tilt the project in favor of the investor, as a way of securing a large investment project and enticing further investment in the country.[128]

While the above views may be true, they provide no indication whether the investors' decision to invest were actually influenced by the stabilisation clauses or by the 'other terms' or by none of these. Indeed, other empirical studies have found that requests for stabilisation clauses are largely reflective of rent–seeking behaviours by investors.[129] In other words, regardless of whether or not stabilisation clauses are important to investors, they would request for them if they feel they can get them especially as 'it does no harm to have it.'[130]

The view that requests for stabilisation clauses are largely reflective of rent-seeking behaviours by investors is supported by the findings of several studies that not all developing countries accept requests for stabilisation clauses and investors do not always insist on the clause.[131] For example, Peter Cameron found that a 'striking feature' of petroleum regimes

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[127] Shemberg (n 42).
[128] Ibid para 21.
[129] See, for example, Mustafa Erkan, *International Energy Investment Law: Stability through Contractual Clauses* (Wolters Kluwer 2011).
[130] Ibid 137 – 138. See also Howse Robert 'Freezing Government Policy: Stabilization Clauses in Investment Contract' (2011) 3(1) ITN <2011) http://www.iisd.org/itn/2011/04/04/freezing-government-policy-stabilization-clauses-in-investment-contracts-2/> accessed 23 March 2012.
[131] Ibid; Shemberg (n 42) para 15; Peter D Cameron, 'Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors' (Report for AIPN, 05 July 2005)

in the world is that not all regimes offer stabilisation clauses and investors 'appear to have no difficulty in living with this.'[132] According to him, one of the reasons for this is that while the perception of risks may be high, the geological risk may be low enough for investors to accept a contract without stabilisation provisions.[133] He therefore concluded that countries with significant proven reserves do not see any need to grant stabilisation clauses.[134]

Accordingly, the only conclusion to be drawn in this thesis, based on the findings from empirical studies of stabilisation clauses, is that stabilisation clauses do not significantly influence investment decisions in the extractive industries of developing countries. Consequently, they play an insignificant role in attracting FDI to developing countries. However, it is important, before leaving this discussion, to examine a contrary finding in a recent publication by UNCTAD.[135] Relying on the findings from case studies of Chile and Canada, the study claimed that stability contracts can be used to attract FDI and therefore recommended 'tax and regulatory stability contracts' to 'mineral-rich developing countries.'[136] This study is significant as it appears to be the only publicly available empirical study which claims that stabilisation clauses help attract FDI. It is therefore important to examine the validity of this claim, especially as it contradicts the conclusion already reached in this thesis.

The first problem with the claim is that the study also covered Canada.[137] Canada, as aptly stated by William Arnold, is 'in fact been more unstable to the mining industry than many developing countries.'[138] Yet, according to this UNCTAD study, Canada has been able

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<http://lba.legis.state.ak.us/sga/doc_log/2006-07-05_aipn_stabilization-cameron_final.pdf > accessed 23 March.

[132] Ibid 13.

[133] Ibid.

[134] Ibid 12. This view was confirmed by the study by Erkan (n 129) 123, 134 – 135.

[135] UNCTAD, *Best Practices* (n 21).

[136] Ibid 84.

[137] Ibid 13.

[138] Arnold (n 107)5. See also section 3.3.3.

to attract and benefit from FDI in its mining sector.[138] This is despite the fact that Canada does not grant stabilisation clauses. This crucial fact may have been overlooked by the study because the authors were influenced by the myth that developed countries such as Canada have lower political risks which make stabilisation clauses less important.[139] However, when the focus is turned to Chile, the facts on Chile, as presented in the study, suggest that stability contracts do not play any significant role in the inflow of FDI to the Chilean mining sector. Rather, they make a strong case for the view that Chile had been able to attract FDI into its mining sector because it possesses the traditional determinants of FDI location.

Chile has around a third of the world's copper reserves and significant reserves of other minerals.[140] As the study acknowledges, this is one of the two major reasons for the extensive exploration in Chile in the past decades.[141] In addition to its favourable geological potential, Chile also ranks high in terms of political stability. As noted in the study, the return of democracy in the early 1990s led to political stability without undermining the market-oriented institutions created in the previous decades.[142]

The study also found that Chile ranks high in terms of quality of governance,[143] while its corruption levels are minimal.[144] It is therefore not surprising that in 2010 Chile became a member of the OECD, the first South American country to join.[145] The study also

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[138] UNCTAD, *Best Practices* (n 21) 13.
[139] This myth has already been debunked in section 3.3.3.
[140] Chile is ranked 5th out of 72 jurisdictions by international mining investors in terms of pure mineral potential. Fred McMahon and Miguel Cervantes, *Annual Survey of Mining Companies 2009/2010* (Fraser Institute 2011).
[141] The other major reason, according to the report is the 'limited taxation of mineral revenues'. UNCTAD, *Best Practices* (n 21) 55.
[142] Ibid 61. According to The Economist, Chile is widely seen as 'a stable, business-friendly environment where contracts are enforced' The Economist 'Chile's Mining Industry: Good Copper Bad Copper' (21 November 2011)http://www.economist.com/node/21540027 > accessed 23 March 2012.
[143] Ibid 62. Chile scores above the Latin American average in all of World Bank's governance and indicators and is in the top quartile in accountability, regulatory quality, government effectiveness, and control of corruption and the rule of law.
[144] Ibid, noting that Chile ranks 25th out of 180 countries in TI's CPI. This was further improved to 22 out of 183 countries. See TI, *CPI 2011* (TI 2011) <http://cpi.transparency.org/cpi2011/results/> accessed 23 March 2012.
[145] Ibid.

scored Chile high on regulatory certainty and fiscal regime.[146] It even scored Chile well above most developed countries in terms of regulatory uncertainty especially as concerns native land claims and environmental regulations.[147] Furthermore, it found that Chile has 'traditionally been one of the lowest taxed mining jurisdictions.'[148] Indeed, until 2006, mining companies did not pay any special tax or royalty but were only subject to Chile's general income tax regime, which is the lowest in Latin America.[149]

Based on the foregoing, it is clear that Chile already possesses the key determinants of FDI in the mining sector and even without stabilisation clauses is already every mining investor's dream. Indeed, a recent analysis of FDI inflow into Latin America and the Caribbean up to 2011 shows that the levels of FDI into individual countries continue to reflect the ranking of the country in terms of key determinants.[150] For example, Brazil continues to attract the highest FDI in the region even though it is not known to grant stabilisation clauses. As such, it is argued that stability contracts have been largely insignificant in the inflow of FDI to the Chilean mining sector for the above reasons in addition to the following.

First, as admitted by the report, stability contracts have been available in Chile since 1974.[151] Yet, it was only from the 1990s, following the return of democracy, that Chilean mining began to attract substantial FDI.[152] Second, in Chile, as is in some other countries, stability contracts are optional and investors with stabilisation clauses are subject to a higher tax rate. For this reason, as the report itself admits, not all foreign investors benefit from

[146] Ibid 64 – 65.
[147] Ibid, relying on the survey by the McMahon and Cervantes (140).
[148] Ibid.
[149] Ibid.
[150] UNECLAC, 'Latin America and the Caribbean: Inward foreign direct investment <http://www.eclac.cl/prensa/noticias/comunicados/0/44870/TablasCP-IED2011-ING_final.pdf> accessed 26 March 2012.
[151] Foreign Investment Law DL 600 1974, art 7.
[152] UNCTAD, *Best Practice* (n 21) fig 111.1 on pg 57.

stabilisation clauses as some opted not to apply for one.[153] Third, as already stated, Chile was admitted into the OECD in 2010. This is significant because OECD countries are not known to grant stabilisation clauses that offer exemptions from new laws.[154] Chile is thus now part of an organisation whose members are able to attract FDI without the aid of stabilisation clauses. In this sense, one can argue that Chile, like other OECD members already possesses the ability to attract FDI into its mining sector without offering stability guarantees.

Indeed, an examination of the data in the same study, showing FDI inflow into the Chilean mining sector between 1978 and 2008, shows no relationship stability contracts and FDI inflow.[155] The data shows that during the 1990s, the Chilean mining sector saw a significant increase in FDI reaching a peak in 1998 but since then FDI inflows have been volatile and below the 1998 levels despite the continued availability of stability contracts.[156] Accordingly, it is submitted that the conclusions reached by UNCTAD, based on 'lessons' from Chile, that stability contracts help attract FDI, must surely be incorrect.

3.4.3 Lessons from Recent Trends in Stabilisation Practice

In the past decade, investor-state disputes have brought to the fore the practice of including stabilisation provisions in the contractual arrangement between host states and foreign investors. In the majority of cases, the disputes have arisen as a result of legislative actions taken by host states to capture a greater share of the windfall from rises in the prices of commodities. The success or failure of these actions has largely depended on how the respective stabilisation clauses are handled. These events may therefore provide some insights as to the role of stabilisation clauses in attracting FDI to developing countries especially by looking at the effect the changes later had on investments decisions. A review of these events reveals two relevant findings. First, it confirms that even in countries where

[153] Ibid.
[154] See Shemberg (n 42) section 6, finding that no OECD country offer exemptions to investors from new laws while only 15 per cent offer an opportunity to claim compensation for compliance with certain new laws.
[155] UNCTAD, *Best Practices* (n 21) fig 111.1 on pg 57.
[156] Ibid.

stabilisation clauses are used, not every investor is protected by it, yet they continue to invest. Secondly, it reinforces the argument that there is no robust link between stabilisation practices and the inflow of FDI. These findings are discussed below.

3.4.3.1 Stabilisation Clauses Not Generally Available to All Investors

Earlier empirical studies have already confirmed that not all developing countries offer stabilisation clauses.[157] What is now becoming increasingly clear is that even in countries where stabilisation clauses are offered, not all investors are protected by the clause. In some cases, the investor has no choice in the matter as stability guarantees are only available to specific projects or sectors. For example, the Petroleum Development of Timor Sea (Tax Stability) Act 2003 established stability agreements only for projects relating to the development of the 'Bayu-Undan field' in Timor-Leste.[158] Similarly, the Nigeria LNG (Fiscal Incentives Guarantees and Assurances) (Amendment) Act 1993 grants stabilisation clauses only to the Nigeria LNG Limited.

In some other cases, entitlement to stabilisation clauses is based on fulfilling certain conditions which may include a minimum threshold of investment by the potential investor. For example, under the Foreign Investment Law of Mongolia *(as amended in 2003*), an investor must be 'intending to undertake an investment project of not less than US$2 million' before it can apply for a stability agreement.[159] In such a case, any investor whose investment falls below this amount cannot get a stability agreement.

However, there are countries, especially in Latin America, where the investor has the choice whether or not to apply for a stability agreement. In such cases, the government simply creates two fiscal regimes. One is for investors with stability contracts and the other is for investors without stability contracts. Usually, the main difference between the two

[157] See section 3.4.2.
[158] Preamble.
[159] Article 19.1.

regimes is an elevated tax rate in the fiscal regime for investors with stability contracts. The higher rate is thus the 'premium' the investor pays to access the protection offered by stabilisation clauses.[160] What is however striking is that a significant number of investors who are qualified to apply for stability agreements in these countries choose not to apply for it.

For example, in Ghana, the process for applying for stability agreements was made transparent through the Mineral and Mining Act 2006.[161] However, since the Act was enacted, no stability agreement has been entered into by the government. Furthermore, the evidence from media reports and press releases indicate that only two of the major mining companies have stability agreements with the government.[162] Thus as many as 20 large-scale mining companies operating in Ghana, including Gold Fields – the fourth largest producer of gold - do not have stability agreements.[163] However, they have continued to invest in Ghana.[164]

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[160] For example, in Chile, investors with stability contracts pay a fixed corporate income tax of 42 per cent while investors without stability contracts pay the standard tax rate of 35 per cent.

[161] Section 48.

[162] According to available information and based on the response by investors to the amendments to the fiscal regime in 2011, only Newmont and AngloGold Ashanti have stability agreements. See, Annual Report Ghana, 'Ghana to Set Up Gold Company to Manage Windfall-Tax Profits'(22 November 2011) <http://annualreportsghana.com/News/Ghana-to-Set-Up-Gold-Company-to-Manage-Windfall-Ta.aspx> accessed 26 March 2012; AngloGold, 'Ghanaian Parliament Approves Stability Agreement with AngloGold' (Press Release, 20 February 2004) <http://www.anglogold.co.za/NR/rdonlyres/10547349-61A0-4C77-9FA5-74EDA1C933F1/0/StabilityAgreement20Feb04.pdf > accessed 26 March 2012; Moses Mozart-Dzawu, 'AngloGold, Newmont Mine Deals Face Ghana Government Review *'Bloomberg*, (Accra, 31 January 2012) <http://www.bloomberg.com/news/2012-01-31/anglogold-newmont-mine-deals-face-ghana-government-review-1-.html> accessed 26 March 2012.

[163] See, Ed Stoddard, 'Ghana to Review All Mining Stability Agreements' *Reuters* (Cape Town, 09 February 2012) <http://af.reuters.com/article/investingNews/idAFJOE81806B20120209> accessed 26 March 2012 ; EIU, *Country Report: Ghana March 2012* (EIU 2012); Ghana News Agency 'Mining Stability Agreement to Renew Tension in the Mining Sector-EIU' (Accra 05 March 2012) http://www.ghananewsagency.org/details/Economics/Mining-stability-agreement-to-renew-tension-in-mining-sector-EIU/?ci=3&ai=40151 accessed 26 March 2012.

[164] Similarly in Peru, Buenaventura, the country's top precious metal miner does not have a stability agreement while another major mining company, XStrata has stability agreements only for their 'principal' projects. Teresa Cespedes, 'Peru in talks over two mining royalty rates-sources' *Reuters* (29 August 2011) <http://af.reuters.com/article/commoditiesNews/idAFN1E77S1K120110829> accessed 26 March 2012; Marco Aquino and Teresa Cespedes, 'Peru Govt. Approves New Mining Royalty Scheme' *Mineweb*, (14 September 2011) <http://www.mineweb.com/mineweb/view/mineweb/en/page504?oid=135420&sn=Detail> accessed 26 March 2012.

The example of Colombia is also worth highlighting. Stability contracts are routinely touted as an incentive designed to attract FDI into Colombia.[165] However, since it was introduced in 2005, the majority of those that have entered into a stability contract with the government are domestic firms.[166] This is despite the fact that most of the foreign firms in the country are eligible to apply.[167] What is even more striking is that most of the projects backed by the IFC, which is a member of the World Bank Group that advocates for the use of stabilisation clauses, are not covered by stability contracts.[168] As one commentator notes, if stability contracts indeed 'ensure future income streams, at an affordable premium a knowledgeable and powerful investor like IFC would show an appetite for them at least out of concern for changes rules that are not limited to specific projects.'[169]

The lesson that can be drawn from the above examples is that while investors may wish to have stabilisation clauses wherever possible, they appear reluctant to pay a premium for them where required. As a result, in such instances, they voluntarily elect to be exposed to adverse changes in the law by going ahead to invest without the clause. Accordingly, it is difficult to argue that stabilisation clauses significantly influence investment decisions and help attract FDI to developing countries. To further explore this point, the next section reviews a selection of countries where significant changes have occurred in their stabilisation practice to see whether the changes affected the inflow of FDI.

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[165] Proexport, '*Investment Booklet December 2010* (Proexport 2010) <http://www.investincolombia.com.co/Adjuntos/094_Incentives%20for%20Investors-December2010.pdf> accessed 26 March 2012.

[166] As of June 2009, only 16 out of 46 LSAs involved foreign firms. Colombia Law and Business Post, 'Foreign Investors Have Signed 16 of 46 Legal Stability Contracts' (02 October2009) <http://colombialawbiz.com/2009/10/02/foreign-investors-have-signed-16-of-46-legal-stability-contracts/> accessed 26 March 2012.

[167] Ibid.

[168] Colombia Law and Business Post, 'Legal Stability Contracts III: Why Do IFC-Backed Projects and Firms Not Use Legal Stability Contracts?' (05 August 2009) <http://colombialawbiz.com/2009/08/05/legal-stability-contracts-iii-why-do-ifc-backed-projects-and-firms-not-use-legal-stability-contracts/> accessed 26 March 2012.

[169] Ibid.

3.4.3.2 Effect of Changes in Stabilisation Practice on the Inflow of FDI

First, it is important to point out that in the majority of countries that enacted legislation to introduce stabilisation clauses, the legislation were part of broader reforms to promote and attract FDI. As such, it has to be acknowledged that it is difficult to establish a clear link between stabilisation clauses and FDI merely by looking at the event or legislation that substantially altered the stabilisation practice. That said, it is also difficult to find any robust link between stabilisation clauses and FDI inflow to a country following a change in policy limiting the availability of stabilisation clauses. In other words, the introduction of stabilisation clauses does not necessarily lead to an increase in FDI into a country and their withdrawal does not automatically lead to a decrease.

In all the countries where sufficient information on stabilisation clauses is publicly available, one is unable to find any example where the mere introduction of stabilisation clauses or stability agreements led to an increase in FDI inflow. In addition to the example of Chile already highlighted above, the experience of Colombia again offers a good illustration.[170]

Colombia enacted legislation providing for stability agreements in 2005 while the first stability agreement was signed in 2006.[171] However, this did not lead to any significant change in the trend of FDI inflow into the country. On the contrary, as shown in Figure I, with the exception of 2008, the inflow of FDI into Colombia in the past decade was highest in 2005, before the first stability contract was signed.

[170] See section 3.4.2 which discussed how Chile introduced stability contracts in 1974 but only began to experience an upsurge in the inflow of FDI in the 1990s.
[171] Investment Stability Law 963 of 2005.

FIGURE I: Annual FDI inflow into Colombia (2000- 2010)

Source: Balance of Payments, *Banco de la República.*[172]

Another relevant point from the figure 1 is that FDI inflow to Colombia started increasing from 2003 and since then has been volatile. This is significant because in 2002, a US–backed security crackdown began in many parts of Colombia to combat drugs and suppress anti-government guerrilla movements.[173] This military action led to an improvement in the security situation in Colombia and the improved security situation is largely cited as the reason for the increase of FDI into Colombia from 2003.[174] The inability of the country to sustain or surpass the peak levels of FDI reached in 2005 despite the introduction of stability agreements, supports this view and shows that improved security is a much more significant determinant of FDI than stabilisation clauses. This is particularly because Colombia had granted tax stability contracts in the past.[175] Yet despite the fact that

[172] As reproduced in ProExport Colombia, 'Report on Foreign Direct Investment in Colombia' (May 2011) <http://www.investincolombia.com.co/Adjuntos/209_Reporte%20de%20Inversion%20en%20ingles.pdf> accessed 26 March 2012.

[173] US General Accounting Office, 'Drug Control: Specific Performance Measures and Long-Term Costs for US Programs in Colombia Have Not Been Developed (Report to Congressional Committees No GAO-03-783, 2003).

[174] See, for example, Helen Murphy and Carlos Vargas, 'Colombia sees $16 bln in FDI this Year' *Reuters* (09 February 2012) <http://www.reuters.com/article/2012/02/09/colombia-economy-idUSL2E8D9B9C20120209> accessed 26 March 2012.

[175] Article 169 of Law 223 of 1995 on Tax Stability Agreements introduced stability agreements, which, according to the Colombian authorities, served the same function as the 2005 stability agreements. Juan Jose

these contracts were 'respected by the government with very good returns for taxpayers', it did not lead to any significant increase in FDI inflow to Colombia.[176]

Doubts whether stabilisation clauses play any significant role in attracting FDI is further heightened by the wide inconsistency over the past decade. On the one hand, there are countries that enacted legislation providing for stabilisation clauses.[177] Yet, on the other hand, many other countries repealed, significantly undermined or reduced stability guarantees granted to investors.[178] If stabilisation clauses play any significant role in attracting FDI as proponents argue, it is safe to assume that the countries that enacted the clause experienced an increase in the inflow of FDI at the expense of the countries that have repealed or significantly undermined the clause. However, it has already been argued that there was no significant increase in FDI in the countries that introduced the clause.[179] Attention will now turn to the countries that either repealed or significantly undermined the clause to see if they lost 'their share' of FDI as a result.[180]

With the exception of Venezuela, and to a lesser extent, Ecuador and Bolivia, there appears to be no effect on the inflow of FDI into the countries reviewed in this thesis where stabilisation clauses were either repealed or undermined in the past decade. It is however important to mention that the cases of Venezuela, Bolivia and Ecuador can rightly be treated as exceptions to a general trend. This is because in these countries, the elimination or undermining of stabilisation guarantees were part of broader national policies involving

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Echavarria and George R Zodrow, 'Foreign Direct Investment and Tax Structure in Colombia' (2003) Inter-American Development Bank Technical Note <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=1856942> accessed 26 March 2012.

[176] Ernst and Young, 'Colombia Enacts Law Protecting Investors through Legal Stability Contracts (Law 963 of 2005)' (2005) Ernst and Young International Tax Alerts No 2005/65, 2 <http://www.evatassurance.com/NR/rdonlyres/ecqbcdslju3kclmmfytvjhvotsqdnthkn7um4t5qtdhsn3as2bk23p6ixh3zee6jsdb2qvbcjbeyncbn5d7dg7k73tg/International+Alert+131.pdf> accessed 26 March 2012. See also the example of Ghana where FDI inflow into the mining sector was highest in 2005 - a year before stabilisation clauses became specifically authorised in 2006. For details, see, Peter Arroja Eshun and Steve Aido Jellicoe, 'The Impact of Foreign Direct Investment on the Development of the Ghanaian Mineral Industry' (2011) 1 *Asian J of B and Management Sciences* 148, 158.

[177] Such countries include: Colombia, Madagascar and East Timor.

[178] Such countries include Kazakhstan, Peru, Zambia, Algeria, Tanzania and Ghana.

[179] See section 3.4.3.1.

[180] A selected list of these countries and the changes that occurred is listed in Appendix I.

nationalisation.[181] In other words, there was a deliberate policy in each of these countries to restrict foreign participation, and consequently, FDI inflows.

For example, while explaining the drop in FDI to Venezuela, the UN Economic Commission for Latin America and the Caribbean (UNECLAC) observed that Venezuela 'focuses on the nationalization of foreign assets rather than on foreign direct investment as a core development objective.'[182] As such despite 'several major investment projects' still going into the country, the compensation paid for acts of nationalisation ensures that the net FDI inflow into the country remained low for several years.[183] Even at that, by the first half of 2011, the country recorded substantial inflow of FDI garnering $1.18 billion after suffering a net withdrawal in 2010.[184]

Excluding the countries mentioned above, the research for this thesis did not find any instance where the elimination or undermining of stabilisation clauses in a country resulted in a significant adverse effect on the inflow of FDI. The experience of Kazakhstan best illustrates this point as the country has substantially eliminated stabilisation clauses for a decade now.

In 2003, Kazakhstan adopted a Law on Investments and new Tax Codes to replace its 1994 Law on Foreign Investment. The repealed Law on Foreign Investment had provided for stability guarantees covering the legal and regulatory regime for foreign investors.[185] Although the new law contained a general commitment by the country that it 'shall guarantee the stability of the conditions of contracts',[186] it also stipulated that this guarantee

[181] The acts of nationalisation in these countries are well known so one does not find it useful to repeat them here. However see Roberto Chang, Constantino Hevia and Norman Loayza, 'Privatization and Nationalization Cycles' (2009) World Bank Policy Research Working Paper 5029, 47 <http://library1.nida.ac.th/worldbankf/fulltext/wps05029.pdf > accessed 26 March 2012.
[182] UNECLAC, 'Foreign Direct Investment in Latin America and the Caribbean' (2010) UNECLAC Briefing paper, 47 <http://www.eclac.org/publicaciones/xml/0/43290/2011-138-LIEI_2010-WEB_INGLES.pdf> accessed 26 March 2012.
[183] Ibid.
[184] UNECLAC, *Latin America* (n 150).
[185] The law also replaced the Law on State Support for Direct Investments 1997.
[186] Article 4.1(3).

did not apply to changes in the laws of Kazakhstan.[187] In other words, investors are now subject to all new laws. Production sharing contracts (PSCs) and subsurface contracts specifically approved by the President were not affected. However, other changes made to the tax code substantially weakened the stabilisation protections in existing subsurface oil and gas contracts.[188]

Unsurprisingly, these changes were condemned by foreign investors, their lawyers and analysts.[189] The new law was described as a law that 'institutionalizes the uncertainty of the business environment' in Kazakhstan.[190] Predictions were therefore made that without a 'significant policy shift', FDI is 'unlikely to be forthcoming into Kazakhstan.'[191] However, rather than a policy shift, Kazakhstan continued with its policy of reducing the legal protections and financial incentives available to foreign investors with the following legal and regulatory changes.

In 2007, the Law on Subsoil and Subsoil Use was amended to empower the country to amend or annul any natural resources contracts that threatened its national or economic interests.[192] This law was further amended in 2010[193] after a new Tax Code (Law No 100 of 2008) had been adopted in 2008. The combination of these changes ensured that tax stability

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[187] Article 4.3 (1 and 2).

[188] For a discussion of these changes, see Kenneth E Mack, 'Protection of the Oil and Gas Investor's Rights in Kazakhstan' (2006) 1 IELTR, 91.

[189] Ibid 91. See also UNESCAP, 'Investment Climate In Kazakhstan: Country Report' (Report presented at Regional Roundtable on FDI for Central Asia, Dushanbe, Tajikistan, 03 – 04 April 2003) 7 - 8 <http://www.unescap.org/tid/mtg/rrtpaper_kazakh.pdf> accessed 26 March 2012; Robert M Cutler, 'Kazakhstan's New Foreign Investment Law' (*Caci Analyst*, 26 February 2003) <http://www.cacianalyst.org/?q=node/368> 26 March 2012; Sabrina Tavernise and Christopher Pala, 'Energy-Rich Kazakhstan Is Suffering Growing Pains' *New York Times*, (New York, 04 January 2003) <http://www.nytimes.com/2003/01/04/business/international-business-energy-rich-kazakhstan-is-suffering-growing-pains.html?pagewanted=all&src=pm> accessed 26 March 2012.

[190] Cutler (n 189)

[191] UNESCAP, *Investment* (n 189) 7 – 8.

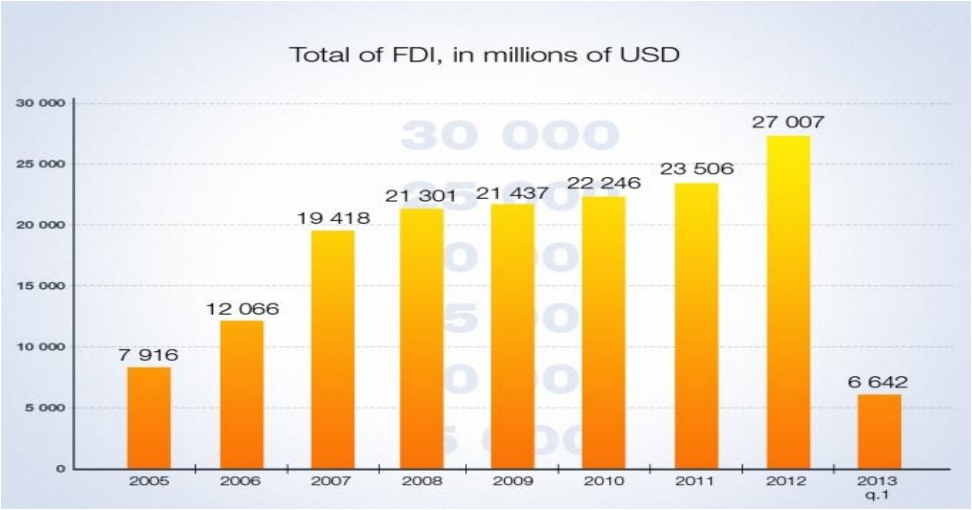
[192] See particularly the new art 45 added to the law. For a summary of the effect of the amendments, see, Freshfields Bruckhaus Deringer, 'New Law Endangers Oil and Gas Contracts in Kazakhstan: What Are Foreign Investors' Rights?' (November 2007) <http://www.freshfields.com/publications/pdfs/2007/nov14/20635.pdf> accessed 26 March 2012.

[193] Law of Subsoil and Subsoil Use 2010. For a detailed analysis of these changes, see, Kuanysh Sarsenbayev, 'Kazakhstan Petroleum Industry 2008–2010: Trends of Resource Nationalism Policy?' (2011) 4 JWELB 369.

provisions were removed from existing subsoil contracts and new taxes imposed.[194] The stabilisation clauses in PSCs were also significantly narrowed as changes in laws relating to tax, custom, national security, defence, environment and healthcare were explicitly exempted.[195]

However, despite these changes and contrary to predictions, available data have yet to reflect any significant adverse effect on the inflow of FDI into Kazakhstan. Rather, data from the Kazakhstan's government, as shown in Figure II below, reveals that FDI inflow into Kazakhstan has been growing consistently since then. This is supported by data from the OECD which estimates that between 2004 and 2009, FDI inflows into Kazakhstan grew at almost 25 per cent a year.[196] Significantly, the majority of the FDI still goes to the extractive industries, the same sector that was mainly affected the changes to stabilisation practice in Kazakhstan.[197]

FIGURE II - FDI inflow into Kazakhstan (2005 - 2012)



Source: National Bank of the Republic of Kazakhstan.[198]

[194] For example, a mineral extraction tax ranging from 7% - 20% replaced the existing Royalty of 0.5% - 2% while Excess Profit Tax was also imposed.
[195] For a summary of these changes, see, Kuanysh (n 193).
[196] OECD, *Competiveness And Private Sector Development: Kazakhstan 2010* (Sector Competitiveness Strategy) (OECD 2011) 19 -20.
[197] Ibid. See also Invest in Kazakhstan', 'FDI per branches' <http://invest.gov.kz/?option=content&section=4&itemid=75> accessed 18 September 2013.
[198] As reproduced by Invest in Kazakhstan, ibid.

The disconnection between the removal of stabilisation clauses in Kazakhstan and FDI inflows into the country is further confirmed by a recent survey of investors.[199] According to the authors of the survey, the removal of fiscal stability from petroleum contracts sent a 'negative signal' to investors.[200] The majority of respondents agreed with this view as 53 percent felt that the level of legal and regulatory transparency and stability in Kazakhstan remained 'unattractive.'[201] However, despite this view, 56 per cent of respondents still felt that Kazakhstan's overall investment attractiveness had not changed over recent years while only 16 percent felt it had deteriorated.[202] in fact, 27 per cent actually felt the investment climate had improved.[122] Furthermore, when asked whether they were satisfied with their investment decisions, the majority of investors answered in the affirmative stating that the business environment is 'challenging but rewarding.'[203] When asked what they would do if they had a chance to reconsider their investment decision with the knowledge that the government will make the regulatory changes, a massive 81 per cent of respondents said they would still have invested.[204] In other words, the presence or absence of stabilisation clauses makes no difference to the investment decision of 81 per cent of the investors surveyed.

A final example can be taken from Zambia. In 2008, the government enacted a new Mines and Minerals Act, which abolished the Mineral Development Agreements (MDAs) containing stabilisation clauses and removed the possibility of granting stabilisation clauses from Zambia's laws.[205] Importantly, despite the withdrawal of stabilisation clauses, a subsequent survey of investors found that no individual factor was a particular deterrent to

[199] 204 prospective and existing investors from over 20 countries were surveyed. Ernst & Young, *Kazakhstan Investment Attractiveness: Ernst & Young's Investor Opinion Survey* (EYGM limited 2011).
[200] Ibid 13.
[201] Ibid 8.
[202] Ibid 13.
[122] Ibid 12
[203] Ibid 6.
[204] Ibid.
[205] Section 159 – 160. The changes are discussed in more details in section 4.2.4 below.

future investment.[206] Rather the factors got a rating of 'not a deterrent to investment' or 'mild deterrent.'[207] The positive response of investors is reinforced in the latest FDI figures into Zambia. Between January and November 2011, Zambia received pledged investment of $4.6 billion, which is above the government's 2011 full year target of $3 billion.[208]

3.5 CONCLUSIONS.

Two presumptions prevail, and are promoted in the legal literature, by the extractive industry and by some international organisations. The first is that developing countries compete with each other to attract FDI on the basis of their political risks. The second is that there are higher levels of political risks in developing countries. Neither of these presumptions is true as such. Nevertheless, stabilisation clauses have been presented to developing countries as an 'essential' medicine that is needed to cure these presumptions and attract FDI.

The available evidence on current trends and future projections in the extractive industry fail to point to a global bidding war among resource-rich developing countries. Rather, it points to an intense competition among foreign investors, backed by their home governments, to gain access to natural resources in developing countries. The review of significant changes in fiscal terms in the extractive industry in resource-rich developed countries shows that their governments are just as likely as those in developing countries to alter the fiscal terms in their extractive industries. In other words, the political risks that stabilisation clauses aim to minimise in developing countries exists, at least in equal measure, in the extractive industry of developed countries. Yet, developed countries do not offer or grant stabilisation clauses to investors.

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[206] McMahon and Cervantes (n 140).
[207] Ibid.
[208] Zambia Development Agency, '2011 FDI pledges soar to $4.6-bln' (20 November 2011) <http://www.zda.org.zm/1875-2011-fdi-pledges-soar-46-bln> accessed 26 March 2012.

The fact that developed countries do not offer stabilisation clauses therefore raises doubts about the essentiality of stabilisation clauses in attracting FDI. Indeed, drawing from lessons learnt from the use of BITs and investment incentives, previous empirical studies on stabilisation clauses, current stabilisation practices, as well as the effect of changes to these practices, the conclusion drawn is that no robust link exists between stabilisation clauses and the inflow of FDI. This conclusion is reinforced by the absence of any reliable empirical evidence to support the contrary view that stabilisation clauses attract FDI to developing countries. The question that then arises is why some developing countries still accept the clause. Possible answers to this question are considered in the next chapter.

CHAPTER 4 – RETHINKING THE CONTEXT OF STABILISATION CLAUSES

4.1 INTRODUCTION

The last chapter highlighted a wide inconsistency in stabilisation practices among developing countries. This chapter explores possible reasons for this inconsistency and why stabilisation clauses were accepted in the first place when their rationale was based on presumptions that diverge from reality.

The chapter is divided into two parts. The first examines the role of the World Bank. It will argue that the re-introduction of stabilisation clauses into several developing countries from the 1990s had more to do with the role played by the World Bank than with the economic justifications for the clause. The second part examines the role of corruption and lack of transparency. It will argue that the grant of stabilisation clauses by a country, and the scope of the clauses so granted, is influenced to a significant extent by corruption and lack of transparency in the contracting process.

4.2 REFORMING UNDER THE SHADOW OF THE WORLD BANK

4.2.1 Background to the Reforms

Much has already been written on the World Bank-led reforms in the mineral sector of developing countries which started in the late 1980s.[1] One does not therefore find it useful to repeat the fuller details here, other than to provide a brief background on the events leading to the reform in order to place the subsequent legal and regulatory changes in proper perspective.[2]

During the period between the 1960s and the 1970s, developing countries' emphasis on the principle of permanent sovereignty over their natural resources (PSNR) led to

[1] For a detailed discussion of the reform process, see, Gary McMahon, *The World Bank's Evolutionary Approach to Mining Sector Reform* (World Bank 2010); William Torrence Onorato, Peter Fox and John Strongman, *World Bank Group Assistance for Minerals Sector Development and Reform in Member Countries* (IBRD/World Bank 1998).

[2] For a background to the reform, see, UNCTAD, *State Participation and Privatization in the Minerals Sector* (UNCTAD 1995); World Bank and IFC, *Mining Reform and the World Bank: Providing a Policy Framework for Development* (IFC 2003) 6- 8; UNECA, *Minerals and Africa's Development: The International Study Group Report on Africa's Mineral Regimes* (UNECA 2011) 9 – 20.

increased state participation in natural resource projects. However, the mid-1980s catastrophic fall in mineral prices significantly reduced the revenue that they derived from their minerals.[3] As the economy of many resource-rich developing countries depended heavily on their income from natural resources, they struggled to repay the expensive loans they had accumulated during the boom period.[4] As these countries turned to the World Bank and other international financial institutions for help, they were told that regulatory reform was the way out of their financial crisis.[5] Such reform, they were told, should focus on policies to promote and attract FDI in order to earn the foreign exchange required to finance their developmental measures and repay their debts.[6]

Having presented the countries with the option of reform, the World Bank and the donor community faced two choices. The first was to 'sit back' and 'wait to see' whether the governments would implement the recommended reforms.[7] The second was to 'take the initiative' and make the governments implement the reforms.[8] The latter option was eventually chosen as the World Bank subsequently took the lead, not only in determining the focus and orientation of the reforms, but also in making governments implement the reforms.

The regulatory framework governing FDI in these countries was a key component of the reforms proposed by the World Bank.[9] This was because in the wake of the emphasis on PSNR, developing countries enacted laws to curtail FDI. The implementation of the reforms proposed by the World Bank thus depended upon the reversal of these laws in favour of new laws which promote, rather than curtail, FDI. To facilitate the reform, the Bank led other international financial institutions to provide financial and technical assistance, together with

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[3] Alfred Maizels, *Commodities in Crisis: The Commodity Crisis of the 1980s and the Political Economy of International Commodity Policies* (Clarendon Press 1992) 5 – 38.
[4] UNCTAD, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* (UNCTAD 2007) 161 – 162.
[5] World Bank/IFC, *Mining Reform* (n 2) 6- 8.
[6] UNCTAD, *WIR 2007* (n 4) 161 - 162; Bonnie Campbell 'Revisiting the Reform Process of African Mining Regimes' (2010) 20 *Canadian Journal of Development Studies* 197 – 217.
[7] World Bank, *Strategy for African Mining* (World Bank 1992) 54.
[8] Ibid.
[9] Ibid 53.

a variety of instruments, to enable these countries to undertake the reforms.[10] By 1998, the Bank was involved in over 20 developing countries in Africa, Asia, Central Europe and Latin America, reviewing and revising laws affecting mineral resources.[11]

The Bank's involvement varied significantly according to the capacity of each country. However, in all cases it went beyond the mere provision of loans or grants to finance the reforms. In the mining sector, for example, and in countries with capacity to carry out the legal reforms independently, the Bank still actively participated in the process.[12] In some of these countries, this was done by providing opinions at the initial stages on the objectives and key aspects of proposed laws.[13] In others, it was done by providing initial diagnostic and technical support through the appointment of legal advisers to participate in key meetings and provide comments at different stages of drafting.[14] In countries with relatively less capacity to undertake the reform, the Bank's staff and its appointed consultants worked directly with local 'experts' to draft the laws.[15] This was particularly how the Bank worked in reviewing mining laws in African countries.[16]

Regardless of the extent of the Bank's involvement in developing countries, all the laws enacted as part of the reforms share certain key features. They were specifically designed to provide greater incentives and better conditions for foreign investors and eased or abolished restrictions on foreign ownership of mining projects.[17] Of particular relevance, they also re-introduced stabilisation clauses into the investment regime of these countries to

[10] For a detailed discussion of the various forms of assistance see: Onorato Fox and Strongman (n 1) 6-12.
[11] Ibid 14. For an updated list specifically for mining, see McMahon (n 1) 31 – 34.
[12] WB/IFC, *Mining Reform* (n 2) 13 - 14. These were predominantly countries from Latin America. See, Fernando Sánchez Albavera, Georgina Ortiz and Nicole Moussa, *Mining in Latin America in the 1990s* (UNECLAC 2001).
[13] The Mining Law of Peru 1992 followed this approach.
[14] The Mining Law of Bolivia 1997 followed this approach.
[15] WB/IFC, *Mining Reform* (n 2) 13 – 14.
[16] Ibid.
[17] UNCTAD, *WIR 2007* (n 4) 161 – 162. For a discussion of similar active participation of the World Bank in legal reforms in the oil and gas sector see William T Onorato, 'Legislative Framework used to Foster Petroleum Development' (1995) World Bank Policy Research Working Paper 1420, <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-1420> accessed 22 January 2014.

lock up these policy changes. What follows is a discussion of how stabilisation clauses became re-introduced as a result of the reforms.

4.2.2 Stabilisation Clauses as a Direct Outcome of the Reforms

Prior to, and in the course of the reforms, stabilisation clauses were heavily promoted by the World Bank as an 'essential' requirement of an investment regime that is attractive to foreign investors.[18] It was therefore a key component of the legislative reforms it proposed to developing countries. For example, the reforms proposed by the Bank for the mining sector in African countries were published by the Bank in *Strategy for African Mining*.[19] In it, the Bank argued that investors require competitive terms and conditions, together with 'iron clad assurances that the investment environment will be stable and that the "rules of the game" will not change.'[20] It therefore recommended for itself and donors to give 'specific assistance' to African governments to update their mining, investment and tax legislation and regulations and to privatise the mining sector.[21]

In line with this recommendation, the World Bank variously advanced Mining Sector Technical Assistance Credits to several African countries to reform their mining sector in accordance with the proposal contained in the document.[22] In other words, receiving the technical assistance from the World Bank, and indeed other forms of support was based upon accepting to implement reforms as proposed by the Bank. For example, one condition attached to the technical assistance to Tanzania to reform its mining sector was for it to establish a 'legal, regulatory and fiscal framework conducive to private mining investment.'[23] Given that the Bank had already determined that a stabilisation clause is an

[18] See, for example, Onorato (n 17)20 – 21.
[19] World Bank, *Strategy* (n 7).
[20] Ibid 10.
[21] Ibid xii.
[22] For a list outlining the legal component of this assistance up to 1995, see, World Bank, 'The World Bank and Legal Technical Assistance: Initial Lessons' (1995) World Bank Policy Research Working Paper 1414, Annex 1 <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-1414> accessed 22 January 2014
[23] 'Development Credit Agreement (Mineral Sector Development Technical Assistance Project) between United Republic of Tanzania and IDA' (23 September 1994) Art III, sch 2 s 1 <http://www-

‘essential’ feature of a conducive investment climate, the implication was that Tanzania must include it in their laws if they were to continue to receive assistance from the Bank.

A similar approach was taken in the mining sector in Latin America and the Caribbean.[24] Here, a ‘stable and equitable’ tax regime that gave investors assurances that taxes will not change was emphasised as a key outcome of the legal reforms to be supported by the Bank.[25] This, the document argued, was because investors needed to be assured that the taxes upon which they based their economic evaluation would not change significantly in the course of the project.[26] ‘Stabilization agreements’ were therefore recommended as a ‘priority requirement’ to grant ‘explicit guarantees’ to investors.[27] The use of stabilisation agreements by the early ‘reformers’ (Chile and Peru) was cited as examples of good practice.[28] Thus, similar to its approach in Africa, the ‘reforming’ countries in the region were supported with loans and technical assistance by the Bank to enact new mining laws or amend existing ones.[29] The use of Legal Stability Agreements in several Latin America countries is a direct outcome of this process.[30]

The World Bank also followed a similar approach to actively influence the re-introduction of stabilisation clauses in the oil and gas sectors of developing countries in the 1990s. In articulating its proposal for reform in this sector, the Bank identified stabilisation clauses as one of the ‘essential elements of legislative frameworks to attract FDI.’[31] It therefore recommended that stabilisation clauses be included in legislation and model

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wds.worldbank.org/external/default/WDSContentServer/WDSP/INF/2004/12/15/DDBE125D7A51E61B85256F0200829B88/1_0/Rendered/PDF/DDBE125D7A51E61B85256F0200829B88.pdf> accessed 13 September 2012.

[24] World Bank, *A Mining Strategy for Latin America and the Caribbean* (IBRD/World Bank 1996).

[25] Ibid (n 24) xv.

[26] Ibid.

[27] Ibid 10, 15 and Box II.1.

[28] Ibid 15 – 16.

[29] Ibid xiii. The ‘reforming’ countries include Argentina, Bolivia, Ecuador, Mexico, Peru, Guatemala and Honduras.

[30] For a discussion of how these countries were pressured to undergo the reforms and in particular to grant stability agreements see: Christian Aid, ‘Undermining the Poor: Mineral Taxation in Latin America’ (2009) Report, 24 – 26 <http://www.christianaid.org.uk/images/undermining-the-poor.pdf> accessed 13 September 2012.

[31] Onorato (n 17) 5 – 27.

contracts so that the investor should be 'secured where possible from the adverse economic effects of certain new statutes, regulations and laws.'[32] As a result, the laws and model contracts drafted with the loans and technical assistance provided or executed by the Bank re-introduced stabilisation clauses into the oil and gas sector in developing countries.

For example, the introduction of stabilisation clauses in Vietnam's oil industry was facilitated through an Energy Sector Management Assistance Programme.[33] The project involved a review of the country's petroleum laws by the World Bank. In line with the already articulated position of the Bank, 'Fiscal stabilization' was recommended as an essential element to be included in the law.[34] Consequently, a full economic equilibrium clause was added to the country's petroleum law.[35]

It is important to mention that the language used to justify and recommend the clause to Vietnam was copied almost verbatim from a World Bank document produced five years earlier.[36] In other words, a one-size-fits-all approach was taken. This suggests that an analysis of whether or not the specific circumstances of Vietnam makes stabilisation clauses necessary, and the potential adverse effect the clause may have on the country's development objectives may not have been undertaken.

The active role played by the World Bank in the comeback of stabilisation clauses is also illustrated in the model Production Sharing Agreements(PSAs) developed by the Bank for use in post-Soviet states in the 1990s. As pointed out by several commentators, these breeds of PSAs were first used in the 1980s.[37] However, they were strongly pushed by the

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[32] Ibid 20 – 21.
[33] World Bank, 'Vietnam's Petroleum Sector: Technical Assistance for the Revision of the Existing Legal and Regulatory Framework' (2003) Joint UNDP/World Bank ESMAP Report, <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2004/03/11/000090341_20040311112612/Rendered/PDF/ESM2690PAPER0Vietnam0petroleum.pdf> accessed 12 September 2012.
[34] Ibid 12, 16 – 17.
[35] Ibid Annex 1 ('Revised Petroleum Law') art 35.
[36] See World Bank, *Vietnam* (n 33) 16 – 17 and compare with Onorato (n 17) 20 – 21.
[37] See, as examples, Ryan Kennedy and Adilzhan Nurmakov, 'Resource Nationalism Trends in Kazakhstan: 2004–2009' (2010) RUSSCASP Project Working Paper, 5 <http://www.fni.no/russcasp/wp-nurmakov-kennedy-kazakhstan.pdf> accessed 13 September 2012; Greg Muttitt, *Hellfire Economics: Multinational*

World Bank for use in the former Soviet states during the 1990s as part of the reforms.[38] Consequently, these breeds of PSAs are now commonly referred to as the 'World Bank model.'[39] A key feature of the 'World Bank model' PSA is the inclusion of stabilisation clauses locking in the terms for the duration of the contract.[40] For example, in Azerbaijan, a total of 21 PSAs were signed under a 1995 Petroleum Technical Assistance Project by the World Bank to assist the Azeri government in restructuring the State owned oil company.[41] Several of these PSAs are now publicly available and they all contain stringent stabilisation clauses.[42]

The foregoing discussion highlights the key role played by the World Bank in the comeback of stabilisation clauses in developing countries from the 1990s. The context in which the clauses were re-introduced has, however, received little attention amongst commentators writing from a legal perspective. Yet as Charles Calomiris argues:

> Throughout history, financial collapses have been defining moments for public policy. Crises promote action, embodied in new financial institutions or policy doctrines. The motives that underlie such policies are sometimes short-sighted - driven by short-run pressures rather than long-run principles - and it is easier to

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Companies and the Contract Dispute over Kashagan, The World's Largest Undeveloped Oilfield (PLATFORM 2007) 4.

[38] Kennedy and Nurmakov (n 37) 5; Muttitt (n 37) 4.

[39] Ibid.

[40] Kennedy and Nurmakov (n 37) 5; Mutitt (n 37) 12 and 17.

[41] World Bank, 'Implementation Completion Report on a Credit in the Amount Of Sdr 14.3 Million (Us$20.8 Million Equivalent) to the Azerbaijan Republic for a Petroleum Technical Assistance Project (31 May 2001) 3 <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2001/07/06/000094946_01062604045124/Rendered/PDF/multi0page.pdf> accessed 13 September 2012.

[42] Some of the PSAs were subsequently published by BP. See BP Caspian 'Legal Agreements' <http://www.bp.com/sectiongenericarticle.do?categoryId=9029334&contentId=7053632> accessed 13 September 2012.

enact unwise policy in the midst of crises than to reverse course after the crisis has passed, after policies become embodied in institutions or statutes.[43]

The next section examines the economic rationale used to recommend the re-introduction of stabilisation clauses to developing countries to determine whether it can be regarded as valid, or whether, as argued by Calomiris, it was just a 'short-sighted' policy recommendation that easily found its way again into the statute books because of the financial crisis and due to pressure from the World Bank.

4.2.3 The Economic Case for the Re-introduction of Stabilisation Clauses

For several reasons, the World Bank's *Strategy for Mining in Africa* provides a good case study for an inquiry into what, if any, was the economic rationale underlying the re-introduction and acceptance of stabilisation clauses into developing countries.[44] First, stabilisation clauses were re-introduced in all the Mining Codes or model agreements in Africa that were enacted or developed as part of the World Bank reforms. Furthermore, several empirical studies have confirmed that stabilisation clauses are prevalent, and in their broadest forms, in the mining sector of sub-Saharan Africa.[45] Second, it is in this document that the World Bank articulated the rationale for, and its approach to, mining regime reform in Africa. This is why the Bank specifically addressed it to 'government officials, donors, academics, the development community at large and the investors themselves.'[46]

In addition, the report claims to outline regulatory and fiscal arrangements designed to reconcile the profitability objectives of investors and the revenue objectives of

[43] Charles W Calomiris, 'The IMF's Imprudent Role as Lender of Last Resort' (1998) 17 *Cato Journal* 275, 275.
[44] (n 7)
[45] See, for example, Andrea Shemberg 'Stabilisation Clauses and Human Rights' (2009) Report, <http://www.ifc.org/ifcext/sustainability.nsf/content/publications_lessonslearned> accessed 16 April 2013
[46] World Bank, *Strategy* (n 7) Foreword.

government.[47] It also acknowledged that the major benefits most developing countries will derive from their mineral resources are tax revenues and foreign exchange receipts.[48] For this reason, it notes: 'successful integration of mining policy with overall economic policy is important.'[49] With this knowledge, the document recommended that stabilisation clauses should be used to protect investors from changes in host states' laws, and in particular, fiscal laws. This implies that the link between the clause and the 'overall economic policy' of the countries including their tax revenues was given due consideration in the report. For the above reasons, the enquiry into the economic rationale underlying the push for stabilisation clauses by the World Bank will focus on this document.

The closest economic justification for the clause found in the document was the link between the clause and the rate of risk premiums.[50] According to the Bank, investors pay higher risk premiums for investment projects in developing countries due to perceived higher political risks.[51] Specifically, it noted that the average return on equity required or targeted is 25 to 30 per cent with a payback of two to four years for developing countries, while that of developed countries is a lower rate of 20 per cent for a longer payback period of five to six years.[52] For this reason, the Bank argued that governments of developing countries can increase their share of rents by making their investment environment less risky, thereby lowering risk premiums.[53]

It is admitted that there is some merit in this argument. However, for stabilisation clauses to be useful to developing countries in this sense, the cost to the government in terms of foregone future tax revenue must be less than the cost to the government in terms of the higher risk premiums paid by investors. Yet, there is nowhere in the report where the Bank

[47] Ibid.
[48] Ibid 27.
[49] Ibid.
[50] Ibid 17.
[51] Ibid.
[52] Ibid.
[53] Ibid.

made any attempt to undertake this analysis. Also, the report did not state or explain that granting stabilisation clauses was the only way to make the investment environment less risky. On the contrary, it noted that governments can make the investment environment less risky by establishing 'clear mining development strategies and sound institutional structures and capabilities and by emphasizing earnings – related taxes rather than royalties.'[54] The question therefore is: How then did the report end up recommending stabilisation clauses for every African country? Thankfully, the answer to this question is provided in the report itself.

Prior to determining the content of its mining reform agenda in the 1980s, the World Bank conducted a survey among potential investors to better understand their 'concerns and prerequisites.'[55] In particular, the survey sought to discover the factors that influence their investment decisions in developing countries. It is worth mentioning that this survey was sent to 80 international mining companies, but only 46 responded to at least some of the survey questions.[56] Investors that responded overwhelmingly agreed that the primary criteria influencing their investment decisions are mineral potential and infrastructure.[57] In particular, two–thirds of respondents were 'willing to be among the first foreign companies' to invest in developing countries if there are good prospects in terms of mineral potential.[58] The next essential pre-condition mentioned by respondents is 'a guarantee of mining rights before starting exploration.'[59] A 'well established mining code, contractual stability, a guaranteed fiscal regime, profit repatriation and access to foreign exchange' then appear as 'critical factors.'[60]

[54] Ibid 10.
[55] Ibid 16 – 19.
[56] Ibid 16.
[57] Ibid 17.
[58] Ibid.
[59] Ibid.
[60] Ibid.

While potential investors reached consensus on the above issues, they differed on the degree of importance of certain factors. On the issue of stability, there were important differences according to the size and nationality of the companies that responded to the survey. The responses of medium-sized companies, which were mostly American and Canadian, were most varied. However, in general, large mining companies preferred to operate under an established mining code rather than negotiate special provisions.[61] On the other hand, small companies were more particularly concerned with fiscal stability and preferred the involvement of multilateral organisations such as the World Bank.[62] This concern for fiscal stability was found to be particularly acute among European companies and they were also the most prepared to negotiate one-off contracts.[63]

When the above responses are read together, a conclusion that can be drawn is that stabilisation clauses were more of a concern to small companies from European countries. Conversely, medium and large-sized companies especially those outside of Europe were relatively less concerned about stability guarantees. As such, they were willing to invest in developing countries once the geological potential and infrastructure were in place. In this scenario, it is difficult to see how the Bank could conclude in the report that stabilisation clauses were essential to attract FDI into the mining sector in Africa. The responses to the Bank's survey do not support such sweeping conclusion even if one were to ignore the fact that just over half of international mining companies bothered to respond to the survey.

The survey was however not the only plank upon which the Bank's recommendation was based. Reliance was also placed on case studies from five developing countries, namely Botswana, Chile, Papua New Guinea, Indonesia and Ghana.[64] According to the World Bank, these countries demonstrate the 'characteristics of an environment conducive to

[61] Ibid 17 – 18.
[62] Ibid.
[63] Ibid.
[64] Ibid Annex 3. Botswana, Chile and Ghana were 'early reformers'.

investment.'[65] A review of the case studies showed that the stabilisation practices of each of these countries varied significantly at the time.

Papua New Guinea did not offer any stability guarantees.[66] In Chile, the 1974 Foreign Investment Law DL 600 allowed investors to opt for a stability agreement fixing the fiscal regime applicable to the investment for a period of ten years in exchange for paying a higher tax rate.[67] In Indonesia, the Contracts of Work (CoW) entered between the government and investors contained stabilisation clauses protecting investors from adverse changes in the fiscal laws.[68] In Ghana and Botswana, earlier mining laws gave the Ministers responsible for mining wide discretion to negotiate terms to be included in major mining projects.[69] The agreements so negotiated were not published at that time. However, the respective Ministers were known to have used their wide discretionary powers to grant stabilisation clauses.[70]

The report noted that all five countries had been successful in attracting FDI to their mining sector commensurate with their perceived geological potential and on terms and conditions that were generally favourable to them.[71] Chile and Papua New Guinea were referred to as 'outstanding successes.'[72] The document did not go further to explain what role, if any, stabilisation clauses may have played in these successes. What is however known is that the 'outstanding' success of Papua New Guinea has nothing to do with stabilisation clauses as the country did not offer the clauses at the time. For the other

[65] Ibid 20.
[66] Ibid 74.
[67] Articles 7 and 8.
[68] Article 13, 5th Generation CoW.
[69] Minerals Act 1976 (Botswana); Minerals and Mining Law 1986 (Ghana).
[70] For example, stabilisation clauses were granted to AngloGold pursuant to the Ghana's Law. See, AngloGold, 'AngloGold and the Government of Ghana Finalise Support Agreement and Agree Definitive Terms of Stability Agreement and Withdrawal of Cautionary Announcement' (Press Release) (12 December 2003) <http://www.anglogold.co.za/NR/rdonlyres/0992DCC8-4A8F-4824-A919-49A0B6B07A33/0/Ashanti_FinaliseSupportCautionaryWithdrawal12Dec03.pdf> accessed 18 September 2012.
[71] World Bank, *Strategy* (n 7) 20.
[72] Ibid.

countries, subsequent World Bank documents suggest that the role, if any, that stabilisation clauses played is secondary.

For example, in Chile, a subsequent World Bank report admitted that an increasing number of mining investments in Chile were already being made without stability agreements from the mid-1990s – the same period the *Strategy for Africa Mining* was published.[73] In the case of Indonesia, Ghana and Botswana, another World Bank document noted that they were successful 'primarily' because all three had 'very attractive geology, implemented sound macroeconomic policies, and their respective mining laws were reasonably administered.'[74]

Contrary to these findings and the varied responses of investors to the World Bank's survey, stabilisation clauses were eventually presented in the report as a key requirement of investors and one that should be included in proposed mining laws and Investment Agreements.[75] This recommendation was rationalised on the ground that investors require 'iron clad assurances that the investment environment will be stable and that the 'rules of the game; will not change.'[76] No explanation was given, for example, as to why these countries should adopt stabilisation clauses when Papua New Guinea achieved 'outstanding successes' without granting the clause. Rather, the recommendation appears to be based merely on the views expressed by some of the investors surveyed by the Bank that they required stabilisation clauses. If this is an acceptable rationale for introducing stabilisation clauses in a country, then every country, developing or not, should be granting stabilisation clauses because as was seen in the last chapter, investors prefer and do request stability guarantees wherever possible.[77]

[73] World Bank, *Mining* (n 24) 16.
[74] World Bank/IFC, *Mining Reform* (n 2) 25.
[75] World Bank, *Strategy* (n 7) 10, 26.
[76] Ibid.
[77] See section 3.4.2.

One must therefore agree with critics who argue that the reforms were introduced from a perspective that privileged the interests of foreign investors.[78] As such, incentives and guarantees to attract potential investors were favoured without due consideration of how they might affect the wider development objectives of these countries.[79] This, as Bonnie Campbell argues, explains why the Bank conducted a survey with foreign investors but conducted no similar consultations with local actors.[80] It also explains why little or no effort was made to link the concerns of investors expressed in the survey with the broader concerns regarding the contribution of the mining sector to national or regional macroeconomic strategies.[81]

Consequently, while the Bank recommended stabilisation clauses to deal with the concerns expressed by investors, the report did not consider the potential negative effect of the clause on host states. This omission is glaring as developing countries had previously rejected the older (and often narrower) forms of stabilisation clauses due to their claimed effect on the sovereign power to legislate.[82] The inability to consider the effect of re-introducing the clause on host states does however conform to the stated objective of the Bank's agenda as contained in the report. The report makes it clear that 'the main objective of the bank's intervention in African mining – whether through technical assistance or investment financing – should be to facilitate private investment and help reduce the country – and project –related risks for the private investors.'[83]

It is beyond dispute that the Banks 'main objective' was achieved as the reforms led to the opening up of the extractive sectors of several developing countries to foreign

[78] See, as examples, Campbell (n 6) 201; Thomas Akabzaa, 'African Mining Codes a Race top the Bottom' (2004)7 *African Agenda* 62 – 63; Bonnie Campbell (ed), *Mining in Africa: Regulation and Development* (Pluto Press 2009); Mining Journal Team, 'African Mining Code Questioned' (2003) *Mining Journal,* 106 – 109. <http://www.unites.uqam.ca/grama/pdf/AfricaCodes-Mining_Journal.pdf> accessed 18 September 2012.
[79] Ibid.
[80] Campbell (n 6) 201.
[81] Ibid.
[82] See section 2.2.
[83] World Bank, *Strategy* (n 7) xii.

investors and the enactment of foreign investors-friendly laws. However, it is also beyond dispute that the increase in mining levels has failed to equate with better development outcomes for these countries. Not surprisingly, the fact that these countries granted excessively generous incentives locked in with stabilisation clauses is often cited as a key factor in the inability of these countries to benefit from increased FDI.[84]

For example, in Ghana, the enactment of the 1986 Mining Code led to increased FDI into the country's mining sector.[85] Yet, for the two decades that the Code was in operation, the increased FDI did not translate into national economic development.[86] Several studies have attributed this to the excessive capital allowances, exceptions, and tax concessions that were granted under the World Bank reforms.[87] It is for this reason that, as will be discussed in more detail later, Ghana is among the many countries currently reviewing stability agreements.[88]

As will also be discussed in more detail below, in some of these countries, even World Bank documents now acknowledge that the generous incentives and stabilisation clauses introduced during the reforms have contributed significantly to their inability to benefit from the increased FDI.[89] This reinforces the argument being made here, that from the perspective of host states, there was little economic rationale for the re-introduction of stabilisation clauses in the 1990s. This however raises a further question. Why did the

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[84] See, for example, Open Society Institute of Southern Africa and others (OSISA), *Breaking the Curse: How Transparent Taxation and Fair Taxes can Turn Africa's Mineral Wealth into Development* (OSISA 2009); Policy Forum 'The Demystification of Mining Contracts in Tanzania' (2010) <http://www.sdsg.org/wp-content/uploads/2010/02/Article-re-Mining-Contracts-in-Tanzania.pdf> accessed 18 September 2012.

[85] Thomas Akabzaa 'Mining in Ghana: implications for National Economic Development and Poverty Reduction' in Campbell (ed) *Mining* (n 78).

[86] Ibid.

[87] Ibid.

[88] Section 4.3.4.

[89] Section 4.3.3; World Bank, 'What Would it take for Zambia's Copper Mining Industry to Achieve its Potential' (2011) Report No 62378-ZM, iii - iv <https://openknowledge.worldbank.org/bitstream/handle/10986/2772/623780ESW0Gray0e0only0900BOX361532B.pdf?sequence=1> accessed 18 September 2012; World Bank, 'Madagascar: Governance and Development Effectiveness Review: A Political Economy Analysis of Governance in Madagascar (2010) Report No 54277-MG, 46 – 49 <http://siteresources.worldbank.org/INTMADAGASCARINFRENCH/Resources/ESW_Gouvernance.pdf > accessed 18 September 2012.

governments agree to the World Bank's recommendation to introduce the clauses into their statute books despite the seeming absence of a convincing economic rationale for it? A possible reason for this is considered below.

4.2.4 Stabilising under the Shadow of the World Bank

Several commentators writing from a legal perspective have highlighted the role financial institutions play in the requests for stabilisation clauses in developing countries.[90] They note that lenders and political risk insurers often push for stabilisation clauses to be included in the agreements governing projects they intend to fund.[91] This, they argue, is because these financial institutions fear that new laws may reduce or damage the commercial viability of the project or negatively affect the repayments of loans.[92] Such analyses often tend to focus on private financial institutions. However, in practice, the World Bank can be included in the list of financial institutions that may be affected by adverse changes in the law for several reasons.

First, the International Finance Corporation (IFC), which is the private sector arm of the World Bank, funds projects in developing countries in association with private investors 'without guarantee of repayment by the member government concerned, in cases where sufficient private capital is not available on reasonable terms.'[93] Secondly, the Multilateral Investment Guarantee Agency (MIGA), also a member of the World Bank Group, issues guarantees for non-commercial risks in respect of FDI in member countries.[94] The World Bank Group therefore has a legitimate reason to be concerned with legal mechanisms, such as stabilisation clauses, which mitigate the political risks of projects that are financially

[90] See, for example, Shemberg (n 45) para 18; Thomas W Wälde and George Ndi, 'Stabilizing International Investment Commitments: International Law versus Contract Interpretation' (1996) 31 *Texas Intl LJ* 216, 228 – 229.
[91] Ibid.
[92] Ibid.
[93] See art 1(i), IFC, *Articles of Agreement (as amended through to 27 June 2012).*
[94] See art 2 *Convention Establishing the Multilateral Investment Guarantee Agency (as amended in 2010).*

supported by the IFC and MIGA as any change in the law which adversely affect such projects will also adversely affect them.

At the same time, the World Bank has another unique role in developing countries. The Bank's International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) provide loans and grants (soft loans) respectively to developing countries where these countries are unable to obtain conventional loans on terms that are 'reasonable.'[95] In addition, the IDA provides grants to developing countries in risk of debt distress.[96] As such, many developing countries turn to the World Bank for the servicing of their debts during periods of financial crisis.[97] This role is enhanced by the Bank's close relationship with the International Monetary Fund (IMF) which has been increasingly playing the role of an international 'lender of last resort.'[98] As such, as one commentator notes, 'mistreating the IMF's sister institution is tantamount to jeopardizing access to your lifeline in the next storm.'[99]

Furthermore, the Bank through the IDA also serves as a 'donor of last resort' to many developing countries.[100] In line with the role, the IDA is the largest source of assistance for

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[95] See art 1 and art V section 1(a) – (c) *IDA Articles of Agreement*; art 1 and art III section 4(ii) IBRD *Articles of Agreement (as amended effective 16 February 1989*).

[96] World Bank 'What is IDA?' <http://www.worldbank.org/ida/what-is-ida.html> accessed 11 October 2012.

[97] See section 4.2.1.

[98] Stanley Fischer, 'On the Need for an International Lender of Last Resort <Http://Www.Imf.Org/External/Np/Speeches/1999/010399.HTM#1> accessed 05 November 2012. Note however that there are debates about whether the IMF or indeed any international financial institution can be called an 'international lender of last resort' in the absence of a clear hegemonic central bank in the international financial system. While these debates remain, it is sufficient for purposes of this thesis that both the World Bank and the IMF did acted as a 'lender of last resort' to developing countries during the financial crisis that preceding the reforms under review. For a useful summary of the debates see: Jeffrey D Sachs 'The International Lender of Last Resort: What Are the Alternatives?'(June 1999) <http://www.earth.columbia.edu/sitefiles/file/Sachs%20Writing/1999/FedResBankofBoston_InternationalLenderofLastResort_June1999.pdf> accessed 05 November 2012.

[99] Stephen V Arbogast, 'Project Financing & Political Risk Mitigation: The Singular Case of the Chad-Cameroon Pipeline' (2009) 4 *Texas J of OGEL*. 269.

[100] Stephen Jones, 'Sector Investment Programs in Africa: Issues and Experience (1997) World Bank Technical Paper No 374 <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2010/10/14/000333037_20101014001849/Rendered/PDF/570740BRI0Find10Box353745B01PUBLIC1.pdf> accessed 11 October 2012.

these countries as well as the single largest source of donor funds for basic social services.[101] This role is further enhanced by the fact that aside from disbursing its own funds, the World Bank sometimes acts as an executing agency for projects being financed by other external donors.[102] For example, the Energy Sector Management Assistance Programme, which provides technical assistance to developing countries, is co-sponsored by the UNDP and 12 developed countries.[103] However, the day–to–day execution of the programme is administered by the World Bank.[104]

Based on the role of the Bank as described above, the Bank can influence policies in these countries through the conditions it attaches to the financial assistance it gives and as explained previously, had used this role to influence the contents of the legislation enacted during the reform period.[105] This much was acknowledged by the Bank in a 1995 publication:

> The Bank then started to condition its lending upon the adoption or implementation by the borrowing governments of certain laws or regulations that reflected the policies agreed upon with the Bank. In this process, the Bank comments on the proposed laws and regulations or amendments thereto prepared by the governments of the borrowing members to ensure that they conform to the objectives of the economic policy changes agreed upon with the Bank. Over the years, legal conditionality in adjustment loans has become more specific and frequent….Structural or sectoral adjustment conditionality

[101] The IDA is the largest sources of assistance to the World's 81 poorest countries, 39 of which are in Africa. World Bank, *IDA* (n 96).
[102] World Bank, *Technical* (n 22) 6.
[103] See ESMAP 'About ESMAP' <http://www.esmap.org/node/21> accessed 05 November 2012.
[104] As mentioned above, it was through this programme that stabilisation clauses were introduced into Vietnam's Petroleum Laws. See World Bank, *Vietnam* (n 33).
[105] Section 4.2.2.

proved to be an effective way for the Bank to encourage its borrowing members to introduce necessary changes to their legal framework.[106]

As stabilisation clauses had already been determined by the Bank to be 'essential', their inclusion, in addition to other investor friendly terms proposed by the Bank, became a condition for continued financial assistance from the Bank.[107]

For example, in the 1990s, Zambia came under enormous pressure from the World Bank and the IMF to 'quickly' privatise its copper mines as part of economic reforms to restore macro stability.[108] However, due to the strategic role of the mines in the country's national development, the government was reluctant to privatise and kept postponing the date of the privatisation.[109] Eventually, the Bank, the IMF and other donors made the privatisation of the mines a condition that Zambia must fulfil to continue to receive loans and other forms of support.[110] In particular, the privatisation was made a pre-condition for Zambia to qualify for debt relief through the Highly Indebted Poor Countries (HIPC) initiative.[111] By 1999, following the continued reluctance of the government to privatise, major donors withheld some $530 million in aid to the country.[112]

Eventually, the government was left with no choice but to proceed with the privatisation despite domestic concerns. As the then finance minister explains: 'We were told by the IMF and the World Bank, that if we privatised we would be able to access debt

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[106] World Bank, *Technical* (n 22) 3 - 4.
[107] OSISA, (n 84) 7 – 10; Christian Aid, *Undermining* (n 30) 24 – 26.
[108] World Bank, *Zambia* (n 89) fn 10. See also Oxford Analytica, 'Exploration of the Impact of Privatisation: Overview and Case Studies (2002) Research Report for EC/DFID, 14 - 15 <http://www.dfid.gov.uk/r4d/PDF/Outputs/EC-PREP/PrivatisationImpactFinalReport.pdf> accessed 18 September 2012.
[109] On the strategic role of mining in Zambia prior to the reforms see, Muna Ndulo, 'Mining Legislation and Mineral Development in Zambia' (1986)19 *Cornell Intl LJ* 1, 5- 6.
[110] Alastair Fraser and John Lungu, 'For Whom the Windfalls? Winners and Losers in the Privatisation of Zambia's Copper Mines' (2007) Report, <http://www.banktrack.org/manage/ems_files/download/for_whom_the_windfalls_/report_for_whom_the_wind_falls.pdf> accessed 19 September 2012.
[111] Ibid 9 – 10.
[112] Bram Posthumus, 'ZCCM: A Tale of Heartbreak and Tears' (2000) *African Business* <http://www.africasia.com/archive/ab/00_02/abmn0201.htm>accessed 19 September 2012.

relief, and this was a huge carrot in front of us – like waving medicine in front of a dying woman. We had no option but to go ahead.'[113] As a result of this scenario, the government was left with little choice than to sell the mines for prices known at that time to be less favourable to the country.[114] The reason for this was that the investors, on realising that the sale of the mines had moved from just a market proposition to a precondition, pushed for, and succeeded in getting prices lower that what had been previously offered.[115]

Consequently, the mines were privatised based on the provisions of the Mines and Minerals Act 1995 which had been enacted in line with the reforms proposed by the Bank and the IMF.[116] Apart from providing for generous incentives and exemptions, the Act contained provisions authorising the mining Minister to include stabilisation clauses in MDAs with investors.[117] It was pursuant to these provisions that MDAs were entered into with foreign investors for the privatised mines through negotiations brokered by the World Bank and the IMF.[118] The exact terms of these MDAs were kept secret at that time. However, it later emerged they all contained stabilisation clauses exempting the investors from changes in the law for between 15 and 20 years.[119]

Another example can be cited from Madagascar. In 1996, the World Bank and the IMF made continued financial support conditional upon the country agreeing to implement the Bank's proposed reforms in its mining sector.[120] As a result, the country had to undertake

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[113] Abi Dymond, interview with Edith Nawakwi, former finance minister, Zambia (Lusaka, 26 July 2007) reproduced in: Scotland Aid Agency, Action for Southern Africa and Christian Aid, 'Undermining Development: Copper Mining in Zambia' (2007) Report, 6 <http://www.actsa.org/Pictures/UpImages/pdf/Undermining%20development%20report.pdf> accessed 19 September 2012

[114] Analytical (n 108)4; Posthumus (n 112).

[115] Ibid.

[116] Fraser and Lungu (n 110) 4.

[117] Section 9.

[118] Fraser and Lungu (n 110) 9 – 10.

[119] Copies of these MDAs were subsequently leaked by several NGOs in Zambia. For an example of the stabilisation clauses, see, ss 11 - 16 of MDA between Zambia and Mopani Copper Mines PLC (31 March 2000) <http://minewatchzambia.blogspot.co.uk/> accessed 02 October 2012.

[120] For details, see, Richard R Marcus, 'Political Change in Madagascar: Populist Democracy or Neopatrimonialism by another Name?' (2004) Institute for Security Studies Occasional Paper 89, <Http://Www.Iss.Co.Za/Pubs/Papers/89/Paper89.Htm> accessed 19 September 2012; Bruno Sarrasin,

the reforms as determined by the World Bank. As the Bank acknowledged, it was the 'leader of the policy dialogue' in the reform process and used this role to 'help' the government undertake institutional and legal reform.[121] The Mining Code of 1999, and the 2001 Law on Large-scale Investments are listed by the Bank as 'outcomes achieved' by the project.[122] This was in addition to the 'Establishment Agreement' for the Ilmenite Mining Project which the Bank had earlier brokered.[123] Unsurprisingly, the Code, the Law and the Establishment Agreement all contained stringent stabilisation clauses exempting investors from all adverse changes in the law but specifically allowing them to benefit from favourable changes.[124]

As mentioned earlier, recent studies, including those commissioned by the Bank, have confirmed that the contributions of mining to the economic development of most developing countries have remained low by international standards as a result of the significant fiscal incentives and guarantees given away as part of the reforms.[125] The Bank however continues to benefit from these incentives and guarantees as they were included in several projects which the IFC and MIGA financially supported during and immediately after the reforms.[126] In other words, on the one hand, stabilisation clauses were pushed by the Bank using its influential role as a lender and donor of last resort to developing countries through the IDA and the IBRD. Meanwhile, on the other hand, the Bank also benefits from

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'Madagascar: A Mining Industry Caught between Environment and Development' in Campbell (ed) *Mining* (n 78).

[121] World Bank, 'Project Summary Sheet – Extractive Industry Review: Madagascar Mining Sector Reform Project P056487' <http://irispublic.worldbank.org/85257559006C22E9/All+Documents/85257559006C22E985256FDD006CB428/$File/MadagascarMiningReform.pdf> accessed 12 September 2012.

[122] Ibid.

[123] See details in the following: Friends of the Earth, *Development Recast: A Review of the Impact of the Rio Tinto Ilmenite Mine in Southern Madagascar* (Friends of the Earth 2007) <http://www.foe.co.uk/resource/reports/development_recast.pdf> accessed 19 September 2012; Marc Frilet, 'The Ilmenite project in Fort-Dauphin, Madagascar: Searching for Long-Term Legal Certainty for Privately Financed Large Infrastructure Projects in Africa' (1999) IBLJ 609.

[124] Articles 12 and 18, Establishment Agreement; ss 154 - 163 Mining Code and arts 30 – 33, Law on Large-scale Investments.

[125] World Bank, *Zambia* (n 89) iii - iv; World Bank *Madagascar* (n 89) 46 – 49.

[126] See section 4.2.3; Christian Aid, *Undermining* (n 30); Amadou Keita and ors, *Legal Tools for Citizen Empowerment: Increasing Local Participation and Benefit in Mali's Mining Sector* (IIED 2008) 8 -9.

the protections offered by the clause in its capacity as a financier of projects containing the clause through IFC and MIGA.

The foregoing highlights the key role played by the World Bank in the return of stabilisation clauses to developing countries from the late 1980s. However, this role has received little attention amongst commentators writing from a legal perspective. In tracing the return of stabilisation clauses, it is common for legal scholars to place the responsibility for the re-introduction of the clause solely on host governments. For example, in explaining the 'unexpected comeback' of stabilisation clauses, Thomas Wälde and George Ndi noted that the scramble for FDI at that time meant that several countries (especially high-risk transition economies) went to 'considerable length to fashion their investment regime to respond to foreign investor concerns.'[127] This, they argued, led to the re-emergence of 'promises not to alter a given legislative regime.'[128]

From a strictly legal perspective, the above view is understandable. This is because while World Bank staff actively participated in the process and in several cases prepared the draft laws that re-introduced stabilisation clauses, the sovereign power to enact them into law rests with governments. However, such a view ignores the important political economy context within which these reforms were undertaken. It is therefore not surprising that commentators writing from a political economy perspective take a significantly different view by recognising the unique bargaining power the Bank had over the countries that underwent the reforms.[129] Consequently, they often place a larger part of the responsibility for the outcome of the reforms, including the stabilisation clauses, on the World Bank and other donors.[130]

[127] Wälde and Ndi (n 90) 218.
[128] Ibid. See also Addullah Faruque, 'Validity and Efficacy of Stabilisation Clauses: Legal Protection vs Functional Value' (2006) 23 *J of Intl Arb* 317, 335.
[129] See, as examples, OSISA (n 84); Campbell (n 6).
[130] Ibid.

Even when legal commentators do acknowledge, or at least allude to, the fact that host governments may have been pressured to accept stabilisation clauses, this pressure is usually attributed to the so–called obsolescing bargaining theory (hereafter 'OBT').[131] The main thesis of this theory is that foreign investors have stronger bargaining power at the initial stage of investment but relative bargaining power shifts to the host government over time as investment projects become profitable.[132] For example, Wälde and Ndi later conceded that sometimes the word 'extracted' rather than 'obtained' may be a 'more correct description' of the way in which foreign investors came to benefit from stabilisation clauses.[133] However, they, like most legal commentators, still relied on the OBT to conclude that the foreign investors were able to 'extract' the stabilisation guarantees because of their stronger bargaining power at the initial stage.[134] This is not a view shared in this thesis.

The discussion on the process leading to the re-introduction of stabilisation clauses shows that in many of these countries, the clauses were introduced mainly together with legislation that eased or completely removed the restrictions on FDI. The clauses were thus part of the legal framework governing FDI before these countries began formal negotiations with foreign investors thereby making the OBT significantly less relevant. Support for the above position can be found in the views of business/management scholars who developed the theory in the first place.[135] The widely held view amongst these scholars is that OBT has largely outlived its usefulness, at least since the 1990s.[136] According to this view, OBT is

[131] For a discussion of this theory, see, Lorraine Eden, Stephanies Lenway and Douglas A Schuler 'From the Obsolescing Bargain to the Political Bargaining Model' (2004) Bush School Working Paper 403 <http://www.voxprof.com/eden/Publications/Eden-Lenway-Schuler-FINAL-GBS.pdf> accessed 14 September 2012.
[132] Ibid.
[133] Wälde and Ndi (n 90) 221.
[134] Ibid 223 - 225. See also Faruque (n 128) 335.
[135] The theory was originally developed in an attempt to explain the widespread acts of nationalisation and expropriation that took place between 1960s and 1970s. See Raymond Vernon *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises* (HUP 1971).
[136] There is massive literature supporting this view. See, as examples, Eden, Lenway and Schuler (131); John Stopford, 'The Growing Interdependence between Transnational Corporations and Governments' (1994) 3 *Transnational Corporations* 53; Alvin Wint, 'Has the Obsolescing Bargain Obsolesced? Negotiating with

now less useful because only a small amount of bargaining takes place as a result of the removal, by many governments, of the restrictions placed on FDI.[137]

The view that the re-introduction of stabilisation clauses has more to do with the World Bank than with OBT is further reinforced by a new approach whereby investors persuade multilateral agencies, such as the World Bank, to support their projects in developing countries.[138] This approach was used in several projects including the cross-border West Africa Gas Pipeline project (hereafter 'WAGP'), the Baku-Tbilisi-Ceyhan (hereafter 'BTC') oil pipeline project and the Chad-Cameroon Oil and Pipeline Projects.[139]

In all three projects, the investors specifically requested that the World Bank be involved. As Stephen Arbogast noted with particular reference to the Chad-Cameroon project, the request by the investors was not because of 'some sudden oil industry funding crises.'[140] Rather, it was a deliberate decision by the investors to use the Bank's influence to mitigate the perceived political risks of the projects.[141] These requests were made at the initial stages of the projects when, if OBT were correct, the investors possessed strong enough bargaining powers to extract stabilisation guarantees to mitigate these risks. Yet, they rather relied on the World Bank's 'unique status' in developing countries that ensures that their governments will be 'highly reluctant to offend' the Bank and as such will 'tread

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Foreign Investors' in Robert Grosse (ed), *International Business and Government Relations in the 21st Century* (CUP 2005).

[137] Ibid. See also PW Hawley, AD Bramley and JM Castellani, 'Competitive Bidding Tactics for New Exploration Concessions' in Thomas W Wälde and George Ndi, (eds), *International Oil and Gas Investment: Moving Eastward?* (CEPMLP 1994) 62 – 65, arguing that foreign investors actually do have a weaker bargaining power at the initial stages of an investment.

[138] For an excellent discussion of this approach, see Arbogast (n 99).

[139] These projects are discussed in more detail in section 4.3.3.

[140] Arbogast (n 99) 278.

[141] Ibid. See also: IFC, 'IFC Approves Investments in Caspian Oil an Pipeline Projects' (Press Release) (04 November 2003) <http://www.ifc.org/ifcext/btc.nsf/Content/MediaBriefing> accessed 25 September 2012; Emad Mekay, 'Finance - Nigeria: New Pipeline a "Recipe for Disaster", Locals Say' *Inter Press Service* (Washington, 27 April 2006) <http://www.ipsnews.net/2006/04/finance-new-pipeline-a-recipe-for-disaster-locals-say/> accessed 25 September 2012; Genoveva Hernández Uriz, 'The Application of World Bank Standards to the Oil Industry: Can the World Bank Group Promote Corporate Responsibility' (2002) 28 *Brooklyn J of Intl Law* 77, 93.

carefully' with the investors.[142] In other words, the investors needed the stronger bargaining power of the World Bank to mitigate the political risks of the projects.

Ultimately, in all three cases, the Bank acceded to the requests of the investors and provided financial and political guarantees for the project.[143] It also actively participated in the formulation of the legal and regulatory framework governing these projects.[144] The result was the inclusion of some of the most stringent, complex and extensive stabilisation clauses seen in this study, in the legal arrangements governing these projects.[145] As the Bank itself acknowledges, its involvement in such transactions is seen by investors as a 'stabilizing factor' because of the Bank's 'long term relationship' with developing countries.[146] This view is consistent with the argument that stabilisation clauses were re-introduced during the reforms largely as a result of the 'stronger bargaining power' possessed by the World Bank (as opposed to investors) over developing countries. Accordingly, this thesis rejects any view that seeks to explain the acceptance of stabilisation clauses solely in terms of an obsolescing bargain between investors and host states.

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[142] Arbogast (n 99) 278.

[143] World Bank, 'World Bank Group Approves Support for Chad-Cameroon Petroleum Development and Pipeline Project' (Press Release, 06 June 2000) <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/CHADEXTN/0,,contentMDK:20058876~menuPK:64282138~pagePK:41367~piPK:279616~theSitePK:349862,00.html> accessed 25 September 2012; World Bank, 'World Bank Board Discusses Inspection Panel Report on West African Gas Pipeline Project and Approves Action Plan' (Press Release, 06 August 2008) http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21865241~menuPK:34463~pagePK:34370~piPK:34424~theSitePK:4607,00.html> accessed 25 September 2012; World Bank, 'Regional Energy Projects: Experience and Approaches of the World Bank Group' (2010) Background Paper for the World Bank Group Energy Strategy, 53 – 56, 58 - 61 <http://siteresources.worldbank.org/EXTESC/Resources/Regional_energy_trade_final.pdf>accessed 25 September 2012.

[144] For example, in the WAGP, one of the Bank's objectives was the 'harmonisation of the 'regional institutional, legal, and regulatory framework' governing the projects. World Bank and MIGA 'Project Appraisal Document' (02 November 2004)11 <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2004/11/09/000090341_20041109105344/Rendered/PDF/303350AFR.pdf> accessed 25 September 2012.

[145] These clauses are discussed in details at section 4.2.

[146] See World Bank, 'Product and Services: Guarantees' <http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/0,,contentMDK:20120721~menuPK:232467~pagePK:41367~piPK:51533~theSitePK:40941,00.html> accessed 28 August 2013. See also World Bank, 'Project Information Document: Chad-(Cameroon) Petroleum Development and Pipeline Project' (23 July 1999) para 7iv <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/07/29/000094946_99031911045693/Rendered/PDF/multi0page.pdf> accessed 25 September 2012.

4.3 CONTRACTING UNDER A DARK CLOUD

The previous section showed that stabilisation clauses were proposed in a uniform manner by the World Bank, at least within specific sectors. Yet, chapter 3 showed wide inconsistency in stabilisation practices among nations and sometimes within a country. This suggests that other reasons, apart from pressure from the World Bank also influence stabilisation practices. This part of the current chapter discusses a possible reason for this. It will argue that there is increasing evidence that corruption and transparency in the contracting process play a significant role in the disparity in stabilisation practices among countries.[147]

4.3.1 Corruption and Transparency in the Extractive Industry in Developing Countries.

First, the point needs be made that there is no precise and universally accepted definition of corruption due to the difficulty in formulating one that can apply to all forms of corruption in every jurisdiction.[148] However, for the purposes of this work, corruption refers to 'the abuse of entrusted power for private gain', in line with the working definition used by Transparency International (TI).[149]

The term 'transparency' also does not have a precise definition. However, for the purposes of this work, it refers to the democratic practice of opening up government information and decision-making processes to scrutiny by citizens.[150] Thus with particular reference to the extractive industry, transparency will require the establishment of clear and

[147] The State of Alaska in the US is included in the analysis for reasons given in section 4.2.4.2.

[148] For a summary of the various definitions, see, Center for Democratic Institutions, 'Human Rights and Corruptions' (2004) CDI Research Paper, 5- 8 <http://www.cdi.anu.edu.au/_research/1998-2004/research_publications/research_downloads/hrc.pdf>accessed 07 November 2012.

[149]TI, 'What is Corruption and How Does the CPI measure it?'<http://www.transparency.org/cpi2011/in_detail> accessed 19 September 2012. This definition is broad enough to encompass all forms of corrupt behaviour relevant to this work.

[150] Mabel Andrade and ors, 'Transparency in Petroleum Contracts: A Comparative Study of Ecuador and Bolivia' (2010-2011) TRACE Briefing Paper, 3 <http://www.publishwhatyoupay.no/sites/all/files/PWYP%20Norway_Article%201_ENGLISH%20WEB.pdf> accessed 19 September 2012.

consistent criteria for the grant of hydrocarbon licences and a public and competitive bidding process. Furthermore, it requires that the contracting process should be one that is open and allows citizens to participate and that the final terms of the contract and information on revenue derived, or to be derived, are all made accessible to the public.[151]

The point also needs to be made that, generally, the laws and regulations governing the extractive industry in most developing countries are public documents. It is the contracts made pursuant to these laws and the process of arriving at these contracts that are often shrouded in secrecy. This lack of transparency and the corrupt practices (both real and perceived) that it engenders are already well documented.[152] Their effects on the sustainable development of these countries have also been well covered in the literature.[153] However, it is useful to summarise these issues in a way that place them within the context of the present discussion.

From the perspective of host governments of developing countries, the rationale for attracting FDI is to enable access to the huge financial resources required to fund measures to promote sustainable development.[154] For this reason, since the 1980s developing countries have been encouraged and supported to create regulatory frameworks that are attractive and conducive for FDI, especially in their mineral resources sector.[155] It was in this context that stabilisation clauses were portrayed as an 'essential' tool for attracting investment.[156]

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[151] Ibid 3.

[152] See, as examples, Ivar Kolstad and Tina Søreide, 'Corruption in Natural Resource Management: Implications for Policy Makers '(2009) 34 *Resources Policy* 214; Ian E Marshall, 'A Survey of Corruption Issues in the Mining and Mineral Sector' (2001) Report of Mining, Minerals and Sustainable Development Project <http://pubs.iied.org/pdfs/G00949.pdf?> accessed 19 September 2012; Global Witness, *Rigged: The Scramble for African Oil, Gas and Minerals* (Global Witness 2012).

[153] See, for example, Toke S Aidt, 'Corruption and Sustainable Development' in Susan Rose-Ackerman and Tina Søreide (eds), *International Handbook on the Economics of Corruption* (vol 2, Edward Elgar 2011).

[154] See, as example, UN General Assembly, 'Agenda 21: A Programme for Action for Sustainable Development', 13 June 1992, UN Doc A/CONF 151/26, Annex I paras 1.4, 2.23, 33.10 and 33.13; Kevin P Gallagher and Daniel Chudnovsky (eds,) *Rethinking Foreign Investment for Sustainable Development: Lessons from Latin America* (Anthem 2010).

[155] Ibid.

[156] See section 4.2.2.

Based on the above, in theory, developing countries accept stabilisation clauses in order to attract FDI to facilitate their sustainable development. This theory however diverges dramatically from the socio-economic reality in many resource-rich developing countries. While many of them may have attracted FDI as a result of creating an 'attractive and conducive' investment climate, the FDI so attracted has yet to significantly promote their sustainable development. Rather, 'many countries home to great resource wealth are also home to some of the world's poorest communities.'[157] This is particularly the case in sub-Sahara Africa where, interestingly, the most stringent stabilisation clauses are often found.

Commentators agree that corruption is the main reason for the above state of affairs.[158] The extractive industry of many resource-rich developing countries is particularly vulnerable to corruption. This is because the high commercial value of such resources makes them a key target for acts of misappropriation, corruption and plundering. This is in addition to the fact that the bulk of FDI into such countries is directed towards projects in this sector.[159] Corruption thus manifests itself not only during the flow and allocation of revenues accruing from natural resources, but also during the negotiation of contracts and licenses. Indeed, numerous studies into the process of negotiating natural resource contracts in developing countries have highlighted how the often opaque nature of the process creates enough room for corruption and enables government officials to act in their own personal interest rather than in the economic interest of the state.[160]

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[157] TI, 'Promoting Revenue Transparency: 2011 Report on Oil and Gas Companies' (01 March 2001) <http://www.transparency.org/news/feature/promoting_revenue_transparency_2011_report_on_oil_and_gas_companies> accessed 19 September 2012.

[158] See, as examples, TI, 'Why Corruption Matters'<http://www.transparency.org.uk/corruption/why-it-matters> accessed 20 September 2012; Kolstad and Søreide (n 152).

[159] Ibid; UNCTAD, *World Investment Report 2012: Towards a New Generation of Investment Policies* (UNCTAD 2012) 39 – 60.

[160] See, for example, Marshall (n 152); OSISA (n 84); Global Witness (n 152); Kolstad and Søreide (n 152); Andrade and ors, *Transparency* (n 150).

It is for the above reasons that initiatives such as the Extractive Industry Transparency Initiative (EITI) have been launched.[161] Through this initiative, and in addition to the work of other NGOs and bodies, some of the most guarded investment contracts have been made public.[162] When this happens, the economic and legal analyses of the contracts often show that the balance of such contracts is strikingly tilted towards foreign investors.[163] This strengthens the perception that the contracts may have been negotiated in secret, and their terms kept secret in order to hide corruption. This perception is in turn strengthened by the findings from a recent study confirming that confidentiality clauses in contracts are often used as a means of hiding corruption rather than protecting trade secrets.[164] There is thus strong support for the view that the eventual terms and conditions of natural resource contracts in many developing countries are significantly being influenced by corruption and lack of transparency. The possible effect of this on stabilisation practices in these countries is considered next.

4.3.2 Corruption, Transparency and Stabilisation Clauses

It is acknowledged that an analysis of the rationale behind the grant of stabilisation clauses should start from a presumption that all parties have acted legally, honestly and in good faith. However, it is also true that many of the contracts containing stabilisation clauses have been negotiated under the opaque circumstances described above. The particularly generous terms seen in the contracts when they are eventually exposed are difficult to

[161]The EITI is a coalition of governments, companies, investors, civil society groups and international organisations launched at the WSSD in 2002. Its aim is to increase transparency over payments by companies to governments, as well as transparency over revenues received by host country governments <http://eiti.org/eiti> accessed 15 November 2012.

[162] See, for example, the Revenue Watch Institute, a non-profit policy and grant making institute launched in 2002 to promote 'effective, transparent and accountable management' of mineral resources 'for the public good' <http://www.revenuewatch.org/about> accessed 12 October 2012.

[163] See, as examples, Policy Forum (n 84); Muttitt (n 37); Global Witness, *Heavy Mittal: A State within a State: The inequitable Mineral Development Agreement between the Government of Liberia and Mittal Steel Holdings NV* (Global Witness 2006); PLATFORM, *A Lake of Oil; Congo's Contracts Escalate Conflict, Pollution and Poverty* (PLATFORM 2010); UN Security Council, 'Report of the Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of Congo, 23 October 2003, UN Doc S/2003/1027.

[164] Peter Rosenblum and Susan Maples, *Contracts Confidential: Ending Secret Deals in the Extractive Industries* (Revenue Watch 2009).

understand without assumptions of some degree of corruption. As Peter Rosenblum and Susan Maples observed, 'inexplicable giveaways and major asymmetries in contracts, while they may simply be due to a lack of capacity of the negotiators, could also point to official misconduct resulting from corruption.'[165]

The circumstances in which most of these contracts have been entered into, and subsequent events and revelations about the contracts and the regimes involved, suggest that more often than not, the reason for such 'inexplicable giveaways' may be corruption rather than incompetence. For example, commentators agree that while the background of the so called 'Arab Spring' may be diverse, the public outcry was largely directed against the wide–scale corruption and lack of accountability in these countries.[166] The 'Arab Spring' also drew attention to the corruption perpetuated by some of the regimes, and an estimate of the massive funds with which they have corruptly enriched themselves has been provided by Transparency International.[167] The list includes the four countries where their leaders have so far been ousted, namely, Egypt, Tunisia, Libya, and Yemen.

These countries also shared another characteristic under their ousted regimes. They all offered stabilisation clauses in their natural resources sectors, the scope of which have been variously described as 'comprehensive', 'considerable', and 'rather extensive'[168] The ouster of these regimes has now opened these contracts to scrutiny and in some of these

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[165] Ibid 41.

[166] See, for example, TI, 'Demands For Better Government Must Be Heeded' <http://cpi.transparency.org/cpi2011/results/>accessed 20 September 2012; Arwa Hassan, 'CPI 2011: After the Arab Spring' (*TI*, 30 November 2011) <http://blog.transparency.org/2011/11/30/corruption-perceptions-index-2011-corruption-and-the-arab-world/> accessed 20 September 2012.

[167] Jermyn P Brooks, 'Corrupt Dictators and the Arab Spring: Implications for Banks and Anti-Money Laundering Rules' (Tackling Corruption across the EU Conference, Brussels, 07 December 2011) <http://www.theparliament.com/fileadmin/theParliament/pdfs/2011-12-07_Jermyn_Brooks_AML__2_.pdf> accessed 20 September 2012.

[168] David Wood, 'Preliminary Report on Fiscal Designs for the Development of Alaska Natural Gas' (November 2008)107. <http://lba.legis.state.ak.us/fiscal/doc_log/2008-12-09_wood_2-3_fiscal_stability.pdf> accessed 20 September 2012; Pedro van Meurs, 'International Fiscal Stability Concepts' (22 July 2005)<http://www.revenue.state.ak.us/gasline/ContractDocuments/Contractors/VanMeurs&Associates/SGI_007787.pdf> accessed 20 September 2012.

countries the contracts are currently being reviewed amidst suspicion that the excessively favourable terms found in them may have been influenced by corruption.

In Libya, for example, a committee has been set up to investigate oil contracts entered into by the previous regime and to end, amend or renegotiate such contracts if corruption is identified.[169] At the same time, several of these companies are also being investigated by the US Securities and Exchange Commission (hereafter 'US SEC') over 'certain illicit payments to Libyan officials' that may have violated the US Foreign Corruption Practice Act.[170]

In such scenarios, it is difficult to isolate the 'rather extensive' stabilisation clauses contained in these contracts from the corrupt allegations surrounding the contracting process. As such, the presumption that stabilisation clauses have been accepted because of a desire to attract FDI for the benefit of these countries must be set aside. This should particularly be the case if a stated aim of the research is to proffer solutions to identified negative effects of the clauses as is the case with this work. Indeed, the study by Andrea Shemberg alluded to this point when it called for additional research to look into the improvement of the 'enabling environment' for 'good' agreements.[171] This additional research, the report recommended, should 'in particular consider the effect of corruption, lack of transparency and non-competitive tendering and procurement process on the eventual form of HGAs.'[172]

It is for the above reasons that this section seeks to examine the possible effects of corruption and lack of transparency on stabilisation practice in developing countries.

[169] Benoit Faucon, Summer Said and Liam Moloney, 'Libya, U.S. Probe Oil - Company Deals' *Wall Street Journal* (08 April 2012 <http://online.wsj.com/article/SB10001424052702303815404577331802347989804.html> accessed 20 September 2012; Jessica Donati, 'Analysis: Libya's Oil Contracts to be Unsure for Months More' *Reuters* (28 March 2012) <http://www.reuters.com/article/2012/03/28/us-libya-exploration-idUSBRE82R0EC20120328> accessed 20 September 2012.

[170] See Eni SpA, 'Form 20-F' (Annual Report to US SEC filed 30 January 2012) F-92 <http://sec.gov/Archives/edgar/data/1002242/000131143512000005/sj0412en20f2011.htm> accessed 20 September 2012; Total S.A, 'Form 20-F/Amendment (Annual Report to US SEC filed 26 March 2012)130 <http://sec.gov/Archives/edgar/data/879764/000119312512134298/d278816d20fa.htm> accessed 20 September 2012.

[171] Shemberg (n 45) Annex 1.

[172] Ibid.

However, before proceeding, some caveats are necessary. First, by its nature, corruption largely takes place under opaque circumstances and is thus difficult to measure. As explained by Adam Graycar, this is because 'the normal empirical tools of measurement are not always useful, as significant transactions are hidden and not reported, and any survey is unlikely to elicit a valid and reliable response.'[173] For this reason, he notes that those who study corruption often do so through 'desk reviews, surveys, focus groups, case studies, field observations, and professional assessments.'[174] As such, he concludes that the results so obtained may apply to a specific study rather than an overall assessment.[175]

Second, even in cases where there is a widespread perception or confirmed cases of corruption in a contractual process, it is hardly the case that the corruption can be linked to specific term(s) in the contract. What is, however, known is that corrupt payments are usually given by investors in exchange for favourable treatment and to obtain special favours from officials of host states.[176] In this sense, a stabilisation clause can be seen as a special favour as it provides an additional guarantee of the stability of contractual terms. This is why in countries where stabilisation practice is relatively more transparent, investors wishing to obtain this 'favour' must furnish some consideration either in the form of the payment of a premium or agree to be subject to a higher tax rate.[177]

Furthermore, from an investors' perspective, stabilisation clauses are arguably the most important clause in investor-state agreements.[178] The reason is simple. The purpose of a stabilisation clause is to protect the key terms in these agreements for the benefit of the

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[173] Adam Graycar, 'Corruption' in Mangai Natarajan(ed), *International Crime and Justice* (CUP 2011) 218.
[174] Ibid.
[175] Ibid.
[176] Ibid 216 – 217.
[177] See section 4.3.4.
[178] See Phillip R Weems and Matt Salo, 'Transactions: Mitigating Expropriation Risk of Natural Gas Projects' (March 2012) King & Spalding Energy Newsletter <http://www.jdsupra.com/legalnews/transactional-transactions-mitigating-33222/> accessed 20 September 2012, noting that 'perhaps the most important clause to consider in a project agreement with a host government is the stabilization clause'. See also Noushin Khushrushahi and ors, 'Mining in Mongolia: Some Recommendations for Long-Term Investment Agreements in the Mongolian Mining Sector' (Institute of Asia Research) <http://www.sociolog.com/jdierkes/ubc/mining_mongolia_edited.pdf> accessed 20 September 2012.

investors. As such, where there is evidence or widespread allegations that these terms have been influenced by corruption, it is difficult to isolate the stabilisation clauses from these allegations and evidence.

Lastly, and based on the reasons already given above on the nature of corruption, and the difficulty in measuring it, the findings in this section do not claim to make an overall assessment that stabilisation clauses are always linked to corruption and lack of transparency. However, they do highlight an increasing link between corruption, transparency and stabilisation clauses which helps to explain, at least in part, the wide disparity in stabilisation practices.

4.3.3 Scope of Stabilisation Clauses and the Reputation of Regimes

There is an increasing link between the scope of stabilisation clauses granted by a country and the reputation of the regimes that granted them. The broadest and most stringent forms of stabilisation clauses seen in this study are mostly in contracts or legislation entered into or enacted by regimes widely perceived to be corrupt and/or dictatorial. These contracts or legislation nearly always contain full freezing or full economic equilibrium clauses or a combination of both. In most cases, they have been drafted to protect the investors from every imaginable circumstance or event that may negatively affect them even if only slightly.

Such contracts are also often drafted to protect the investors for the entire duration of the contract or at least a significantly long period. At the same time, these clauses often allow the investors to benefit from favourable changes in law. In most cases, these contracts have been negotiated under opaque conditions and the eventual terms kept secret as well. The stabilisation clauses only become known when they are leaked by civil society groups/NGOs or published by a subsequent government following the adoption of transparency initiatives.

The link between the scope of stabilisation clauses and the reputation of the regimes that granted them appears to hold true whether or not the contracts have been entered into as part of the reform process. Thus, regardless of whether these governments have been put under pressure from the World Bank, corrupt and/or dictatorial regimes appear more likely to grant the most stringent forms of stabilisation clauses. This includes the stabilisation clauses in the agreements governing the WAGP, the BTC oil pipeline project and the Chad–Cameroon oil and pipeline project all of which are well known for their broad scope.

With respect to the WAGP, there is an International Project Agreement (hereafter 'IPA') which established an 'Agreed Regime.'[179] This 'Agreed Regime' is protected by full hybrid clauses. The clauses exempt the investors from all changes that may adversely affect the Agreed Regime including, court decisions, acts or omissions of the state and its agencies, new laws and taxes, and international treaties or similar commitments entered by the state.[180] In the event that these laws are made applicable to the investor(s), they are to be restored to the 'same or an economically equivalent position it was or they were in prior to such change.'[181] If the state fails to do this, the investor(s) must be paid 'prompt, adequate and effective compensation.'[182] The stability of the Agreed Regime is further reinforced by full hybrid clauses in the Treaty between the respective host governments.[183]

Similarly, the respective BTC HGAs contain identical combination of detailed and complex freezing and economic equilibrium clauses.[184] The freezing clause provides that no law 'now or hereafter existing' can 'limit, abridge or affect adversely the rights' of the

[179] Article 29
[180] Ibid art 36.2.
[181] Ibid art 36.2(a).
[182] Ibid art 36.4.
[183] Treaty on The West African Gas Pipeline Project between Benin and Ghana and Nigeria and Togo (31 January 2003) art VII s 2(3) (b) art VII ss 2 and 3.
[184] Each host government ie Azerbaijan, Georgia, and Turkey, all have separate HGAs with the Consortium.

investors 'or otherwise amend, repeal or take precedence over' the Project Agreement.[185] The governments also agreed to 'restore the Economic Equilibrium established under the Project Agreements if and to the extent that the Economic Equilibrium is disrupted or negatively affected, directly or indirectly, as a result of any change (whether the change is specific to the Project or of general application)' in law '(including any Turkish Laws regarding Taxes, health, safety and the environment).'[186]

The Chad–Cameroon project is also governed by several agreements. However, for the purposes of this study, the four key documents are the 1988 Convention Agreement,[187] the 2004 Convention Agreement replacing it,[188] the 1997 COTCO Convention of Establishment (COTCO-Cameroon)[189] and the TOTCO Convention of Establishment (TOTCO-Chad).[190] The stabilisation clauses in these agreements differ in the way in which they are drafted.[191] However, each contains a combination of stringent freezing and economic equilibrium clauses protecting the investors for the entire duration of the project.[192] The governments agreed that they 'shall not modify such legal, tax, customs, and exchange control regime in such a way as to adversely affect the rights and obligations' of the investors.[193] In addition, 'no legislative, regulatory or administrative measure', which is

[185] Article 21.2, HGA between and among the Government of Turkey and the State Oil Company of the Azerbaijan Republic and BP Exploration (Caspian Sea) Ltd. and ors (19 October 2000). See also arts 20.2, Georgian HGA and art 20.2 of the Azeri HGA.
[186] Article 7.2(xi) Turkish HGA. See also 7.2(x) of both the Georgian and Azeri HGAs.
[187] The 1988 Convention Agreement granted an exploration permit valid until 2004, and a 30-year concession to develop oilfields.
[188] The 2004 Convention Agreement renewed the 1988 Convention.
[189] Convention of Establishment between the Republic of Cameroon and the Cameroon Oil Transportation Company (hereafter 'Cameroon-COTCO Convention') 1998.
[190] Convention d'Etablissement between the Republic of Chad and the Tchad Oil Transportation Company (TOTCO), 10 July 1998.
[191] See also generally, art 30 COTCO-Cameron, art 21 TOTCO-Chad art 34 Chad 1988, art 34 Chad 2004.
[192] The duration of each agreement and contract is between 25 and 35 years with option of renewal for the same period. See generally art 2.2 Chad 2004, art 3.1 TOTCO-Chad, art 3.1 COTCO-Cameroon.
[193] Article 24.2 COTCO-Cameroon. See also generally art 24 COTCO – Cameroon, art 21 TOTCO-Chad and art 34 of the 2004 Chadian Convention.

contrary to the provisions of the Convention, shall apply to the investors without their prior written consent.'[194]

Taken together, these three projects contain some of the most stringent, complex and extensive stabilisation clauses seen in this study. These clauses have already received extensive criticism in the academic literature and the work of NGOs on account of their radical and stringent nature and the way in which they might affect the protection of human rights.[195] They were also all granted under opaque circumstances by regimes known to be dictatorial and/or widely perceived to be corrupt. At the same time, they were also all actively supported by the World Bank amidst intense criticism about the benefits of the projects to citizens. The Chad-Cameroon oil pipeline project is particularly illustrative in this respect.[196]

The four agreements containing the stringent stabilisation clauses were signed between 1988 and 2004. In the case of Chad, the 1988 Chad Convention was signed by former president Hissène Habré who ruled Chad from 1982 until he was deposed in 1990. He fled to Senegal in 1990 after committing widespread misappropriations and human rights abuses, including political killings and systematic torture.[197] He was first indicted in 2000 by Senegal and in 2005 by Belgium for charges on crimes against humanity, war crimes and

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[194] Article 24.2 COTCO–Cameroon.

[195] See, as examples, Nicholas Hildyard and Greg Muttitt, Turbo-Charging Investor Sovereignty: Investment Agreements and Corporate Colonialism' (*The Corner House*, 11 February 2006) <http://www.thecornerhouse.org.uk/sites/thecornerhouse.org.uk/files/HGAPSA.pdf> accessed 24 September 2012; Amnesty International, *Contracting out of Human Rights: The Chad-Cameroon Pipeline Project* (AI 2005); Amnesty International, *Human Rights on the Line: The Baku-Tbilisi-Ceyhan Pipeline Project* (AI 2006).

[196] For similar analyses of the WAGP and the BTC projects, see the following, PLATFORM and ors 'Oil Companies Colonise Turkey MAI through the Back Door' (Press Release)(30 August 2002) <http://www.carbonweb.org/showitem.asp?article=108&parent=9> accessed 26 September 2012; Baku Ceyhan Campaign and ors, 'Developmental, Human Rights and Environmental Impacts of the Baku-Tblisi-Ceyhan Oil Pipeline' (Memorandum From Concerned Non-Governmental Organizations to DFID and ors) (November 2002) <http://www.baku.org.uk/correspondence/DfID_memo_feb_2003.pdf> accessed 26 September 2012; World Bank, 'The Inspection Panel Report and Recommendation on Request for Inspection'<http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2006/07/19/000090341_20060719133405/Rendered/PDF/367910GH0INSP1R200610004.pdf> accessed 26 September 2012.

[197] For details, see: Chad, 'Report of the Commission of Inquiry into the Crimes and Misappropriations Committed by Ex-President Habré, His Accomplices And/or Accessories' (07 May 1992) reprinted in Neil J Kritz (ed) *Transitional justice: How Emerging Democracies Reckon with Former Regimes* (vol 3: Laws, Rulings and Reports (US institute for Peace Press 1995) 51 – 93.

torture.[198] He now faces trial for these offences before a special war-crimes court set up by the Senegalese government in 2012 on the orders of the African Union.[199]

The 1998 TOTCO–Chad and the 2004 Chad Convention were signed by Habré's successor Idriss Déby, who has ruled Chad since 1992 and is also running a dictatorial government.[200] The regime is also well known for perpetrating widespread human rights abuses and 'extensive misuse of public funds.'[201] In 2004 when the Chad Convention was signed, the country appeared in Transparency International's Corruption Perception Index (hereafter 'CPI') [202] for the first time and was ranked as third most corrupt country in the world.[203]

The reputation of the regime in Cameroon was no different. The stabilisation clauses in the 1998 COTCO – Cameroon were granted under the regime of Paul Biya who has ruled Cameroon since 1982 to date. In 1998 when the Convention was signed, Cameroon was listed as the most corrupt country in the world by Transparency International, a position it retained the following year.[204]

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[198] Human Rights Watch, 'Senegal New Court to try Chad Ex-Dictator in Senegal' (22 August 2012) < http://www.hrw.org/news/2012/08/22/senegal-new-court-try-chad-ex-dictator-senegal> accessed 26 September 2012.

[199] Human Rights Watch, 'The Case of Hissène Habré before the Extraordinary African Chambers in Senegal: Questions and Answers' (*HRW*, 11 September 2012 <http://www.hrw.org/sites/default/files/related_material/Q&A%20on%20Habre%20Case%20Before%20Extraordinary%20African%20Chambers%20in%20Senegal%20EN.pdf> accessed 26 September 2012.

[200] Ian Gary and Nikki Reisch, 'Chad's Oil: Miracle or Mirage? Following the Money in Africa's Newest Petro-State' (2005) Report, 16 <http://crs.org/publications/showpdf.cfm?pdf_id=187> accessed 26 September 2012.

[201] Ibid 15; Bureau of Democracy, Human Rights, and Labour, 'Country Report on Human Rights Practices for Chad 2003' (*US Dept of State*, 25 February 2004) <http://www.state.gov/j/drl/rls/hrrpt/2003/27719.htm> accessed 26 September 2012.

[202] TI, 'CPI 2011' <http://cpi.transparency.org/cpi2011/results/> accessed 15 November 2011.The CPI is an annual ranking of countries according to their perceived levels of public sector corruption. The ranking is based on experts' assessments and data from opinion surveys conducted by independent and reputable organisations. The index uses perceptions due to the difficulty in measuring corruption. While this has led to some criticisms, the ranking is arguably the world's most reliable estimate of public sector corruption and is extensively used by anti-corruption practitioners.

[203] TI, '2004 CPI' <http://www.icgg.org/corruption.cpi_2004.html> accessed 26 September 2012.

[204] TI, 'CPI 1998' <http://archive.transparency.org/policy_research/surveys_indices/cpi/previous_cpi/1998>; TI, 'CPI 1999<http://archive.transparency.org/policy_research/surveys_indices/cpi/previous_cpi/1999> accessed 26 September 2012.

Based on the antecedents of the regimes in these countries, several local citizens together with a number of local and international NGOs called on the World Bank not to support the project until issues of corruption, transparency and the impacts of the projects were addressed.[205] They argued that based on the endemic corruption and political repression in the country, the project would only generate profits for foreign investors and revenues for the corrupt enrichment of the regime and the further repression of the people.[206] However, amidst these protests, the Bank provided the legal and financial support and guarantees required to enable the project to proceed. The result was the stringent stabilisation clauses described above.

Subsequent events in Chad have confirmed that the stabilisation clauses were never granted because of a desire by the regime to attract FDI for the sustainable development of the country.[207] This is because, under pressure from civil society and NGOs, the World Bank pressured the Chadian government to agree to invest at least 70 per cent of the revenue from the project on 'priority programs' that will facilitate the sustainable development of the country.[208] However, once the project began to generate revenues, and in keeping with the antecedents of the regime, the President consistently ignored these arrangements.[209] The revenue was repeatedly diverted for other purposes.[210] This suggests that contrary to the

[205] World Bank, 'The Inspection Panel Report and Recommendation on Request for Inspection Chad: Petroleum Development and Pipeline Project' (17 September 2001) Annexures <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2004/06/16/000265513_20040616173126/Rendered/PDF/22745.pdf> accessed 26 September 2012; Bank Information Center, 'Chadian Civil Society Organizations Conduct Month-Long Campaign Around Pipeline's Official Inauguration.' (15 November 2003) <http://www.bicusa.org/en/Article.576.aspx> accessed 26 September 2012.

[206] BIC, *Chadian* (n 205) Annex 1 paras 5 – 6.

[207] Note that the focus is more on Chad because the bulk of the project is in the Chadian axis.

[208] Law Number 001/PR/99 Relating to the Management of Oil Revenues of 30 December 1998, and subsequent amendments and decrees.

[209] World Bank, 'World Bank, Chad Reach Interim Agreement on Funding, Oil Revenue Management' (Press Release) (26 April 2006) <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/0,,contentMDK:20903775~menuPK:258657~pagePK:146736~piPK:146830~theSitePK:258644,00.html>accessed 26 September 2012.

[210] BBC, 'Chad "needs oil money for arms"' (19 April 2006) <http://news.bbc.co.uk/1/hi/world/africa/4923254.stm> accessed 26 September 2012.

theoretical rationale for stabilisation clauses, the sustainable development of the country was not the reason the stringent stabilisation clauses were granted to 'attract' the project.

By September 2008, even the World Bank was forced to admit that it is 'evident' that the arrangements to allocate funds for the sustainable development of the country 'were not working.'[211] It therefore decided to withdraw its support for the project.[212] Significantly, the withdrawal only came after the full repayment of the IBRD and the IDA components of the loan it had granted to Chad.[213] As such, as far as IBRD and IDA are concerned, the World Bank did not suffer any financial loss. It has also not suffered any significant financial loss for the IFC component of its loans as the investors are protected by the stringent stabilisation clauses which the Bank helped to broker.[214]

The stabilisation clauses in the BTC pipeline projects, the WAGP and the Chad-Cameroon project have received some attention in the literature. However, this should not be taken to mean that they are isolated cases where stringent stabilisation clauses have been granted by regimes with the reputation of being corrupt and dictatorial. While many mineral resources contracts are still kept secret, an increasing number of contracts that have been leaked or subsequently published point to a relationship between corruption, lack of transparency and stringent stabilisation clauses. A number of examples can be cited to illustrate this point.

The original Mittal Steel MDA granted by the government of Liberia was negotiated in secret and its terms kept secret as well.[215] Its terms and conditions, including the stabilisation clauses only came to light after the agreement was leaked by some local

[211] World Bank, 'World Bank Statement on Chad –Cameroon Pipeline' (Press Release) (09 September 2008) <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21894530~pagePK:34370~piPK:34424~theSitePK:4607,00.html> accessed 26 September 2012.
[212] Ibid.
[213] Ibid.
[214] See section 4.2.4.
[215] MDA between the Government of Liberia and Mittal Steel Holdings AG and Mittal Steel (Liberia) Holdings Limited (17 August 2005). The MDA was subsequently renegotiated by a new government.

citizens.[216] The agreement contained the following combination of full freezing and inconsistency clauses exempting Mittal Steel from all adverse changes in the law but allowing it to benefit from favourable changes:

> ….any modifications that could be made in the future to the Law as in effect on the Effective Date shall not apply to the CONCESSIONAIRE and its Associates without their prior written consent, but the CONCESSIONAIRE and its Associates may at any time elect to be governed by the legal and regulatory provisions resulting from changes made at any time in the Law as in effect on the Effective Date. In the event of any conflict between this Agreement or the rights, obligations and duties of a Party under this Agreement, and any other Law, including administrative rules and procedures and matters relating to procedure, and applicable international law, then this Agreement shall govern the rights, obligations and duties of the Parties.[217]

The stabilisation clauses were included to protect the terms of the contracts for potentially 50 years (initial term of 25 years with the option of renewal for another 25 years).[218] It was granted by a transitional government described as 'notoriously' and 'exceedingly' corrupt.[219] Soon after the transitional government left office, the Dutch National Police's International Corruption Project began an investigation into the circumstances surrounding the Mittal deal.[220] In addition, key members of the transitional government including its Chairman were later indicted for corruption during their tenure by

[216] Rosenblum and Maples (n 164) 52 and endnotes 123.
[217] Article XIX, s 9.
[218] Article III, s 2
[219] Global Witness, 'Mittal Steel did the right thing – will Firestone?' (Press Release) 30th April 2007) <http://www.globalwitness.org/library/mittal-steel-did-right-thing-%E2%80%93-will-firestone> accessed 26 September 2012; Rosenblum and Maples (n 164) 52. See also Nicolas Cook, 'Liberia's Post-War Development: Key Issues and U.S. Assistance' (2010) CRS Report for Congress No RL33185, 35 - 38 <http://www.fas.org/sgp/crs/row/RL33185.pdf> accessed 26 September 2012.
[220] Global Witness, *Heavy Mittal* (n 163) 11.

an audit undertaken by ECOWAS and are currently undergoing criminal proceedings in Liberia.[221]

Another example can be cited from the stabilisation clauses in the mining sector of Madagascar, established as part of mining sector reforms undertaken with technical assistance from the World Bank.[222] All three of the distinct regimes established by the reforms contain stringent stabilisation clauses exempting investors from all new laws but allowing them to benefit if the changes are favourable. For example, in the Establishment Agreement, the investors, 'its affiliates and its Shareholders and Employees' are exempted from the adverse effect of any 'legislative or regulatory decision' for the entire 40-year duration of the Agreement.[223] Furthermore, in the event that there is an 'unforeseen modification of the economic circumstances which disturbs the economy of the project' to the detriment of the investors, 'the State shall take appropriate measures to re-establish the economic balance thus disturbed.'[224] Similar clauses exist in the Mining Code and the Law on Large-scale Investment where investors are exempted from all changes in law for specified periods (between 8 and 40 forty years) depending on the level of investment.[225]

It should be stated that the World Bank now describes these stabilisation clauses as 'rather rigid' and 'demonstrates no room for adjustments for an extended period of time.'[226] These clauses were all granted or enacted into law during the regime of former President Didier Ratsiraka, who has been described as 'nothing more than a dictator, practicing nepotism, corruption and power politics.'[227] He ruled Madagascar for 23 years making

[221] For details, see, Cook (n 219) 37.
[222] See section 4.2.4.
[223] Preamble and art 12
[224] Article 12. See also art 18.2.
[225] Articles 12 and 18 of the Establishment Agreement; arts 154 - 163 of the Mining Code and arts 30 - 33 of the Law on Large Scale Investments.
[226] World Bank, *Madagascar* (n 89) 48.
[227]Edmond Razafimahefa, President of the Churches of Jesus Christ in Madagascar in Simon Robinson, 'Tropical Trouble' *Time Magazine* (16 June 2002) <http://www.time.com/time/magazine/article/0,9171,262929,00.html> accessed 26 September 2012

several constitutional changes to increase his powers while engendering corruption.[228] He refused to hand over power even after he was defeated in an election until he was forced into exile by an armed rebellion.[229] He and several of his officials were subsequently tried and convicted for corruption or abuse of office.[230]

Another example can be cited from the stabilisation clauses granted in respect of the Nigeria Liquefied Natural Gas (hereafter 'NLNG') project.[231] Under these clauses, the government commits itself not to amend the fiscal regime governing the project without the prior written agreement of the investors.[232] The investors are further exempted from 'new laws, regulations, taxes duties imposts, or charges of whatever nature which are not applicable generally to companies incorporated in Nigeria.'[233] In addition, the investors have a right to 'prompt, adequate and effective compensation in the event of expropriation of tangible property or property rights or interference with contract rights.'[234] The clauses are to remain effective 'so long as the Company or any successor thereto, is in existence and carrying on' its business.[235]

The scope of these stabilisation clauses was rightly described as 'rare' and 'extensive' at the time they were granted.[236] The clauses were granted through a military decree signed by General Sani Abacha, who ran a remarkably dictatorial government until his death in 1998. His government was characterised by extra-judicial killings, arbitrary

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[228] Marcus (n 120); Lauren Ploch and Nicolas Cook, 'Madagascar's Political Crisis' (2012) CRS Report for Congress R40448 <http://www.fas.org/sgp/crs/row/R40448.pdf> accessed 26 September 2012.

[229] BBC 'Ratsiraka: 'Big Man' Cut to Size' (05 July 2002) <http://news.bbc.co.uk/1/hi/world/africa/2098635.stm> accessed 26 September 2012.

[230] Ploch and Cook (n 228) 8; BBC 'Madagascar ex-president Ratsiraka Returns From exile' (24 November 2011) <http://www.bbc.co.uk/news/world-africa-15871838> accessed 26 September 2012.

[231] See Nigerian LNG (Fiscal Incentives Guarantees and Assurances) (Amendment) Act 1993 (Hereafter 'NLNG Act'). The Act was originally enacted as a military decree in 1993 but following the advent of democratic government, it is now deemed to be an Act.

[232] Para 2 to second sch.

[233] Para 3 to second sch.

[234] Para 21 to second sch.

[235] Preamble.

[236] Yinka Omorogbe, 'Law and Investor Protection in the Nigerian Natural Gas Industry' (1996) 14JENRL 179,188

imprisonment and draconian legislation.[237] At the same time, he was also well known for his remarkable corruption and was listed in a 2003 report by Transparency International as the world's fourth most corrupt leader in recent history.[238] Almost US$3 billion of his looted funds have so far been traced and approximately US$1.3 billion recovered and returned to the country.[239] After his death, he and several of his accomplices were variously indicted for bribery and corruption including for accepting bribes to influence the award of contracts for the construction of the same NLNG project for which the stabilisation clauses were granted.[240]

Another example can be cited from the Production Sharing Agreements (PSA) signed by Kazakhstan during the 1990s. These PSAs were drafted in line with the country's model contracts developed with the support of the World Bank.[241] For example, the 1997 model PSA contained a full freezing clause exempting investors from any 'amendments and additions to legislation which cause a deterioration' to their financial position.[242] It also contained a full economic equilibrium clause which ensures that if such amendments and additions are applied, then the parties shall meet to 'introduce such amendments or alterations into the contract, which are necessary to restore the economic interest of the

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[237] See generally: Human Right Watch Nigeria, 'The Price of Oil: Corporate Responsibility and Human Rights Violations in Nigeria's Oil Producing Communities (January 1999) <http://www.legaloil.com/Documents/Library/HRW1999.pdf> accessed 12 October 2012.

[238] TI, 'Global Corruption Report 2003' (23 JANUARY 2003) <http://www.transparency.org/whatwedo/pub/global_corruption_report_2003_access_to_information> accessed 26 September 2012.

[239] For details, see, TI, 'Impact of International Asset Recovery and Anti-money Laundering Efforts on Poverty Reduction and Political Accountability' 2 (*TI*, 17 January 2010) <http://www.transparency.org/files/content/corruptionqas/230_Impact_of_asset_recovery_and_money_laundering_on_poverty_reduction.pdf> accessed 28 May 2012; 'Asset Recovery Knowledge Center (ARKC) 'Sani Abacha' <http://www.assetrecovery.org/kc/node/52f770df-a33e-11dc-bf1b-335d0754ba85.0;jsessionid=61B51EE213EAC8CF54D7541F97BDAB56> accessed 28 May 2012.

[240] For details, see, Dauda Garuba, 'Nigeria: Halliburton, Bribes and the Deceit of "Zero-Tolerance" for Corruption' (*Revenue Watch*, 09 April 2009) <http://www.revenuewatch.org/news/nigeria-halliburton-bribes-and-deceit-zero-tolerance-corruption#_ftn12> accessed 26 September 2012; Salisu Usman, 'The Opacity and Conduit of Corruption in the Nigeria Oil Sector: Beyond the Rhetoric of the Anti-Corruption Crusade' (2011) 13 *J of Sust Devt in Africa* 294*; US Security & Exchange Commission v Halliburton Company & KBR INC.* US District Court, Texas, Civil Action No 4:09-399, Complaint of 11 February 2009, <http://www.sec.gov/litigation/complaints/2009/comp20897.pdf> accessed 26 September 2012.

[241] See discussion on the 'World Bank model' PSAs in section 4.2.2.

[242] Model Contract for Oil and Gas 1997 (Decree 108 of 1997) art 28.2.

parties to their status as of the moment of signing the contracts.'[243] In line with these Model Contracts, several PSAs signed in the 1990s contained similar stringent stabilisation clauses protecting investors from unfavourable current and future laws usually for the entire duration of the agreement, which in some cases is up to 40 years.[244]

The PSAs were negotiated during the World Bank-led reform process but the negotiations were carried out under extremely opaque conditions amidst widespread suspicion that their terms were being influenced by corruption.[245] These allegations were subsequently confirmed through several legal proceedings in the US and elsewhere.[246] The summary of the indictments in the US which have now led to some convictions is that bribes totalling over $80 million were offered on behalf of several oil companies to key officials of Kazakhstan including the President and Prime Minister.[247]

According to the court documents, these bribes helped to facilitate the acquisition of six lucrative oil and gas rights.[248] Of particular relevance, these 'lucrative' oil and gas rights relate to the projects known to be protected by stringent stabilisation clauses.[249] The indictment noted that the unlawful payments 'defrauded the Government of Kazakhstan of funds to which it was entitled from oil transactions, and defrauded the people of Kazakhstan of the right to the honest services of their elected and appointed

[243] Article 28.16

[244] See, for example, PSA between Kazakhstan and Agip, BP and others in respect of the North Caspian Sea (hereafter 'Kashagan') (18 November 1997) arts 23.1, 29.1 and 40.2.

[245] Richard Pomfret, 'Kazakhstan's Economy since Independence: Does the Oil Boom offer a Second Chance for Sustainable Development?' (2005) 57 *Europe-Asia Studies* 859; Muttitt (n 37).

[246] For details, see, Global Witness, *Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues* (Global Witness 2004) 7 - 19; Promfret *Kazakhstan* (n 246) 15 – 16.

[247] For details, see, *USA v James H Griffen*, US District Court, New York, Indictment No 03 CRIM 404 Indictment of 08 April 2003 <http://www.justice.gov/criminal/fraud/fcpa/cases/giffen/04-02-03giffen-indict.pdf> accessed 26 May 2013; US Attorney General's Office, 'American Businessman Charged with Making Unlawful Payments to Kazakh Government Officials in Connection with the Sale of Share in Oil Field to Mobil Oil (Press Release,31 March 2003) <http://www.justice.gov/usao/nys/pressreleases/March03/giffinprcom.pdf> accessed 26 May 2013.

[248] Ibid.

[249] This includes the Kashagan project and the projects relating to the Tengiz and Karachaganak oil and gas fields which are also governed by PSAs containing stringent stabilisation clauses.

officials.'[250] In other words, the terms and conditions of the contracts, including the stabilisation clauses, were a product of dishonest services rendered by the Kazakhstan officials. In a related development in Italy, ENI is currently being investigated over allegations of corruption in Kazakhstan.[251] The specific allegation is that ENI gave at least $20 million in bribes to a son-in-law of the Kazakh President who helped influence the first phase of the company's investment in Kashagan oil field.

A final example can be cited from the stabilisation practice in the Democratic Republic of Congo (hereafter 'DRC'). For example, a 2008 Congo-China agreement states that 'all new legal and regulatory requirements which put the mining joint venture and the contractor in charge of infrastructure at a disadvantage will not be applied'[252] In other words, the investors are exempted from *all* adverse changes in the laws and regulations. It is therefore not surprising that a group of legal scholars described this clause as 'one of the most comprehensive and uncompromising stabilisation clauses' they have ever seen.[253]

The same description can be applied to the identical stabilisation clauses contained in two PSAs signed in 2006 and 2008.[254] Both clauses exempt the investors from changes in the 'general legal, financial, petroleum, tax, customs and economic conditions' for the entire duration of the agreement while allowing them to benefit from any favourable changes.[255] These PSAs and the mining agreement were negotiated in secret and the final contracts were never publicly released. Their terms, including their stringent stabilisation clauses only

[250] *USA v Griffen* (n 247) 3.

[251] UPI, 'Eni Accused of Corruption in Kazakhstan' *UPI* (Astana, 11 May 2012) <http://www.upi.com/Business_News/Energy-Resources/2012/05/11/Eni-accused-of-corruption-in-Kazakhstan/UPI-72151336743660/#ixzz21WMHz0ML> accessed 26 September 2012; Reuters 'Italy's Prosecutors Seek to Curb Eni's Kazakh ops' (10 May 2012) <http://uk.reuters.com/article/2012/05/10/eni-kazakhstan-idUKI6E8E700R20120510> accessed 26 September 2012.

[252] Collaborative Agreement between the Democratic Republic of Congo and the Chinese Companies Group and ors (April 2008) art 1.4.

[253] Sheldon Leader, Judith Schönsteiner and Rasmiya Kazimova, as cited in Global Witness, *China - Congo: Friends in Need* (Global Witness 2011)129.

[254] PSA between the DRC and Tullow DRC BV And Héritage DRC Ltd. (July 2006); PSA for Block I of the DRC Albert Graben between the DRC and Divine Inspiration Consortium Group (Pty) Ltd. (January 2008).

[255] Articles 28 of both PSAs

became known after they were leaked by NGOs/civil society.[256] The context in which these agreements, just as every other agreement, were signed is aptly summarised by Global Witness as follows:

> Over the last ten years, in particular, numerous lucrative mining agreements were signed in opaque deals between unaccountable and unelected political leaders, mining companies and other economic operators. Little information is available on the circumstances surrounding the signature of these contracts and how much money was paid, and to whom, in the process. The result has been that vast profits have flowed out of the country, and into the pockets of corrupt leaders and businessmen, while the Congolese population continues to be subjected to extreme poverty.[257]

Indeed, the fact that the mineral sector in DRC has been and continues to be characterised by a lack of transparency, corruption and complete disregard for the laws of the country is well documented in numerous reports including those prepared by a Panel of Experts commissioned by the United Nations.[258] In summary, these reports show how successive governments granted mineral contracts to investors in circumstances 'widely perceived to be suspect.'[259] Such contracts, the panel found, often contained terms that

[256] Leaked copies were made available on Congolese internet news sites and on the Global Witness website.
[257] Global Witness, 'The Congolese Mining Sector in the Balance Lack of Transparency Risks Undermining Review of Mining Contracts' (2007) Global Witness Briefing Paper 2007, 3 <http://www.globalwitness.org/sites/default/files/pdfs/mining_contract_review_oct07_en.pdf> accessed 27 September 2012.
[258] See, for example UN Panel, *S/2003/1027* (n 163).
[259] Ibid para 27.

appeared to be 'particularly generous for the foreign investors involved.'[260] It also showed that in some other cases, the grants of the concessions were done illegally.[261]

From the perspective of investors, it may be argued that stringent stabilisation clauses are commensurate with the heightened political risks of the project brought about by the reputation of the regimes. In other words, the fact that a regime is widely known to be corrupt and/or dictatorial makes it more untrusted and thus provides legitimate reasons for investors to be protected by broader forms of stabilisation clauses. However, the circumstances in which some of these clauses have been granted suggest that the clauses may have had little to do with the level of the perceived risk in the country. The circumstances surrounding the extensive stabilisation clauses for the Nigerian LNG project is particularly illustrative.

The company was incorporated in 1989 and was granted very generous incentives and exemptions at the time.[262] However, these incentives and exemptions were not protected by stabilisation clauses. The extensive stabilisation clauses were included through an amendment decree signed on 18 November 1993 by Sani Abacha who only assumed power the evening before (i.e. on 17 November 1993) through a military coup. In such a scenario, it is difficult to conceive how the regime could have been legitimately convinced in just one night that the extensive stabilisation clauses were required to attract the project.

Furthermore, all other decrees promulgated by the regime prior to, and immediately after, the Nigeria LNG decree had nothing to do with the promotion or attraction of FDI. Rather they all introduced measures to entrench dictatorship and corruption.[263] This therefore suggests that rather than a desire to attract FDI to promote sustainable development, the

[260] Ibid.
[261] 'Report of the Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of the Congo' (Interim Report), 12 April 2001, UN Doc S/2001/357, para 207.
[262] NLNG (Fiscal Incentives, Guarantees And Assurances) Decree No. 39 Of 1990
[263] For a list, see ABFR and Co., 'Chronology of Nigeria Decrees: 1993' <http://www.abfrco.com/1993n.htm> accessed 12 October 2012.

clauses may have been the outcome of an opportunistic behaviour. This view is supported by the following section which discusses the inability of most of these clauses to survive when faced with minimum standards of transparency.

4.3.4 Transparency and Stabilisation Clauses

The preceding section argued that there is increasing evidence that the broadest and most stringent forms of stabilisation clauses are granted by corrupt and/or dictatorial governments. This section argues that conversely, an increasing number of stabilisation clauses have been eliminated or had their scope reduced in the face of improved transparency and accountability in natural resource management.

Before proceeding with the analysis, it is important to first mention that such transparency initiatives affecting stabilisation clauses are mostly implemented alongside other measures aimed at increasing the benefits that accrue to the countries from their extractive industry. For this reason, some commentators claim these changes are motivated by greed within host governments and anti-western sentiments against foreign investors.[264] In the words of Jeffery Sachs, 'judged by the financial press of the US and Europe, the renegotiations of contractual terms are a sign of perfidious host-country behaviour.'[265] However, he proceeds to strongly rebut this view and insists that there is 'much more than meets the eye.'[266] He traces the cancellations and restructuring of these contracts to their inability to pass 'minimal standards of honesty, transparency and due process.'[267] He therefore concludes:

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[264] See, for example, AFM Maniruzzaman, 'The Issue of Resource Nationalism: Risk Engineering and Dispute Management in The Oil and Gas Industry' (2009) 5 *Texas J of OGEL* 79, 82 - 83; The Economist 'Resource Nationalism in Africa: Wish You Were Mine' *The Economist* (Johannesburg, 11 February 2012) <http://www.economist.com/node/21547285> accessed 27 September 2012.

[265] Jeffrey D Sachs, 'Addressing Political Risk In the Energy Sector' in EIU and Columbia Program on International Investment (eds) *World Investment Prospects to 2011*: *Foreign Direct Investment And The Challenge of Political Risk*) <http://graphics.eiu.com/upload/WIP_2007_WEB.pdf> accessed 28 September 2012.

[266] Ibid 81.

[267] Ibid.

> The ultimate source of contractual instability in Russia, Bolivia and many other countries, is not arbitrary host-country behaviour but rather the lack of legitimacy of the contractual process in the first place. The negotiations between investors and the state are habitually secret, and the resulting terms are almost always secret as well. An air of corruption hangs heavily over most deals. The public has no confidence in the legitimacy of the investor-state relationship.[268]

Given previous findings, this study must surely agree with Sachs. The vast majority of the instances described where stabilisation clauses have been eliminated or had their scope significantly reduced occurred as a result of increased transparency and accountability.[269] The fact that these changes took place within the context of reforms aimed at ensuring more benefits for the host state is also understandable. As explained in previous sections, many of these stabilisation clauses were granted together with particularly generous terms in circumstances similar to that described by Sachs. It therefore follows that any effort to alter these clauses will necessarily be accompanied with reforms to alter the generous terms they were intended to stabilise in the first place.

4.3.4.1 Effect of Transparency on Stabilisation Clauses

The secrecy surrounding many existing contracts in the extractive industry of many developing countries has led to widespread perceptions among citizens that these contracts may have been influenced by corruption and that their terms and conditions are favourable to investors and against the interest of the country. This, coupled with the inability of the citizens to enjoy the benefits of the revenue generated by these contracts, has led to demands for more transparency and accountability in natural resource management.

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[268] Ibid.

[269] A notable exception is Equatorial Guinea which eliminated stabilisation clauses in 2006 without any significant efforts to improve transparency and accountability. See Hydrocarbon Law 2006, ch XXVII.

In response to these demands, several governments in developing countries have been elected largely on campaign promises to increase transparency and accountability in the management of the natural resource sector. In some cases, these promises have been made together with specific promises to review, override or undermine stabilisation clauses. In keeping with these promises, these governments have introduced measures aimed at improving transparency. An increasingly noticeable effect of these initiatives is the elimination, or reduction, in the scope of stabilisation clauses granted by the affected countries.

The nationalisation of the Bolivian hydrocarbon sector, which also led to the removal of stabilisation clauses from the country's hydrocarbon laws, is a good illustration in this regard. That nationalisation has received substantial attention in the literature. However, the analysis is often presented solely from the perspective of a resource nationalism agenda by President Evo Morales.[270] Little mention is given to the key role played by transparency and accountability in these processes.[271] In reality, however, the decision to nationalise, including the removal of the stabilisation clauses, was the decision of the Bolivian people, not Morales'. This decision was expressed in a referendum in 2004 where the people voted by a huge majority to nationalise the hydrocarbon sector.[272]

Of particular relevance, Bolivians voted by an overwhelming majority of 86.6 per cent to repeal the Hydrocarbon Law 1996 which introduced stabilisation clauses into the

[270] See, for example, James Rochlin, 'Latin America's Left Turn and the New Strategic Landscape: the Case of Bolivia' (2007) 28 *Third World Quarterly* 1327; Carin Zissis, 'Council of Foreign Relations 'Bolivia's Nationalisation of Oil and Gas' (2012) Council of Foreign Relations' Backgrounder <http://www.cfr.org/economics/bolivias-nationalization-oil-gas/p10682#p2> accessed 28 September 2012.

[271] However see the following which considered the role of transparency and democracy in the nationalisation process: Joseph Stiglitz, 'Nationalization of Bolivia's Energy Resources Driven by Commendable Democratic Progress' (Economist's View, 05 July 2006) <http://economistsview.typepad.com/economistsview/2006/07/stiglitz_nation.html> accessed 28 September 2012; Andrade and ors, *Transparency* (n 142).

[272] For a detailed discussion on the referendum, see, David JA Cairns and ors, 'The Terms of Supreme Decree No. 28701 ("the Nationalisation Decree")' (2006) 4 *International Arb LR* http://www.luzmenu.com/cremades/Noticias/99/99.pdf accessed 28 September 2012.

country.[273] The new Hydrocarbon Law, enacted to reflect the results of the referendum, imposed a duty on the government to be transparent in the management of the hydrocarbon sector by making it mandatory for contracts to be made public and giving citizens a right to information.[274] At the same time, it also increased taxes, and authorised the government to renegotiate and replace the existing Risk Sharing Contracts containing stabilisation clauses with Operating Agreements.[275]

The Law still authorised the government to grant stabilisation clauses in the Operating Agreement.[276] However, unlike the previous stabilisation clauses which exempted investors from all laws and taxes for the entire term of the contract, the new law limits stabilisation guarantees to the fiscal regime and subject to a maximum of 10 years.[277] In addition, the agreements must be approved by the National Congress before they can become effective.[278]

While the people were still disaffected that the provisions of the law did not go far enough, the two immediate predecessors of Morales were unwilling to implement the law largely on the ground that it went too far against investors.[279] This ultimately led to their fall from office in a space of two years.[280] In the election that followed, Evo Morales was overwhelming elected largely because he promised to implement in full the decision of the people as expressed in the 2004 referendum.[281] In line with this promise, Bolivia has taken significant steps to improve transparency in the hydrocarbon sector.[282] Citizens can now

[273] Section 52.
[274] Article 10b
[275] Law of Hydrocarbons No 3058 of 2005, arts 3 – 8, 52 – 57 and 63.
[276] Article 63.
[277] Ibid.
[278] Ibid.
[279] For details, see, Brent Z Kaup, 'A Neoliberal Nationalization? The Constraints on Natural-Gas-Led Development in Bolivia' (2010) 37 *Latin American Perspectives* 123.
[280] Ibid 123.
[281] Maria Victoria Varga, 'Bolivia's New Contract Terms: Operating under the Nationalization Regime' (2007) OGEL 1, 1-2; Kathryn B Botham, 'Bolivia's Legal Gamble: Negotiating Nationalisation' (2008) 26 *Wisconsin Intl LJ* 506.
[282] These measures include the full implementation of the Law on Transparency and Access to Government Information No 27329 of 2004; enactment of a Law on Sustainable Development of the Hydrocarbons Sector No 3740 of 2006 and the creation of a Ministry of Institutional Transparency and Struggle against Corruption established through Supreme Decree No 29894 of 2009. For a detailed analysis of these measures, see,

access information about the terms and conditions of hydrocarbon contracts and the revenue derived from such contracts. Of particular relevance, the Nationalisation Decree enacted to reflect the wishes of the people, as expressed in the referendum, made no provision for stabilisation clauses to be included in the Operating Agreement.[283] To date, as Bolivia continues to improve transparency in its hydrocarbon sector, stabilisation clauses are not known to have returned.

A similar scenario is unfolding in Ghana. Several reports have highlighted the complete lack of transparency that existed in its mining sector prior to 2009.[284] This fuelled suspicions that the decision to grant mining concessions, and the terms included in the concessions, were being influenced by corruption.[285] It is however widely known that some of these contracts contained stabilisation clauses lasting at least 15 years even though their exact scope remains unknown.[286] However, indications are that they may be very broad. For example, the 2004 Annual Report of AngloGold Ashanti acknowledged that the company has a stability agreement which exempts it from the adverse effects of new laws and other changes relating to 'mining operations, taxes, fees and other fiscal imports' for a period of at least 15 years.[287]

In 2009, President John Atta Mills ran and won his election on a party manifesto that promised the implementation of several policies in the 'mining and extractive industry',

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Revenue Watch 'Bolivia: Transparency Snapshot' <http://www.revenuewatch.org/countries/latin-america/bolivia/transparency-snapshot> accessed 28 September 2012.

[283] See generally the Supreme Decree No 28701 of 2006 ("Nationalisation Decree").

[284] See, for example, Joseph Ayee and ors, 'Political Economy of the Mining Sector in Ghana' (2011) World Bank Policy Research Working Paper 5730 <http://www.cmi.no/publications/file/4091-political-economy-of-the-mining-sector-in-ghana.pdf>.

[285] Ibid. see also, E Gyimah-Boadi, 'Another Step Forward for Ghana' (2009) 20 *Journal of Democracy* 138, 147.

[286] Ayee and ors (n 284) 28 – 29.

[287] AngloGold Ashanti, 'Annual Report 2004' 13 - 14 <http://www.anglogold.com/subwebs/informationforinvestors/annualreport04/report/pdf/p12_14.pdf> accessed 28 September 2012.

some of which are particularly relevant to this study.[288] The Manifesto promised to implement measures to ensure 'participatory review of mining and development' and 'transparency in the management of mineral resources.'[289] It also promised that if elected, the government will 'abolish investment agreements that make mining operations enclaves exempt from legislative reforms/national emergencies.'[290] In line with these promises, a committee was set up to review stability agreements entered into by the country.[291] Furthermore, the government has subsequently accepted a related recommendation by a Constitutional Review Committee which recommended that a provision allowing the government to undertake a periodic review of existing stabilisation clauses should be included in the country's constitutions.[292]

Another example can be cited from Zambia. As has been previously discussed, stabilisation clauses were re-introduced by the Mines and Minerals Act 1995 enacted under the shadow of the World Bank and the IMF.[293] Pursuant to this Act, stringent stabilisation clauses were included in MDAs signed during the regime of former president Frederick Chiluba.[294] However the fact that the government came under enormous pressure from these institutions to privatise the mines is only one side of the story. The other is that the privatisation process was undertaken under very opaque circumstances with allegations of

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[288] National Democratic Congress of Ghana, 'Manifesto' <http://www.ghanaweb.com/GhanaHomePage/election2008/NDC_Manifesto.pdf> accessed 28 September 2012.
[289] Ibid.
[290] Ibid.
[291] Rowland Phillips-Addo, 'Gov't Re-Negotiates Mining Agreements' *Business News* (Accra, 30 April 2012); Reuters, 'Ghana to Review All Mining Stability Agreements' (09 February 2012) <http://af.reuters.com/article/investingNews/idAFJOE81806B20120209> accessed 28 September 2012.
[292] Republic of Ghana, 'White Paper on the Report of the Constitution' (June 2012) 43 <http://kitnes.net/1_6/1_124170/1_950361.pdf> accessed 28 September 2012.
[293] See section 4.2.4 and Mines and Minerals Act, 1995, ss 9(1) (2).
[294] See section 4.2.4.

corruption hanging over the MDAs signed by the government.[295] In addition, the proceeds from the privatisation were plundered by the government leaving the majority of the citizens in a worse–off condition than they were before the privatisation.[296] This led to widespread public discontent from 2007 about the lack of transparency and inability of the sector to benefit the country.[297]

Consequently, a new Mines and Minerals Development Act was enacted in 2008 aimed at improving transparency and increasing the benefits of mining to the country.[298] The Act substantially curtailed the discretion given to the Mines Minister under the old Act.[299] In particular, the possibility of the Minister granting stabilisation clauses through secretly negotiated MDAs was removed as the new Act abolished the grant of MDAs through which the Minister was previously able to grant stabilisation clauses.[300] No other provision was included in the Act allowing for stabilisation clauses. Rather all existing MDAs containing stabilisation clauses were abolished.[301] Stabilisation clauses have thus been unable to survive the transparency initiatives of the new governments.[302] It should be stated however, that following threats of arbitration by investors that already had stabilisation clauses, the government agreed to allow such stabilisation clauses to remain valid for 10 years.[303]

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[295] For details, see, Jan Kees van Dong, 'The Plundering of Zambian Resources by Frederick Chiluba and his Friends: A Case Study Of The Interaction Between National Politics and the International Drive Towards Good Governance' (2009)108 *African Affairs* 69; The Independent UK, 'Frederick Chiluba: Politician Who Promised A Bright Future For Zambia But Became Mired In Corruption' (London, 22 June 2011) <http://www.independent.co.uk/news/obituaries/frederick-chiluba-politician-who-promised-a-bright-future-for-zambia-but-became-mired-in-corruption-2300631.html> accessed 14 October 2012.
[296] Ibid.
[297] World Bank, *Zambia* (n 89) 16.
[298] For example, the country adopted the UN Convention against Corruption and the AU Convention on Preventing and Combating Corruption in 2007 and targeted its first EITI report for 2008.
[299] See especially sections 12 and 150 and First Sch.
[300] Section 159.
[301] Section 160.
[302] Zambia's ranking in TI's CPI improved from 115th out of 180 countries in 2008 to 91st out of 183 countries. See TI, 'CPI 2011' (<http://cpi.transparency.org/cpi2011/results/> accessed 02 October 2012.
[303] See 'Ministerial Statements on the Status of Mining Taxation', (Undated) 6 <http://www.parliament.gov.zm/index.php?option=com_docman&task=doc_view&gid=770> accessed 02 October 2012.

However, this was only after the affected companies agreed to comply with the new fiscal regime in the 2008 Act.[304]

Similarly in Tanzania, a lack of transparency in the process leading to the grant of MDAs under the 1998 Mining Act created a widespread perception of corruption amidst public sentiment that the MDAs contained 'unnecessary tax incentives and stabilisation clauses.'[305] These sentiments were confirmed when leaked copies of several MDAs showed that they all contained a combination of full freezing and economic equilibrium clauses protecting the investors from any change that puts them in a 'worse off situation.'[306] The duration of the clauses was for potentially 50 years, with an initial 25 years and an option of renewal upon the same terms and conditions.[307]

However, in 2005, President Jakaya Kikwete was elected largely on a campaign promise to improve transparency in the mining sector and review all MDAs entered under opaque conditions.[308] In line with these promises, the government has embarked on several initiatives to promote transparency in the mining sector, including commencing the EITI validation process and submitted its first EITI report in 2011.[309] These initiatives were taken alongside the enactment of a new Mining Act in 2010. The new Act still grants the Minister the power to enter into MDAs containing stabilisation clauses. However, this is now limited to 'applicable rates of royalties, taxes, duties and levies.'[310] Furthermore, certain conditions, including a minimum threshold of investment must now be met before the clause can be

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[304] Ibid.

[305] Policy Forum, *Demystification* (n 84); Bubelwa Kaiza, 'Tanzania's Mining Boom: Initiatives for Increased Transparency and Accountability in the Starting Holes' (*Heinrich Böll*, 08 July 2008) <http://www.za.boell.org/web/resource-governance-570.html> accessed 02 October 2012.

[306] See, for example, art 11 Gold Mine Development Agreement Between the Government of the United Republic of Tanzania and Pangea Minerals Ltd (Tulawaka Mine) December 2003). This and other MDAs were leaked and analysed in Policy Forum, *Demystification* (n 84).

[307] See, for example, *Tulawaka MDA* (n 306) Preamble, arts 3.2 and art 5.

[308] HakiElimu, *Government Promises II* (HakiElimu 2007) <http://hakielimu.org/files/publications/document114govt_promises_II_en%20.pdf> accessed 02 October 2012; Richard Mgamba, 'How Billions Failed to Block Mining Reforms' (*IPP Media*, 22 April 2012) <http://www.ippmedia.com/frontend/index.php/x.com/dining/bo?l=40777> accessed 02 October 2012

[309] EITI, 'Tanzania Discloses Mining Revenues in First EITI Report' (*EITI*, 11 February 2011) <http://eiti.org/news-events/tanzania-discloses-mining-revenues-first-eiti-report#> accessed 02 October 2012.

[310] Article 10.4(a).

granted.[311] Significantly, any stabilisation clause so granted is subject to review every 5 years, as is every other term of the MDA.[312] Thus, the possibility of a stabilisation clause that protects investors for potentially 50 years has been eliminated. Although these changes are not applicable to investors with existing stabilisation clauses, the Tanzania Chamber of Mines and Minerals (TCME) insists that such investors are under 'considerable pressure' to comply with the changes.[313]

A final example of a country where transparency initiatives by new governments resulted in the elimination of stabilisation clauses or a restriction in its scope can be cited from the Sierra Leone mining sector. Prior to 2007, the country's mining sector was characterised by what has been described as 'extreme lack of transparency.'[314] All but one of the mining agreements entered into during this period were negotiated in secret, and the terms also kept secret.[315] This led to a widespread perception amongst civil society that these agreements contain 'stabilisation and confidentiality clauses.'[316] This perception was strengthened in 2002 when the 2001 Sierra Rutile Agreement was published. The agreement had been negotiated and kept secretly but became a public document when, in order to strengthen the protections accorded to the investors, it was enacted as an Act of parliament and published in the Government Gazette.[317]

The stabilisation clauses in the agreement exempted the investors from complying with the provisions of existing laws where such provisions are inconsistent with the

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[311] Article 10.3a.
[312] Article 12.
[313] So far, only African Barrick Gold is known to have agreed to comply with the new law despite their stabilisation clauses. TCME, 'Tanzania Chamber of Minerals and Energy Statement on Stability of Mining Development Agreements' PAJOMA (Tanzania Minerals Industry Update) (July 2012 Issue 8)1 <http://www.tcme.or.tz/fileadmin/newsletters/Pamoja_Issue_08.pdf> accessed 02 October 2012.
[314] National Advocacy Coalition on Extractives (NACE), *Sierra Leone at the Crossroads: Seizing the Chance to Benefit from Mining'* (NACE 2009) <http://www.christianaid.org.uk/Images/sierra-leone-at-the-crossroads.pdf> accessed 04 October 2012.
[315] The only exception was the Sierra Rutile Agreement (Ratification) Act 2002 (ratified 21 March 2002) Supplement to the Sierra Leone Gazette, Vol CXXXIII, No 15. 21 March 2002.
[316] Lansana Fofana, 'Sierra Leone: Activists Cry Foul over Mining Policy' (*IPS*, 26 August 2008) <http://www.ipsnews.net/2008/08/sierra-leone-activists-cry-foul-over-mining-policy/> accessed 04 October 2012.
[317] (n 315).

agreement.[318] Furthermore, 'in the event that the Government enacts any legislation or changes any administrative rule or practice…which results in more onerous obligations being placed upon the company' the government agreed to 'hold the company harmless in respect of the increased cost of performing the more onerous obligations.'[319]

The now public terms of this agreement, coupled with the perception that they had been corruptly obtained, created widespread mistrust of the government and the companies.[320] As a result, Ernest Koroma won the presidential election in 2007 on a 'strong anti-corruption ticket.'[321] One of the five 'core principles' of his manifesto was to ensure 'integrity, transparency and accountability in the conduct of public affairs.'[322] It also contained a promise to 'review all exploration and mining contracts that are in operation.'[323]

In line with the above promises, the country became an EITI candidate country in 2008 and published its first report in 2010.[324] In addition, in 2008, the government established a Task Force to review the country's minerals policy. Based on the report of the Task Force, the government embarked on a review of the existing mining contracts to ensure greater benefits for the country and to improve accountability and transparency 'according to the Extractive Industry Transparency Initiative compliance model.'[325] So far, at least two mining agreements, including the Sierra Rutile Agreement, have been negotiated.[326] More

[318] Article 11(e) 1 and 2.
[319] Article 11(e) 3.
[320] NACE, *Sierra Leone* (n 314) 1.
[321] Mark Doyle, 'Can Sierra Leone Flush Away Corruption' *BBC* (London, 23 January 2009) <http://news.bbc.co.uk/1/hi/world/africa/7834228.stm> accessed 02 October 2012.
[322] All Peoples Congress, 'Manifesto for 2007 Elections'<http://www.sierraherald.com/apc-manifesto.htm> accessed 02 October 2012.
[323] Ibid [14.2.b]. See also [13.3.c].
[324] For details, see the website of the Sierra Leone EITI, <http://www.sleiti.org/> accessed 04 October 2012.
[325]Saidu Bah, 'Government to Review Mining Contracts for EITI Compliance' (*Awoko*, 21 July 2011) <http://www.awoko.org/2011/07/21/govt-to-review-mining-contracts-for-eiti-compliance/> accessed 04 October 2012; Report of the Presidential Task Force for the Review of Mineral Rights (April 2009).
[326] Government of Sierra Leone, 'Presidential Address to Parliament' (25 September 2012) para 80 <http://www.statehouse.gov.sl/index.php/component/content/article/34-news-articles/561-sierra-leone-government-presidential-address-delivered-by-his-excellency-the-president-dr-ernest-bai-koroma-gcrsl-president-of-the-republic-and-commander-in-chief-of-the-republic-of-sierra-leone-armed-forces-on-the-occasion-of-the-end-of-the-fif> accessed 04 October 2012.

importantly, the 2009 Mines and Minerals Act enacted alongside this review introduced several measures to improve transparency and stronger governance in the mining sector.[327]

For example, the rights and obligations of all relevant parties in the grant of mining licenses have been made very clear, and the relevant government bodies must now provide, in writing, reasons for their decisions.[328] Investors, or potential investors, adversely affected by such decisions can now challenge them in Court.[329] In addition, the Act imposed an obligation on the relevant Minister to ensure greater access to mining agreements and other relevant documents.[330] In line with these provisions, in January 2012, the government launched an Online Repository where relevant information on mining documents and revenues could be publicly accessed.[331]

Consistent with the findings in several other countries, stabilisation clauses in Sierra Leone were affected by the introduction of these transparency initiatives. Under the previous Act, the Secretary of State was able to grant stabilisation clauses by virtue of the wide discretionary power given to him to privately negotiate mining agreements.[332] However, this provision was removed in the 2009 Act thereby removing the possibility of stabilisation clauses being legally granted in Sierra Leone's mining sector.

4.3.4.2 Changes to Stabilisation Practice: Transparency or Obsolescing Bargaining?

The changes in the use of stabilisation clauses discussed above were implemented by new governments several years after the original legislation or contracts containing the stabilisation clauses were enacted or entered into. It is therefore possible that those who still hold on to the obsolescing bargaining theory may use it to explain these changes. In other

[327] For the transparency provisions, see particularly ss 159 to 160 of the Act. See also Revenue Watch, 'Sierra Leone: Transparency Snapshot' <http://www.revenuewatch.org/countries/africa/sierra-leone/transparency-snapshot> accessed 04 October 2012.
[328] See, for example, ss 60.1, 63.7, 72.1.
[329] Sections 60.3, 72.4, 97.5, 107.5.
[330] Sections 49 and 159.
[331] Government of Sierra Leone, 'GoSL Online Repository' <http://sierraleone.revenuesystems.org/login/auth> accessed 04 October 2012.
[332] Mines and Minerals Act 1994, s 22.

words, it is possible to argue that the governments were subsequently able to alter the stabilisation clauses simply because they had a stronger bargaining power than when the stabilisation clauses were originally granted. However, such an argument ceases to be convincing in the face of an increasing number of cases where the changes took place either during negotiations or immediately after the clauses became known to the public. The circumstances in which these changes occurred suggest that the original unsatisfactory stabilisation clauses were largely a function of the lack of transparency in the contracting process rather than the stronger bargaining power of the investors.

For example, the stringent stabilisation clauses in the BTC pipeline project were subsequently reduced in 2003 to exclude laws relating to human rights, labour, health, safety and the environment from its ambit.[333] However, this was not because of any increase in the bargaining powers of the respective governments. Rather, it resulted from a Unilateral Undertaking by the investors.[334] This happened because the IFC 'strongly encouraged' the investors to disclose the key project documents as a way of dealing with the intense criticisms surrounding the project.[335] Consequently, the investors published the key project agreements online in 2003.[336] Following the publication, several terms of the agreements and, in particular, the 'radical' nature of the stabilisation clauses received intense criticism in both the academic literature and from NGOs.[337] Four months later and without any known interference by the governments, the investors made the undertaking reducing the scope of the clauses. This suggests that the scope of the initial clause may have gone beyond what the investors legitimately required. Yet, the clauses were included in the agreements and remained unchallenged for as long as the terms of the agreements were kept confidential.

[333] See section 4.2.3 for the discussion on the original clause.
[334] Article 1, BTC Human Rights Undertaking (22 September 2003) <http://subsites.bp.com/caspian/Human%20Rights%20Undertaking.pdf> accessed 04 October 2012.
[335] IFC, 'Baku-Tbilisi-Ceyhan Oil Pipeline Project: Environmental and Social Issues <http://www.ifc.org/ifcext/btc.nsf/content/environmentaland_socialissues> accessed 04 October 2012
[336] See <http://www.bp.com/sectiongenericarticle.do?categoryId=9029334&contentId=7053632> accessed 04 October 2012.
[337] See Amnesty International, *Human Rights* (n 195).

Similarly, the scope of the full freezing clauses in the Mittal Steel MDA was also subsequently narrowed to cover specific fiscal issues.[338] The original agreement was signed in August 2005 at a time when Ellen Johnson-Sirleaf, who was the frontline candidate for the then forthcoming presidential elections, had promised to review all contracts signed by the transitional government if she were to win.[339] The renegotiation process commenced in January 2006 (5 months after the original agreement was signed), and the amended agreement was signed in December 2006. The company did not therefore start its operations in Liberia until the amended agreement was signed and ratified by the Liberian Parliament.[340]

As such, the decision by the investors to accept the new terms including the significantly narrower stabilisation clauses cannot be attributed to the OBT. Rather, it reflects the fact that the broad scope of the initial stabilisation clauses may have been unnecessary, but was included because of the lack of transparency in the process leading to the agreement. This may explain why the clauses were unable to pass the minimal standards of transparency established by the new government. These transparency measures have seen Liberia move from 137th out of 159 countries in the 2005 Transparency International CPI[341] to 91st out of 183 countries in the 2011 CPI.[342]

As part of the transparency measures, mineral resource contracts are no longer confidential documents but must be scrutinised and approved by parliament after which they are published online.[343] A review of some of the recent agreements that are now online show

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[338] See discussion in section 4.3.3. For details of the changes see, Government of Liberia, 'Summary of the Main Changes Brought About by the Review of the Mittal Mineral Development Agreement <http://www.emansion.gov.lr/doc/MittalAgreementFinalMitrix.pdf> accessed 04 October 2012.
[339] Cook *Liberia's* (n 219) 11.
[340] See, for example, Reuters, 'Liberia says has signed Revised Mittal mining deal' (28 December 2006) http://uk.reuters.com/article/2006/12/28/liberia-mittal-idUKL2847972320061228> accessed 04 October 2012.
[341] TI, 'CPI 2005' <http://archive.transparency.org/policy_research/surveys_indices/cpi/2005>accessed 04 October 2012.
[342] TI, 'CPI 2011' (n308).
[343] All contracts, concessions and agreements are now available online at <http://www.leiti.org.lr/content_maindoc.php?main=65&related=65> accessed 04 October 2012.

that with the increased transparency, the scope of stabilisation clauses granted in the Liberian mining sector is becoming narrower and more 'balanced'. In addition, several provisions have been included to make the agreements more flexible.

For example, the stabilisation clause in a 2011 MDA only stabilises taxes and duties.[344] As such, except as provided in the Agreement and the country's Revenue Code, the investors are subject to all Liberian laws 'in effect from time to time, including with respect to labor, environmental, health and safety, customs and tax matters.'[345] Where such laws impose 'additional material obligations' on the investors, the parties shall agree on 'appropriate transitional arrangements' in order to give the investors 'a reasonable period of time' to comply.[346] However, even the stabilised taxes and duties can be adjusted in line with a periodic review to be undertaken every 5 years.[347] In addition, the parties agreed to modify the agreement at any time where a 'Profound Change in Circumstances' has occurred.[348] These provisions should enable the government to levy a windfall profit tax where the prices of minerals rise significantly beyond what was obtainable at the time the agreement was signed. Such an action may not have been possible under previous stabilisation clauses.

The argument that some unnecessary stabilisation clauses may have been included in natural resource contracts because of a lack of transparency is further supported by the recently renegotiated London Mining Agreement in Sierra Leone.[349] As explained earlier, the possibility of granting stabilisation clauses in the Sierra Leonean mining sector was removed in 2009.[350] However, in spite of this, the government still granted a stabilisation clause to London Mining that same year. The clauses exempted the investor from any

[344] MDA between Liberia and ors and Bloom Fountain Limited and anor' (03 August 2011) art 14(2) (b).
[345] Article 30(1).
[346] Article 19(9) (b) (i).
[347] Article 14(2) b.
[348] Article 31(1). See also Concession Agreement between Liberia and Golden Veroleum (Liberia) Inc. (16 August 2010) art 32(1) (profound change in circumstances') art 31(1) (Applicability of Liberia Laws).
[349] Mining Agreement between Sierra Leone and London Mining Company Limited (December 2009).
[350] Section 22 of the 1994 Mines and Minerals Act which enabled the Secretary of State to do so was not repeated in the 2009 Mines and Minerals Act.

change in the tax laws for the 25 year duration of the agreement with the option of renewal for a further 15 years on the same fiscal terms.[351]

In line with the newly introduced transparency initiatives, members of the public and, in particular, civil society groups gained access to the terms of the agreement. Consequently, the stabilisation clause, along with some other terms of the agreement, were criticised for being 'illegal'.[352] In the absence of any law with which to justify the stabilisation clause, the government was left with no option but to renegotiate the agreement.[353] The amended agreement, while hailed as an improvement still faces some criticisms.[354] However, perhaps not surprisingly, the stabilisation clauses did not survive the test of transparency and were removed. Rather, the agreement now specifically provides that the terms of the agreement will be reviewed in 2020 and 'any new fiscal benefits will be subject to negotiation.'[355]

The link between transparency and stabilisation clauses can also be seen in the increasing number of cases where increased transparency and public scrutiny in the course of on-going negotiations ensure that proposed stabilisation clauses were removed, or their scope significantly reduced. Two cases are particularly illustrative. The first is the negotiations that led to the signing of PSAs between the Ugandan government and Tullow Oil (and its partners) over the Lake Albert Rift Basin project. The second is the botched Fiscal Contract for the Alaska pipeline project.

Public and parliamentary interest in the negotiations leading to the PSAs between the Ugandan government and Tullows Oil and its partners was heightened following the

[351] Sections 3(b) and 6(c).
[352] See, for example, Campaign for Just Mining in Sierra Leone, 'London Mining Lease Agreement Undermines President Koroma's Agenda For Change' (Press Release, 10 May 2010) <http://www.kaicombeyfoundation.org/documents/PRESSRELEASE_001.pdf> accessed 04 October 2012; NACE, 'NACE Expresses Dismay at Ratification of African Minerals Agreement' (Press Release, 13 September 2010) <http://www.thenewpeople.com/images/nace_release.pdf> accessed 04 October 2012.
[353] The new agreement was signed in August 2011 and ratified by Parliament in March 2012.
[354] NACE, 'The Revised London Mining Agreement: Better, But Still a Major Problem' (27 March 2012) <http://www.christianaid.org.uk/Images/sierra-leone-mining-briefing.pdf> accessed 04 October 2012.
[355] Section 6(8).

publication of a leaked copy of an earlier PSA for the project.[356] The scrutiny was especially focused on the following stabilisation clause:

> If following the effective date, there is any change, or series of changes, in the laws or regulations of Uganda which materially reduces the economic benefits derived or to be derived by Licensee hereunder, Licensee may notify the Government accordingly and thereafter the Parties shall meet to negotiate in good faith and agree upon the necessary modifications to this agreement to restore Licensee to substantially the same overall economic position as prevailed hereunder prior to such change(s).[357]

The clause was widely criticised by both civil society and the country's parliament.[358] The country's parliament went further and took the unusual step of passing a resolution asking the government to review all PSAs already executed and 'in particular' to 'discard' the stabilisation clauses.[359] The resolutions also contained several paragraphs requesting an account of all revenue received by the government,[360] that the government joins the EITI[361] and that confidential clauses be removed from future contracts.[362]

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[356] See generally PLATFORM and Civil Society Coalition on Oil, Uganda, *Contracts Curse: Uganda's Oil Agreements Place Profit before People* (PLATFORM 2010). The PSA was signed in 2004 with Heritage Oil Limited as the main partner. However, the company subsequently sold its stake and the Licence also subsequently expired in 2010. The negotiations were thus for the purpose of signing new PSAs with the new partners based on the renewed Licence.
[357] Clause 33.2 PSA between Uganda and Heritage Oil Limited and ors 2004.
[358] See, for example PLATFORM (n 356); Belinda Kasemiire, 'Uganda: Stabilisation Clauses in Oil Deals Are Bad' *The Monitor* (Kampala, 29 January 2012) <http://allafrica.com/stories/201201300482.html> accessed 04 October 2012.
[359] Parliament of Uganda, 'Resolution of Parliament in Respect Of Regularization of the Oil Sector and Other Matters Incidental Thereto' (11 October 2012) Resolution 4 <http://thisisafrica.files.wordpress.com/2012/02/resolution-of-parliament-on-the-oil-sector-oct_112011.pdf> accessed 04 October 2012. For a transcript of the parliamentary sitting, see, <http://www.parliament.go.ug/hansard/hans_view_date.jsp?dateYYYY=2011&dateMM=10&dateDD=11> accessed 04 October 2012.
[360] Ibid paras 5 - 6.
[361] Ibid para 7.
[362] Ibid para 8.

The President failed to comply with many of the resolutions. However, the scrutiny from the public and parliament was enough to make him send a request to the investors asking them to remove the stabilisation clauses in the draft PSAs. The request and the subsequent negotiations that followed were widely reported in the media.[363] In the end, even with this half-hearted approach, statements and Press Releases issued by the government suggest that the scope of the stabilisation clauses have been significantly narrowed.[364]

The new version, according to the President, is 'tightly defined' and only allows the investors to be compensated where tax measures cause a 'substantial loss of economic benefits' to them.[365] Furthermore, the 'loss of economic benefits' is said to be 'scientifically defined' using Net present value (NPV) as the yardstick.[366] Neither the PSAs nor the stabilisation clauses has been formally released to the public. As such, a more accurate analysis of the scope of the amended stabilisation clauses must wait. However, as one commentator notes,[367] the brevity of the press statement released by Tullow Oil to confirm the signing of the PSAs is an indication of the concessions they may have had to make.[368]

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[363] See, for example, Elias Biryabarema, 'Uganda Asks Tullow, Others To Drop Protective Clause' *Reuters* (Kampala, 26 September 2011) <http://af.reuters.com/article/investingNews/idAFJOE78P0L320110926> accessed 04 May 2013; Elias Biryabarema, 'Uganda's Museveni Says Tullow farm out Deal Delayed' *Reuters* (Kampala, 27 January 2012) <http://af.reuters.com/article/investingNews/idAFJOE80Q08N20120127> accessed 04 May 2013; Mercy Nalugo and Yasiin Mugerwa, 'Tullow Oil Agreement Hits Snag Over Clause Favouring Tullow' *Daily Monitor* (Kampala, 23 January 2012)< http://www.monitor.co.ug/News/National/-/688334/1312352/-/b1gpucz/-/index.html> accessed 04 May 2013; Upstream, 'Tullow 'Hits New Uganda Impasse' <Http://Www.Upstreamonline.Com/Live/Article300390.Ece> accessed 04 May 2013.

[364] Ministry of Energy and Mineral Development, 'Government of Uganda signs Production Sharing Agreements with Tullow Uganda Limited' (Press Release, 03 February 2012) 2 <http://thisisafrica.files.wordpress.com/2012/02/press-release-ministry-of-energy-psa-signing.pdf>; 'Statement made by the Minister of Energy and Mineral Development'(03 February 2012) <http://www.mediacentre.go.ug/details.php?catId=3&item=1552> accessed 04 October 2012.

[365] President Yoweri Kaguta Museveni, 'Address to Parliament' (10 February 2012)<http://www.mediacentre.go.ug/details.php?catId=6&item=1566> accessed 04 October 2012

[366] Ibid.

[367] Angelo Izama, 'Tullow begins Uganda farmdown after PSA signing with Uganda Government' (*African Arguments*, 08 February 2012) <http://africanarguments.org/2012/02/08/tullow-begins-uganda-farmdown-after-psa-signing-with-uganda-government-by-angelo-izama/> accessed 04 October 2012

[368] Tullow Oil, 'Government of Uganda and Tullow sign Production Sharing Agreements' (Press Release, 03 February 2012) <http://www.tullowoil.com/index.asp?pageid=137&newsid=727> accessed 02 October 2012

The second example comes from the stabilisation clauses included in the botched Fiscal Contract governing the Alaska pipeline project in the US.[369] In 2006, the investors reached an agreement with the then Governor Frank Murkowski on the fiscal regime to govern the project.[370] The fiscal regime was to comprise a Petroleum Profit Tax' (hereafter 'PPT'),[371] and the Fiscal Contract.[372] The terms of these agreements were arrived at following years of negotiations conducted privately by the Governor and his aides. It must be said that such 'private' negotiations were consistent with Alaska laws at the time.[373] However, many Alaskans viewed this particular negotiation with suspicion.[374] This was especially because several top civil servants and the consultant appointed by the government were either fired or resigned because they insisted that the fiscal regime was too favourable to investors.[375]

The suspicions surrounding the negotiations were confirmed when the terms were made public after being presented to the Alaska legislature for approval. Both the PPT and the Fiscal Contract came under intense scrutiny. The PPT was criticised for giving investors

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[369] For a useful summary of the project, see, Matthew Berman and ors, 'The Alaska Natural Gas Pipeline: What's It All About?' (2005) Institute of Social and Economic Research Policy Brief <http://www.iser.uaa.alaska.edu/Publications/revisedgaspipeline.pdf> accessed 08 October 2012; Daniel Johnston, 'The Alaska Gas Story: How it Stands Now' (2006) 25 *Petroleum Accounting and Financial Management Journal* 99.

[370] SitNews, 'Governor Announces Agreement on Gas Pipeline Legislation Proposed to Modernize Oil Taxes' (22 February 2006) http://www.sitnews.us/0206news/022206/022206_gas_agreement.html accessed 08 October 2012; SitNews, 'Governor Completes Negotiation on Oil Fiscal Certainty Portion of Gas Pipeline Contract' (25 May 2006) <http://www.sitnews.us/0506news/052506/052506_oil_gas.html> accessed 08 October 2012.

[371] House Bill 3001 (HB 3001) passed August 2006.

[372] Draft Alaska Stranded Gas Fiscal Contract Between The State Of Alaska and BP Exploration (Alaska) Inc., ConocoPhillips Alaska, Inc., and ExxonMobil Alaska Production Inc (24 May 2006).

[373] Alaska Stranded Gas Development Act 1998 (*as amended in 2003*) ss 140 – 200.

[374] Johnston, *Alaska* (n 369) 106.

[375] Andrea W Lorenz, 'Butting Brains: Two Consultants Square off on Just How Much is enough for Alaska to Take its Gas Pipeline Development' (2007) *The Patch*, 18 – 22. <http://www.danieljohnston.com/pdf/butting_brains.pdf> accessed 08 October 2012.

concessions that were 'way in excess of what the economics of the project required',[376] for containing too many 'sweeteners' for the investors and for being 'unfair' to Alaska.[377]

The criticisms against the Fiscal Contract were more intense largely because it contained a stabilisation clause protecting the fiscal regime established by the PPT.[378] The clause provides that the 'State is temporarily contracting away for the Term its power to impose any new Taxes, or change any existing Taxes, that apply to each Participant's Interests in its oil and gas related business activity in Alaska.'[379] It therefore exempts the investors from future changes in the tax laws of Alaska for between 30 and 45 years.[380] This clause was supported by the legislative committee overseeing the project,[381] and presented to the State legislature for approval despite the fact that according to the Alaskan constitution, 'the power of taxation shall never be surrendered.'[382]

Amidst aggressive lobbying by the investors and intense debate in the media and the legislature, the PPT was passed in 2006. However, the Fiscal Contract was rejected in its entirety as the legislature succumbed to public sentiments, particularly those directed against the stabilisation clause.[383] However, the damage had already been done to the Governor's popularity, and he suffered a humiliating defeat in the Republican primary elections which took place that same year.[384]

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[376] Tom Irwin (former Commissioner in Alaska Department of Natural Resources who was fired for opposing the agreements) as quoted by Kent Garber, 'A Look at Palin's Role in Alaska's Big Natural Gas Pipeline Project' (03 September 2008) <http://www.usnews.com/news/campaign-2008/articles/2008/09/03/a-look-at-palins-role-in-alaskas-big-natural-gas-pipeline-project> accessed 08 October 2012.
[377] Johnston, *Alaska* (n 369) 100.
[378] Daniel Johnston, 'Changing Fiscal Landscape' (2008) 1 JWELB 31, 40 – 41.
[379] Article 11(1) (b)(ix).
[380] Article 3(2) of the Fiscal Contract defines the 'term' to be a minimum of 30 years and a maximum of 45 years subject to certain circumstances.
[381] See 'Recommendations of Joint Committee on Natural Gas Pipelines to the Twenty – Third Legislation' (10 October 2002) Recommendation B5 deals with the stabilisation clause.
[382] Article IX, s 1 of the Alaska Constitution.
[383] Under the Stranded Gas Development Act, the legislature cannot amend such a contract. They must accept all its terms or reject all its terms.
[384] 'Electoral History: Race for Governor (primary) <http://www.frankmurkowski.com/> accessed 08 October 2012 2006; Dennis Zaki, 'Alaska Governor Frank Murkowski Now Rated The Most Unpopular Governor in Entire Country' *Alaska Report* (25 September 2006) <http://alaskareport.com/wn10118a.htm> accessed 08 October 2012.

Elected because of promises made during the campaign, the new Governor, Sarah Palin, urged the Alaska State Legislature to review the PPT. Consequently, a new Act was enacted in 2007 which amended some of the fiscal terms in the PPT and in particular increased the revenue accruable to the state.[385] Furthermore, the Alaska Stranded Gas Development Act which enabled the previous government to negotiate privately with investors was repealed and replaced by the Alaska Gas Inducement Act (AGIA). The new Act eliminated the possibility of private negotiations, instead providing that the evaluation and selection of investors for projects should take place in an open and competitive public process.[386] In line with the provisions of this Act, a new agreement was subsequently reached with investors for the project under a more transparent process. Unsurprisingly, it did not contain stabilisation clauses and the project is proceeding without the clause.[387] This is despite the fact that the investors continue to desire and request 'competitive and stable fiscal terms.'[388]

The fact that the stabilisation clause did not survive in the new transparently negotiated agreement is, however, only one part of the story. The other is that the terms of the previous agreement (of which the stabilisation is one), were in fact influenced by corruption. Soon after his electoral defeat, the former governor and his chief of staff were arrested and indicted along with several local and national legislators, lobbyists and

[385] Alaska Clear and Equitable Share Act (ACES) HR 200. For a detailed discussion of the changes introduced by the Act, see KPMG, 'Alaska's Clear and Equitable Share ("ACES") Production Tax and Available Credits' (28 February 2011) <http://www.us.kpmg.com/microsite/taxnewsflash/2011/Feb/AK_ACES.pdf> accessed 08 October 2012.

[386] See especially ss 140 – 190. For more details about the AGIA see State of Alaska, 'Frequently Asked Questions Regarding the Alaska Gasoline Inducement Act '("AGIA") and the AGIA Process <http://www.gov.state.ak.us/agia/agia_faqs_11808.pdf> accessed 08 October 2012.

[387] BP and ors, 'ExxonMobil, ConocoPhillips, BP and Alaska Pipeline Project Working Together to Commercialize North Slope Natural Gas' (Press Release, 30 March 2012) <http://thealaskapipelineproject.com/docs/news_releases/20120330.pdf> accessed 08 October 2012; Tom Fowler And Ángel González, 'Alaska, Gas Firms Clear Way for Pipeline' *Wall Street Journal* (New York, 31 March 2012) <http://online.wsj.com/article/SB10001424052702303816504577313703552129434.html> accessed 08 October 2012.

[388] Ibid.

executives of VECO (an Alaska based oil service company) over widely publicised allegations of bribery and corruption.[389]

The summary of the allegation, as aptly captured by one of the many press releases announcing the indictments, is that the government officials 'conspired to perform official acts in exchange for monetary and other financial gain to the detriment of Alaska, its economy, and its citizenry.'[390] Specifically, they were indicted for collecting bribes in exchange for supporting the inclusion of favourable terms for investors in the PPT and Fiscal Contract.[391] As at October 2011, the indictments have led to 10 convictions including 6 former Alaskan legislators, 2 senior executives of VECO, a business man, and a lobbyist.[392]

It should be emphasised that Alaska is in a developed country while the focus of this work is on developing countries. However, the use of Alaska as an illustration is deliberate. The purpose is to show that the link between stabilisation clauses and corruption and lack of transparency remains true whatever the level of development of the country. In this sense, it can be argued that the relatively lower rate of corruption in developed countries plays an important role in the absence of stabilisation clauses in these countries. The Alaska example suggests that one reason for this is because it will be more difficult to grant stabilisation clauses in developed countries due to the higher level and/or demand for transparency and accountability. At the same time, the electoral backlash is likely to be more severe in view of the relatively stronger level of democracy in developed countries.

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[389] MSCBC, 'Alaska Lawmakers Indicted on Bribery Charges' (05 April 2007) <http://www.msnbc.msn.com/id/18498022/ns/politics/t/alaska-lawmakers-indicted-bribery-charges/#.UHL_MZjA-_E> accessed 08 October 2012.

[390] US Department of Justice (hereafter USDOJ), 'Three Current and Former Alaska State Legislators Indicted on Public Corruption Charges' (Press Release, 04 May 2007) <http://www.justice.gov/opa/pr/2007/May/07_crm_330.html> accessed 08 October 2012.

[391] Ibid.

[392] Details of the convictions are available at the website of the USDOJ. For a summary, see, USDOJ, 'Former Alaska Legislators Peter Kott and Victor Kohring Convicted and Sentenced For Public Corruption Crimes' (Press Release, 21 October 2011) <http://www.justice.gov/usao/ak/news/2011/October%20_2011/Kott_and_Kohring_10-21-11.html> accessed 08 October 2011.

Further, the Alaskan Alaska Fiscal Contract is the only instance seen in this study (at least in the last decade) where a government in a developed country, or any of its constituent units, accepted a stabilisation clause and went as far as including it in a draft bill. It is therefore significant that the State of Alaska and the negotiation process leading to the Fiscal Contract share several similar characteristics with the examples already discussed in developing countries. First, the agreements were negotiated in secret. Second, many of the key actors were later indicted for bribery and corruption. Third, around the time the agreements were being negotiated, several studies rated Alaska as having the most corrupt public sector in the US.[393] Finally, the stabilisation clause could not survive the minimal standards of transparency, and this did not stop the project from proceeding. This is not a mere coincidence. Rather, it is consistent with the findings of this thesis that a significant number of stabilisation clauses granted by developing countries may have been unnecessary but were nevertheless granted due to corruption and the lack of transparency in the contracting process.

4.4. STABILISING ILLEGITIMACY?

Before concluding this chapter, it is important to emphasise that it is not suggested here that stabilisation clauses are only negotiated and accepted by corrupt and/or dictatorial governments under opaque circumstances. There are several developing countries where stabilisation clauses are granted transparently by relatively transparent and accountable governments. The stabilisation regimes in Latin American countries offer a good example in this regard.[394]

[393] See, for example, Edward L Glaeser and Raven E Saks, 'Corruption in America' (2006) 90 *Journal of Public Economics* 1053, 1058 (Table 1) and 1069 (Appendix A); Craig A. Depken, II and Courtney L Lafountain, 'Fiscal Consequences of Public Corruption: Empirical Evidence from State Bond Ratings' (2006)126 *Public Choice* 75, 79.

[394] For a detailed and up to date discussion on stabilisation regimes in Latin America, see Hernando Otero and Enrique Gomex Pinzon (eds), *Latin America Investment Protections: Comparative Perspective on Law Treaties And Disputes For Investors States and Counsel* (Martinus Nijhoff 2012).

In the first ever Revenue Watch Index released in 2010, all nine Latin American countries that were assessed ranked relatively high in the transparency of their extractive industries.[395] Brazil, Chile, Colombia, Ecuador, Mexico and Peru were ranked in the highest of the three tiers in the index, which means that their governments provide public information relating to the management of their extractive industries.[396] The remaining three countries (Trinidad and Tobago, Venezuela and Bolivia) were in the middle tier of the index, meaning that while there are still some gaps, their governments provide citizens with substantial information about their management of the extractive industry.[397]

Consistent with the findings in this study, the high level of transparency in these countries is reflected in their stabilisation practices. Brazil, Mexico, Bolivia and Ecuador are not known to grant stabilisation clauses and have no laws authorising the grant of stabilisation clauses.[398] The remaining countries do have stabilisation regimes in place. However, in line with the high level of transparency in these countries, the procedure and criteria for the grant of a stabilisation clause is clear, consistent and transparent.

For example, specific agencies or committees are given the responsibility to negotiate and grant the clause in accordance with the criteria already established.[399] The scope and duration of the clauses granted are limited and the investors must meet certain criteria which ensure that these countries benefit directly from the grant of the clause.[400] Despite this, however, their governments still find it difficult to justify the grant of the clause in the face

[395] The Revenue Watch Index 2010 is the first attempt to measure and compare the information governments disclose about their oil, gas and mining industries. It assessed 41 resource-rich countries including Norway and United States. For details, see, Revenue Watch and TI, *2010 Revenue Watch Index: Transparency: Governments and the Oil, Gas and Mining Industry* (Revenue Watch 2010) 2 <http://www.revenuewatch.org/rwindex2010/pdf/RevenueWatchIndex_2010.pdf> accessed 08 October 2012.
[396] Revenue Watch, 'Revenue Watch Index: Latin America and The Oil, Gas and Mining Industries' <http://www.revenuewatch.org/rwindex2010/pdf/pc_index_report_latinamerica_fs_rev1.pdf> accessed 30 November 2012.
[397] Ibid.
[398] Note that in Ecuador, arts 271 and 339 of the 1998 Constitution allowed for stabilisation clauses. However, there are no similar provisions in the current 2008 Constitution.
[399] For example in Peru this is done by the National Commission of Investments and Foreign Technologies (CONITE).
[400] See discussion in section 3.4.3.1.

of transparency. As a result, they have had to manage public sentiments against the clause by either altering the clause or taking steps to limit the further grant of the clause. For example, as at the end of 2011, Venezuela has not entered into a stability contract since 1999 when its current stabilisation regime was put in place.[401]

Similarly, in Colombia, the government took steps in 2011 to further restrict access to the clause. New investment was redefined to ensure that stability agreements cannot be entered into for on-going projects.[402] Furthermore, previously an investor had to pay the equivalent of 0.5% (unproductive periods) and 1% (productive periods) of the amount invested to get in order to benefit from a stabilisation clause. However under the new law, the consideration the investor will pay is to be assessed according to the risks to be assumed by the country should they enter into a stability agreement.[403]

In Chile, the government imposed a tax on mining companies in order to deal with domestic pressure following the high mining prices in 2005.[404] Five years later, the tax was increased to raise funds to deal with the earthquake suffered by the country at that time.[405] Both changes were not enforced on companies that had stabilisation clauses in their contracts. However, in both cases the majority of the companies 'voluntarily' complied.[406]

In Peru, the previous government was also unable to justify the continuous adherence to stabilisation clauses but was unwilling to take any action against existing contracts with stabilisation clauses.[407] Consequently, President Ollanta Humala based his 2011 election campaign largely on a promise to impose higher royalties and was the only candidate who

[401] Law on Promotion and Protection of Foreign Investment 1999, arts 17 -18.
[402] Law No 1450 on National Development Plan 2011, art 49.
[403] Articles 48 and 49.
[404] Law No 20.026 on Specific Tax on Mining Activity 2005.
[405] Law No 20.469 on Modifications to the Tax on Mining Activity 2010.
[406] For example, as at 19 January 2011, 81.8% of mining companies with stability agreements had agreed to comply with the law. See, Foreign Investment Committee, 'Great Interest Shown by Mining Companies' (19 January 2012) <http://www.foreigninvestment.cl/index.php?option=com_content&view=article&id=225:noticia-principal-14&catid=38:noticias&Itemid=106> accessed 15 October 2012.
[407] Mineweb, 'Peru Suspends Mining Concessions in Several Provinces' (01 June 2011) <http://www.mineweb.com/mineweb/view/mineweb/en/page72068?oid=128350&sn=Detail&pid=72068> accessed 08 October 2012.

promised to review existing tax stability contracts if elected.[408] He won. In line with his promise, by September of that same year, new laws were passed by Congress to implement these promises. [409] The laws increased taxes and royalties for companies without stability contracts while companies with stability agreements were to pay a voluntary Special Mining Contribution.

Proponents of stabilisation clauses see it as a tool that host governments can use to attract FDI to facilitate their sustainable development. No doubt, this might be a reason for the grant of stabilisation clauses by some governments. However, the findings in this study also suggest that the re-introduction of stabilisation clauses into the statute books of many developing countries resulted from pressure from the World Bank rather than their conviction that the clauses were indeed required to attract FDI. It also shows that an increasing number of stabilisation clauses may not have been granted had the contracting process met even minimal standards of transparency.

All the examples found in this study, where stabilisation clauses were reduced or eliminated, took place within the last decade and in the context of the rapid growth at the global level in transparency and accountability initiatives in the extractive industry. The evidence suggests that as these initiatives crystallise in countries, the use of stabilisation clauses diminishes. In other words, while governments appear willing to grant stabilisation clauses when negotiations are conducted in secret, they seem unable to defend or justify the inclusion of the clause when they are held to account by their citizens. This may explain why in several countries, parties and candidates have been elected into office largely on the platform that if elected, they will review, override or undermine stabilisation clauses. The rejection of stabilisation clauses is thus closely tied to public sentiments over the legitimacy

[408] Ryan Dube, 'The Humala Factor: Left Wing Rhetoric with A Free Market Twist?' (12 April 2012) <http://www.bnamericas.com/features.jsp?documento=1244750&idioma=I&sector=7> accessed 08 October 2012

[409] Law amending the Mining Royalty Law; Law establishing the Special Mining Contribution; and Law establishing the Special Mining Tax.

of the contracts in the first place. In other words, the citizens are not prepared to stabilise illegitimacy.

4.5. CONCLUSIONS

The re-introduction of stabilisation clauses into the statute books of many developing countries was largely influenced by pressure applied by the World Bank during the Bank-led reforms. Stabilisation clauses were made a key component of the legislative reforms the Bank proposed to, and facilitated in, developing countries. Receiving technical assistance and other forms of support from the Bank became conditional upon implementing the reforms, including the grant of stabilisation clauses. In view of the Bank's relationship with developing countries as a major lender, such developing countries were left with little or no choice but to accept the reforms, including the stabilisation clauses, especially in the light of the economic crisis at the time.

Corruption and lack of transparency in the contracting process also help to explain why several developing countries re-introduced stabilisation clauses and continued to grant even more extensive forms of the clause. Thus, regardless of whether these governments had been put under pressure from the World Bank, the most stringent forms of stabilisation clauses were more likely to be found in contracts or legislation entered into, or enacted by, regimes known to be (or widely perceived to be) corrupt and/or dictatorial.

Conversely, increased transparency and accountability in the contracting process usually led to the removal or reduction in the scope of stabilisation clauses granted by a country. Within the past decade, an increasing number of countries have either eliminated or significantly reduced the scope of stabilisation clauses that they grant, all in the context of the rapid growth at the global level of transparency and accountability initiatives in the extractive industry.

This thesis does not claim that only corrupt and/or dictatorial governments continue to accept stabilisation clauses. There are several developing countries where, in relative terms, stabilisation clauses are granted openly by transparent and accountable governments. However, even in these countries, the link between stabilisation clauses and transparency holds true. The higher levels of transparency are reflected in their stabilisation practices. This is seen in the narrower scope and limited duration of stabilisation clauses that they grant and the extraction of some form of consideration from investors before they can access the clause.

CHAPTER 5 - SUSTAINABLE DEVELOPMENT AND THE MISPLACED FOCUS ON SOCIAL AND ENVIRONMENTAL LAWS

5.1 INTRODUCTION

The literature on the impact of stabilisation clauses has evolved in a compartmentalised way by focusing on the potential impacts of the clauses on host states' abilities to enact and implement social and environmental laws.[1] Yet, the concept of sustainable development emerged as a result of the rejection of the 'unsustainable' approach whereby environmental protection, social development and economic growth are compartmentalised and treated as separate and distinct goals.

The chapter is therefore aimed at building an understanding of sustainable development and to demonstrate that the focus on social and/or environmental laws in the literature on the impact of stabilisation clauses is misplaced. The chapter will begin by briefly tracing the evolution of sustainable development in international law and policy. The meaning and core elements of sustainable development are then discussed. This will be followed by an examination of the legal relevance and implication of sustainable development. The chapter will conclude with an examination of the misplaced focus on social and environmental laws.

5.2 SUSTAINABLE DEVELOPMENT

5.2.1 Evolution of Sustainable Development in International Law and Policy

The recognition that environmental and developmental problems are global in nature and therefore require international cooperation to arrive at solutions gave birth to concerns for sustainable development at the global level.[2] Consequently, the UN General Assembly

[1] In some of the literature, 'human rights' is sometimes used as a surrogate for social and environmental law.

[2] This arose out of the scholarly debates during that period over the effect of industrialisation in developed countries and population growth in developing countries on the global resource base. See, as examples, Thomas Malthus, *An Essay on the Principle of Population*' (1st edn, J.Johnson 1798); Paul R Ehrlich, *The Population Bomb* (Ballantine Books 1968); Donella H Meadows and ors, *The Limits to Growth: A Report for the Club of Rome's Project on the Predicament of Mankind* (Universe Book 1972).

(UNGA) resolved to convene a UN Conference on the Human Environment.[3] To prepare for the conference, its Secretary-General was mandated to submit a report dealing, among other issues, with 'the main problems facing developed and developing countries...including the possibilities for increased international cooperation, especially as they relate to economic and social development, in particular of the developing countries.'[4]

As an aid in the preparation of this report, the Secretary-General commissioned a panel of experts to advise him on the relationship between the environment and development.[5] In the resulting 'Founex Report', the panel observed that the concern for the environment in developed countries had resulted from the undesirable effects of industrialisation.[6] However, for developing countries, the major environmental problems that they faced were 'predominantly problems that reflect poverty and the very lack of development of their societies.'[7] The report therefore advised that 'in large measure, the environmental problems that are of importance in developing countries are those that can be overcome by development itself.'[8]

In 1972, in line with the original mandate of UNGA and based upon the findings of the Founex Report, the UN Conference on the Human Environment (hereafter 'UNCHE') was convened in Stockholm, Sweden.[9] The Conference witnessed a sharp dissonance between developing and developed countries.[10] While developed countries steered the debate towards environmental issues, developing countries focused on development issues, and, in

[3] UNGA, 'Problems of the Human Environment' 03 December 1968, UN Doc A/Res 2398.
[4] Ibid.
[5] For details, see, UN, *Development and Environment: Report and Working Papers of a Panel of Experts Convened by the Secretary-General of the United Nations Conference on the Human Environment* (UN 1972) (hereafter 'Founex Report').
[6] Ibid para 1.2.
[7] Ibid para 1.4.
[8] Ibid para 1.5.
[9] UN, 'Report of the UN Conference on the Human Environment' (Stockholm 06 – 16 June 1972, UN Doc A/CONF.48/4/Rev 1).
[10] For a detailed account of this dissonance, see the following: Louis B Sohn, 'The Stockholm Declaration on the Human Environment' (1973) 14 *Harvard Intl L Rev* 423; Lavanya Rajamani, *Differential Treatment in International Environmental Law* (OUP 2006) 55.

particular, poverty eradication.[11] To reconcile these positions, economic development was recognised as not being necessarily incompatible with environmental protection in the documents adopted at the UNCHE.[12] Although none of these documents contains the term 'sustainable development', they contain provisions that laid the foundation for the formulation of the concept, including the need to integrate environmental protection with social and economic development.[13]

About a decade after UNCHE, a World Commission on Environment and Development was constituted by the UN General Assembly to continue with the global efforts to promote development that was sustainable.[14] A key mandate of the Commission was to recommend ways of achieving greater cooperation between developed and developing nations that would 'lead to the achievement of common and mutually supportive objectives which take account of the interrelationships between people, resources, environment and development.'[15]

In 1987, the Commission submitted its report and in it recommended 'sustainable development' as the solution to global environmental and development problems.[16] The report, widely known as the *Brundtland Report,* stated that the key element of 'sustainable development' is the recognition that environmental protection and economic development are inextricably linked and therefore, must be completely integrated in decision-making 'not just to protect the environment, but also to protect and promote development.[17] The report and its recommendations were accepted by the UN General Assembly and transmitted to all

[11] Ibid.
[12] The three outcome documents are: *Declaration of the UN Conference on the Human Environment,* 16 June 1972, UN Doc A/CONF.48/14/Rev (hereafter 'Stockholm Declaration'); *Action Plan on the Environment,* 16, June 1972, UN Doc. A/Conf.48/14/Rev; *Resolution on Institutional and Financial Arrangements,* 16 June 1972, UN Doc A/Conf.48/14/Rev.1.
[13] See, for example, *Stockholm Declaration* (n 12) Preamble and principles 8 – 18.
[14] UNGA, *Process of Participation of the Environmental Perspective to the Year 2000 and Beyond,* 19 December 1983, UN Doc A/RES/38/161.
[15] Ibid para 8b
[16] World Commission on Environment and Development, *Our Common Future* (OUP 1987) (hereafter '*Brundtland Report')* 8, 309-343.
[17] Ibid 4-5, 37. The Report is called 'Brundtland Report' in reference to the Chairman of the Commission, Gro Harlem Brundtland.

governments and UN agencies, inviting them 'to take account of the analysis and recommendations contained in the Report of the Commission in determining their policies and programmes.'[18]

In 1992, in line with the recommendation of the *Brundtland Report*, the UN Conference on Environment and Development (UNCED) was convened in Rio de Janeiro, Brazil.[19] The Conference reaffirmed the idea developed at Stockholm, and reinforced in the *Brundtland Report*, that environmental protection is not necessarily incompatible with development. However, it did so with a changed tone, approach, and philosophy, as reflected in the title 'UNCED'.[20] At Stockholm, the focus had been on the impact of human activities on the environment and the environment was assessed in terms of human needs. At Rio, the focus shifted to development concerns and on how to ensure that economic development processes took into account environmental protection. The shift in focus was deliberate, and resulted from the issues highlighted in the *Brundtland Report* and the efforts by a coalition formed by developing countries to ensure that their developmental concerns shared the centre stage with environmental considerations.[21]

For the purposes of this thesis, the most significant documents produced by the UNCED are the Declaration on Environment and Development ('Rio Declaration')[22] and Agenda 21: A Programme for Action for Sustainable Development.[23] The Rio Declaration contained 27 principles, which again emphasised the need to integrate environmental protection with the development process in order to equitably meet the needs of present and

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[18] UNGA, *Report of the World Commission on Environment and Development*, 11 December 1987, UN Doc A/RES/42/187, Resolution 6.
[19] *Brundtland Report* (n 16) 343; UNGA, *United Nations Conference on Environment and Development*, 22 December 1989, UN Doc RES/44/228, Resolution 3.
[20] Marie-Claire Cordonier Segger, 'Sustainable Development in International Law' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in National and International Law* (ELP 2008) 98; Rajamani (n 10) 59 – 60.
[21] The shift was made in Working Group III in one of the session of the UNCED Preparatory Committee following a proposal by the Brazilian delegate. See Philippe H Sand, 'UNCED and the Development of International Environmental Law' (1993) 8 JNREL 209, 228, Segger (n 20) 98; Rajamani (n 10) 60.
[22] 14 June 1992, UN Doc A/CONF.151/26) Annex 1 (hereafter *'Rio Declaration*').
[23] Ibid Annex II (hereafter *'Agenda 21'*)

future generation.[24] Of particular relevance, the Declaration clearly affirmed the anthropocentricity of the concept of sustainable development by making human beings 'the centre of concerns for sustainable development.'[25] As such, unlike the Stockholm Declaration, it was less specific on the management of natural resources and nature conservation, while emphasising poverty reduction and development concerns.[26]

Agenda 21 contains a comprehensive plan, complete with strategies, programmes, and recommendations of actions that states can adopt to implement sustainable development in accordance with the principles contained in the Rio Declaration.[27] It is important to note, and these are points that will be emphasised often in this thesis, that Agenda 21 is a 'dynamic programme' evolving 'over time in the light of changing needs and circumstances.'[28] In addition, it is to be implemented by each country 'according to their different situations, capacities and priorities.'[29]

The Rio Declaration and Agenda 21 reflected the understanding of what sustainable development meant to states at the time. They provided a substantive elaboration of the concept and also laid the legal and institutional foundations for its practical application and implementation.[30] Although both documents are not legally binding, their importance is underscored by the fact that they still serve as guidelines for national, regional and international action to promote sustainable development.[31] They also continue to exert significant influence in the practical application and implementation of sustainable

[24] Ibid. The two most significant principles in this regards is principles 3 and 4.
[25] Ibid Principle 1.
[26] Ibid Principles 5 – 6.
[27] (n 23). For a useful review, see: Michael McCoy and Patrick McCulley, *The Road from Rio: An NGO Action Guide to Environment and Development (*Utrecht Books 1993).
[28] *Agenda 21* (n 23) para 1.6.
[29] Ibid.
[30] Alexandre S Timoshenko, 'From Stockholm to Rio: The Institutionalization of Sustainable Development in Winfried Lang (ed), *Sustainable development and international law* (Graham & Trotman 1995) 152.
[31] For example, countries are still working to develop and implement National Sustainable Development Strategies as required by Agenda 21. <http://www.un.org/esa/dsd/dsd_aofw_nsds/nsds_pdfs/NSDS_map.pdf> accessed 30 March 2011.

development both internationally and nationally.[32] It therefore comes as no surprise that the Rio Conference has been described as the 'political legitimization of sustainable development.'[33]

In 2002, the World Summit on Sustainable Development (WSSD) was held in Johannesburg, South Africa, to review progress made since Rio and 'reinvigorate the global commitment to sustainable development.'[34] In the lead up to the conference, developing countries again laid emphasis on economic and social development and sought to ensure that these formed the core of the agenda at the conference.[35] Ultimately, the WSSD focused on five specific subjects known by the acronym WEHAB (water and sanitation, energy, health care, agriculture and biological diversity).[36]

The summit adopted two policy documents: The Johannesburg Declaration on Sustainable Development (hereafter 'Johannesburg Declaration')[37] and the Johannesburg Plan of Implementation (hereafter 'Johannesburg Plan').[38] The Johannesburg Declaration reaffirmed the commitment of the international community to sustainable development, traced the efforts made so far by the global community to achieve it, and highlighted the present challenges facing humanity.[39] On the other hand, the 'Johannesburg Plan outlined the main points of international and national policy to be undertaken to implement the commitments originally agreed at the Rio Conference and reaffirmed at WSSD.

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[32] For example, pursuant to chapter 8 of Agenda 21, at least 106 countries have now adopted and are implementing national strategies for sustainable development (NSDS). See: Division for Sustainable Development, 'National Sustainable Development Strategies- the Global Picture' <http://www.un.org/esa/dsd/dsd_aofw_nsds/nsds_pdfs/NSDS_map_bg_note.pdf> accessed 22 April 2011.
[33] Timoshenko (n 30) 152.
[34] UNGA, *Ten-year Review of Progress Achieved in the Implementation of the Outcome of the United Nations Conference on Environment and Development*, 20 December 2000, UN Doc A/Res/55/199.
[35] For an excellent discussion of the build-up to the WSSD see Rajamani (n 10) 61 -66.
[36] See generally UN, *Johannesburg Plan of Implementation* 04 September 2002, UN Doc A/Conf.199/20.
[37] UNCED, *Johannesburg Declaration of the World Summit on Sustainable Development*, 04 September 2002, UN Doc A/Conf.199/20, 1
[38] *Johannesburg Plan* (n 36). For a detailed discussion on the outcome of the summit, see, Kevin R Gray, 'World Summit on Sustainable Development: Accomplishments and New Directions?' (2003) 52 ICLQ 256.
[39] See generally principles 1 – 14.

The WSSD discussions brought various constitutive elements of development thinking together and thus the contents of the outcome documents provided a good overview of how the international community conceptualised sustainable development at that time.[40] The most important contribution in this regard is the clarification of the components of sustainable development. Both the Declaration and the Plan recognised environmental protection, economic development and social development as the 'interdependent and mutually reinforcing pillars' of sustainable development and advocated for greater integration between them.[41] This approach followed the success of developing countries at the WSSD to define sustainable development so that it incorporated social and economic development.[42] The more integrated, balanced treatment of the social, economic and environmental goals showed how the concept of sustainable development has evolved, and, as will be discussed later, reflects the contemporary understanding of sustainable development.[43]

In line with the 10-yearly gatherings since UNCED, the UN Conference on Sustainable Development (hereafter 'Rio+20') was held in 2012.[44] The outcome document renewed political commitment for sustainable development, assessed progress made, examined implementation gaps, and recommended ways to address new and emerging challenges.[45] Of particular concern to this thesis is the fact that the Conference reaffirmed three points.

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[40] Nico Schrijver, *The Evolution of Sustainable Development in International Law: Inception, Meaning and Status* (Martinus Nijhoff 2008) 95 – 96.
[41] *Johannesburg Declaration* (n 37) Principle 5; *Johannesburg Plan* (n 36) para 2.
[42] For details, see, Jeffrey D Sachs and Andrew M Warner, 'Globalization and International Competitiveness: Some Broad Lessons of the Past Decade' in Jeffrey D Sachs and World Economic Forum (eds), *The Global Competitiveness Report 2000* (OUP 2000) 18 -27.
[43] See section 5.2.2.
[44] UNGA, *The Future We Want*, 11 September 2012, UN Doc. A/RES/66/288.
[45] Ibid.

First, it reaffirmed the Rio principles and past action plans on sustainable development.[46] Second, it reaffirmed that environmental protection, social development and economic growth are the three pillars of sustainable development and therefore called for these pillars to be integrated, 'recognizing their interlinkages, so as to achieve sustainable development in all its dimensions.'[47] Third, it reaffirmed that the eradication of poverty remains the 'greatest global challenge facing the world today and an indispensable requirement for sustainable development.'[48]

The relevance of these affirmations is that they show that there has been little change to the understanding of sustainable development in international law and policy 20 years after Rio. Furthermore, for developing countries, the challenges of sustainable development remain the same 50 years after the Stockholm Conference. These are points that will be returned to later.[49] Before then, it is important to examine the meaning and core elements of sustainable development.

5.2.2 What is Sustainable Development?

Almost three decades after the term 'sustainable development' was made popular by the *Brundtland Report,* some commentators still feel its exact meaning remains unclear.[50] What then is the 'sustainable development' upon which global consensus was reached at Rio and reaffirmed at Johannesburg and Rio+20? Is it indeed possible or desirable to have an 'exact' meaning of sustainable development for it to be achieved? This section attempts to answer these questions.

The *Brundtland Report,* in proposing 'sustainable development' defined it as 'development that meets the needs of the present without compromising the ability of future

[46] Ibid paras 15, 17.
[47] Ibid para 3. See also para 6.
[48] Ibid para 2. See also para 4.
[49] See generally section 5.3.2
[50] See, for example, Vaughan Lowe, 'Sustainable Development and Unsustainable Arguments' in Alan Boyle & David Freestone (eds), *International Law and Sustainable Development* (OUP, 1999) 29 - 30; Andrea Ross 'Modern Interpretations of Sustainable Development' (2009) 36 *J of L and Society* 32,34.

generation to meet their own needs.'[51] However, the imprecise nature of this definition has led to an avalanche of interpretations. A review of these interpretations reveals that they work within the definition in the *Brundtland Report* but differ in terms of the emphasis placed on one or more of the pillars of sustainable development.[52] Consequently, although the definition in the *Brundtland Report* remains the most widely quoted definition of sustainable development, some commentators have argued in favour of a single precise international definition.[53] The summary of their argument is that a single precise definition will make the concept easier to implement by states and enforced by courts.[54]

The argument in favour of a unitary definition for sustainable development is however rejected by others.[55] The most incisive rejection of this argument comes from Michael Jacobs.[56] While he concedes that it is important to continue to clarify 'what the concept means in practice', he argues convincingly that the debate over the 'meaning of the concept' is misguided.[57] This, he argues, is because sustainable development is a 'contestable concept.'[58] Contestable concepts, he explains, have two levels of meaning. The first is unitary and vague and is often expressed in a short definition while the second level of meaning is how the concept should be interpreted in practice.[59]

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[51] *Brundtland Report* (n 16) 43.
[52] For a useful review of various interpretations, see: Peter P Rogers, Kazi F Jalal and John A Boyd, *An Introduction to Sustainable Development* (Earthscan 2008) 42-79.
[53] Those who have argued in favour of a single precise definition include: Gunther Handl, 'Sustainable Development: General Rules versus Specific Obligations' in Winfried Lang (ed), *Sustainable development and international law* (Graham & Trotman 1995); Alan Boyle and David Freestone, 'Introduction' in Alan Boyle and David Freestone (eds), *International Law and Sustainable Development* (OUP 1999) 16; Marie–Claire Cordonier Segger and Ashfaq Khalfan, *Sustainable Development Law: Principles, Practices, & Prospects* (OUP 2004) 4; Andrea Ross, 'Why Legislate for Sustainable Development? An Examination of Sustainable Development Provisions in UK and Scottish Statutes' (2008) 20 JEL 35.
[54] Ibid.
[55] See, for example, Michael Jacobs, 'Sustainable Development: A Contested Concept' in Andrew Dobson (ed) *Fairness and Futurity: Essays on Environmental Sustainability and Social Justice* (OUP 1999); Maria Lee, *EU Environmental Law: Challenges, Change and Decision–Making* (Hart Publishing 2005).
[56] Ibid.
[57] Ibid 25.
[58] Ibid
[59] Ibid.

Accordingly, he argues that a unitary definition for sustainable development is only possible at the first level and that has been achieved by the definition in the *Brundtland Report.*[60] The variety of definitions at the second level, he argues, is due to the different interests of those who use the term.[61] However, neither the vagueness nor variety of definitions makes the concept useless.[62] He therefore concludes that the definition in the *Brundtland Report* is deemed sufficient to express the concept; arguments can then proceed as to what must be done to achieve it in practice.[63]

While there may be some merit in the arguments for a unitary definition of sustainable development, one cannot but agree with Jacobs. This is because the *Brundtland Report* made it clear that although the pursuit of sustainable development should be a global objective, 'no single blueprint of sustainability will be found, as economic and social systems and ecological conditions differ widely among countries.'[64] For this reason, the Report proposed that the interpretations of what constitutes sustainable development may vary among countries.[65] However, all interpretations 'must share certain general features and must flow from the consensus on the basic concept of sustainable development and on a broad strategic framework for achieving it.'[66] Furthermore, Agenda 21 also recognised the futility in defining sustainable development in precise terms as it allows countries to interpret the principles contained in the Rio Declaration 'according to their different situations, capacities and priorities.'[67]

As such, it is argued that a single precise definition of sustainable development is not required for the concept to be promoted, especially at the national level. This thesis therefore makes no attempt to provide a single precise definition of sustainable development. Instead,

[60] Ibid 25 – 26.
[61] Ibid.
[62] Ibid.
[63] Ibid 26. See also Lee (n 55) 28.
[64] *Brundtland Report* (n 16) 40.
[65] Ibid 43.
[66] Ibid.
[67] (n 23) para 1.6.

the focus will be on the contemporary understanding of sustainable development and the common elements that can be identified as being central to a sustainable development approach. Consequently, based on the prior review of the evolution of the concept in international law and policy, the contemporary understanding of sustainable development is the integration of economic development, environmental protection, and social development in development decision–making in order to improve the quality of life of the present generation while enabling future generations to do the same.[68] A discussion of the core elements inherent in this understanding follows.

5.2.3 The Core Elements of Sustainable Development

A common approach by commentators in discussions about the meaning of sustainable development is to identify the main 'principles' or 'elements' of the concept.[69] A review of the various principles identified by commentators reveals a striking similarity indicating some degree of consensus about the content of sustainable development. It is however not particularly useful to this thesis to consider all the principles. As such, the discussion here is limited to a brief overview of the three principles upon which an overwhelming consensus has been formed as comprising the minimum requirements of sustainable development. This is based upon a review of their recurrence in international legal texts and the academic literature.

5.2.3.1 Principle of Integration

The principle of integration has been variously referred to as the 'central',[70] 'foundational',[71] and 'most essential' principle of sustainable development.[72] Notions of the

[68] This understanding is also reflected in the use of the term in international instruments and jurisprudence. See section 5.2.4.
[69] See, for example, Philippe Sands, *Principles of International Environmental Law* (2nd edn, CUP 2003) 253-266; Duncan French, *International Law and Policy on Sustainable Development* (MUP 2005) 51 – 70; Jane Holder and Maria Lee, *Environmental Protection, Law, and Policy: Text and Materials* (2nd edn, CUP 2007) 231-243; Patricia Birnie, Alan Boyle and Catherine Redgwell, *International Law on the Environment* (3rd edn OUP 2009) 116-123; Jacobs (n 55) 24; Boyle and Freestone (n 53) 8 – 16.
[70] French (n 69) 54.

principle can be found in the Stockholm Declaration.[73] However, it was Principle 4 of the Rio Declaration that gave birth to the principle of integration as it is being conceptualised today when it stated that 'in order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it'[74]

Essentially, the principle requires the simultaneous and coherent considerations of economic, social and environmental concerns in a development decision. This requirement lies at the heart of sustainable development and the application of the other principles of the concept depends largely on an integrated approach. As such, there is consensus amongst commentators that the principle serves as a conceptual framework to guide the consideration of other principles and thus best reflects how sustainable development should be pursued in practice.[75] It is therefore not surprising that the principle permeates the Rio instruments, the documents produced at the various conferences on sustainable development and international treaties aimed at sustainable development.[76] If interpreted correctly, the principle should affect the way policies are created and realised both at the national and international levels and also guide the implementation of specific measures aimed at sustainable development.[77]

5.2.3.2 Intergenerational Equity

A core idea behind sustainable development is that the present generation should consider the long term effects of their actions in order not to constrain the ability of future generations to meet their own needs. Intergenerational equity is therefore one of the main

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[71] John C Dernbach, 'Achieving Sustainable Development: The Centrality and Multiple Facets of Integrated Decision-making' (2003) 10 *Indiana J of Global Legal Studies* 247, 250.
[72] Howard Mann, 'Comment on the Paper by Philippe Sands' in Winfried Lang (ed), *Sustainable Development and International Law* (Graham & Trotman 1995) 71.
[73] See, for example, *Stockholm Declaration* (n 12) Preamble, paras 8 – 16.
[74] (n 22).
[75] See, as examples, Segger and Khalfan (n 53) 102; Jeffrey D Kovar, 'A Short Guide to the Rio Declaration" (1993) 4 *Colorado J of Intl Env L and P* 119, 127.
[76] See, as examples, *Agenda 21* (n 23) para 1.6; *Johannesburg Plan* (n 36) para 2; *Johannesburg Declaration* (n 37) Principle 5; UNGA, *The Future* (n 44) para 3. See also section 5.2.4.
[77] French (n 69) 55; ILA, 'New Delhi Declaration of Principles of International Law Relating to Sustainable Development' (2002) paras 7.2 – 7.3.

justifications for sustainable development. The principle of intergenerational equity had existed separately in both international environmental law and international development law.[78] They were then brought together within the context of sustainable development by the following: 'The right to development must be fulfilled so as to equitably meet the developmental and environmental needs of present and future generations.'[79]

Intergenerational equity refers to the obligation of present generations to take into account the long term impact of their activities in order to ensure that future generations are also able to meet their own developmental and environmental needs.[80] While this basic premise is understood, there remains considerable scope for debate as to how to implement the principle in practice.[81] However, commentators do agree that the starting point in pursuing intergenerational equity is to ensure that the present generation do not unduly restrict or impose unreasonable constraints on the options that are available to future generations to meet their own needs and to solve their problems.[82]

5.2.3.3 Intragenerational Equity

Unlike intergenerational equity which seeks to address equity *between* generations, intragenerational equity addresses inequity *within* the present generation.[83] Essentially the principle refers to the obligation to ensure a fair and just distribution of the benefits of the earth's resources within the present generation. Although this includes the obligation to ensure equity within a country, it is particularly concerned with addressing the widening gap

[78] On the environmental side, see for example, 'Convention for the Protection of the Mediterranean Sea against Pollution, and Protocols (16 February 1976) 15 *ILM* 290 preamble. On the development side, see, for example, UN, 'Declaration on the Establishment of a New International Economic Order', 01 May 1974, UN Doc. A/RES/S-6/3201, preamble.
[79] (n 22) Principle 5.
[80] For a useful analysis of this principle, see, Edith Brown Weiss, *In Fairness to Future Generations: International Law, Common Patrimony, and Intergenerational Equity* (UNUP 1989).
[81] The debate is largely due to uncertainty about what the needs of future generations might be. For a summary of these debates, see, French (n 69) 59 – 62; Boyle and Freestone (n 69) 12 – 14.
[82] See, as examples, *Brundtland Report* (n 16) 22 – 23; Weiss (n 80); Boyle and Freestone (n 69) 12.
[83] See: Segger and Khalfan (n 53) 122 – 132.

in resources between developing and developed countries in the sustainable development discourse.[84]

Intragenerational equity is critical to sustainable development as it will be difficult to avoid ecological and other crises without the eradication of poverty and inequity within the current generation.[85] This is because those within the present generation who cannot meet their essential needs will often destroy their immediate environment in order to survive.[86] Accordingly, without intragenerational equity, it would be difficult to achieve intergenerational equity, and consequently, sustainable development.

While there remains a difference of opinion on the modalities and instruments to be used to implement intragenerational equity, its main idea of ensuring fairness and justice within the present generations, and, its importance to sustainable development, is generally understood and accepted by the global community. In practice, it usually takes the form of provision of financial assistance from developed to developing countries, and the application of the principle of common but differentiated responsibility.[87]

5.2.4 Legal Relevance and Status of Sustainable Development in International Law and Policy.

This section examines the legal relevance and status of sustainable development. The main aim is to show how the concept has grown, how it is being conceptualised or understood and the duty that it imposes on states. The analysis will include a brief examination of the usage of 'sustainable development' in international legal texts and in national constitutions. It will conclude with an analysis of the legal status of the concept in international law.

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[84] Ibid. See also *Rio Declaration* (n 22) Principles 5 – 7; *Agenda 21* (n 23) ch 3.
[85] *Brundtland Report* (n 16) 28-30, 43-48.
[86] Ibid.
[87] See generally, Barbara J Bramble, 'Financial Resources for the Transition to Sustainable Development' in Felix Dodds (ed), *Earth Summit 2002* (Earthscan 2000).

References to 'sustainable development' can be found in a growing number of treaties covering various issues at both the global and regional levels.[88] Such references may appear as a principle to be taken into account in the implementation of the treaty. For example, parties to the 1994 Agreement Establishing the World Trade Organisation (WTO) agreed that their relations and activities should be conducted 'in accordance with the objective of sustainable development.'[89]

In other cases, sustainable development is included as an objective or a purpose of the treaty. For example, an objective of the 2007 Charter of the Association of Southeast Asian Nations is to 'promote sustainable development so as to ensure the protection of the region's environment, the sustainability of its natural resources, the preservation of its cultural heritage and the high quality of life of its people'[90]

The references to sustainable development in a growing number of treaties are particularly relevant for two reasons. First, it confirms the contemporary understanding of sustainable development. Thus although the sustainable development objective is worded slightly differently in each treaty, generally, the principle of integration is reflected within each interpretation.[91] Interestingly, this remains the case even in treaties where the parties are mainly developed countries. For example, the signatories to the European Landscape Convention proclaimed that they are 'concerned to achieve sustainable development based on a balanced and harmonious relationship between social needs, economic activity and the environment.'[92]

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[88] The scope of this thesis does not permit a detailed discussion of these references. For a detailed review up to 2008, see: Nico Schrijver, *The Evolution of Sustainable Development in International Law: Inception, Meaning and Status* (Martinus Nijhoff 2008) 102 – 131.
[89](15 April 1994, entered into force 01 January 1995) Preamble.
[90] (20 November 2007, entered into force 15 December 2008) art 1(9).
[91] See, for example, the elaborate definition in art 3(1) of the 2002 Convention for Cooperation in the Protection and Sustainable Development of the Marine and Coastal Environment of the Northeast Pacific (Antigua 18 February 2002, not yet in force) IELMT 14.
[92] (Florence, 20 October 2000, entered into force on 01 March 2004) (ETS No 176) Preamble.

Second, the references to sustainable development in a growing number of treaties can be seen as evidence of state practice recognising sustainable development as an objective of the international community and one which each country is expected to promote and take into account when implementing treaties.[93] It is conceded that mere references do not create legally binding obligations to achieve sustainable development *per se*. However, the fact that the concept is made an objective or purpose of a treaty makes it directly relevant not only in the implementation of the obligations imposed by the treaty but also in any judicial interpretation of the provisions of the treaty.

The view that the references to sustainable development in treaties have legal implications received support from the Appellate Body of the WTO in the *Shrimp Products Case*.[94] It considered the legal significance of the sustainable development objective in the WTO Agreement and concluded that the explicit recognition of sustainable development as an objective 'demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development.'[95] As such, the concept of sustainable development 'must add colour, texture and shading' to the interpretation of the agreements annexed to the WTO Agreement.[96]

At the national level, a significant number of national constitutions now contain references to sustainable development.[97] In some of these constitutions, the references may be found in the preamble.[98] However, in the majority of cases, sustainable development appears as part of the objectives and general principles to guide national policies. For

[93] Besides incorporating the concept of sustainable development in treaties, sustainable development is also recognised as an objective of the international community in numerous non-binding instruments including, 2000 UN Millennium Declaration, 08 September 2000, UN Doc A/Res/55/2, art 22; 2009 Copenhagen Accord, 18 December 2009, arts 1 and 5.
[94] Appellate Body Report on *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, dated 12 October 1998
[95] Ibid [153].
[96] Ibid.
[97] At the last count, at least 40 countries have references to sustainable development in their national Constitutions. The collection of constitutions (including translations) used for this thesis was obtained from Heinonline, 'World Constitution Illustrated' <http://www.heinonline.org/HOL/COW?collection=cow> accessed 27 April 2011.
[98] See, for example, the preamble to Constitution of Montenegro 2007.

example, one of the 'fundamental tasks of the state' prescribed in the 2010 Constitution of the Republic of Angola is 'to promote harmonious and sustainable development throughout national territory.'[99]

The reference to sustainable development in national constitutions is worded and operationalised slightly differently in each constitution. However, most formulations reflect the contemporary understanding of the concept built around the core elements. For example, the preamble to the French Charter for the Environment highlights intergenerational and intragenerational equities by stating that 'in order to ensure sustainable development, choices designed to meet the needs of the present generation should not jeopardise the ability of future generations and other peoples to meet their own needs.'[100] The Charter then goes on to advocate for an integrated approach by proclaiming that 'public policies shall promote sustainable development. To this end they shall reconcile the protection and enhancement of the environment with economic development and social progress.'[101]

While national constitutions are not formal sources of international law within the context of Article 38 (1) of the ICJ Statute, they contain the fundamental principles of national legal orders and also constitute an important aspect of state practice.[102] Therefore, the growing reference to sustainable development in national constitutions is an indication of the weight states attach to the concept. For example, the Constitution of Ethiopia 1994 goes even further to create a collective 'right' to sustainable development.[103] Furthermore, it provides that the sustainable development of Ethiopia is the central focus of the country's foreign policy and 'all international agreements and relations concluded, established or

[99] Article 21(m). See also Constitution of Uganda 1995, art XXVII (1); Constitution of Kosovo 2008, art 119 (4); Constitution of Kenya 2010, arts 10(2) (d) and 69 (1) (2).
[100] The Charter for the Environment is part of the Constitution of France by virtue of Constitutional Law No. 2005-205 of 01 March 2005.
[101] Article 6. See also Constitution of the Maldives 2008, art 22.
[102] Schrijver, *Evolution* (n 88) 153.
[103] See article 43 (1) 'The Peoples of Ethiopia as a whole, and each Nation, Nationality and People in Ethiopia in particular have the right to improved living standards and to sustainable development'.

conducted by the State shall protect and ensure Ethiopia's right to sustainable development.'[104]

Despite the widespread endorsement of sustainable development by states in international and national legal texts, the legal status of the concept has been the subject of debate. A review of these debates indicates three broad positions. At one end of the spectrum there are those who argue that the concept is a norm of international customary law.[105] The strongest support for this view comes from Judge Christopher Weeramantry.[106] He argues that sustainable development is not merely a concept but is a 'principle with normative value.'[107] For support, he relies on the 'wide and general recognition of the concept' in international instruments, by international organisations and in state practice.[108] He therefore concludes that the principle of sustainable development 'is thus a part of modern international law by reason not only of its inescapable logical necessity, but also by reason of its wide and general acceptance by the global community.'[109]

The view that the principle of sustainable development is now part of customary international law is however rejected by those at the other end of the spectrum. The most incisive criticism in this regard comes from Vaughan Lowe.[110] He rejects the suggestion by Judge Weeramantry that references to the concept in international instruments are evidence of the concept's translation into customary international law.[111] Although he concedes that there is frequent use of the term in international legal texts, he argues that this does not translate into evidence of general practice accepting the concept as law, in the absence of any

[104] Article 43 (3).
[105] See, as examples, Judge Weeramantry (*Hungary/Slovakia*) (*Gabcikovo-Nagymaros case)* [1997] ICJ Report 7 (Separate Opinion) 94 – 110; David Luff, 'An Overview of International Law of Sustainable Development and a Confrontation between WTO Rules and Sustainable Development' (1996) 29 *Belgian Review of Intl Law* 90.
[106] Ibid.
[107] Ibid 88.
[108] Ibid 92 – 110.
[109] Ibid 95. See smilar arguments by Luff (n 105) 94 – 97; Maria-Claire Cordonier Segger, 'Sustainable Development in International Law' in Hans Christian Bugge and Christian Voigt (eds), *Sustainable Development in National and International Law* (ELP 2008) 139 – 141.
[110] Lowe (n 50)
[111] Ibid 23.

instance where states rely on the concept as a binding rule of law constraining their conduct.[112]

More fundamentally, Lowe argues that the uncertainty regarding the exact meaning and scope of the concept means it lacks a 'fundamentally norm-creating character such as could be regarded as forming the basis of a general rule of law' as laid down by the ICJ in the *North Sea Continental Shelf Cases*.[113] Consequently, although he agrees that the concept does have normative status, he maintains that 'the argument that sustainable development is a norm of customary international law, binding on and directing the conduct of states, and which can be applied by tribunals, is not sustainable.'[114]

The dominant view however falls somewhere between these two extremes discussed above. Proponents of this view concede that sustainable development still falls short of a binding international legal principle.[115] However, they argue that the concept nevertheless significantly influences decision-making in all contexts and the practice of states.[116]

For example, Nico Schrijver argues that Lowe stretched his criticism of Judge Weeramantry 'somewhat too far' especially as regards his argument that the concept suffers from theoretical obscurity and confusion.[117] He agrees that the concept is not yet a binding rule of customary law.[118] However, he concludes that based on 'significant recent developments', the concept has become an established objective of the international

[112] Ibid 23 – 24.
[113] Ibid 31. (*Germany/Denmark; Germany/Netherlands*) [1969] ICJ Rep 3.
[114] Ibid 30. See also French (n 69) 51; Handl (n 53) 25 – 26.
[115] See as examples, Birnie, Boyle and Redgwell (n 69)126 - 127; Nico Schrivjer, 'Development - The Neglected Dimension in the Post - Rio International Law of Sustainable Development' in Hans Christian Bugge and Christina Voigt (eds), *Sustainable Development in International and National Law* (ELP 2008)233; BM Marong, 'From Rio to Johannesburg: Some Reflections on the Role of International Legal Norms in Sustainable Development (2004) 16 *Georgetown Intl Env L Rev* 21, 45.
[116] Ibid.
[117] Schrivjer, *Development* (n 115) 233.
[118] Ibid.

community and a concept with an 'established status' in international law, although he does not state what this status is.[119]

Similarly, BM Marong agrees that the concept could be normative in the sense that it serves as a guide to practical reasoning in diverse decision-making contexts at the national and international levels.[120] However, he suggests that the concept is best treated as an overarching societal objective for which law has a role to play for it to be achieved.[121] Based on this perspective, he concludes that although it falls short of a binding legal obligation, the legal notion of sustainable development implies a legitimate expectation on the part of the international community that states and other actors conduct their affairs in line with the objective of sustainable development.[122]

The differing views of commentators concerning the legal status of sustainable development in international law indicate that no easy answer can be given to the question. While there is no doubt that there is widespread global acceptance of 'sustainable development', this is not sufficient to make it a rule of customary international law in the traditional sense. For it to be one, states must also 'feel that they are conforming to what amounts to a legal obligation.'[123] At present, it is difficult to argue that this is the case. For example, almost 20 years after Agenda 21 called on states to adopt sustainable development strategies to integrate policies, some states are yet to adopt such a policy suggesting that they do not feel legally bound to do so.[124] In other words, it is difficult to argue with certainty that there is *opinio juris*, which along with state practice, is required to establish a binding legal custom under customary international law.[125] Consequently, it must be conceded that at

[119] Ibid.
[120] Marong (n 115) 45.
[121] Ibid.
[122] Ibid. See also Birnie, Boyle and Redgwell (n 69) 127 arguing that 'international law does require states and international bodies to take into account the objective of sustainable development, and to employ appropriate processes for doing so.'
[123] See art 38(1) (b) Statute of the ICJ and its interpretation in *North Sea Continental Shelf Cases* (n 113) [77].
[124] (n 23).
[125] ICJ Statute, art 38(1) (b).

present, sustainable development is yet to attain the status of a binding rule of customary international law, in the traditional sense.

However, that is not the end of the matter. As some commentators have noted, the legal relevance of sustainable development is not solely dependent on its normative status.[126] The historical evolution of the concept and its use in international legal texts shows that international law recognises a principle (or at least the concept) of sustainable development. The jurisprudence on sustainable development also confirms that the concept does influence the outcome of cases and the practice of states irrespective of its legal status.[127] For example, in the *Pulp Mills* case, the ICJ, in interpreting Article 27 of the 1975 Statute of the River Uruguay affirmed sustainable development as an objective of the global community which should influence the practice of states.[128]

The decisions of some national courts also confirm that states are expected to pursue the objective of sustainable development irrespective of its exact status in international law. For example, in the *Eppawela Case* the Sri Lankan Supreme Court noted as follows:

> Admittedly, the principles set out in the Stockholm and Rio De Janeiro Declarations are not legally binding in the way in which an Act of our Parliament would be. It may be regarded merely as "soft law" Nevertheless, as a Member of the United Nations, they could hardly be ignored by Sri Lanka.[129]

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[126] For example, Birnie, Boyle & Redgwell (n 69) 126 – 127; French (n 69) 51; Sand (n 69) 263 – 266.

[127] See, as examples, *Shrimp Products Case* (n 94) [153]; Panel Report on *United States – Restrictions on Imports of Tuna* DS21/R reprinted in (1994) ILM 839 [5.42]; *Case Concerning the Pulp Mills on the River Uruguay* (*Argentina/Uruguay*) (Judgment delivered 20 April 2010) [177] <http://www.icj-cij.org/docket/files/135/15877.pdf> accessed 08 January 2014.

[128] Ibid

[129] *Bulankulama & Ors v Secretary, Ministry of Industrial Development & Ors.* (*Eppawela Case) (*Judgement delivered on 7 April 2000) (University of Minnesota Human Rights Library)[274] (Amerasinghe, J.) <http://www1.umn.edu/humanrts/research/srilanka/caselaw/Speech/Bulankulama_v_Secretary_MoID.htm >accessed 18 April 2011.

Similarly, in the *Fuel Retailers case*, the South African Constitutional Court construed and applied the concept of sustainable development based on its evolution in international law and went on to dismiss the appeal partly because it was 'not persuaded that the principles of sustainable development are engaged' in the matter.[130]

5.3 THE MISPLACED FOCUS ON SOCIAL AND ENVIRONMENTAL LAWS

Agenda 21 states that investment is critical to the ability of developing countries to achieve sustainable development.[131] It therefore encouraged countries, in particular developing countries, to mobilise 'higher levels of foreign direct investment' through policies that promote investment.[132] For this reason, countries were advised to maintain a 'stable policy regime' as it encourages investment by enabling business and industry to implement longer-term policies.[133]

However, at the same time, Agenda 21 also encouraged each country to 'establish policies that allows them to benefit fully from the flows of foreign investment, within the framework of national, social, economic and developmental goals.'[134] The question that arises is whether developing countries are able to establish and implement the required policies where they have granted stabilisation clauses to create a 'stable policy regime' for investment purposes. In other words, do stabilisation clauses adversely affect sustainable development by limiting the ability of states to establish and implement the policies required to promote their sustainable development? For over a decade after the Rio Conference and the re-introduction of stabilisation clauses into developing countries, this question has received little attention.

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[130] *Fuel Retailers Association of Southern Africa v. Director-General Environmental Management, Department of Agriculture, Conservation and Environment, Mpumalanga Province* & ors (Constitutional Court, South Africa, Judgment delivered 03 June 2007) (2007) ZACC 13 [118] Sachs J.
[131] (n 23) para 2.23.
[132] Ibid para 33.15.
[133] Ibid para 30.1.
[134] Ibid para 2.37.

Concerns about the effect of stabilisation clauses on host states' regulatory abilities began in earnest in 2003 following the publication of the Baku-Tbilisi-Ceyhan (hereafter 'BTC') pipeline project documents.[135] Amnesty International then published a report claiming that the stabilisation clauses contained in the project documents had the potential to limit the host states' ability to implement their human rights obligations under international law.[136] The report generated substantial interest and resulted in a huge literature on the potential impacts of stabilisation clauses on host states' regulatory abilities.[137] However, these studies were concentrated on the potential impact of the clause on the ability of states to enact and implement social and environmental laws.[138] This remained the case even where such studies claimed to focus on the impact of the clause on sustainable development.

For example, Audley Sheppard and Antony Crockett posed the question whether stabilisation clauses are a threat to sustainable development.[139] They then answered the question simply by considering what impact, if any, the clause has on the enactment and application of social and environmental laws on investors.[140] Similarly, Lorenzo Cotula sought to examine 'the implications of the regulatory taking doctrine and of stabilisation clauses for host state regulation in pursuit of sustainable development goals.'[141] However, he quickly added that the analysis focuses 'specifically' on the impact of the clause on the

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[135] See BP, 'Legal Agreements' <http://www.bp.com/sectiongenericarticle.do?categoryId=9029334&contentId=7053632> accessed 16 April 2012.

[136] Amnesty International, *Human Rights on the Line: The Baku-Tbilisi-Ceyhan pipeline project* (AI 2003).

[137] See, as examples, Andrea Shemberg, 'Stabilization Clauses and Human Rights' (2009) Report, <http://www.ifc.org/ifcext/sustainability.nsf/content/publications_lessonslearned> accessed 16 April 2013; Lorenzo Cotula, 'Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses' (2008) 1 JWELB 158; Jernej Letner Cernic 'Corporate Human Rights Obligations under Stabilization Clauses (2010) 11 *German LJ* 210.

[138] In some of the literature, 'human rights' is used as a surrogate either for social laws or for both social and environmental laws.

[139] Audley Sheppard and Antony Crockett, 'Are Stabilisation Clauses a Threat to Sustainable Development' in Marie–Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe, (eds), *Sustainable Development in World Investment Law* (Kluwer Law 2011) 329 – 350.

[140] Ibid.

[141] Lorenza Cotula, 'Regulatory Takings, Stabilization Clauses and Sustainable Development' (OECD Global Forum on International Investment VII Conference, Paris, 27 – 28 March 2008) 3 <http://www.oecd.org/investment/globalforum/40311122.pdf> accessed 16 April 2012.

enactment of 'regulation raising the social and environmental standards applicable to investment projects.'[142]

The remainder of this chapter will argue against this approach whereby the impact of stabilisation clauses is considered solely in terms of its impact on the ability of host states to enact and apply social and environmental laws on investors or investment projects. In doing so, due consideration is given to the possible reasons why this approach has been followed in the literature. This is particularly important in view of the avalanche of material and the diverse demography of the authors behind these works (academicians, practitioners, NGOs, UN agencies, international financial organisations and so on). The reasons given below are not intended to be exhaustive. However, they reflect the main reasons behind this approach, based upon a review of the literature.

5.3.1 Possible Reasons behind the Focus on Social and Environmental Laws

5.3.1.1 Fragmented Institutions and Policies

One reason why the literature on the impacts of stabilisation clauses has been focused on social and environmental laws is the fragmented and compartmentalised nature of institutions and policies. As a result, institutions tend to analyse the impact of the clause only to the extent that it affects their narrow compartmentalised concerns.

For example, the UN Special Representative of the Secretary-General for Business and Human Rights (SRSG) helped facilitate research about the potential effects of stabilisation clauses on human rights.[143] Yet several years later, the UN Conference on Trade and Development recommended stabilisation clauses to developing countries as an investment attraction tool.[144] The concerns raised earlier about the clause by the SRSG (another UN

[142] Ibid 1.
[143] Shemberg (n 137) vii.
[144] UNCTAD, *Best Practices in Investment for Development Case Studies in FDI: How to Attract and Benefit from FDI in Mining: Lessons from Canada and Chile* (UNCTAD 2011) 89 – 91.

body) were simply ignored as no mention was made about the potential impact of the clause on human rights.

The compartmentalised analysis of stabilisation clauses is especially prevalent in the literature that is written from a legal perspective. Environmental lawyers are generally concerned with the potential impact of stabilisation clauses on the enactment of environmental laws.[145] Human rights lawyers are generally concerned with its potential impact on human rights laws.[146] On the other hand, investment lawyers generally view stabilisation clauses simply as an investment protection tool.[147] As a result, they generally ignore the potential impacts of the clause but are mainly concerned with how to make the clause more effective in protecting investors.[148]

The focus on human rights and the environment in discussions on the impact of stabilisation clauses is further fuelled by the fact that the legal debates surrounding the impact of the clause were brought to the fore by those working in the field of human rights and/or the environment. Commentators not in this field usually only became engaged in the debate from the perspective of investors' protection. Their involvement thus appears to be an attempt to ensure that 'opponents' of stabilisation clauses do not use the currently more morally fashionable human rights and environmental discourses to undermine the protection being offered by the clauses.

For example, Sheppard[149] and Crockett[150] are generally commercial practitioners and their examination of the impact of the clause seems more about challenging the view that

[145] See, for example, Kyla Tienhaara, 'Unilateral Commitments to Investment Protection: Does the Promise of Stability Restrict Environmental Policy Development?' (2006) YBIEL 139.
[146] See, for example, Cernic (n 137).
[147]See, for example, AFM Maniruzzaman, 'Damages for Breach of Stabilisation Clauses in International Investment Law: Where Do We Stand Today? '(2007) IELTR 246.
[148] Ibid.
[149] See the profile at Clifford Chance <http://www.cliffordchance.com/about_us/find_people_and_offices/partners/gb/audley_sheppard.html> accessed 13 August 2013.

stabilisation clauses affect human rights in favour of their claimed function in investment attraction.[151] Similarly, both the World Bank and the IFC have been actively involved in the processes that led to the drafting of the stringent stabilisation clauses in the BTC pipeline project and the project was partly funded by the IFC.[152] At that time, no attempt was made to consider the potential adverse effect the clauses might have on host governments. However, when the potential impact of the clause on human rights was brought to the fore by human rights NGOs, the IFC quickly intervened in the debate by jointly facilitating the study by Andrea Shemberg.[153]

The point needs to be made that separating policies and institutions into distinct parts with each institution focused on its compartmentalised concerns may not be wrong in itself. However, where such institutions are concerned with policies that directly relate to the pillars of sustainable development, then such fragmentation may create 'institutional gaps' in the pursuit of sustainable development as it directly conflicts with the principle of integration which is at the heart of sustainable development.[154] Indeed, a key challenge to sustainable development identified in the *Brundtland Report*, is that the institutions facing the challenges, both at the national and international levels, have been established based on their 'narrow preoccupations and compartmentalized concerns.'[155]

The need to analyse the impacts of stabilisation clauses through an integrated, rather than a fragmented, approach becomes even more important since the clauses are mainly used in the extractive industry, as have been noted in previous chapters. This is because projects in this sector usually have a huge combination of interconnected economic, social and

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[150]See profile at Clifford Chance <http://www.cliffordchance.com/about_us/find_people_and_offices/lawyers/gb/antony_crockett.html> accessed 13 August 2013.
[151] See, for example, Sheppard and Crockett (n 143).
[152] See section 4.3.3.
[153] Shemberg (n 137).
[154] *Brundtland Report* (n 16)
[155] Ibid 9.

environmental impacts. It therefore makes little sense to approach the impact of stabilisation clauses only as to their social and or environmental impact.

5.3.1.2 Reluctance to Engage with Economics

The focus on social laws (including human rights) and environmental laws in the literature on the impact of stabilisation clauses may also be due to the reluctance by lawyers to engage with economics.[156] This reluctance, it must be said, is not limited to analyses of stabilisation clauses. Rather, it is reflective of the way in which lawyers, particularly public international lawyers, tend to approach issues relating to the relationship between natural resource exploitation and sustainable development in developing countries.[157] This, as Thomas Wälde has argued, is because public international lawyers, especially those in the field of environmental law, generally hold the view that economic analysis is 'beside the point and likely to be incorrect, confusing and misleading anyway.'[158]

The argument may be made that the reluctance to engage with economics is justified by the fact that such an analysis is best undertaken by economists, rather than lawyers. If this argument is true, then it can also be used to question the competence of lawyers to analyse the impact of stabilisation clauses on environmental protection since lawyers are not environmental scientists. The point being made here is that, in practice, legal commentators advocate for stronger environmental and human rights protection based either on data from the environmental sciences or actual evidence of human rights abuses and environmental degradation. In the same way, consideration can and ought to be given to economic data, or the actual evidence of the economic situation in developing countries when analysing the impact of stabilisation clauses.

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[156] This reluctance, it must be said, also exists in their analysis of the rationale and purpose of stabilisation clauses. See generally sections 3.2 and 3.3.

[157] For an excellent discussion of this point, see Thomas W Wälde, 'Natural Resources and Sustainable Development: From 'Good Intentions' To 'Good Consequences' (2004) 2 OGEL 1.

[158] Ibid 4.

It is therefore not suggested here that engaging with economics when analysing the impact of stabilisation clauses on sustainable development will provide all the answers. It is also not suggested that legal commentators should conduct a sophisticated economic analysis of the impact of stabilisation clauses. However, there seems to be a reluctance by legal commentators to consider even the most basic economic analysis or to apply basic economic data to their analysis of stabilisation clauses. As a result, the analyses tend to diverge significantly from practice.

For example, the discussion in chapter 3 showed that legal commentators justify the acceptance of stabilisation clauses by reference to a need by developing countries to compete for FDI.[159] However, a review of the literature on current trends and future projection in the extractive industry, in addition to a basic application of the economic principle of demand and supply, tells another story.[160] Similarly, legal commentators generally assume that stabilisation clauses attract FDI.[161] However, a review of the inflow of FDI into selected countries, following changes to their stabilisation clauses, did not point to any robust link between stabilisation clauses and FDI.[162] Rather, the empirical evidence that does exist in the economic literature on the determinants of FDI suggests that the political risk that stabilisation clauses are aimed at is a marginal factor in investment decision-making.[163]

Engaging with economics in an analysis of stabilisation clauses is particularly important to understanding the impact of stabilisation clauses because a stabilisation clause is primarily an economic tool aimed at protecting the 'economics' of the project in favour of the investor.[164] In addition, they were re-introduced into developing countries as part of broader economic reforms aimed at attracting FDI to facilitate those countries' sustainable

[159] See section 3.2.2.
[160] Ibid.
[161] See section 3.4.
[162] Ibid.
[163] See section 3.3.2.
[164] See section 2.4.

development.[165] Furthermore, a review of the available evidence, including from press statements, media reports, parliamentary hearings, international arbitration, domestic court cases and government documents dealing with disputes between governments and foreign investors over stabilisation clauses, reveal that the causes of the disputes are fiscal in nature.[166]

Thus, the reluctance to engage in economics has created a situation where there is a 'controversy' in the literature over the potential impact of stabilisation clauses on human rights and environmental laws. Meanwhile, the only controversy over stabilisation clauses that do exist in the real world is centred on fiscal and economic issues.[167] This clearly suggests that, for host governments, it is the economic and fiscal constraints that stabilisation clauses impose on them that affect their ability to pursue sustainable development objectives. As such, the focus on human rights and environmental laws, while ignoring the economic consequences, masks the real threat that stabilisation clauses pose to their sustainable development.

5.3.1.3 Lack of Exposure to the Situation in Developing Countries

Stabilisation clauses are used in developing countries. As such, the effects of whatever constraints they impose are borne primarily by developing countries. Consequently, if an analysis of the impact of the clause on sustainable development is to have any semblance to reality, it must be done within the context of the situation in developing countries. This is particularly so because the discussion of the evolution of

[165] See section 4.2.

[166] The only two exceptions seen in this study where the disputes were seemingly environmental are the disputes involving stabilisation clauses in Kazakhstan (particularly the Kashagan project) and the Sakhalin II project in Russia. However, even in both cases, commentators agree that the environmental issues were merely used by the governments as a smokescreen to get better economic terms from the contracts. For details see: David Wood, 'Preliminary Report on Fiscal Designs for the Development of Alaska Natural Gas' (2008) Report for the State of Alaska Legislative Budget and Audit Committee, 101 - 105 <http://lba.legis.state.ak.us/fiscal/doc_log/2008-12-09_wood_2-3_fiscal_stability.pdf> accessed 17 April 2013; Cotula, *Regulatory* (n 141) 11.

[167] Many of these disputes, including those that have been arbitrated upon have been discussed in chapter 2 or will be discussed in the next chapter.

sustainable development in international law and policy shows that sustainable development poses different challenges for developed and developing countries.[168]

For developed countries, the key challenge is how to get the benefits of a cleaner environment without sacrificing economic growth. This is because the bulk of their environmental problems are caused by industrialisation and technological development.[169] However, the environmental problems in most developing countries are predominantly caused by poverty and economic under-development.[170] This difference in the sustainable development challenges for developed and developing countries is reflected in all the major documents on sustainable development and the environmental policies of developing countries.[171]

Furthermore, the extractive industry plays a critical role in the ability of many resource-rich developing countries to achieve sustainable development compared to resource rich developed countries. For example, in the 2011/2012 fiscal year, the total contribution of the oil and gas sector to the UK's economy was about two per cent.[172] This was despite the fact that in the same year, the UK was one of the largest producers of oil and gas in the EU.[173] That same fiscal year, the oil industry in Nigeria accounted for 95 per cent of all exports and almost 80 per cent of all government revenue.[174] Thomas Wälde is therefore

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[168] See section 5.2.1.

[169] 'Founex Report' (n 6) paras 1.2 – 1.6.

[170] Ibid.

[171] See, as example, *Brundtland Report* (n 16); *Johannesburg Plan*, (n 36) paras 7 - 13; Ministry of Environment, Peru, *National Environmental Policy* (2010) 7 <http://www.theredddesk.org/sites/default/files/national_environmental_policy_peru_0.pdf> accessed 17 April 2013; United Republic of Tanzania, *National Environmental Policy* (1997) 1 – 2 <http://www.tzonline.org/pdf/nationalenvironmentalpolicy.pdf> accessed 17 April 2013.

[172] The industry contributed £11.2 billion out of a total government revenue of around 600billion. See, Oil and Gas UK, *Economic Report 2012* (O&GUK 2012) 6 <http://www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC030.pdf> accessed 17 April 2013; HM Treasury, *Budget 2011* (HMSO 2011) <http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf > accessed 17 April 2013.

[173] In 2011, the UK ranked 19th in global oil and gas production, 3rd in gas production in Europe and 2nd in oil production in Europe. See: Oil and Gas UK, 'Knowledge Center: Economics, Energy Policy and Gas' <http://www.oilandgasuk.co.uk/economics.cfm> accessed 13 May 2013.

[174] Nigeria EITI, 'Financial Audit: An Independent Report Assessing and Reconciling Financial Flows within Nigeria's Oil and Gas Industry – 2009 to 2011' (2011) Report for EITI, <http://eiti.org/files/NEITI-EITI-Core-Audit-Report-Oil-Gas-2009-2011-310113-New_4.pdf> accessed 17 April 2013.

surely correct when he concluded that the extent to which developing countries depend on their natural resource is 'to a degree not understood in developed countries.'[175]

It is therefore not surprising that as seen in the previous chapter, the social, political and economic systems in most resource-rich developing countries are determined, to a large extent, by the foreign exchange earnings and tax receipts from the extractive industries.[176] Indeed, several governments have been replaced largely because of their policies towards the extractive industries.[177] In some of these countries, the elections of new governments were partly influenced by specific campaign promises to review natural resources contracts including stabilisation clauses in order to obtain greater economic benefits for their countries.[178]

Based on the above, it could be possible to analyse the impact of stabilisation clauses in the UK (assuming the government grants such clauses) by focusing on their social and environmental impacts and still reach conclusions that reflect reality. However, it is difficult to see how such an approach can produce conclusions that are relevant to developing countries in view of the way in which receipts from their extractive industries affect their ability to promote sustainable development. The focus on the impacts of stabilisation clauses on environmental and social laws may therefore reflect a lack of practical and theoretical understanding of the situation in developing countries.[179] This is because such an approach takes the analysis out of the context of developing countries where stabilisation clauses are used.

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[175] Wälde, *Natural Resources* (n 157) 14.
[176] See section 4.3.
[177] See section 4.3.4.
[178] Such countries include Peru, Ghana, Zambia, Peru, and Bolivia.
[179] See also the argument by Thomas Wälde that 'enthusiastic academics and activists' from the West ignore the social, political, and institutional context of rules when analysing the relationship between natural resource and sustainable development in developing countries because of a lack of exposure to the situation in these countries. Wälde, *Natural Resources* (n 157) 25.

5.3.1.4 Western Influence

The focus on environmental and human rights laws in the literature on the impact of stabilisation clauses also reflects how sustainable development is sometimes treated in international law and politics. As Nico Schrijver correctly argues, over the years, developmental concerns have been given relatively less weight in international law and politics in the field of sustainable development.[180] Thus since the 1992 UNCED, international environmental law and human rights have received an impressive follow up while the international law of development has been neglected and subject to considerable challenges.[181]

In an unrelated study, Thomas Wälde makes some comments which help to explain the neglect mentioned by Schrijver above.[182] He argues that most of the debate, formulation and discussion of 'sustainable development' come from developed countries.[183] Where this is not the case, the debate is nevertheless heavily influenced and usually funded (directly or indirectly) by developed nations.[184] This, he argues, ensures that the debate is 'intellectually "owned"' by developed countries but spread through NGOs and their branches in the developing countries.'[185] For this reason, he argues, the voice of developing countries is rarely heard in substance.[186] The situation, he further notes, is made worse by the fact that the badly equipped state of developing countries' universities means that 'there is little, if any, possibility of think-tank work not dependent on Western funding, which almost always favours work in, with and for Western themes.'[187] This therefore makes it 'almost impossible' for an intellectual from a developing country to act independently from the

[180] Schrijver, *Development* (n 115) 243.
[181] Ibid. See similar arguments in Malcolm Gillis 'Some Neglected Aspect of Sustainable Development' in Sisay Asefa (eds), *The Economics of Sustainable Development* (WE Upjohn Institute for Employment Research 2005) 19 – 30.
[182] Wälde, *Natural Resources* (n 157) 21 -23.
[183] Ibid 22.
[184] Ibid.
[185] Ibid.
[186] Ibid.
[187] Ibid.

direct or indirect influence and expectations that come with such funding, especially as these expectations are 'clothed in a morally appealing philanthropic and friendly language.'[188]

The above views separately expressed by Wälde and Schrijver may be used to explain the focus on human rights and environmental protection in the literature on the impact of stabilisation clauses. The findings in this thesis, and a review of the literature, show that concerns have always been raised by commentators writing from a developing countries' perspective about the potential economic and development implication of stabilisation clauses. However, these concerns, and how they might affect sustainable development have not attracted any significant international attention.

An example of this is Yinka Omoregbe, who in 1996 raised concerns about the economic implication of stabilisation clauses in the Nigerian LNG (Fiscal Incentives Guarantees and Assurances) (Amendment) Act 1993.[189] She argued that the clauses have the potential to prevent the government's revenue expectations from the project from being met.[190] Also, during the parliamentary processes that led to the enactment of Ghana's Minerals and Mining Act 2006, several local activists and civil society objected to the inclusion of stabilisation clauses in the Act.[191] They argued that stability agreements should not be included in the Act, because 'economic situations can change for better or worse.'[192] However because these concerns were mainly economic in nature, they were not seen as a sustainable development issue. Neither did they attract significant international attention. In

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[188] Ibid.

[189] Yinka Omoregbe, 'Law and Investor Protection in the Nigerian Natural Gas Industry' (1996) 14 JENRL, 179, 189 – 190.

[190] Ibid.

[191] See, for example, National Coalition for Mining, 'Ghana: Memorandum on the Minerals and Mining Bill 2005' (13 June 2005) <http://www.minesandcommunities.org/article.php?a=1803> accessed 18 April 2011.

[192] Ibid. See also similar concerns raised about stabilisation clauses in Sierra Leone: NACE, 'Sierra Leone at the Crossroads: Seizing the Chance to Benefit from Mining (2009) 15 and 35 <http://www.christianaid.org.uk/Images/sierra-leone-at-the-crossroads.pdf> accessed 17 April 2013; Campaign For Just Mining-Sierra Leone, 'London Mining Lease Agreement Undermines President Koroma's Agenda for Change.' (Press Release, 10 May 2010) <Http://Www.Kaicombeyfoundation.Org/Documents/Pressrelease_001.Pdf>accessed 17 April 2013; Lansana Fofana, 'SIeirra Leone: Activists Cry Foul over Mining Policy' (*Inter Press Service*, 26 August 2008) <http://www.ipsnews.net/2008/08/sierra-leone-activists-cry-foul-over-mining-policy/> accessed 17 April 2013.

fact, such concerns are often dismissed by Western investment lawyers and press as a mere expression of resource nationalism sentiments.[193] Where host governments listen to these concerns and take steps towards it, their actions are also judged by the Western press as 'a sign of perfidious host-country behaviour.'[194]

Stabilisation clauses only generated massive interest and attention when Amnesty International highlighted their potential impact upon human rights (used as a surrogate for social and environmental laws) impact.[195] Since then, the flurry of commentaries and studies on the impact of stabilisation clauses, which has been mainly undertaken or sponsored by NGOs, academics or institutions from or based in the West, have taken the same approach. The focus has thus been in line with the sustainable development priorities of developed countries, rather than addressing the real concerns in developing countries where the clauses are used. It therefore comes as no surprise that despite the massive literature on the impact of stabilisation clauses on human rights and environmental laws, Sheppard and Crockett could still reach the following conclusions in 2012 that brings into question the practical relevance of such studies:

> To date, there appears to be no evidence to support the argument that stabilisation clauses have a chilling effect on the improvement of human rights or environmental standards. In particular, the authors of this chapter are not aware of

[193] See, as examples, AFM Maniruzzaman, 'The Issue of Resource Nationalism: Risk Engineering and Dispute Management in The Oil and Gas Industry' (2009) 5 *Texas J of OGEL* 79, 82 - 83; The Economist 'Resource Nationalism in Africa: Wish You Were Mine' *The Economist* (London, 11 February 2012) <http://www.economist.com/node/21547285> accessed 27 September 2012.

[194] Jeffrey D Sachs, 'Addressing Political Risk In the Energy Sector' in EIU and Columbia Program on International Investment (eds) *World Investment Prospects to 2011*: *Foreign Direct Investment And The Challenge of Political Risk* (EIU 2007) 81 <http://graphics.eiu.com/upload/WIP_2007_WEB.pdf> accessed 17 Aril 2013. See also section 4.3.4.

[195] Amnesty International, *Human Rights on the Line: The Baku-Tbilisi-Ceyhan pipeline project* (AI 2003).

any reported case law, arbitral award, or even anecdotal evidence that demonstrates that stabilization clauses have had this chilling effect in practice.[196]

Winfred Beckerman is therefore surely correct when he argued that unless the environmental aspects of a sustainable development problem in a developing country are highlighted, such problems are unlikely to attract international attention and interest.[197]

5.3.1.5 Flawed Interpretation of the Concept of Sustainable Development

As explained earlier, the focus on social and environmental laws remains true even when the specific literature claims to be focused on the impact of stabilisation clauses on sustainable development.[198] For example, Sheppard and Crockett concluded that stabilisation clauses are not a threat to sustainable development because they did not operate as a constraint to 'bonafide law reform in relation to environmental or social matters.'[199] This way of viewing the impact of stabilisation clauses reflects the arguments seen in the few commentaries purporting to analyse the impact of stabilisation clauses on sustainable development.[200] It thus explains that the focus on social and environmental laws is due, in part, to a flawed understanding or interpretation of sustainable development.

First, such an approach ignores the principle of integration which as noted previously has been variously described as the 'central', 'foundational', 'bedrock and 'most essential' principle of sustainable development.[201] Indeed, the historical evolution of sustainable development shows that the concept was proposed because humanity faced an 'interlocking

[196] Sheppard and Crockett (n 139) 339-340.
[197] Wilfred Beckerman, 'Sustainable Development and Our Obligations to Future Generations' in Andrea Dobson (eds) *Fairness and Futurity: Essays on Environmental Sustainability and Social Justice* (OUP 1999) 88 citing how the international community only became interested in the sustainable development challenges being faced by the Ogoni tribe in Niger Delta, Nigeria when the environmental aspect of the problems were highlighted.
[198] See section 5.3.
[199] Sheppard and Crockett (n 139) 335.
[200] See: Cotula, *Regulatory* (n 141) 1.
[201] See section 5.2.3.

crisis.'[202] Yet the policies enacted, and institutions established, to deal with the crisis have been fragmented, leading to development that is unsustainable because environmental, social and economic goals are treated solely as distinct and separate goals.[203] It is therefore submitted that an analysis of the impact of stabilisation clauses on sustainable development, which ignores its impact on economic growth and how this might affect the other two pillars, negates the basic premise of sustainable development.

Second, a review of the literature also suggests that the focus on social and environmental laws may be due to an interpretation of sustainable development that treats the concept as being interchangeable with environmental protection. This flawed understanding of sustainable development, it must be said, is not limited to the analyses of the impacts of stabilisation clauses. Rather, it reflects the way some public international environmental lawyers tend to interpret sustainable development.[204] In other words, for such lawyers, sustainable development is viewed as a synonym for environmental protection.[205]

However, some other public international lawyers have challenged this approach, and rightly so. For example, Maria-Claire Cordonier Segger argues that sustainable development was not proposed as a 'compromise term' to refer to a more environmentally friendly way of exploiting natural resources, nor as a 'softer' way to refer to environmental laws and policies in developing countries.[206] Indeed, although sustainable development law encompasses much of international environmental law, there are important differences. As Patricia Birnie, Alan Boyle and Catherine Redgwell argue:

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[202] *Brundtland Report* (n 16) 4.
[203] Ibid 4 - 10.
[204] See, for example, Marc Pallemaerts, 'Is Multilateralism the Future? Sustainable Development or Globalisation as a Comprehensive Vision of the Future of Humanity' (2003) 5 *Environment, Development and Sustainability* 275.
[205] Ibid. see also Rajamani (n 10) 61.
[206] Segger (n 109) 97 – 98.

> International environmental law encompasses both much and less of sustainable development. There is major overlap in rules, principles, techniques and institutions, but the goals are by no means identical. Most obviously, sustainable development is as much about economic development as about environmental protection; while these two goals are integrated, they remain distinct. [207]

The discussion of the evolution of sustainable development in international law supports the view that sustainable development is as much about economic development as it is about environmental protection and social growth.[208] As a result, sustainable development may be impeded not only when the exploitation of natural resources is environmentally inefficient but also when it is commercially inefficient.[209] This means that any constraints on the ability of the government to maximise the commercial efficiency of its extractive industry also affects sustainable development. As such, an analysis of the impact of stabilisation clauses that ignores this aspect but claims to be focused on 'sustainable development' is unsustainable.

The final flaw with analysing the impacts of stabilisation clauses on sustainable development solely in relation to their social and environmental impacts is that this assumes that sustainable development is a fixed state of harmony. In other words, it assumes that progress has been made within the economic pillar by using stabilisation clauses to attract FDI. As such what is required is to subsequently enact and implement social and environmental laws in order to maintain the harmony. This view of sustainable development is flawed because the 'sustainable development' proposed in the *Brundtland Report*, discussed at global conferences and used in several legal texts, is 'not a fixed state of

[207] (n 69). See also Kamal Hossain, 'The Rio Conference and Post-Rio - The New International Economic Order' in Najib Al-Nauimi and Richard Meese (eds), *International legal issues arising under the United Nations Decade of international law : Qatar international Law conference : Papers* (Martinus Nijhoff 1995).
[208] See section 5.2.1.
[209] Wälde, *Natural Resources* (n 157) 32.

harmony.'[210] Rather, it is 'a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development, and institutional change are made consistent with future as well as present needs.'[211] It is for this reason that Agenda 21 is a 'dynamic programme' evolving 'over time in the light of changing needs and circumstances.'[212]

Thus to achieve sustainable development, governments must adopt and implement laws and policies that facilitate sustainable development, and 'regularly assess and modify them' when appropriate to improve their effectiveness.[213] It thus means that all laws, including fiscal and economic laws must be able to adapt to change if they are to remain effective in promoting sustainable development.

Accordingly, if stabilisation clauses impose constraints on the ability of host states to regularly assess and modify their fiscal or economic laws, sustainable development is impeded. However, this impact may not be revealed where the analysis simply focuses on the ability of a government to enact social and environmental laws. This is particularly the case for developing countries where the link between economic growth, social development and environmental protection operate most directly.[214]

Before concluding this discussion, it is important to emphasise that it is not suggested here that the literature dealing with stabilisation clauses and human rights and/or environmental protection serve no useful purpose. Such studies, and in particular the study by Andrea Shemberg, have helped to highlight how stabilisation clauses are drafted, and how this may constrain the ability of host states to protect human rights and the environment.[215] However, it is argued that this is as far as such studies may go.

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[210] *Brundtland Report* (n 16) 6.
[211] Ibid.
[212] (n 23) para 1.6.
[213] Ibid para 8.13.
[214] *Brundtland Report* (n 16) 32; *Founex Report* (n 6) paras 1.2 – 1.4., 51.
[215] Shemberg (n 137).

Based on the discussion so far in this chapter, it is submitted that studying the impacts of stabilisation clauses solely in terms of their impacts on human rights seems to be an overly simplistic, emotional response to a more complicated issue. For such analyses to have any semblance to reality, they must go further to give careful consideration to the often complex interactions between all three pillars of sustainable development and how stabilisation clauses affect their integration. This is particularly so because, as the following analysis will show, fiscal and economic policies are critical to the ability of developing countries to promote sustainable development.

5.3.2 Economic and Fiscal Policies and Sustainable Development

First, the point needs to be made that it may be possible to identify certain measures taken to implement sustainable development according to the constituent pillar at which they are aimed. However, more often such measures do not fit into strict categorisation. This is because the purpose and effect of such laws may significantly impact on more than one of the pillars of sustainable development.[216] In addition, several countries have enacted, or are in the process of enacting, laws specifically aimed at sustainable development.[217] These laws cannot be appropriately labelled as 'environmental', 'social' or 'economic laws'. They are simply 'sustainable development' laws, even where they are not explicitly so named.[218]

Whatever the title given to laws enacted to implement sustainable development and the specific pillar(s) at which that they may be aimed, their effective implementation largely depends on the ability of the governments in question to fund the measures prescribed in their laws. For example, the Manitoba Sustainable Development Act 1997 imposed a duty on the provincial government to provide grants to support 'innovative projects, activities,

[216] Indeed, it is typical for modern laws in the extractive industries to combine far reaching provisions dealing with environmental protection, economic development and social progress in the same law.
[217] See, as examples, Sustainable Development Act of Manitoba 1997; Federal Sustainable Development Act of Canada 2008; Future Generations (Wales) Bill (previously the Sustainable Development Bill).
[218]For example, the main function of the Niger Delta Development Commission is to 'conceive, plan and implement…projects and programmes for the sustainable development of the Niger-Delta'. See Niger Delta Development Commission Act 2000, s7.1(b)

research and developments that further the sustainability of Manitoba's economy, environment, human health and social well-being and support environmentally sustainable economic growth.'[219] The grants were to be given from a 'Sustainable Development Innovations Fund' established for that purpose, which consisted of 'amounts appropriated to it.'[220] The effectiveness of this Fund, and the measures that it was expected to finance, thus depended on the amount of revenue available to the province. This in turn depended on the effectiveness of their fiscal and economic policies in generating revenue.

The importance of effective fiscal policies in promoting sustainable development is even more critical for developing countries as they are more constrained by financial resources in their pursuit of sustainable development. It is for this reason that Agenda 21 called for a 'substantial flow of new and additional financial resources to developing countries, in order to cover the incremental costs for the actions they have to undertake' to implement sustainable development.[221] However, as will be discussed in detail later, sustainable development is better advanced when the means to finance the measures taken to implement it come, as much as possible, from domestic resources.[222]

The principal sources of domestic finance are private savings and government revenue derived mainly from taxation.[223] Thus the tax policy, which forms part of the government's fiscal policies, is of crucial importance to the promotion of sustainable development in these countries.[224] This is particularly so as weak tax structures in many developing countries have ensured that, despite being poorer and in need of more funds,

[219] Section 17 (2) (a).
[220] Section 17 (1).
[221] (n 23) para 1.4. See also UNGA, *The Future* (n 44) para 253.
[222] See section 6.2.2.
[223] UNCTAD, *Economic Development in Africa: Reclaiming Policy Space Domestic Resource Mobilization and Developmental States* (UNCTAD 2007).
[224] Ibid 1. See also Bárbara Castelletti, 'Taxes in Latin America: Do Wealth and Inequality Matter? (2008) OECD Policy Insights No 79, 1 <http://www.oecd.org/dev/41561596.pdf>accessed 19 April 2013.

developing countries' tax revenues remain, on average, lower than those of developed countries.[225]

Given the importance of fiscal policies including, tax policies in the ability of developing countries to achieve sustainable development, the fact that these issues are not getting the attention they deserve in international legal discourse has been described as 'strange' and 'surprising'.[226] This argument can be extended into the context of this thesis to argue that given the importance of fiscal laws in promoting sustainable development, it is strange and surprising that studies into the impact of stabilisation clauses have focused almost entirely on social and environmental laws. This surprise, however, diminishes when viewed against the arguments made in the last section.[227] The neglect of fiscal policies and other development issues is therefore not because these issues are not important. Rather, it is because the debate and discussion have been heavily framed and/or influenced by the West.

Before concluding on this point, it is important to mention that in recent years, increasing attention is being given to the link between taxation and sustainable development. The interaction between fiscal policies, including tax laws, poverty eradication and human rights protection has been receiving more attention. Consistent with the argument made in previous sections, the increased attention has been brought about by a shift in the rhetoric in the West. This debate is again largely influenced by human rights and environmental groups who are increasingly beginning to see the link between fiscal and other non–environmental/human rights policies and the realisation of human rights.[228]

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[225] OECD, *Revenue Statistics for Latin America 2012* (OECD 2012); Centre for Research on Multinational Corporations (CMRC), *Taxation and Financing for Development* (SOMO 2008) 1.
[226] CMRC (n 225) 1.
[227] See section 5.3.1.
[228] See, as examples, Tax Justice Network Africa, 'Taxation and Human Rights (2011) 2 *Africa Tax Spotlight*, 1 <http://www.taxjustice.net/cms/upload/pdf/Africa_Tax_Spotlight_6th_edition.pdf> accessed 19 April 2013; Tax Justice Network Germany 'Taxes and Human rights (2013) Policy brief <http://eurodad.org/wp-content/uploads/2013/02/infosteuergerechtigkeit008e.pdf> accessed 19 April 2013; Business and Human Rights Resource Center, 'Tax Avoidance: An Introduction' <http://www.business-humanrights.org/Documents/Taxavoidance> accessed 19 April 2013.

For example, in a 2010 event jointly organised by the Business and Human Rights Resource Centre and Global Witness, significant attention was given to the effect on human rights of issues such as corruption and lack of transparency, inequitable concession contracts, and tax avoidance/evasion.[229] According to the co-hosts, these issues were identified as 'deserving greater attention by governments, companies and civil society when it comes to policy and law-making.'[230] This, they argued, was because these issues have been 'at best peripheral to the human rights and business' debate thus far.[231]

The reason for this shift is simple. The recent (and on-going) economic crisis in many developed countries has brought about a realisation that protecting the environment and human rights depends to a significant extent on economic policies.[232] Economic policies taken to implement austerity measures have reduced capital allocation for the full realisation of some human rights, especially economic, social and cultural rights.[233] As governments' priorities stay focused on economic recovery, certain expenditure is now regarded as a burden that can no longer be afforded. Indeed many governments of developed countries are currently reforming their welfare systems and cutting public spending despite concerns that these measures impede the realisation of certain human rights.

For example, human rights concerns have been raised over the so-called 'bedroom tax' being implemented in the UK whereby housing benefit payments have been reduced for

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[229] Office of the High Commissioner for Human Rights (OHCHR), 'Summary Of Proceedings Of Side Events To The Consultation Of The Office Of The High Commissioner For Human Rights On Operationalizing The Framework For Business And Human Rights', 16 April 2010, A/HRC/14/29/Add.1 <http://www2.ohchr.org/english/issues/globalization/business/docs/A.HRC.14.29.Add.1_ch.pdf> accessed 19 April 2013.
[230] Ibid para 14.
[231] Ibid.
[232] OHCHR, 'Fiscal and Tax Policies 2014' <http://www.ohchr.org/EN/Issues/Poverty/Pages/Fiscalandtaxpolicy2014.aspx>accessed 17 September 2013.
[233] See, Ariranga G Pillay (Chairperson, Committee on Economic, Social and Cultural Rights), 'Reference: CESCR/48th/SP/MAB/SW' (16 May 2012) <http://www2.ohchr.org/english/bodies/cescr/docs/LetterCESCRtoSP16.05.12.pdf> accessed 17 September 2013. See also OHCHR, 'Impact of Austerity Measures on the Enjoyment of Human Rights' <http://www.ohchr.org/EN/Issues/Poverty/Pages/ImpactofausteritymeasuresontheenjoymentHR.aspx>accessed 17 September 2013.

social tenants deemed by the government to have more bedrooms than they need.[234] However, the government has consistently rejected these concerns largely on the ground that the 'bedroom tax' is required to save £500m a year as part of the government's austerity measures.[235]

It is for such reasons that the role of fiscal and tax policies in replenishing this diminished capital stream for promoting sustainable development, including the protection of human rights and the environment, has taken on added significance in the UK and other developed countries. It has therefore been given 'greater exposure' by human rights and environmental groups.[236] As a result, tax evasion and tax avoidance issues have been brought to the fore by several governments in developed countries, including the British Prime Minister who pledged to use the G8 'to drive a more serious debate on tax evasion and tax avoidance' because it is an issue 'whose time has come.'[237]

5.4 CONCLUSIONS

There will always be those who argue over the exact meaning and legal status of sustainable development. However, the basic premise and core elements of the concept are now largely established. The historical evolution of the concept shows that its goal is to reconcile economic, social and environment policies to improve the quality of life of present generations without placing undue constraints on the ability of future generations to do the same. Furthermore, the usage of 'sustainable development' in international legal texts and jurisprudence confirms that it is now a fully established objective of the international

[234] See, for example, Amelia Gentleman ''Shocking' Bedroom Tax Should Be Axed, Says UN Investigator' *The Guardian* (London, 11 September 2013) <http://www.theguardian.com/society/2013/sep/11/bedroom-tax-should-be-axed-says-un-investigator> accessed 11 September 2013.

[235] BBC, 'Grant Shapps: UN "Bedroom Tax" Report is a Disgrace' (11 September 2013 <http://www.bbc.co.uk/news/uk-politics-24044597> accessed 11 September 2013.

[236] OHCHR, *Summary* (n 229) para 17.

[237] 'Prime Minister David Cameron, 'Speech to the World Economic Forum in Davos' (24 January 2013) <http://www.number10.gov.uk/news/prime-minister-david-camerons-speech-to-the-world-economic-forum-in-davos/> accessed 19 April 2013.

community and states are therefore expected to conduct their affairs in line with this objective.

Despite the widespread acceptance and usage of sustainable development, little is known about the way in which it may be affected by stabilisation clauses. This is because while much has been written on the potential impact of the clause, the focus has been on social and environmental laws. The second part of this chapter sought to explain the possible reasons for this focus and in the process argued that the focus is misplaced. Indeed, for developing countries, fiscal and economic policy reforms are as important, if not more important, to sustainable development, than simply enacting more environmental and social laws. This is because achieving sustainable development depends to a significant extent on the ability of governments to alter their fiscal and economic policies to ensure that the maximum available resources are provided to fund their sustainable development measures. As the following chapter will argue, stabilisation clauses impose a constraint on the ability of host states to do this.

CHAPTER 6 – THE IMPACT OF STABILISATION CLAUSES ON SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES

6.1 INTRODUCTION

The last chapter argued that if an analysis of the impact of stabilisation clauses is to have any semblance to reality, it must give careful consideration of the complex interactions between the pillars of sustainable development. It must also be undertaken with a particular eye on the sustainable development challenges in developing countries as this is where the clauses are used. This is what this chapter seeks to do.

In practice, the exact way in which stabilisation clauses affect sustainable development may vary from country to country. This thesis therefore takes a three-pronged approach to discussing these effects. First, the chapter will examine the straightforward link between fiscal/economic policies and the enactment and implementation of environmental and social laws, including human rights laws. The aim is to show that the constraints imposed by stabilisation clauses on fiscal and economic policies directly affect the other pillars of sustainable development. Second, four ways in which stabilisation clauses can affect sustainable development in any resource-rich developing country are discussed. Finally, two case studies will be presented to help illustrate how stabilisation clauses affect sustainable development in practice.

6.2 THE REDUCTION OF POLICY SPACE ON SOCIAL AND ENVIRONMENTAL LAWS.

As explained earlier, sustainable development is promoted when social, economic and environmental goals are integrated in development decision-making. As such, if a policy aimed at promoting sustainable development is to be effective, it must give careful consideration to the interactions between these three pillars. As stated by Agenda 21, such policies should be regularly assessed and modified in the light of changing needs and

circumstances to improve their effectiveness.[1] The need for such adaptive policies is particularly acute as global sustainable development challenges are becoming increasingly complex, dynamic and uncertain.[2]

In many developing countries, there is already significant evidence of how foreign investors exploit weak regulatory frameworks to commit human rights abuses and damage the environment.[3] At the same time, there is also significant evidence that foreign investors exploit weak tax structures to evade or avoid paying taxes.[4] This is in addition to the fact that many of these contracts, which have been signed with corrupt and/or dictatorial regimes, already provide over-generous terms to investors thereby reducing the revenue accruing to the countries.[5] As such, if the extractive industry in resource-rich developing countries is to contribute to their sustainable development, their legal and regulatory regimes will need to be regularly assessed and modified in the light of changing needs and circumstances, not only to protect the environment and human rights but also to promote economic development. Stabilisation clauses, however, impose a significant constraint on the ability of developing countries to do this.

The main way in which stabilisation clauses affect sustainable development is that they reduce the policy space needed to alter fiscal and economic policies to mobilise the maximum of available resources to finance sustainable development measures. By exempting investors from new laws or ensuring that they are compensated for complying with such laws, stabilisation clauses reduce the space within which developing countries can

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[1] UNCED, *Agenda 21: A Programme for Action for Sustainable Development*, 14 June 1992, UN Doc A/CONF.151/26 Annex II, para 1.6 and 8.13.
[2] See generally Darren Swanson and Suruchi Bhadwal (eds), *Creating Adaptive Policies: A Guide For Policy-Making in an Uncertain World* (Sage 2009).
[3] See, for example, Amnesty International, *Nigeria: Petroleum, Pollution and Poverty in the Niger Delta,* (AI, 2009).
[4] See, for example, Open Society Institute of Southern Africa and ors (OSISA), *Breaking the Curse: How Transparent Taxation and Fair Taxes can Turn Africa's Mineral Wealth into Development* (OSISA 2009).
[5] See section 4.3.

subsequently alter their fiscal and economy policies to make them more effective in the light of changing needs and circumstances.

For example, a 2010 report on Madagascar conducted for the World Bank found that the government's revenue from its mining regime was relatively low by international standards.[6] The reason for this, the report notes, was that the 'rigid' stabilisation clauses in the mining agreements 'demonstrate no room for adjustments for an extended period of time.'[7] As a result, while the government's expenditure and public expectations will rise in the years ahead, the government's revenues will remain limited.[8] This example broadly reflects the way in which stabilisation clauses affect the ability of several developing countries to alter their fiscal regime to raise revenue to fund their sustainable development objectives.

Thus, the effect of the focus in the literature on the impact of stabilisation clauses on social and environmental laws is that it creates a distinction between the ability of host countries to enact and implement such laws and their ability to alter the fiscal regime applicable to an investment. As far as the effective implementation of sustainable development is concerned, such a distinction hardly exists in practice. As the following sections will show, any limitation placed by stabilisation clauses on host states' ability to enact and implement fiscal and economic laws affects, not only economic progress, but also environmental protection and social growth.

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[6] World Bank, 'Madagascar: Governance and Development Effectiveness Review A Political Economy Analysis of Governance in Madagascar' (2010) Report No 54277, 46 - 49 <http://siteresources.worldbank.org/INTMADAGASCARINFRENCH/Resources/ESW_Gouvernance.pdf>accessed 18 April 2013.

[7] Ibid 48.

[8] Ibid. See also similar finding in another World Bank report on Zambia. World Bank, 'What would it take for Zambia's Copper Mining Industry to Achieve its Potential' (2011) Report No 62378-ZM, iii - iv <https://openknowledge.worldbank.org/bitstream/handle/10986/2772/623780ESW0Gray0e0only0900BOX361532B.pdf?sequence=1> accessed 18 April 2012.

6.2.1 Fiscal/Economic Policies and Environmental Protection.

Laws and regulations are important in protecting the environment. Indeed, at the national level, the use of 'command and control' regulation, which involves the setting of standards to protect the environment, have made substantial gains.[9] However they have been variously criticised for being rigid,[10] complex,[11] and for discouraging market innovation as firms have no incentive to protect the environment beyond the standards set.[12]

More importantly, 'command and control' regulation has also been criticised as being inefficient, ineffective and incapable of addressing some of the major current environmental challenges such as climate change, loss of biodiversity, deforestation and unsustainable consumption of natural resources.[13] The reason for this is that these problems are extremely complex and tackling them has enormous economic and social implications.[14]

For example, addressing reliance on carbon dioxide, one of the major contributors to climate change, will have implications for a range of industrial, agricultural, transport and consumption activities. Consequently, there are doubts about the effectiveness of command and control environmental regulation in bringing about meaningful change across such an expanse of daily life.[15] Thus to be effective, environmental laws and regulations dealing with these issues will need to be complemented by fiscal and economic policies. This point was aptly made in Agenda 21:

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[9] For a detailed discussion of this point, see, Carolyn Abbot, 'Environmental Command Regulation' in Benjamin J Richardson and Stepan Wood (eds), *Environmental Law for Sustainability: A Reader* (Hart 2006) 61 – 96.

[10] Ibid. For standards to be effective, they need to be revised frequently in line with further scientific evidence on the emission they seek to control. In practice, the legislative process might not be able to keep up with such changes.

[11] This includes both causal complexity and complexity of the interactions between actors in society. A useful summary of the complexities is found in Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self–Regulation in a 'Post-Regulatory' World' (2001) 54 *Current Legal Problems* 103, 106.

[12] Jane Holder and Maria Lee, *Environmental Protection, Law and Policy: Text and Materials* (2nd ed, CUP 2007) 419 – 421; Eric W Orts 'Reflexive Environmental Law' (1995) 89 Northwestern University Law Review 1227, 1229 – 1231.

[13] Ibid.

[14] Ibid.

[15] Ibid.

> Environmental law and regulation are important but cannot alone be expected to deal with the problems of environment and development. Prices, markets and governmental fiscal and economic policies also play a complementary role in shaping attitudes and behaviour towards the environment.[16]

It is for this reason that the use of 'economic' or 'market-based' instruments have for long been advocated in the academic literature, by international organisations and at global conferences on sustainable development.[17]

An economic instrument encompasses any policy instrument designed to use prices or economic incentives to influence behaviour in a way that achieves environmental objectives. They may be classified in a number of ways. However, the instruments usually identified are taxes/charges/levies, tradeable quotas, subsidies, deposit-refund schemes and performance bonds.[18]

The case for the use of economic instruments in dealing with environmental and sustainable development challenges is already well established in the literature.[19] Taxes or levies put a price on either emissions from, or inputs into, a process.[20] They therefore help to internalise the external cost of goods and services.[21] Economic instruments are also useful in implementing the 'polluter pays principle', which is a key principle of sustainable development.[22] This is because through taxes or levies, whoever is responsible for damage to

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[16] *Agenda 21* (n 1) para 8.27.

[17] See, as examples, Bruce A Ackerman and Richard B Stewart, 'Reforming Environmental Law: The Democratic Case for Market Incentives' (1988) 13 *Columbia JEL* 171; OECD, *Economic Instruments for Environmental Regulation* (OECD 1989); UNCED, *Rio Declaration on Environment and Development*, 14 June 1992, UN Doc A/CONF.151/26) Annex II (hereafter *'Rio Declaration*') Principle 16.

[18] OECD *Economic* (n 17) 14.

[19] See, as examples, Ackerman and Stewart (n 17); David Driese,n 'Economic Instruments and Sustainable Development' in Benjamin J Richardson and Stepan Wood (eds), *Environmental Law for Sustainability: A Reader* (Hart 2006) 227 – 308.

[20] Ibid.

[21] Ibid.

[22] For a detailed discussion of this point, see: Clare Coffey and Jodi Newcombe, 'The Polluter Pays Principle and Fisheries: The Role of Taxes and Charges' (2007) <http://jncc.defra.gov.uk/pdf/thepollute2.pdf>accessed 17 September 2013.

the environment can be made to bear the cost associated with repairing the damage.[23] This financial burden on the polluter thus serves as an incentive for the polluter to use less harmful environmental practices, while the revenue generated can be used to fund environmental protection measures.[24]

It is therefore not surprising that economic instruments have been described as the 'hottest growth industry in environmental law.'[25] Their use is also projected to continue to increase in the future not only because of their effectiveness and efficiency but also because they engender a degree of political acceptability that cuts across party and ideological boundaries.[26] Thus whilst not without some critics, the use of economic instruments is a policy option that is available and encouraged for use in all countries, including developing countries, to protect the environment.[27]

The presence of stabilisation clauses may however reduce the policy space within which developing countries can utilise economic instruments to protect the environment. This is because economic or market based instruments are usually fiscal in nature, often imposed in the form of taxes or levies, and usually administered by the relevant government body saddled with the responsibility of managing taxes.[28] As such, even where a stabilisation clause does not mention environmental laws or explicitly exclude them, it could still affect environmental protection by limiting the ability of host states to use economic and other market-based instruments to protect the environment. This is because they may breach

[23] Ibid.
[24] For example, part of the revenue raised by the Aggregate levy introduced in 2002 in the UK was paid into a Sustainability Fund to promote alternatives to virgin aggregate and to reduce the environmental impact of aggregate extraction. See DEFRA, *Aggregates Levy Sustainability Fund in England: 2002 – 2007* (DEFRA 2006).
[25] Orts (n 14) 1241.
[26] Stuart Bell and Donald McGillivray, *Environmental Law* (7th edn) (OUP 2008) 243.
[27] For example, it has been argued that tax and reduction targets are not usually sufficiently high to offer a real incentive for the firms to reduce pollution. Neil Carter, *The Politics of the Environment: Ideas, Activism, Policy* (CUP 2007) 336.
[28] See, for example, the 'Carbon Tax' in the UK administered by HM Revenue and Custom. For a useful summary see, HM Revenue and Custom 'Carbon Price Floor' <http://www.hm-treasury.gov.uk/d/carbon_price_floor.pdf> accessed 06 May 2013.

stabilisation clauses if they impose fiscal measures to discourage environmentally harmful behaviour or to raise revenue to finance environmental protection measures.

Consequently, even where the host state has the ability to enact and implement environmental laws, the constraints imposed by stabilisation clauses reduce the policy options available to the host country to formulate appropriate environmental laws and policies, and effectively implement them. They may therefore continue to rely on a 'command and control' regulation even when it is ineffective and inefficient to do so. Furthermore, by imposing a constraint on the ability of a host state to alter their fiscal and economic policies, stabilisation clauses can weaken the ability of developing countries to generate revenue to finance measures aimed at promoting economic growth and eradicating poverty. This again has a direct effect on the environment, as those who are poor will often destroy their environment in order to survive.[29]

6.2.2 Fiscal/Economic Policies and Social Laws.

Similar to the arguments made with respect to environmental protection, the mere enactment of social laws cannot lead to the improvement of social standards, and in particular, the promotion of human rights. A lot depends on the enactment and implementation of progressive and equitable economic policies.[30] This is particularly the case for the actualisation of rights that go beyond traditional civil and political rights.[31] This is because the enjoyment and enforcement of civil and political rights depend, to a large extent, on the state of democracy in the country. As such, in most democratic countries, such

[29] World Commission on Environment and Development, *Our Common Future* (OUP 1987) (hereafter '*Brundtland Report'* 8.

[30] For a detailed case study that fully explores this point, see, Center for Economic and Social Rights (CESR), *Assessing Fiscal Policies from a Human Rights Perspective: Methodological Case Study on the Use of Available Resources to Realize Economic, Social and Cultural Rights in Guatemala* (CESR 2012).

[31] Civil and political rights or 'first generation' rights include the right to vote, right to assemble, right to fair trial, right to free speech, right to freedom from torture and right to protection of the law. At the international level, they are mainly codified in the first part of the *Universal Declaration on Human Rights* 10 December 1948, UN Doc Res/A/810 and the *International Covenant on Civil and Political Rights* (adopted 16 December 1966, entered into force 23 March 1976).

rights are already recognised and included as constitutional rights.[32] Such rights are therefore unlikely to be significantly threatened solely by stabilisation clauses.

On the other hand, the realisation of so-called 'second'[33] and 'third' generation rights[34] is closely linked to favourable fiscal and economic conditions. For example, for the right to education to be realised, governments must build schools and employ teachers. No amount of human rights law can build a classroom. Governments must therefore have access to the financial and technical resources to facilitate the realisation of these rights.

The straightforward link between economic policies and the realisation of human rights was recognised in the International Covenant on Economic, Social and Cultural Rights where parties agreed:

> to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.[35]

More recently, the interactions between economic/fiscal policies, poverty eradication and human rights were highlighted in the UN Guiding Principles on Extreme Poverty and Human Rights adopted by the UN Human Rights Council.[36] Article 3 notes: 'poverty is an

[32] See, for example, arts 33 to 44 of the Constitution of Nigeria 1999.
[33] 'Second generation' rights or economic, social and cultural rights include the right to education, right to housing, right to health, right to employment, right to adequate income. At the international level, they are mainly codified in the second part of the *Declaration on Human Rights* (n 31).
[34] Third generation rights or collective/solidarity rights include the right to economic development and right to a healthy environment. See African Charter on Human and Peoples' Rights (adopted 27 June 1981, entered into force 21 October 1986) arts 21 – 24. Note that there are debates about the categorisation of rights which is beyond the scope of this thesis. For a detailed discussion of the categorisation of rights and the debates, see Christian Tomuschat, *Human Rights: Between Idealism and Realism* (OUP 2003) 24 – 57.
[35] (16 December 1966, entered into force 03 January 1976) art 2
[36] (Adopted 27th September 2012).

urgent human rights concern in itself' and is 'both a cause and a consequence of human rights violations and an enabling condition for other violations.'[37] It then went on to draw the following link between fiscal and economic policies, and environmental protection and human rights:

> States must take deliberate, specific and targeted steps, individually and jointly, to create an international enabling environment conducive to poverty reduction, including in matters relating to bilateral and multilateral trade, investment, taxation, finance, environmental protection and development cooperation. This includes cooperating to mobilize the maximum of available resources for the universal fulfilment of human rights.[38]

The Tax Justice Network in Germany has also recently identified three ways in which fiscal policies can contribute to human rights.[39] First, they argue that fiscal policies help to raise the revenue required to finance the public goods and services required for the realisation of human rights.[40] Second, fiscal policies promote the realisation of human rights by contributing to the redistribution of income from the richer to the poorer strata of society.[41] Third, they can help reduce conduct that is detrimental to human rights by internalising the ecological and social costs of certain goods and services.[42]

In the light of this straightforward link between fiscal and economic policies and human rights, stabilisation clauses can also affect the ability of host states to protect human rights, even if human rights laws are excluded from their scope. Where, as is always the

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[37] Ibid.
[38] Ibid art 33.
[39] Tax Justice Network, Germany 'Taxes and Human rights (2013) Policy brief <http://eurodad.org/wp-content/uploads/2013/02/infosteuergerechtigkeit008e.pdf> accessed 19 April 2013.
[40] Ibid.
[41] Ibid.
[42] Ibid.

case, such clauses cover fiscal laws, the host state will be unable to mobilise the maximum of available resources to use to facilitate the realisation of human rights. Such a country may therefore be unwilling to enact any binding law recognising and giving legal effect to many social and economic rights, not because it lacks the power to do so but because it cannot afford it.

Based on the foregoing, it is submitted that if the evidence in developing countries counts for anything, it is not the constraints stabilisation clauses impose on the legislative competence of host states in the area of human rights and environmental laws that affect sustainable development. It is the constraints that they impose on host states' ability to enact and implement the fiscal policies or the fiscal aspects of the laws (including human rights and environmental laws) that underpin sustainable development. A discussion of four areas in which this constraint may affect sustainable development follows.

6.3 IN WHAT WAYS DO STABILISATION CLAUSES AFFECT SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES?

6.3.1 Stabilisation Clauses and Domestic Resource Mobilisation

The point has already been made that in many developing countries, the main challenge faced in achieving sustainable development is finance.[43] It is for this reason that richer developed countries pledged to offer financial support equivalent to 0.7 per cent of their Gross National Income (GNI) in international development aid to developing countries.[44]

There are however several problems with excessive reliance on aid to finance sustainable development. First, it is insufficient and unstable. The 0.7 per cent aid target is a moral, rather than a legal commitment. Richer developed countries are therefore not under

[43] See section 5.3.2.

[44] The 0.7 per cent target was first formally recognised in 1970 and has been repeatedly endorsed at several international conferences. See, UNGA, *International Development Strategy for the Second United Nations Decade*, 24 October 1970, UN Doc A/Res/25/2626, para 43; *Agenda* 21 (n 1) para 33.15.

any legal commitment to meet the target. Consequently, over 30 years after it was set, only five countries have met the target.[45] It is also volatile as it depends to some extent on the economic and political situation in the donor country. Thus, the recent financial and economic crisis in several developed countries has weakened the commitment of these countries to meet the 0.7 per cent aid target.[46] As a result, development aid to poor countries has been falling in the last few years.[47]

For example, in 2010, the UK government reaffirmed its commitment to meet the 0.7 per cent target and to 'enshrine this commitment into law.'[48] However, the government has yet to meet this commitment, while plans to enshrine it into law have been repeatedly postponed.[49] It is thus difficult to achieve sustainable development through such an insufficient and volatile source of funding. Indeed, a recent UN report had warned that the developing world is unlikely to meet the targets set in the Millennium Development Goals (MDGs) primarily because Western donors have reneged on their aid commitments.[50]

Second, a point emphasised in the earlier *Brundtland Report* is that international development aid has failed to facilitate sustainable development in developing countries not only because of its inadequacy but also because 'too often' such aid reflects the priorities of the donor, rather than the needs of the recipients.[51] Yet, almost three decades after the *Brundtland Report*, little has changed. International development aid is still often tied to conditions that may not necessarily reflect the sustainable development priorities of the

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[45] Only Denmark, Luxembourg, Sweden, Norway and the Netherlands have met the target. See Development Initiatives, 'Official Development Assistance: Guide' (February 2013) <http://www.devinit.org/wp-content/uploads/Guide-to-ODA.pdf> accessed 07 May 2013.

[46] OECD, 'Aid to Poor Countries Slips Further as Governments Tighten Budgets' <http://www.oecd.org/newsroom/aidtopoorcountriesslipsfurtherasgovernmentstightenbudgets.htm> accessed 07 May 2013.

[47] Ibid. Development aid fell by 4 per cent in real terms in 2012 after falling by 2 per cent in 2011.

[48] HM Government, 'The Coalition: Our Programme for Government' (2010) 22 <http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg_187876.pdf> accessed 08 May 2013.

[49] Roland Watson, 'Cameron Drops Pledge to Write Foreign Aid Increase into Law' *The Times* (London, 22 April 2013) < http://www.thetimes.co.uk/tto/news/politics/article3745370.ece> accessed 08 May 2013.

[50] UN, *The Global Partnership for Development: Making Rhetoric a Reality* (UN 2012).

[51] *Brundtland Report* (n 29) 4.

recipient country.[52] Rather, they remain 'heavily concentrated and dependent on the priorities (often geopolitical or strategic, including security considerations) of the donors.'[53]

It is conceded, as some have argued, that in some cases the donor countries impose these conditions because they are legitimately interested in ensuring that the aid money is put to efficient use, especially in countries with high rates of corruption.[54] In addition, the attached conditions may include the implementation of certain reforms that the donors see as being beneficial to the recipient country's sustainable development. However, even where the intentions of the donor countries are genuine, it may still produce an unsustainable outcome.

In the first place, as some commentators have noted, the focus on the priorities of the donors may push through reforms regardless of their viability in the light of country specific circumstances.[55] This may impede, rather than promote, sustainable development because the multiplicity of the challenges facing several developing countries requires policies tailored to the specific situation of each country, rather than a 'one-size-fits-all approach.'[56] It is for this reason that it was recommended that Agenda 21 should be implemented 'according to the different situations, capacities and priorities of countries.'[57] Thus, where a country's domestic policies would contribute to their sustainable development but may negatively affect the interests of donors, the country may be unable to effectively implement such a policy if doing so will breach the condition attached to the development aid.

Furthermore, as acknowledged by even the World Bank, the 'main problem' with attaching conditions to aid is that even where the reforms are beneficial to the recipient

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[52] UNCTAD, *Economic Development in Africa: Reclaiming Policy Space Domestic Resource Mobilization and Developmental States* (UNCTAD 2007)6.
[53] Ibid.
[54] World Bank, *Beyond Economic Growth: An Introduction to Sustainable Development* (2nd edn) (World Bank 2004) 100 – 101.
[55] UNCTAD, *Africa* (52) 4-5; Paul H. Brietzke 'The Politics of Legal Reform' (2004) 3 *Washington University Global Studies Law Review* 1, 19.
[56] Ibid.
[57] (n 1) para 1.6.

country, they may not feel that they 'own' the reforms.[58] As a result, they may proceed to implement the reforms in a 'formal, superficial and unsustainable' manner.[59] And as Paul Brietzke argues, this may end up 'poisoning the well' for more sensible reforms later.[60] In addition, it may mean that the government and policy-makers of developing countries will be more accountable to donors and their investors than they are to their citizens.[61]

There is thus a growing consensus that developing countries must look inwards and harness domestic resources to finance their sustainable development measures.[62] In other words, sustainable development requires that the means to finance public goods and services should come, as much as possible, from domestic resources especially tax revenues. This will increase the stability of the government's budget and aid planning towards sustainable development as tax revenue is much less volatile and more predictable than development aid.[63] In addition, it will reduce dependence on aid and foreign loans thereby freeing these countries, at least to some extent, from the conditions attached and their potential adverse effect on sustainable development. In other words, it gives developing countries a greater 'policy space' and flexibility within which to define their sustainable development goals in the light of their country specific priorities, rather than that of donors.[64] In short, it will mean that these countries can 'own' their sustainable development goals and processes.

However, a key challenge for many resource-rich developing countries in mobilising domestic resources is legal tax avoidance by multinationals in the extractive industry.[65] As discussed in chapter 4, the combination of pressure from the World Bank and corrupt and/or dictatorial leaders led to the granting of a vast array of tax incentives and exemptions to

[58] World Bank, *Beyond* (n 54) 100 – 101.
[59] Ibid.
[60] Brietzke (n 55) 22.
[61] AFDB, OECD and UNECA, *Africa Economic Outlook 2010: Public Resource Mobilisation and Aid* (AFDB and ors, 2010).
[62] See, for examples, UNCTAD, *Africa* (n 52) 1.
[63] Ibid.
[64] Ibid.
[65] AFDB, *Africa* (n61). See also the case study of Tanzania in section 6.4.2.

foreign investors by developing countries.[66] As many of these exemptions and incentives now unnecessarily deprive the affected countries of revenues, reforming the tax system is required to increase tax collection and mobilise domestic resources. In many of these countries, stabilisation clauses have been used by investors to undermine such reforms and therefore impede governments from mobilising the domestic resources required to free themselves from excessive reliance on international development aid. In some cases, foreign investors simply rely on the stabilisation clauses to continue to apply the previous fiscal regime, which, as far as the countries' laws are concerned, has ceased to become law. For example, mining investors with stability agreements in Ghana are still paying the old rate of three per cent in royalties rather than the five per cent introduced by the Minerals and Mining (Amendment) Act 2010.[67]

In other cases, the stabilisation clauses are used as a bargaining tool by the investors to extract concessions from the government, including the granting of stabilisation clauses for an extended period at the new rate. For example, in Zambia, investors with stabilisation clauses only agreed to apply part of the fiscal regime established by the 2008 Mines and Minerals Act after they used the threat of international arbitration to make the government reinstate for another 10 years stabilisation clauses that they had previously abolished.[68]

Whether investors refuse to comply with the law or agree to comply after extracting concessions from the government, the result is a reduction in the efficacy of the law. The use of stabilisation clauses has therefore created a situation where several poor developing countries are unable to mobilise the maximum available domestic resources to finance their sustainable development and are therefore forced to continue to rely on aid. Indeed, a study

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[66] See section 4.3.

[67] Article 794; Ghana EITI, 'Duffuor Inaugurates Team to Review Mining Stability Agreements' <http://www.geiti.gov.gh/site/index.php?option=com_content&view=article&id=145:duffuor-inaugurates-team-to-review-mining-stability-agreements&catid=1:latest-news&Itemid=29> accessed 13 May 2013.

[68] See 'Ministerial Statement on the Status of Mining Taxation' 6 <http://www.parliament.gov.zm/index.php?option=com_docman&task=doc_view&gid=770> accessed 02 October 2012.

by Martin Sturmer using Ghana, Zambia and Namibia as case studies, found that developing countries generate relatively low revenues from their extractive industries compared to Australia.[69] In particular, he found that if these countries were to fix their taxes in line with Australia's implicit tax rates, they would receive the equivalent of 35 per cent of Official Development Assistance (ODA) from 2003 to 2008.[70] Yet, as the findings from this study show, all three countries (particularly Zambia and Ghana) are being constrained by stabilisation clauses from making any alteration to the fiscal regime in their mining sectors.

Meanwhile, the richer developed countries are able to alter their fiscal regimes and raise more revenue from which they are able to give development aid to the poorer developing countries. For example, the UK was able to raise around £2billion in 2011 by increasing the supplementary charge on companies operating in the North Sea from 20 per cent to 30 per cent.[71] That same year, the UK gave ODA and humanitarian assistance worth around £78 million to Ghana.[72] Yet, that same year, Ghana was able to double its revenue from the mining sector to $500 million from $210million the previous year due to an increase in the royalty rate from 3 per cent to 5 per cent.[73] The increase in revenue is significant and is reflective of the impact even a marginal adjustment to fiscal policy and tax rate can make. However, it also gives an idea of the financial and revenue implications of the constraints that stabilisation clauses can impose on the ability of developing countries to mobilise domestic resources to finance sustainable development programmes. This is especially because some of the major mining companies have so far relied on stabilisation

[69] Martin Sturman, 'Let the Good Times Roll? Raising Tax Revenues from the Extractive Sector in Sub-Saharan Africa during the Commodity Price Boom (2010) German Development Institute Discussion Paper No 7/2010 <http://www.die-gdi.de/uploads/media/DP_7.2010.pdf> accessed 23 January 2014.
[70] Ibid 1.
[71] HM Treasury, *Budget 2011* (HMSO 2011) para 1.146 <http://cdn.hm-treasury.gov.uk/2011budget_complete.pdf> accessed 08 May 2013.
[72] DFID, *Annual Report and Accounts 2011–12* (DFID 2012) 205 – 207.
[73] EITI, 'Ghana's Revenues from Natural Resources Increase 400%' (08 March 2013) <http://eiti.org/news/ghana-eiti-reports-revenue-oil-and-gas-first-time> accessed 07 May 2013.

clauses to avoid paying the new rate of taxes and royalties. All the increases have thus largely come from companies without stabilisation clauses.

Before concluding this section, it is important to also observe that the difficulties that stabilisation clauses impose on domestic resource mobilisation are likely to be exacerbated during periods of economic or financial crisis. This is because during such periods, developing countries are often faced with unique economic crises, including balance of payments problems caused by acute foreign exchange shortages.[74] In such a period of 'development emergency', a developing country's ability to mitigate the effect of the crisis is largely tied to its ability to enact and implement urgent fiscal measures that may include temporary tax measures and capital restrictions.[75] Yet, as many developing countries noted during the last global recession that affected them, they will require 'greater policy flexibility' to be able to do so.[76] As stabilisation clauses reduce the policy space to undertake such fiscal measures, it is likely to hinder the ability of developing countries that grant the clause to take the measures required without acting in breach of the clause.

6.3.2 Stabilisation Clauses and 'Windfall Profit' Taxes

Another way in which stabilisation clauses affect sustainable development in developing countries is that they may be used to impose a constraint on their ability to benefit from unexpected but significant changes in the economic, or geological, fortune of a project. For example, the sustained rise in the prices of most non-renewable natural resources since 2003 was largely unforeseen.[77] As a result, the fiscal regime in many countries is such that a declining proportion of the increasing profit accrues to the

[74] See IBRD/World Bank, *Global Monitoring Report 2009: A Development Emergency,* (IBRD/World Bank 2009) 4 – 5, 45.
[75] Ibid 47 – 48; UNGA *Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development,* 09 July 2009, UN Doc A/RES/63/303 para 14 – 15.
[76] Ibid para 18.
[77] Center for Economics and Management, *Oil and Gas Exploration and Production: Reserves, Costs, Contracts* (Editions Technip 2007) 37 – 40.

government.[78] Even where these contracts do contain an internal mechanism that adjusts the benefits of the government and investors in line with changes in profitability, it may still be unable to fully benefit the host state where the balance of the original contracts is heavily tilted in favour of the investors.[79]

While the need to alter the fiscal regime for this purpose is important to both developed and developing countries, it is particularly so for developing countries. This is because most developed countries have relatively well-developed and sophisticated tax systems that may be able to accommodate their desire to capture some of the additional profits. However, this is not the case in developing countries. Furthermore, many of the contracts in developing countries containing stabilisation clauses have been negotiated and signed during the period of World Bank reforms when the prices of mineral resources were relatively low, in addition to the over generous incentives granted to investors.[80] As a result, most resource-rich countries (both developed and developing) have sought to review the fiscal regimes governing these contracts to enable them to also benefit fully from the additional or 'windfall' profits.[81]

The simplest method used by several countries to capture some of the additional benefits is the imposition of a 'windfall' tax otherwise called 'additional' or 'supplementary' tax'.[82] A windfall profit tax is a tax imposed only on additional profits based upon a pre-determined threshold.[83] The additional revenues generated could then be used to finance sustainable development measures. For example, in 2012, the Australian government introduced profit-based taxes on all new and existing oil, gas and mining companies in

[78] Thomas W Wälde, 'Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law' (2008) 1 JWELB 55.
[79] Ibid.
[80] See section 4.3.
[81] See generally, RA Dawe and A Russell, 'How to Capture the Windfall Profits from High Oil Prices: How Should Oil-rich Governments Share the Revenue with E & P Companies over the Production Period' (2014) 9 *Energy Sources: Part B, Economics, Planning and Policy* 17.
[82] Bryan Land, 'Capturing a Fair Share of Fiscal Benefits in the Extractive Industry' (2009)18 *Transnational Corporations* 156, 164.
[83] Ibid.

Australia.[84] The taxes formed part of a taxation system reform aimed at creating a tax structure that would 'position Australia to deal with its social, economic and environmental challenges and enhance economic, social and environmental wellbeing.'[85] Part of the additional revenue is to be used to fund a $3.6 billion 'Benefits of the Boom' package announced in the 2012-13 Budget.[86] The package includes lump sum allowances to struggling Australians, tax reliefs for Australian businesses and investments in 'critical productivity-enhancing infrastructure' especially in the regions where oil, gas and mining activities occur.[87]

Similarly, since 2002 the UK government has imposed and increased a 'supplementary charge' on all oil companies operating in the North Sea.[88] Part of the funds raised by the charge were used to fund several sustainable development initiatives, including the cancellation of a planned increase in fuel duty and an immediate cut in pump prices.[89] These measures ensured progress in the social and economic pillar of sustainable development. However, in taking this decision, environmental protection was integrated into the decision-making process.[90] This led to the conclusion that the increase in the charge will not increase activity in the oil and gas industry and therefore pose no 'sustainable development, wider environment and health' risk.[91]

The above examples reflect how relatively easy it is for developed countries to impose windfall profit taxes and use the additional revenue to fund sustainable development

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[84] See Mineral Resource Rent Tax (MRRT) 2012 and Petroleum Resource Rent Tax (PRRT) (as amended in 2012).

[85] Commonwealth of Australia, *Australia's Future Tax System: Report to the Treasurer* (Part One: Overview) (Commonwealth of Australia, 2010) v and Recommendations 45 – 48.

[86] Press Office of the Deputy Prime Minster and Treasurer 'Resource Tax Reforms Start Spreading Benefits of the Boom from Tomorrow' (Media Release No. 054 of 2012) <http://ministers.treasury.gov.au/wmsDisplayDocs.aspx?doc=pressreleases/2012/054.htm&pageID=003&min=wms&Year=2012&DocType=0> accessed 08 May 2013.

[87] Ibid.

[88] See more details in section 3.3.3. The latest increase was announced in the 2011 Budget. See, HM Treasury, *Budget 2011* (n 71) para 1.146.

[89] Ibid.

[90] HM Revenue and Custom 'Oil and Gas Taxation: Supplementary Charge' (23 March 2011) 3 <http://www.hmrc.gov.uk/budget2011/tiin6133.pdf > accessed 08 May 2013.

[91] Ibid.

measures. The laws imposing the taxes in Australia were passed in March 2012 and came into effect in July 2012. The UK's increase was announced in the 2011 Budget Speech and was effective immediately.[92] In both cases, the taxes were applied equally to new and existing projects, without exceptions, despite opposition and complaints from the industry.[93] This is because while investors were not happy with the changes, they could not, and did not, mount any legal challenge against the taxes in the absence of any contractual commitment by the host governments in the form of a stabilisation clause.

However, several developing countries analysed in this thesis have been largely unsuccessful in their attempts to enact and implement windfall profit taxes for similar reasons. This is because investors in these countries have been able to rely on stabilisation clauses to successfully challenge the enactment or implementation of similar profit-based taxes. In some cases, they have been able to rely on stabilisation clauses to delay the enactment of windfall profit tax laws. Where such laws have been enacted, they are also able to rely on the clauses to seek to be exempted from their applicability or to be compensated for complying with them. Faced with the threat of international arbitration and the possibility of being ordered to pay huge amounts in compensation for breach of stabilisation clauses, developing countries are left with four possible options.

The first option is to delay either the enactment or the implementation of the law despite the legitimate intentions behind it especially in terms of its contribution to sustainable development. For example, the government of Tanzania has so far been unable to impose a windfall profit tax because of significant opposition from the industry relying on

[92] Ibid.

[93] See, for example, Oil and Gas UK 'Budget 2011 Q&A' <http://www.oilandgasuk.co.uk/knowledgecentre/Budget2011QA.cfm> accessed 08 May 2013.

stabilisation clauses.[94] This is despite the clear advice from its Planning Commission to do so in order to mobilise revenue to finance its Five Year Development Plan.[95]

The second option taken by governments is to abolish such laws if they have already been enacted and in the process forego the projected revenue. This is especially the case where the vast majority of the investors for whom the laws have been made have been granted stabilisation clauses. In such a case applying the law to a few, and in most cases smaller investors, may not achieve the desired purpose. This is the option taken, for example, by Zambia. In 2008, the country introduced a windfall profit tax as part of the fiscal regime established by the new mining law.[96] In introducing the tax, the government was aware of the potential constraints the stabilisation clauses in existing Mineral Development Agreements (MDAs) imposed on their ability to enforce the law. This is clear from the parliamentary debates leading to the enactment of the law, where the country's parliamentarians noted that the stabilisation clauses placed the MDAs 'above the fiscal laws' of Zambia.[97] It was for this reason that the MDAs containing the stabilisation clauses were abolished.[98] However, following the threats of arbitration, the government had to abolish the windfall profit tax in 2009.[99]

The third alternative taken by developing countries is to apply the windfall profit tax on investors without stabilisation clauses while exempting those with stabilisation clauses. They may otherwise apply the law to all investors and compensate those with stabilisation clauses. This option again has the effect of reducing the effectiveness of the law by reducing

[94] See details in section 6.4.2.

[95] United Republic of Tanzania, *The Tanzania Five Year Development Plan: 2011/2012 – 2015/2016: Unleashing Tanzania's Latent Growth Potentials* (2011) 71 - 72 <http://www.tanzania.go.tz/pdf/FYDP-2012-02-02.pdf> accessed 08 May 2013.

[96] The windfall profit tax was introduced through an amendment to the income tax law which is incorporated by reference into the new mining law. See s 138, Mines and Minerals Development Act 2008 and ss 46, 64b and 10th Schedule of the Income Tax (Amendment) Act 2008.

[97] The Zambian Parliament 'Mines and Minerals (Amendment) Bill, 2007' (Debates of 23 March 2007)2 <http://www.parliament.gov.zm/index.php?option=com_content&task=view&id=522&Itemid=86&limit=1&limitstart=1> accessed 09 May 2013.

[98] Ibid. The MDAs were abolished by s 160 (1) Mines and Minerals Development Act 2008.

[99] The amendments were affected through ss 7, 9 and 16, Income Tax (Amendment) Act 2009. On the threat of arbitration leading to the amendment, see World Bank, *Zambia* (n 8) 19.

the projected revenue the government could have derived to fund their sustainable development objectives. This is especially the case if the majority of the investors, who would have been affected by the law, have been granted stabilisation clauses.

An example of a country that took this approach is Peru. Since 2006, windfall profit taxes have dominated the country's political space and presidential campaigns.[100] Successive governments expressed their intention to impose such a tax to raise revenue to fund infrastructure, tackle poverty and address economic distortions.[101] However, due to continuous opposition from investors with stabilisation clauses, the imposition of a windfall profit tax was delayed until 2011.[102] Similar opposition by investors relying on stabilisation clauses, have also made the current government adjust its campaign promise to introduce a windfall profit tax even though there was a 'political consensus' that it should be imposed.[103] In the end, in order to fulfil its election promise to impose windfall profit tax, while at the same time avoiding arbitration, the government had to exempt companies with stabilisation clauses from the bulk of the fiscal changes. They were exempted from paying royalties and windfall profit taxes. The changes only required them to pay a 'special contribution', subject to their agreeing to do so.[104] However, those without stabilisation clauses were made to pay increased royalties on their operating profits and a windfall profits tax on their net profits.[105]

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[100] For a background and how the previous efforts ended, see the following, Felipe Bedoya, 'Peru Negotiates Windfall Profit Tax' (*Revenue Watch*, 18 October 2011) <http://www.revenuewatch.org/news/blog/peru-negotiates-windfall-profit-tax> accessed 09 May 2013; Carlos Monge and ors, 'Peru discusses renewing voluntary mining company contributions as alternative to windfall profit tax.' (*Revenue Watch*, 15 July 2010) <http://www.revenuewatch.org/news/an%C3%A1lisis-quincenal-latin-america-update-july-15-2010> accessed 09 May 2013; World Gold Council, *The Economic Contribution of Large Scale Gold mining in Peru* (2nd edn, WGC, 2012) 16 – 19.
[101] Ibid.
[102] Ibid.
[103] Teresa Cespedes, 'Humala Seeks to Reassure Peru Mining Companies on Tax' *Reuters* (07 June 2011) <http://www.reuters.com/article/2011/06/08/us-peru-election-idUSTRE75702520110608> accessed 09 May 2013; President Olllanta Campaign, 'Guidelines for Social and Economic Policy for a National Consensus Government' (2011) 4 <http://www.latinreporters.com/perouHumalaDirectivesPolEcoSociale052011.pdf> accessed 09 May 2013.
[104] Law No 29790 establishing a Special Mining Contribution 2011.
[105] Law No 29789 establishing a new Special Mining Tax) 2011.

The last option taken by developing countries is to ignore the constraints imposed by stabilisation clauses and insist on applying the windfall tax to all investors. However, in the few cases seen in this thesis where this option was used, many of the investors with stabilisation clauses went ahead and instituted international arbitration against the country for breach of the stabilisation clauses and/or relevant Bilateral Investment Treaties.[106] This is particularly the case in countries such as Bolivia, Ecuador and Venezuela where windfall profit taxes were combined with several other measures including direct and indirect nationalisations leading to several international arbitration proceedings against these countries.[107] Consequently, the governments were either forced to negotiate and compensate investors or had arbitral awards entered against them for damages in favour of investors for the losses suffered as a result of the windfall profit tax.[108]

Whether the disputes in question ended with the investor being compensated or judgment entered against the host state, the consequences remain the same. The amount of revenue intended to be mobilised to fund sustainable development measures was either significantly reduced or altogether foregone. For example, the two major oil investors in Algeria relied on stabilisation clauses to institute international arbitration proceedings against the country for applying a 2006 windfall profit tax on them.[109] In the end, the government had to settle both cases by agreeing to pay a sizeable compensation to both investors.[110] Both investors were seeking approximately $10 billion against the country for

[106] Countries in the category include China, Algeria, Bolivia, Venezuela and Ecuador.

[107] These disputes led to a number of arbitrations including *Burlington Resources Inc v Ecuador*, ICSID Case No ARB/08/5, Decision on Liability of 14 December 2012. Many of them are still pending.

[108] This was the case in Algeria, Ecuador, Bolivia and Venezuela.

[109] *Mærsk Olie, Algeria A/S v Algeria*, ICSID Case No ARB/09/14, Discontinued 30 May 2012; *Anadarko Algeria Co. LLC and Maersk Olie, Algeria AS v Sonatrach*. UNCITRAL (discontinued in 2012). Before filing the suit, the company had already assured their shareholders that they expect 'to ultimately receive relief through the stabilization provision once its applicability is recognized in a settlement agreement or in international arbitration'. See: Anadarko, 'Anadarko to Reserve for New Algeria Tax Expense' (Press Release, 05 February 2007) <http://media.corporate-ir.net/media_files/nys/apc/news2/apc_070205.pdf> accessed 09 May 2013.

[110] Maersk Oil, 'Maersk Oil settles Algerian tax claims' (Press Release, 9 March 2012) <http://www.maerskoil.com/Media-OLD/NewsAndPressReleases/Pages/MaerskOilsettlesAlgeriantaxclaims.aspx> accessed 09 May 2013;

the effect of the tax. Yet, the settlement reached included a delivery of additional crude oil volumes in the amount of approximately $2.7 billion within a year.[111] It also included an amendment to the PSA that adds at least $2.6 billion to the net present value of the company at current prices and an extension to the development licences granted under the PSA for a further 25 years.[112]

The size of the compensation package shows the amount of revenue which the government had to forgo because of stabilisation clauses. However, doing so may have enabled the government to avoid the possibility of being held liable by arbitrators to completely indemnify the investors for all the losses suffered as a result of the law, as was the case in some recent arbitral awards.[113] Thus regardless of which option a host state decides to take, stabilisation clauses are likely to impose constraints on a state's ability to benefit from additional profit brought about by an unexpected change in the economic fortune of a project. This unduly affects their ability to mobilise resources to finance their sustainable development measures.

Before concluding the discussion under this heading, it is important to point out that it is not suggested here that foreign investors should not be protected from arbitrary and opportunistic unilateral adjustments to the fiscal regime governing their investment. Indeed, too frequent changes to the fiscal regime could reduce the overall viability of FDI in a country and consequently reduce its inflow. However, the need for fiscal stability must be balanced with the legitimate pursuit of host governments' sustainable development goals.

Anadarko, 'Anadarko Announces Resolution of Algeria Tax Dispute' (09 March 2012) < http://www.anadarko.com/Investor/Pages/NewsReleases/NewsReleases.aspx?release-id=1671189> accessed 09 May 2013.

[111] Ibid. $1.8 billion to Anadarko and an additional $920 million in crude to Maersk.

[112] Ibid.

[113] *Duke Energy International Peru Investments No. 1, Ltd v Peru*, ICSID Case No ARB/03/28, Award of 18 August 2008; *Burlington v Ecuador* (n 107).

The evidence seen in this thesis is that stabilisation clauses, as they are currently drafted, do not achieve this balance.[114]

The example of windfall taxes is discussed here in greater detail not only because it highlights this imbalance but also because of its unique implication for sustainable development. This is because while questions may be asked about the fairness or policy legitimacy of tax increases, there does seem to be a clear justification for countries wanting to impose windfall profits to earn additional revenue for their development.

By definition, a windfall profit tax is imposed on additional net profits earned by companies.[115] They are therefore mainly paid during periods of unusually high prices.[116] Thus from the investor's perspective, a windfall profit tax rarely affects the economic equilibrium of the project in a significant manner. For this reason, such taxes can rarely constitute an expropriation. Indeed, in *Burlington v Ecuador*, the majority of the arbitrators rejected the investor's claim that the windfall profit tax was expropriatory.[117] They held that since the tax was based on excess profits, even the 99 per cent rate did not 'substantially' deprive Burlington of its investment neither did it render it 'worthless or unviable.'[118]

A similar view was taken by the tribunal in *Sergei Paushok and ors v. Mongolia.*[119] Here the tribunal also found that Mongolia's 2006 windfall profit tax, calculated at 68 per cent rate, was compatible with the FET standard established by the Mongolia-Russia BIT.[120] The tribunal went on to dismiss the entire claim mainly because the investor did not have a

[114] Recommendations to achieve a better balance are made in section 7.3.3.
[115] Land (n 82).
[116] Ibid. For example, Zambia's botched attempt to impose a windfall profit tax in 2008 occurred at a time when copper prices were four times higher than the prices assumed in the business feasibility studies of the companies investing in Zambia's copper mining. OSISA (n 4).
[117] *Burlington v Ecuador* (n 107) [456]
[118] Ibid.
[119] (UNCITRAL) (Award on Jurisdiction and Liability, 28 April 2011)
[120] Mark Storry and Alexandra Ashikhimina, 'Mongolia: Open for Business' (July/August 2010) Engineering and Mining Journal, 58 <http://www.gbreports.com/admin/reports/EMJ_MongoliaReport2010.pdf> accessed 13 May 2013.

stabilisation clauses which would have protected it from the increase.[121] On the other hand, the tribunal in *Burlington v Ecuador* held that Ecuador was liable to pay damages to the investor, not because the effect of the windfall tax was expropriatory but because the steps Ecuador took in enforcing the tax (contrary to the stabilisation clause) constituted expropriation.[122] In other words, both tribunals made similar findings that the windfall tax laws in Ecuador and Mongolia did not constitute expropriation. However, the fact that Burlington had a stabilisation clause contributed to a different outcome.

While windfall profit taxes may not significantly affect the economic equilibrium of an investment, the inability of host governments to impose such taxes can substantially undermine sustainable development for several reasons. Firstly, the volatile nature of commodities prices makes it increasingly difficult to foresee with certainty the future economics of these projects.[123] As a result, there is a great deal of uncertainty about the extent, quality and future prices of the resource at the time of entering into the contract.[124] For these reasons, the ability of resource-rich developing countries to achieve sustainable development is significantly affected by the cyclical nature of commodities' prices.[125]

A windfall profit tax is therefore a good way, not only to undertake as many sustainable development measures as possible, but also, to save some of the windfall in order to cushion the effect of periods of low prices or negative shocks from market fluctuations. This is particularly important for sustainable development as the progressive realisation of human rights and the environment is often impeded or undermined during periods of economic and financial crisis.[126] It was the inability to do this that contributed to the economic crisis that undermined sustainable development in many developing countries

[121] *Paushok* (n 119)[361] –[370]
[122] *Burlington v Ecuador* (n 107) [546]
[123] Thomas W Wälde and Abba Kolo, 'Renegotiation and Contract Adaptation in the International Investment Projects: Applicable Legal Principles and Industry Practices' (2003) 1 OGEL 1, 2.
[124] Ibid.
[125] See section 4.3.
[126] See sections 6.2.1 and 6.2.2.

during the period of sustained low minerals prices in the 1980s.[127] It therefore makes sense that if the sustainable development of these countries was negatively affected by unusually low prices, it ought to be significantly promoted by unusually high prices. This is especially so because for many of these countries, their geological endowment is increasingly becoming the only comparative advantage that they possess to compete in an increasingly competitive global economy.[128]

Secondly, as observed by UNCTAD, since most of these resources are non-renewable 'the underlying philosophical presumption' in their administration is that the government should derive 'maximum benefits from any surpluses generated.'[129] This philosophical presumption is tied to the fact that as these resources are finite, the host state's ability to mobilise revenue from it to finance their sustainable development will terminate once these resources run out. Accordingly, achieving sustainable development is closely tied to their commercially and environmentally efficient exploitation, not only for the benefit of the present generation but also for the benefit of future generations. If the present generation is unable to maximise the benefit of any surplus, they are likely to be unable to pass on any significant benefit from the exploitation of these resources to future generations.

At the same time, future generations will be left with little or no extractive minerals from which to mobilise revenue to finance their needs. It therefore seems perfectly legitimate for governments to seek to capture some of the benefits of extreme market forces towards which neither party has made any material investment or strategic contribution.[130] However, as this section has argued, stabilisation clauses can impose a significant constraint on the

[127] See section 4.3.
[128] See Thomas W. Wälde 'Natural Resources and Sustainable Development: From 'Good Intentions' To 'Good Consequences' (2004) 2 OGEL 1.
[129] UNCTAD, *Africa* (n 52) 44.
[130] Africa's Center for Economic Transformation, 'Profiting from the Commodities Boom – Will Windfall Taxes hurt Africa's Mining Sector?' <http://acetforafrica.org/profiting-from-the-commodities-boom-will-windfall-taxes-hurt-africas-mining-sector/03-2012/> accessed 13 May 2013.

ability of host countries to do so thereby affecting their ability to promote sustainable development.

6.3.3 Stabilisation Clauses, Energy Subsidy Reform and Sustainable Development

Another way in which the reduction of fiscal policy space by stabilisation clauses can affect sustainable development is in the area of energy subsidy reform.[131] In most developing countries, energy prices are kept low through subsidies.[132] This means that generally, the government pays the difference between the lower price of fuel at the pumps and the actual higher cost of the product.[133]

Energy subsidies have been rationalised on account of their sustainable development function, including the eradication of poverty and promotion of social cohesion. The reason is that subsidising energy products in this way helps alleviate poverty and facilitate economic growth by ensuring that citizens, especially those within low income groups, can afford modern sources of energy.[134] In addition, for resource-rich developing countries, it is often seen as a way of spreading the benefits of the resources to their citizens.[135] It is for this reason that most of the world's fuel subsidies are found in developing countries, especially those which themselves export fossil fuels.[136]

However, current policy consensus is that energy subsidies have wide-ranging adverse consequences for sustainable development that outweigh their benefits.[137] The initial

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[131] Unless otherwise stated, energy subsidies in this thesis refer to subsidies for fossil fuels.

[132] For a detailed analysis of energy subsidies, see the following: IMF, 'Energy Subsidy Reform: Lessons and Implications' (*IMF*, 28 January 2013) <http://www.imf.org/external/np/pp/eng/2013/012813.pdf> accessed 10 May 2013; International Energy Agency and ors 'Joint report by IEA, OPEC, OECD and World Bank on Fossil-fuel and Other Energy Subsidies: An update of the G20 Pittsburgh and Toronto Commitments' (2011) <http://www.oecd.org/env/49090716.pdf> accessed 10 May 2013.

[133] Ibid.

[134] Ibid.

[135] Ibid.

[136] Ibid.

[137] Much has been written on this point in addition to the IMF and IEA studies already referenced above (n 132). See, as examples, Stephan Barg, Aaron Cosbey and Ronald Steenblik, 'A Sustainable Development Framework for Assessing the Benefits of Subsidy Reform in OECD' in OECD (ed), *Subsidy Reform and Sustainable Development: Political Economy Aspects* (OECD 2007); UNEP, IEA and OECD, *Reforming Energy Subsidies: An Explanatory Summary of the Issues and Challenges in Removing or Modifying Subsidies*

adverse effects are largely economic in nature. However, they do generate significant environmental and social consequences. In terms of their economic impacts, commentators agree that subsidies encourage wasteful consumption as they keep energy products under-priced.[138] This increases the economic costs to the government and thus may increase fiscal imbalances and reduce the amount of resources available to finance other sustainable development measures.[139] Energy subsidies may therefore have adverse consequences for economic growth in the long term as they can lead to an economically inefficient allocation of scarce resources.[140]

In terms of social progress, while subsidies are touted as a way of promoting social cohesion and eradicating poverty, in practice, they often generate negative impact on social development.[141] This is because several studies have suggested that the benefits of the subsidies are often captured by higher-income households due to their higher per capita consumption levels.[142] As a result, the poorest members of society, who need the subsidies most, do not get a fair share of the benefits.[143] Thus, rather than improving social cohesion and facilitating intra-generational equity, energy subsidies often reinforce social inequality thereby undermining the pursuit of sustainable development.

The environment is also negatively affected by energy subsidies in several ways. Allocating funds for energy subsidies to keep energy products under-priced can reduce both

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on Energy that Undermine the Pursuit of Sustainable Development (UNEP 2002); UNEP *Reforming Energy Subsidies: Opportunities to Contribute to the Climate Change Agenda* (UNEP 2008); Carolyn Fisher and Michael Toman, 'Environmentally and Economically Damaging Subsidies: Concepts and Illustrations' (2000) 14 *Climate Change Issues Brief*, 1.

[138] Fisher and Toman (n 137) 13; IMF, *Energy* (n 132) 5; Barg and ors (n 137) 34; IEA and ors, *Joint Report* (n 132).

[139] Ibid.

[140] Ibid.

[141] Ibid.

[142] For example, the IMF study shows that on average, the richest 20 per cent of households in middle and low income countries capture 6 times more in total fuel product subsidies that the poorest 20 per cent of households. IMF, *Energy* (n 132) 19 – 20 and Figure 7. See also Javier Arze del Granado, David Coady, and Robert Gillingham 'The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries' (2010) IMF Working Paper No WP/10/202 <http://www.imf.org/external/pubs/ft/wp/2010/wp10202.pdf> accessed 10 May 2013.

[143] Ibid.

the funds available, and the incentives for investment, into renewable energy.[144] It also masks the environmental costs of energy products thereby helping to negate the implementation of the polluter pays principle.[145] By encouraging excessive consumption, it also accelerates the depletion of natural resources with implications for future generations.[146] Finally, energy subsidies also contribute to global warming as increased consumption leads to increased greenhouse gas emissions and other pollutants.[147] It is for this reason that Annex 1 Parties to the Kyoto Protocol pledged to progressively reduce 'fiscal incentives, tax and duty exemptions and subsidies in all greenhouse gas emitting sectors.'[148] Several OECD and IEA analyses indicate that phasing out subsidies could reduce greenhouse gas emissions by as much as 10 per cent by 2050 compared with business-as-usual.[149]

Implementing reforms aimed at removing energy subsidies is therefore one key way to promote sustainable development. Apart from helping to protect the environment, it should also free up revenues, some of which can be invested into critical sectors and measures that can facilitate sustainable development.[150] For resource-rich developing countries, undertaking such reforms is becoming increasingly 'crucial and urgent' to their sustainable development due to the sustained high world oil prices.[151] This is because a higher price in international markets means that the governments will spend more on subsidies to keep the price lower in the domestic market.[152] Yet, it is in these countries that

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[144] IMF, *Energy* (n 132) 5.
[145] Ibid.
[146] Ibid.
[147] Ibid.
[148] Article 2(1) (a) (v) Kyoto Protocol to the UN Framework Convention on Climate Change (UN 1998).
[149] OECD, '*Interim Report of the Green Growth Strategy: Implementing our Commitment for a Sustainable Future* (OECD 2010) 10.
[150] Barg and ors (n 137).
[151] Gulf News, 'IMF Urges Morocco to Remove Fuel Subsidies' (18 December 2012) <http://gulfnews.com/business/general/imf-urges-morocco-to-remove-fuel-subsidies-1.1120752> accessed 10 May 2013. See also Robert Bacon and Masami Kojima, 'Phasing out Subsidies: Recent Experience with Fuel in Developing Countries' (2006) 310 *Public Policy Journal* <http://rru.worldbank.org/documents/publicpolicyjournal/310bacon_Kojima.pdf> accessed 10 May 2013.
[152] IMF, *Energy* (n 132) 1.

the cost of subsidies is 'especially acute' as oil exporting developing countries accounted for two-thirds of the world's total.[153]

Meanwhile, as discussed in the previous section, many of these countries are unable to capture fair benefits from the increase in world prices because of stabilisation clauses.[154] Thus, subsidising energy prices is increasingly becoming a growing economic liability for these developing countries leading to increased public debt and squeezing other government spending.[155] Consequently, in recent years, an increasing number of countries have concluded reforms, or are in the process of reforming, inefficient energy subsidies.[156] In view of the complex relationship between subsidies and environmental protection, social growth and economic development, most commentators agree that for reforms aimed at eliminating subsidies to be effective, they must be managed within the context of sustainable development.[157]

Despite the widely acknowledged benefits of reforming energy subsidies, it remains a politically difficult decision, especially for governments of resource-rich developing countries. This is because the original idea behind introducing subsidies was to help alleviate poverty and spread the benefit of the resources. The effects of removing such subsidies may therefore hit the poorest and most vulnerable hardest. Thus to be successful, a reform must include measures to strengthen social safety nets to ensure that consumers can cope with the higher price in the long run.[158] This is particularly the case for developing countries as they already have weak or non-existent safety nets.

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[153] Ibid. See also Coady and ors, 'Petroleum Product Subsidies: Costly, Inequitable, and Rising' (2010) IMF Staff Position Note SPN/10/05 <http://www.imf.org/external/pubs/ft/spn/2010/spn1005.pdf> accessed 10 May 2013.
[154] See section 6.3.2.
[155] Bacon and Kojima (n 151); IMF, *Energy* (n 132).
[156] Since 2010, almost half of the economies having fossil-fuel consumption subsidies under the price-gap approach have either implemented fossil-fuel subsidy reforms or announced plans to do. IMF, *Energy* (n 132).
[157] See as examples, IEA and ors (n 132) 10 – 13; Barg and ors (n 137) 34.
[158] IMF, *Energy* (n 132) 19.

There is no 'one size fits all' approach on how to do this. However, the consensus that has emerged from the literature on subsidies reform and lessons from past experiences are that reforms must include immediate short-term measures to address any acute impacts, especially on low-income households and other vulnerable groups.[159] Such mitigating measures can include targeted cash or near-cash transfers, school meals and subsidised urban transport.[160] It therefore means that governments must mobilise revenue to undertake these measures, especially those requiring immediate implementation. In most cases, doing so will require an adjustment in certain fiscal policies, especially in the energy sector where the subsidy is being applied. This is so even in wealthier developed countries where energy subsidies have already been substantially removed.

For example, part of the revenue raised by the Supplementary Charge in the UK was used to offset some of the immediate impacts of the high energy prices and to tackle long term fuel poverty.[161] Similarly, the recently introduced carbon tax on generators of fossil-fuel based energy in the UK is designed to discourage fossil fuel consumption while also providing an incentive to invest in low-carbon power generation.[162] At the same time, part of the revenue raised will be used to tackle long term fuel poverty.[163] Also, the Australian government recently introduced a carbon tax for similar reasons.[164] More than half of the revenue to be generated is to be used to help, in particular, low income households in the

[159] Ibid 7.
[160] Ibid.
[161] These measures include tax–free Winter Fuel Payments and Cold Weather Payments and grants for more energy efficient homes. See, HM Treasury, *Budget 2011* (n 71).
[162] HM Revenue and Custom *Carbon Price* (n 28).
[163] Ibid.
[164] CPA Australia, 'Summary of The Australian Government's Climate Change Plan' <http://www.cpaaustralia.com.au/~/media/Corporate/AllFiles/Document/professional-resources/business/Summary-of-australian-governments-climate-change-plan.pdf> accessed 10 September 2013.

form of tax cuts and increased welfare payments to help mitigate the immediate and long term effect of high energy prices.[165]

However, for developing countries that grant stabilisation clauses, the clauses can impose a significant constraint on their ability to implement similar reforms. As discussed in previous sections, stabilisation clauses have been relied upon by investors in not complying with laws used to mobilised domestic resources either in the form of tax or royalty increases or in the form of windfall profit taxes. As carbon taxes constitute a fiscal measure, they are likely to be covered by stabilisation clauses, even if they are also directed to deal with environmental issues.[166]

This constraint makes it more difficult for developing countries to address issues such as climate change. It also makes it difficult for them to undertake successful subsidy reforms as a result of the limitation in their ability to mobilise funds to implement immediate mitigating measures for the majority of their citizens who are to be acutely affected by the removal of energy subsidies. In other words, they are deprived of 'climate finance', described as a 'viable means of attaining funding and capacity-building for a broad spectrum of policies and measures required for removing fossil fuel subsidies, mitigating negative consequences and leveraging co-benefits.' [167]

As a result of the reduced fiscal space brought about by stabilisation clauses, the option left to many developing countries is to pass on the entire burden of the removal of subsides to their citizens. In other words, the citizens, many of whom already live in poverty, are expected to pay for the increase in world oil prices, while the bulk of the windfall accrues

[165] Ibid. At least 9 out of 10 Australian households will receive some form of assistance which according to the government will ensure that many low income households will receive greater assistance than the impact of a carbon price.

[166] According to the IMF, eliminating subsidies and replacing them with appropriate carbon taxes could cut global greenhouse-gas emissions by 13 per cent and curtail air pollution. IMF, *Energy* (n 132) 18 – 19.

[167] Climate Focus, 'Fuel Subsidies and Climate Finance Using Climate Finance to Remove Fossil Fuel Subsidies' (2013) Climate Focus Discussion Paper <http://www.climatefocus.com/documents/files/fuel_subsidies_and_climate_finance.pdf> accessed 10 May 2013.

to investors with stabilisation clauses. As a result, despite the sound economics behind the removal of fuel subsidies and its potential benefits to sustainable development, it is politically difficult to implement in developing countries. Attempts to do so have been met with protests by citizens who are unwilling to undergo further suffering.[168]

For example, Ghana removed fuel subsidies in December 2011, about the same time it imposed a windfall profit tax and increased corporate taxes in the mining sector.[169] However, after some of the major mining companies relied on stabilisation clauses and refused to pay the new taxes, the estimated revenue from the increases was substantially reduced and the government decided to abolish the tax.[170] Thus, in the absence of sufficient revenue to undertake effective immediate mitigation measures, the government was forced to

[168] These countries include Nigeria, Guinea, Cameroon and Chad, Indonesia, Malaysia and India all of whom grant stabilisation clauses in varying degrees in their extractive industries. For reviews of these efforts and the aftermath, see the following: Bacon and Kojima (n 151); Kerryn Lang and Peter Wooders, 'India's Fuel Subsidies: Policy Recommendations for Reform (2012) IIED Policy Brief <http://www.iisd.org/pdf/2012/india_fuel_subsidies_policy_brief.pdf> accessed 10 May 2013; Asia Sentinel, 'Indonesia's Fuel Subsidy Quandary' (14 March 2013) <http://www.asiasentinel.com/index.php?option=com_content&task=view&id=5250&Itemid=226> accessed 10 May 2013; Sam Chee Kong, 'Should the Government remove fuel subsidies?' *Malaysia Chronicle* (03 April 2012) <http://www.malaysia-chronicle.com/index.php?option=com_k2&view=item&id=31203:should-the-government-remove-fuel-subsidies?&Itemid=2> accessed 10 May 2013; Thisday, 'Nigerians Protest Removal of Fuel Subsidy' *Thisday* (Lagos, 03 January 2012)<http://www.thisdaylive.com/articles/nigerians-protest-removal-of-fuel-subsidy/106373/> accessed 10 May 2013; Nelipher Moyo and Vera Songwe, 'Removal of Fuel Subsidies in Nigeria: An Economic Necessity and a Political Dilemma' (10 January 2012) <http://www.brookings.edu/research/opinions/2012/01/10-fuel-subsidies-nigeria-songwe> accessed 10 May 2013.

[169] Government of Ghana, 'Budget Speech: Budget Statement and Economic Policy of the Government of Ghana For the 2012 Financial Year (Undated) [para 38 <http://www.ghana.gov.gh/documents/2012budgethi.pdf> accessed 08 May 2013. See also, Guy Crawford, 'Ghana's Fossil-Fuel Subsidy Reform' (2012) IDS Case Study No 09 <http://www.ids.ac.uk/files/dmfile/LHcasestudy09-FossilfuelsGhana.pdf> accessed 10 May 2013.

[170] Business Week Africa, 'Govt. Withdraws Proposed Windfall Mining tax from Parliament' *Business Week Africa* (Accra, 10 – 16 September 2012) <http://www.mybusinessweekafrica.com/topheadlines_detail.php?ID=2316> accessed 08 May 2013; Republic of Ghana, 'Budget Speech: Budget Statement and Economic Policy of the Government of Ghana For the 2013 Financial Year (05 March 2013)[124]<http://www.parliament.gh/assets/file/Budget%20Statement%20/2013%20BUDGET%20SPEECH%20FINAL%20PRINT.pdf> accessed 08 May 2013.

reinstate the subsidy in 2012 following massive protests in the country.[171] This was despite the fact that the government continues to insist that its removal remained 'long overdue.'[172]

6.3.4 Stabilisation Clauses and Policy Coherence

The grant of stabilisation clauses in a country may also affect sustainable development by creating policy incoherence. The discussion in chapter 3 showed that in several developing countries, stabilisation clauses are granted to some investors and not to others even within the same sector.[173] This has created a situation where in a bid to adhere to the terms of stabilisation clauses, several governments have had to design different fiscal regimes or laws for investors with stabilisation clauses.[174] No doubt this approach has its benefits as it allows the government to be able to implement new fiscal policies, including new tax laws, on some investors. However, it also raises several policy implications which may affect the ability of governments to effectively pursue their sustainable development goals.

In the first place, where stabilisation clauses are only granted to foreign companies but not to local companies, it can create unequal competition between foreign and domestic investors. To help understand how this unequal competition may arise and the way in which it might affect sustainable development, it may be useful to draw lessons from the application of the principle of non-discrimination in international economic law as embodied in the obligation to provide national treatment.

The obligation to provide national treatment is perhaps the single most important standard of treatment in international investment agreements.[175] It can be defined as 'a

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[171] Crawford (n 169).
[172] Modern Ghana, 'Fuel Subsidy Removal Is Long Overdue- Finance Minister' *Modern Ghana* (Accra, 17 February 2013) <http://www.modernghana.com/news/445861/1/fuel-subsidy-removal-is-long-overduefinance-minist.html> accessed 10 May 2013; Daily Graphic, 'Remove fuel subsidies now - Central Bank' *Daily Graphic* (Accra, 14 February 2013) <http://www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.php?ID=264949> accessed 10 May 2013.
[173] See generally section 3.4.
[174] See section 3.4.3.
[175] For a detailed discussion see UNCTAD, *National Treatment* (UNCTAD 1999).

principle whereby a host country extends to foreign investors treatment that is at least as favourable as the treatment that it accords to national investors in like circumstances.'[176] The idea behind the principle is to ensure some level of 'competitive equality' between foreign and domestic investors.[177] Of particular relevance to this thesis is the fact that this principle, while intended as a tool to attract FDI, also raises some important development issues.[178]

A strict application of the principle in practice may actually work to create unfair competition against the national investors, especially in developing countries. This is because in most cases, the foreign firms have more economic advantages in terms of access to finance, skills, technical know-how and markets. For this reason, a rigid application of the principle may impede or otherwise negatively affect the development of domestic companies. Thus, for such countries to maximise the contribution of FDI, some degree of flexibility may be required in the treatment of national investors to ensure that the application of national treatment does not create a *de facto* better treatment for foreign investors.[179] This flexibility is required to create certain qualifications and exceptions to national treatment, when appropriate, in order to accommodate the development needs of the country.[180]

Based on the foregoing, where stabilisation clauses are granted to foreign but not to local investors, it works to create the opposite effect of what is required to maximise the contributions of FDI to a country's development. As discussed in chapter 3, stabilisation clauses are mainly available for and granted to foreign investors.[181] This may largely be due to the fact that the clauses were re-introduced as part of reforms to attract FDI. As a result, it is often the case that domestic companies that operate even within the same sectors are not

[176] Ibid 2.
[177] Ibid.
[178] Ibid.
[179] Ibid 62 – 62.
[180] Ibid.
[181] One exception see in this study is Colombia where the clauses are available to both local and foreign investors. See section 3.4.3.

granted the clause. They are therefore subject to changes in the laws of the host state and must comply with any new tax laws enacted by the country. This creates a situation whereby domestic companies may pay more in taxes and are subjected to a greater financial burden than foreign companies.

Thus, while in practice, the application of the principle of national treatment requires some exemptions and qualifications to protect development policies in developing countries, the grant of stabilisation clauses to only foreign investors creates the opposite effect. First, it entrenches a formal *de facto* discrimination against domestic investors and may therefore facilitate an even greater distortions in the domestic economy. Second, as stabilisation clauses reduce policy space, they reduce the flexibility that the host government needs to ensure that the application of national treatment does not lead to a *de facto* more favourable treatment for foreign investors. Consequently, the ability of domestic firms to grow and to maximise the benefits of the spill over effect of FDI may be significantly constrained, thereby defeating some of the rationale for seeking to attract FDI in the first place.

Where, as is in some countries, stabilisation clauses are granted to some foreign investors and not to others, then an unfair playing field is also created among foreign investors. Again, this can impede, rather than promote sustainable development in the long run. As such, in the longer term, a country may have to grant stabilisation clauses to other investors or risk not attracting others. For example, several other Liquefied Natural Gas (LNG) projects have been considered in Nigeria for several years.[182] To create a level playing field, the government may need to grant similar incentives and guarantees as it did to Nigeria LNG Limited.[183] However, to date, none have been able to take-off. Part of the problem is that the investors are not satisfied with the level of guarantees being offered to

[182] Including the Brass LNG and the Olokola LNG. See, NNPC, 'NNPC Okaya Olokola LNG Project' <http://www.nnpcgroup.com/PublicRelations/NNPCinthenews/tabid/92/articleType/ArticleView/articleId/213/NNPC-okays-Olokola-LNG-project.aspx> accessed 13 May 2013.
[183] Nigerian LNG (Fiscal Incentives Guarantees and Assurances) (Amendment) Act 1993.

them and are demanding more from the government in terms of absorbing the political risks of the project.[184]

Similarly, several of the mining companies without stability agreements in Ghana have also threatened to cut down on investments in the country due to the introduction of a new fiscal regime.[185] Significantly, the complaint is not so much about the burden of the fiscal regime.[186] Rather, they argue that a situation where they have to pay more taxes and royalties than other major foreign companies is 'not sustainable' as it does not create a 'level playing field.'[187] For these reasons, some of the companies have also decided to pursue and obtain stability agreements and to tie their future investment decisions to the ability to obtain one.[188]

Also, the introduction of a windfall profit tax in Mongolia was a contributory factor in the withdrawal from the country of several smaller foreign companies who did not have stability agreements.[189] Many of them left because they could not get financing to continue their projects.[190] While the details of the reasons behind the inability of these companies to get funding are not fully known, it is possible to infer from the discussion in chapter 4 that the bankability of their projects diminished.[191] This is to be expected because where all other things are equal, a project financier with limited resources to finance competing projects in a country is more likely to finance the project with a stabilisation clause than the project without one. Thus unless the government is willing to grant stabilisation clauses to all

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[184] Sweet Crude, 'Brass LNG May Never Take Off' (24 January 2013) <http://sweetcrudereports.com/2013/01/24/brass-lng-may-never-take-off/, accessed 13 May 2013.
[185] Ed Stoddard, 'Gold Fields says $1bln Ghana Investment at Risk' *Reuters* (05 December 2011) <http://www.reuters.com/article/2011/12/05/goldfields-ghana-idUSL5E7N51SN20111205> accessed 13 May 2013.
[186] Ibid.
[187] Ibid.
[188] Gold Fields, 'Ghana's Prominent Role in Gold Fields' (Press Release, 18 February 2013) <http://www.goldfields.co.za/news_article.php?articleID=1568> accessed 13 May 2013.
[189] Storry and Ashikhima (n 120) 47.
[190] Ibid.
[191] See section 4.3.4 on the interest of financial institutions in stabilisation clauses.

investors, at least within the same sector, the selective granting of the clause may end up discouraging further investment.[192]

Further, the exemption of certain companies from the effect of new laws because of stabilisation clauses raises a question of policy coherence. This is because as new laws are being enacted and made applicable only to certain investors, it creates a complex situation whereby different rules will apply to different companies even within the same sector. Considering that the regulatory regime in most developing countries is weak, this creates an unnecessary complication for regulatory agencies that may increase the cost of regulation and encourage tax avoidance.

For example, some of the fiscal incentives granted to the Nigerian LNG were stipulated to expire in six years if a cumulative average sale price were to reach a specified amount.[193] However, the relevant agencies mandated to implement the provision could not implement this threshold stipulation because they did not have the sales data to carry out the required analysis.[194] It is partly for this reason that the relevant minister called for the NLNG Act to be reviewed in order to make it 'industry specific' rather than 'company specific.'[195]

The policy incoherence caused by stabilisation clauses can also create a situation whereby these agencies are made to enforce laws that are no longer in existence. This is because, where over the years, such countries repeal existing laws and enact new laws to replace them, investors with stabilisation clauses will not be affected by the new laws. At the same time, they may not be affected by any law as the old law may have been repealed. Regulatory agencies may be expected to enforce laws and regulations that are no longer on

[192] The government eventually annulled the law to create a level playing field for investors. See Windfall Profit Tax Law (Invalidation Law) 2009.
[193] Section 2 Nigeria LNG (Fiscal Incentives Guarantees and Assurances) (Amendment) Act 1993.
[194] Ministry of Finance 'Comments by the Minister of Finance on the Bill For an Act to Amend the Nigeria LNG (Fiscal Incentives, Guarantees, And Assurances) Act (03 June 2008) 3. Further details in the case study at section 6.4.1.
[195] Ibid 10.

the statute books of the country and for which regulatory capacity may have been extinguished.

The previous chapter discussed how many African countries have enacted new mining laws that generally include more measures on transparency, impose higher environmental and social standards on investors and increased taxes and royalties.[196] However, in many of these countries, several companies with stabilisation clauses have refused to comply with the new laws, especially with the fiscal changes. They have therefore relied on their stabilisation clauses to continue to apply the fiscal regime established by the previous laws that now only exist in their contracts but not the countries' statute books. As some stabilisation clauses have been granted for as long as the company is operating or the project is in existence, it means that a company may actually be subject to no law for decades. The country may therefore be left with the option of regulating the company solely by what is contained in their contract as that will be the only document governing their relationship which remains applicable. This creates a regulatory nightmare for regulators and affects their ability to effectively regulate these companies in order to ensure that they do not undermine the sustainable development interests of those countries.

6.4 CASE STUDIES

This section presents two case studies. The first deals with stabilisation clauses granted to Nigerian Liquefied Natural Gas Limited ('NLNG Limited'). The second relates to stabilisation clauses granted in the Tanzania mining sector. Both cases help to illustrate how stabilisation clauses affect sustainable development in practice. In particular, they are intended to illustrate how the limitation placed by stabilisation clauses on fiscal and economic policies can affect measures directly aimed at improving social and environmental standards.

[196] See section 4.3.

The choice of the case studies is motivated by several considerations. The stabilisation clauses are still in effect and the constraints that they impose are still on-going. Yet at the same time, enough time has passed since they were granted. They therefore provide an opportunity to analyse the impact of stabilisation clauses that were granted over a long period of time and is therefore sufficient to make a useful assessment of their effect but within the context of the on-going constraints that they impose. Furthermore, the laws and relevant documents are either publicly available or easily obtainable. Finally, the laws and measures that the stabilisation clauses constrain highlight the relationship between economic growth, social development and environmental protection and how a constraint imposed by stabilisation clauses on one of these areas affects the others equally.

6.4.1. Case Study One: Stabilisation Clauses in the Nigeria LNG (Fiscal incentives, Guarantees and Assurances) (Amendment) Act 1993

The Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act 1993 was enacted in favour of the Nigeria Liquefied Natural Gas Company Limited (hereafter 'NLNG Limited') with respect to the Nigeria Liquefied Natural Gas Project in the Niger Delta region of Nigeria. This region is regarded as having one of the world's most sensitive environments due to its large wetlands and high concentration of biodiversity.[197] It also contains all the country's oil and gas resources that contribute to the bulk of national revenue.[198] As a result, the environment is faced with severe threats from oil and gas exploration activities, in addition to inadequate farming practices and deforestation.[199] The region is therefore a good example of where the integration of environmental concerns into development projects is fundamental to sustainable development. Yet over the years, the unwillingness of successive

[197] PO Phil-Eze and IC Okoro, 'Sustainable Biodiversity Conservation in the Niger Delta: A Practical Approach to Conservation Site Selection' (2009) 18 Biodiversity Conservation, 1247, 1248 – 1251; World Bank, *Defining an Environmental Development Strategy for the Niger Delta* (vol 1) (World Bank 1995) para 1.4.

[198] Nigeria EITI, 'Financial Audit: An Independent Report Assessing and Reconciling Financial Flows within Nigeria's Oil and Gas Industry – 2009 to 2011' (2011) EITI Report <http://eiti.org/files/NEITI-EITI-Core-Audit-Report-Oil-Gas-2009-2011-310113-New_4.pdf> accessed 17 April 2013.

[199] Phil-Eze and Okoro (n 197).

governments and oil and gas investors to carry out this integration has led to environmental degradation, facilitated human rights violations, created social ills and increased poverty among the inhabitants of the region.[200]

As a result of the above, a 1995 World Bank report noted that the region's '*tremendous potential for economic growth and sustainable development remains unfulfilled and its future is threatened by deteriorating economic conditions that are not being addressed by present policies and actions.*[201] The Bank therefore concluded that an '*urgent need exists to implement mechanisms to protect the life and health of the region's inhabitants and its ecological systems from further deterioration'* [202]

While it was the environmental aspects of these issues that first drew international attention to the situation, numerous studies have found that the environmental aspects of the problem are not due to the lack of environmental laws to regulate oil and gas exploitation.[203] In particular, according to some experts interviewed in a study by Amnesty International, the country's environmental laws are 'minimally sufficient' in terms of compliance with international standards in relation to oil operations.[204] The environmental degradation thus occurs because of the lack of enforcement of these laws.[205]

The consensus from these studies is that the main reason for the lack of enforcement of the country's environmental laws is lack of capacity and resources.[206] All the regulatory agencies were found to be seriously constrained by lack of basic technical, financial and

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[200] The adverse effects of oil and gas exploitation in the Niger Delta are already well documented in the literature. See, as examples, Ibiba Lucky Worika, 'Deprivation, Despoilation and Destitution: Whither Environment and Human Rights in Nigeria's Niger Delta' (2002) 8 ILSA JICL, 1, 5; Amnesty International, *Nigeria: Petroleum, Pollution and Poverty in the Niger Delta,* (AI 2009).
[201] World Bank, *Defining I* (n 197) v [Emphasis original].
[202] Ibid.
[203]See, as examples, Amnesty International, *Nigeria* (n 200); World Bank, *Defining an Environmental Development Strategy for the Niger Delta* (vol II) (World Bank 1995) 45-53; UNDP, *Niger Delta Human Development Report* (UNDP 1996) 73 – 80.
[204] Amnesty International, *Nigeria* (n 200) 41.
[205] Ibid.
[206] Ibid; World Bank, *Defining II* (n 203) 45 – 53; UNDP, *Niger* (n 203) 91-92.

material resources required to carry out their duties effectively.[207] Accordingly, a key recommendation made in these reports is that there should be a substantial increase in the resources allocated to the regulatory agencies to improve their technical capacity.[208]

An effective response to environmental pollution is, however, only part of the story. The other is to prevent the pollution from occurring in the first place. While some of these spills are caused by defective equipment and lack of maintenance, an increasing proportion is caused by sabotage by third parties.[209] In some cases, this is caused through vandalism of oil infrastructure by criminal gangs. However, increasingly, it is caused by community members for economic reasons.[210] Many youths and other community members damage oil pipes in order to steal small quantities of oil for sale or personal use.[211] Others deliberately damage the pipelines as a way of extorting compensation or clean-up contracts from the companies.[212]

Based on the foregoing, dealing with the challenges in the region requires an integrated approach as encapsulated in the principle of sustainable development, not only to protect human rights and the environment, but also to promote economic growth and, in particular, eradicate poverty.[213] Thus, one way in which the government responded was to establish, in 2000, a Niger Delta Development Commission (NDDC) to deal with the challenge in a holistic manner in line with the principle of sustainable development.[214] For example, the NDDC was mandated to:

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[207] Ibid.
[208] Ibid.
[209] Amnesty International (n 200) 15 - 17; UNDP, *Niger* (n 50) 85-92; District Court of The Hague, 'Dutch Judgments on Liability Shell: Decision on Oil Spills in Nigeria' (Press Release, 30 January 2013) <http://www.rechtspraak.nl/Organisatie/Rechtbanken/Den-Haag/Nieuws/Documents/Persbericht_Shell_UK.pdf> accessed 17 April 2013.
[210] Ibid.
[211] Ibid.
[212] Ibid.
[213] Note that even the environmental threats that are not directly connected to oil and gas activities are also largely caused by socio-economic factors: Phil-Eze and Okoro (n 197).
[214] Niger Delta Development Commission Act 2000 (hereafter 'NDDC Act').

> conceive, plan and implement, in accordance with set rules and regulations, projects and programmes for the sustainable development of the Niger-Delta area in the field of transportation including roads, jetties and waterways, health, education, employment, industrialization, agriculture and fisheries, housing and urban development, water supply, electricity and telecommunications.[215]

At the same time, the NDDC was also to 'tackle ecological and environmental problems that arise from the exploration of oil mineral in the Niger-Delta area' and to 'liaise with the various oil mineral and gas prospecting and producing companies on all matters of pollution prevention and control.'[216]

As is often the case in the real world, these measures require funds to be implemented. Thus to be effective, they needed to be underpinned by a fiscal policy that ensured a sustainable means of funding. Accordingly, the NDDC Act imposed an obligation on the national government and all oil producing and gas-processing companies operating in the area to make a yearly contribution to the NDDC.[217] In particular, each oil and gas company operating in the region was to contribute 3 per cent of their total annual budget to the NDDC.[218]

While other companies are complying with this provision, the NLNG Limited has been able to rely on the following stabilisation clause to not comply with the law:

> Without prejudice to any other provision contained herein, neither the company nor its shareholders in their capacity as shareholders in the company shall in any way be subject to new laws, regulations, taxes duties imposts, or

[215] Ibid s 7(1) (b).
[216] Ibid s 7(1) (h) and (I).
[217] See generally section 14.
[218] Section 14(2) (b).

charges of whatever nature which are not applicable generally to companies incorporated in Nigeria or to shareholders in the companies incorporated in Nigeria respectively.[219]

Consequently, the NDDC commenced legal proceedings to compel NLNG Limited to comply with the law.[220] In court, the NLNG Limited relied on the stabilisation clause to argue that the NDDC Act, being a new law, did not apply to it.[221] The court upheld this argument but added that the clause is nonetheless unconstitutional as it fetters the legislative powers of parliament.[222] It therefore advised that the clause 'needs to be reviewed' by parliament.[223]

In line with the advice by the court, the country's parliament commenced the process of amending the NLNG Act by removing the stabilisation clauses contained it in so as 'to bring it into conformity' with the country's constitution.[224] This was however opposed by the NLNG Limited and it threatened to institute international arbitration if the stabilisation clause was removed and it was made to comply with the NDDC Act and several other new laws with which it had refused to comply.[225]

On the other hand, the NDDC in its memorandum argued against the clause and called for it to be abolished.[226] According to the Commission, the clause has enabled NLNG

[219] Nigeria LNG Act (n 193) s 3 to second sch.
[220] *Niger Delta Development Commission v Nigeria Liquefied Natural Gas Company Ltd*, Suit No FHC/PH/CS/313/2005, Judgment of 11 July 2007
[221] Ibid 22- 23.
[222] Ibid 32 - 33. Note however that the court did not make any formal order declaring the NLNG Act unconstitutional as this was not a relief sought by the claimant and this was upheld on appeal. See, *Niger Delta Development Commission v Nigeria LNG Limited* (Appeal No CA/PH/520/07) (Judgment delivered 02 December 2010).
[223] Ibid.
[224] 'Bill for an Act to amend the Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act (6 March 2008, National Assembly Journal, No. 10) Explanatory Note.
[225] NLNG Limited, 'Memorandum to the House of Representatives Committee on Gas Resources in Re: Bill for an Act to Amend the Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Act' (04 June 2008) 9 – 10; JA Ogbodo, 'NLNG's boss cautions as Reps seek to amend Act' *Guardian* (Lagos, 08 June, 2008).
[226] NDDC, 'Memorandum to the House Committee on Gas Resources on the Bill on an Act to Amend the NLNG (Fiscal Incentives, Guarantees and Assurances Act 1990) (10 June 2008).

Limited to evade its obligation under the NDDC Act thereby depriving the Commission of significant revenue to carry out its mandate.[227] Thus, despite the fact that NLNG Limited is one of the country's most profitable companies, it has so far been able to evade its obligation under the NDDC Act because of the stabilisation clauses.[228] In fact, perhaps due to its threat, the parliamentary process to remove the stabilisation clauses was abandoned when it could not be completed by the parliament that commenced it.

Consequently, despite the 'urgent need' to implement measures to facilitate the sustainable development of the Niger Delta, the stabilisation clauses in the NLNG Act have created an 'enclave' for the company, insulating it from having to make the statutory contribution to NDDC. As such, the ability of the NDDC to fulfil its mandate to 'conceive, plan and implement…projects and programmes for the sustainable development of the Niger-Delta' is being constrained, to the extent to which NLNG Limited's funds would have contributed.[229]

Beyond the NDDC and the Niger Delta, the stabilisation clauses have also acted to deprive the national government and several of its agencies of revenue while also distorting national economic policies.[230] For example, both the Nigeria National Petroleum Corporation (NNPC) and the Ministry of Finance submitted memoranda requesting that the clauses be removed for the above reasons.[231] In particular, the finance ministry in arguing against the clause noted that it is important for government to be able to 'suspend or revoke laws when faced with the need to raise taxes, or in fulfilment of international trade

[227] Ibid.
[228] Business Day, 'NLNG Makes N500 Billion Yearly to Dwarf Banks Total Profits' *Business Day* (Lagos, 19 November 2007).
[229] NDDC Act (n 214) s 7(1) (b).
[230] These Ministries and agencies include the Ministry of Finance, the Nigeria National Petroleum Corporation (NNPC) and the Nigerian Maritime Administration and Safety Agency (NIMASA).
[231] Minister of Finance 'Comments by the Minister of Finance on the Bill For an Act to Amend the Nigeria LNG (Fiscal Incentives, Guarantees, And Assurances) Act (03 June 2008)7; NNPC, 'Memorandum submitted by the NNPC to the House of Representatives committee on Gas Resources' (17 June 2008) 2.

agreements, or to bring its regimes in line with international best practices or to remain competitive.'[232]

Similarly, the Nigeria Maritime Administration and Safety Agency (NIMASA), which enforces the country's maritime laws, also called for the clause to be abolished as it constrains their ability to fulfil their mandate.[233] It explained that NLNG Limited has relied on the stabilisation clauses to avoid a statutory 3 per cent levy imposed on gross freight earned by ship-owners operating in Nigeria, as well as other maritime international obligations on safety, pollution, labour and security.[234] As a result, NLNG Limited's activities 'have no significant positive impact on the Nigerian Maritime industry. Instead, the activities of the company have negative impact on the environment with the attendant economic and political consequences on the Niger Delta region of the country.'[235]

In a renewed effort to compel the NLNG to comply with these laws, the agency recently halted the NLNG's vessels from operating in the country.[236] According to the agency, this course of action became inevitable following the 'NLNG's disregard and unwillingness to abide by the country's maritime laws, especially the section of the NIMASA Act that mandates payment of levies.'[237] It remains to be seen how this latest effort will conclude since the stabilisation clauses are still valid. However, whatever the outcome, the decision by the agency further highlights the on-going constraints the stabilisation clause in the NLNG Act imposes.

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[232] Minister of Finance (n231)8.
[233] NIMASA, 'Memorandum submitted by Nigerian Maritime Administration and Safety Agency (NIMASA) to the House of Representatives committee on Gas Resources' (undated).
[234] Ibid 2; NIMASA Act 2007, s 15(a).
[235] NIMASA (n 233) 2.
[236] Yemi Adebowale, 'NIMASA Shuts out NLNG Vessels from Bonny Channels' *Thisday* (Lagos, 04 May 2013) <http://www.thisdaylive.com/articles/nimasa-shuts-out-nlng-vessels-from-bonny-channels/146685/> accessed 29 August 2013.
[237] Ibid.

6.4.2. Case Study Two: Stabilisation Clauses in Tanzania's Mining Sector.

Tanzania is one of the countries where pressure from the World Bank led to the signing of several Mineral Development Agreements (MDAs) in secret, and their terms kept secret as well.[238] The secrecy fuelled a widespread perception of corruption among the public and that the MDAs contained 'unnecessary tax incentives and stabilisation clauses.'[239] These sentiments were confirmed when leaked copies of several MDAs showed that they all contained a combination of full freezing and economic equilibrium clauses protecting the investors from any changes that put them in a 'worse off situation.'[240] The duration of the clauses were for (potentially) 50 years, with an initial 25 years and an option of renewal upon the same terms and conditions.[241]

The incentives and exemptions coupled with tax evasion and aggressive tax avoidance by companies have ensured that the contribution of mining to the country's revenue and GDP remained low.[242] According to a recent report by the IMF, this low 'fiscal impact' of the 'growing' mining sector is 'unlikely to change in the coming years, partly because of' the 'large' tax holidays and incentives.[243] It is therefore not surprising that the

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[238] See section 4.3.4.

[239] Policy Forum, 'The Demystification of Mining Contracts in Tanzania' (2010) <http://www.sdsg.org/wp-content/uploads/2010/02/Article-re-Mining-Contracts-in-Tanzania.pdf> accessed 18 September 2012. See also Bubelwa Kaiza, 'Tanzania's Mining Boom: Initiatives for Increased Transparency and Accountability in the Starting Holes (*Heinrich Böll*, 08 July 2008) <http://www.za.boell.org/web/resource-governance-570.html> accessed 02 October 2012.

[240]See, for example, art 11 Gold MDA Between the Government of the United Republic of Tanzania and Pangea Minerals Ltd (Tulawaka Mine) December 2003).

[241] Ibid Preamble, arts 3.2 and 5

[242] These are the findings of several studies, audits and reviews. See, as examples, Tanzania Episcopal Conference, National Muslim Council of Tanzania and Christian Council of Tanzania, *The One Billion Dollar Question: How Can Tanzania Stop Losing So Much Tax Revenue* (TEC 2012) Policy Forum, 'An Analysis Of Tanzania's Budget Revenue Projections: How Much Revenue Are We Losing?: Tanzania Budget 2009/2010 (2009) Policy Forum Policy Brief <http://www.policyforum-tz.org/files/Howmuchrevenuearewelosing.pdf> accessed 07 May 2013; Mark Curtis and Tundu Lissu, *A Golden Opportunity?: How Tanzania is Failing to Benefit from Gold Mining* (2nd Edn, TEC 2008); United Republic of Tanzania, 'Report of the Review of MDAs and Fiscal Regime for the Mineral Sector', (September 2006)(hereafter 'Masha's Commission's report'); Robert J Utz, *Sustaining and Sharing Economic Growth in Tanzania* (IBRD/World Bank 2005); The United Republic of Tanzania, 'Report of the Presidential Mining Review Committee to Advise the Government on Oversight of the Mining Sector' (vol 2) (April 2008)(hereafter 'Bomadi Commission Report'); IMF, 'United Republic of Tanzania: 2011 Article IV Consultation and Second Review Under the Policy Support Document' (2011) IMF Country Report No 11/105 <www.imf.org/external/pubs/ft/scr/2011/cr11105.pdf> accessed 08 May 2011.

[243] IMF, *Tanzania* (n 242) 14.

studies on the mining sector all recommended that the fiscal regime governing the sector should be reviewed to increase the contribution of mining to the revenue of the government to enable it to finance its sustainable development objectives.[244] Several of these studies and reviews went further to specifically recommend that provisions in existing MDAs, especially those relating to taxation, should be renegotiated.[245]

In line with these recommendations, the government enacted a new Mining Act in 2010. The Act removed several tax incentives and increased the rate of royalties from 3 per cent to 4 per cent.[246] However, so far, only one of the major mining companies in the country has agreed to comply with the law, and in particular, the marginal increase in the royalty rate.[247] The other major mining companies have relied on stabilisation clauses in their MDAs to not apply the law. Efforts by the government to make them pay have led to threats of international arbitration.[248]

For example, following the announcement of the plans, one of the major mining companies immediately released a statement reminding the government that their MDAs 'guarantee tax and fiscal stabilisation…by reference to the law in force at the effective date of the agreement.'[249] They therefore argued that the MDAs 'cannot be amended' without their consent.[250] The government has thus been forced to go into endless negotiations with these companies since 2010 to persuade them to at least comply with some of the terms of the new law and in particular the royalty.[251] Although media reports suggested that the

[244] See, as examples, *Bomadi Commission* (n 242) 100 – 114; *Masha's Committee* (n 242) 10; Curtis and Lissu (n 242)42; OSISA (n 4) 60; Tanzania Episcopal Conference and ors (n 242) 32 - 33.
[245] Ibid.
[246] Mining Act 2010, ss 87 – 93.
[247] So far, only African Barrick Gold is known to have agreed to comply with the new law. See Tanzania Chambers of Minerals and Energy, 'Statement on Stability of Mining Development Agreements' (PAJOMA, July 2012 Issue 8) 1 <http://www.tcme.or.tz/fileadmin/newsletters/Pamoja_Issue_08.pdf> accessed 06 May 2013.
[248] Ibid.
[249] African Barrick Gold Plc, 'Comment on Reports of Potential Tanzanian Super Profits Tax' (Press Release, 08 June 2011) <http://www.africanbarrickgold.com/~/media/Files/A/African-Barrick-Gold/Attachments/press-releases/2011/comment-on-reports-of-potential-tanzanian-super-profits-tax.pdf> accessed 08 May 2013.
[250] Ibid.
[251] Ibid.

companies have agreed to comply, this has been dismissed by the body representing miners in Tanzania as 'inaccurate reporting.'[252] Rather, they argued that discussions are still on-going but advised the government to 'respect the sanctity' of the stabilisation clauses in the MDAs.[253] The sustainable development of Tanzania will therefore have to wait until such a time, if at all, when the companies agree to voluntarily comply with the law or until the MDAs expire.[254]

The difficult situation is perpetuated by the fact that the government has already been forced to raise revenue from other sources, including by increasing Value Added Taxes and Pay As You Earn, in addition to taxes paid on drinks, fuel and cigarettes.[255] The extent of these increases is such that the current general consensus amongst Tanzanians is that these sectors are already overtaxed and any further increases will lead to a further rise in the cost of living, thereby increasing poverty and impeding sustainable development.[256]

The effect of the government's inability to alter its fiscal regime to mobilise revenue is particularly critical in view of the fact that a number of reports on sustainable development and environmental protection in Tanzania have identified lack of resources as the main challenge preventing Tanzania from achieving sustainable development. For example, the country's 1997 Environmental Policy noted that one of the main ways to protect the environment is to mobilise and allocate resources towards 'poverty–related environmental problems.'[257] On the other hand, the IMF has also made it clear that without 'explicit' and 'in-depth reassessment of the current fiscal policy', Tanzania will be unable to generate the

[252] Ibid.
[253] Ibid.
[254] As discussed in section 4.3.4, some of the MDAs can last for up to 50 years.
[255] Policy Forum (n 242).
[256] Ibid.
[257] United Republic of Tanzania, *National Environmental Policy* (1997) 1 –2 2 <http://www.tzonline.org/pdf/nationalenvironmentalpolicy.pdf> accessed 17 April 2013.

revenue needed to finance the social and infrastructural needs of its rising population and growing demand for public services.[258]

Similarly, the country's current Five-Year Development Plan (FYDP) contains several 'strategic interventions' to promote the sustainable development of Tanzania.[259] The Plan notes that the 'preservation of the rich ecological base of Tanzania and mitigating and adapting to the impact of climate change are of prime importance in ensuring sustainable growth.'[260] For this reason, the plan notes that 'environmental concerns need to be mainstreamed in all future policy measures and henceforth they will be given utmost priority in FYDP along with climate-wise economic development policies.'[261] Revenue from mineral resources is supposed to be 'one of the important sources of financing the FYDP.'[262] As such, in view of the 'relatively small' revenue from the mineral sector at a time that mineral prices are increasing, the report noted that it is 'vital' for Tanzania to introduce 'a super-profit tax on the windfall earnings from the mineral sector.'[263]

Furthermore, the country's national report submitted for the Rio+20 Conference highlighted the status of the 'implementation of the 1992 Rio outcomes, challenges faced, gaps and recommendations for future improvements' in Tanzania.[264] The report noted that the country has made significant progress in implementing 'international sustainable development and environmental commitments as well as regional and national environmental agreements, policies, legislation and strategies.'[265] However, it also observed that 'despite the country's commitments', their efforts at achievements have been

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[258] IMF, *Tanzania* (n 242) 14.
[259] United Republic of Tanzania, *The Tanzania Five Year Development Plan 2011/2012-2015/2016: Unleashing Tanzania's Latent Growth Potentials* (2012) <http://www.mipango.go.tz/documents/FYDP-2012-07-26.pdf> accessed 06 May 2013.
[260] Ibid 38.
[261] Ibid 39.
[262] Ibid 90.
[263] Ibid.
[264] United Republic of Tanzania, *National Report for the United Nations Conference on Sustainable Development, Rio*+20 (2012) vii.
[265] Ibid 109.

constrained by several key factors including, 'insufficient resources to adequately address environmental and sustainable development issues.'[266] In particular, lack of funds was mentioned as the main constraint the country faces in implementing several environmental instruments including, the UN Convention on Biological Diversity (CBD), the UN Convention to Combat Desertification and the UN Framework Convention on Climate Change.[267]

The report therefore observed that Tanzania's achievement of sustainable development was dependent upon several fiscal and economic measures, including measures that will enable it to gain access to 'new, additional, predictable and stable funding for addressing sustainable development particularly new and emerging issues.'[268] For this reason, one of the 'priority interventions' suggested in the report is for the government to increase the contribution of the mining sector to the national GDP and government's revenue, in addition to improving environmental management in the mining activities. [269]

Based on the foregoing, it is difficult to see how Tanzania can achieve sustainable development when it is being constrained by stabilisation clauses from implementing vital fiscal measures required to promote sustainable development. In other words, for the government and people of Tanzania, the practical challenge posed by stabilisation clauses is not that they have stopped them from enacting new social and environmental laws. Rather, it is that they are constraining them from making the mining sector contribute more revenue to finance their sustainable development measures, including measures to improve social and environmental standards. It is therefore not surprising that, although the current Mining Act limits the scope of stabilisation clauses that may be granted by the government to fiscal

[266] Ibid. It is important to mention that none of these factors related to the lack of or inability to enact environmental laws.
[267] Ibid 42 – 44.
[268] Ibid 109 – 110.
[269] Ibid 73 – 74.

issues,[270] there is an increasing demand that this provision be reviewed to remove the possibility of providing investors with fiscal stabilisation clauses.[271]

6.5 CONCLUSIONS

A realistic analysis of the impact of stabilisation clauses reveals that it is not the constraints that the clauses impose on the legislative competence of host states in the area of social and environmental laws that affect sustainable development. Rather, it is the constraints that they impose on host states' ability to enact and implement the fiscal policies or the fiscal aspects of laws that underpin sustainable development. By exempting investors from the effects of changes in the law, stabilisation clauses reduce the policy space available to developing countries to alter their fiscal and economic policies in order to mobilise the maximum of available resources to finance their sustainable development measures. The way in which stabilisation clauses affect countries may vary from country to country. However, some of these effects may apply generally.

First, stabilisation clauses help to reinforce developing countries' reliance on foreign aid by constraining their ability to mobilise the maximum available domestic resources. As a result, their ability to define and implement their sustainable development goals in light of their specific priorities is affected because of the conditions usually tied to development aid.

Second, they prevent several developing countries from altering their fiscal regime to capture some of the 'windfall' profits brought about by the largely unexpected and sustained high prices of mineral resources.

Third, for resource-rich developing countries, stabilisation clauses may impose a significant constraint on the ability of their governments to reform energy subsidies in order to promote sustainable development. This is because the reduction of their fiscal policy

[270] Section 10 (4).
[271] See, for example, Tanzania Episcopal Conference (n 242) 32 – 33.

space deprives them of ‘climate finance’ and other funds needed to implement measures to mitigate the impact of subsidy reform on lower incomes groups.

Finally, stabilisation clauses may create policy incoherence, with implications for sustainable development as different sets of laws may be applicable to investors even within the same sector.

CHAPTER 7 - FINAL CONCLUSIONS

This thesis has examined the rationale and on-going purpose of stabilisation clauses and the way in which they undermine efforts by governments of developing countries to promote sustainable development. The main findings of the study, its wider implications and recommendations are summarised in the following sections.

7.1 SUMMARY OF MAIN FINDINGS

7.1.1 Validity and Legal Effect of Stabilisation Clauses

Within the last decade, several arbitral tribunals have provided more clarity on the legal effect and validity of stabilisation clauses. Some of the decisions are mainly focused on the interpretation of the fair and equitable treatment standard in bilateral investments treaties. However, the arbitrators went on to make useful comments on the effect that the inclusion of stabilisation clauses would have had on the outcome of the cases.

The review of the relevant cases in section 2.6 confirms that stabilisation clauses are legally valid and binding on host governments. A freezing clause freezes the laws and regulations applicable to an investment at the time the contract was concluded. It therefore prevents the government from enacting, amending or modifying any laws and regulations to the detriment of investors. An economic equilibrium clause entitles the investors to be compensated by the host state to the extent of any financial loss suffered as a result of changes in the law.

Stabilisation clauses were previously thought to only cover changes in the formal text of laws. However, the tribunal in *Duke Energy International Peru Investments No. 1, Ltd v Peru* extended it to cover a change in the interpretation of the law even if the text of the law has not changed.[1] According to the tribunal, the inclusion of a stabilisation clause in the agreement also means that a stable interpretation or application of the law, which was in

[1] ICSID Case No ARB/03/28, Award of 18 August 2008.

place at the time the agreement was signed, will not be changed to the detriment of the investor.[2] Further, the stabilised law may not be interpreted or applied in a patently unreasonable or arbitrary manner.[3]

The discussion in section 2.7.2 also shows that stabilisation clauses are legally effective in supporting claims against host states for breach of investment treaty obligations, especially obligations relating to the fair and equitable treatment standard. Where an investor benefits from a stabilisation clause, a host state is unlikely to be successful if it seeks to rely on the defence of 'police powers' to justify the regulatory changes. The investor is thus more likely to succeed in a treaty-based claim for indirect expropriation or a regulatory taking where a stabilisation clause had been granted in their favour.

The reason for the above is because the decisions of arbitral tribunals are to the effect that a stabilisation clause gives an investor an almost absolute right to claim a legitimate expectation that the laws of the host state will not change to its detriment.[4] Thus, under general customary international law, a legitimate expectation about the stability of the laws of the host state is usually considered against the circumstances of the changes and the effect of the changes on the investor. However, such an assessment may not be required where there is a specific promise of stability in the form of a stabilisation clause. All that the tribunal will be concerned with is whether the host state acted in breach of the clause. If so, then the investor is entitled to compensation irrespective of the circumstances, purpose and magnitude of the impact of the law on the investor.

7.1.2 Stabilisation Clauses: Perceptions versus Realities

Two presumptions prevail and are promoted by the extractive industry, by some international organisations, and in the legal literature. The first is that developing countries compete with each other to attract FDI. The second is that there are higher levels of political

[2] Ibid [227].
[3] Ibid.
[4] See generally section 2.6.1.

risks in developing countries. Neither of these presumptions is true as such. Nevertheless, stabilisation clauses have been presented to developing countries as an 'essential' cure for these misleading presumptions.

With regards to the presumption of the need to compete, the available evidence on current trends and future projections in the extractive industry, which is based largely on the basic economic principle of supply and demand, was analysed in section 3.2. The evidence did not point to a global bidding war between resource-rich developing countries to win FDI. On the contrary, it pointed to a more intense competition among foreign investors, backed by their home state governments, to gain access to natural resources in developing countries. As such, the idea that developing countries accept stabilisation clauses because of a need to compete to attract FDI is not one shared by this thesis.

The presumption of higher political risks in developing countries was also examined in section 3.3. The distinction made by Daniel Wagner between 'government risks' and 'instability risks' proved particularly useful in this regard.[5] This is because stabilisation clauses are drafted to deal with 'government risks' and not 'instability risks.' To determine whether 'government risks' are indeed higher in developing countries, thereby necessitating the use of stabilisation clauses, significant changes in fiscal terms in the extractive industry in resource-rich developed countries between 2002 and 2012 were reviewed.[6]

The findings showed that governments of developed countries are just as likely as those in developing countries to alter the fiscal terms in their extractive industries. This is in addition to the constant regulatory changes in developed countries that are introduced to address environmental, and health and safety issues. This thesis therefore concluded that

[5] Daniel Wagner, 'Defining Political Risks' (*IRMI,* October 2000) <http://www.irmi.com/expert/articles/2000/wagner10.aspx> accessed 22 March 2012 noting that 'instability risks' include risks such as civil wars, riots, and kidnappings while 'government risks' are those that arise from the actions of a governmental authority and include tax hikes, regulatory changes and breach of contracts.
[6] See Appendix 1.

the political risks that stabilisation clauses aim to minimise in developing countries exist, at least in equal measure, in the extractive industry of developed countries. Yet, developed countries do not offer or grant stabilisation clauses to minimise these risks but are still able to attract FDI into their extractive sectors. For this reason, this thesis disagrees with the claim that stabilisation clauses are an 'essential' requirement to attract FDI into developing countries.

The analysis in section 3.4 supports the above position taken in this thesis. The analysis showed that several developing countries do not grant stabilisation clauses but continue to attract FDI in their extractive industries. Some countries grant the clauses only to certain investors, yet other investors still invest in the same sector without the clause. Some other countries offer investors the choice to benefit from the clause upon the fulfilment of certain conditions, such as being subject to a higher tax rate or paying a premium. Again, many investors in such countries choose not to apply for it but continue to invest.

Furthermore, except in the instances where stabilisation clauses were granted at the same time the country was opening the sector to foreign investors, this study did not find any instance where the mere introduction of stabilisation clauses or stability agreements in a country led to a significant increase in FDI inflow into that country. It also did not observe any significant adverse effect on the inflow of FDI in many of the countries that have repealed, significantly undermined or reduced the scope of stabilisation clauses. The conclusion therefore is that while investors may request stabilisation clauses wherever possible, the grant or otherwise of the clause do not influence investment decisions in a significant way. This is particularly so in the extractive industry where the most important factor is, and has always been, the mineral potential of the host country.

7.1.3 Stabilising under the World Bank's Shadow and under a Dark Cloud

Stabilisation clauses became popular from the late 1960s but this popularity appeared

to diminish substantially from the 1970s onwards. The clauses however made an 'unexpected comeback' in more extensive forms from the late 1980s.[7] The common reason suggested in the literature for the revival revolves around the two presumptions discussed in the last section. However, chapter 3 concluded that these presumptions diverge from reality. There must therefore be some other explanation as to why a significant number of developing countries nevertheless re-introduced, and, in some cases, continue to grant stabilisation clauses. The conclusion in chapter 4 is that two factors contributed significantly to the return of even more extensive forms of stabilisation clauses from the late 1980s. The first was external pressure, mainly from the World Bank, while the second factor was corruption and lack of transparency on the part of the governments granting the clause.

The re-introduction of stabilisation clauses into the statute books of many developing countries from the late 1980s was largely influenced by pressure applied by the World Bank during the Bank-led reforms.[8] The World Bank saw stabilisation clauses as an essential element of an attractive investment climate. It therefore made it a key component of the legislative reforms it proposed and facilitated in developing countries. Receiving technical assistance and other forms of support from the Bank became conditional upon implementing the reforms, including the grant of stabilisation clauses.

The Bank's relationship with developing countries as a major lender and as an executing agency for projects being financed by several external donors, left many developing countries with little or no choice but to accept the reforms, especially in the light of the economic crisis at the time. They therefore included stabilisation clauses in the legislation enacted and/or the contracts concluded as part of the reform programme. All of which was in accordance with the Bank's requirement to continue to receive financial and

[7] Thomas W Wälde and Abba Kolo, 'Environmental Regulation, Investment Protection and ''Regulatory Taking'' In International Law' (2001) 50 ICLQ 811, 819.

[8] This role has received little or no attention in the legal literature on stabilisation clauses. However, it has received some attention in the political economy literature and in the work of some NGOs focused generally on the reform process.

technical assistance from the Bank. This was despite the fact that the Bank's position favouring stabilisation clauses was arrived at without a firm basis concerning the effectiveness of the clause in attracting FDI and its effect on the wider development objectives of these countries.

Corruption and lack of transparency in the contracting process also help to explain why several developing countries re-introduced stabilisation clauses and continued to grant even more extensive forms of the clause. This remained the case whether or not the contract containing the clause was a direct outcome of the World Bank's reform programme. Thus, regardless of whether these governments had been put under pressure from the World Bank, the most stringent forms of stabilisation clauses were more likely to be found in contracts or legislation entered into, or enacted by, regimes known to be (or widely perceived to be) corrupt and/or dictatorial.

Corrupt and/or dictatorial governments were therefore more likely to grant full freezing clauses or full economic equilibrium clauses. They were also more likely to grant stabilisation clauses for long durations and to allow investors to benefit from favourable changes in the law. In most cases, these contracts had been negotiated under a shroud of secrecy, and the eventual terms kept secret as well. Their terms, including the stabilisation clauses, only become known when they were leaked by civil society groups, or published by a subsequent government.

Conversely, increased transparency and accountability in the contracting process usually led to the removal or reduction in the scope of stabilisation clauses granted by a country. Within the past decade, an increasing number of countries have either eliminated or significantly reduced the scope of stabilisation clauses that they granted. This was usually done in the context of the rapid growth at the global level of transparency and accountability initiatives in the extractive industry. This suggests that while governments appear willing to

grant stabilisation clauses when negotiations are conducted in secret, they are unable to defend or justify them when they are held to account under a more transparent process. This may explain why, within the last decade, candidates or political parties have been elected into office largely by promising to review, override or undermine stabilisation clauses.[9]

It is important to point out that this thesis does not claim that only corrupt and/or dictatorial governments continue to accept stabilisation clauses. There are several developing countries where, in relative terms, stabilisation clauses are granted openly by transparent and accountable governments.[10] However, even in these countries, the claim of a link between stabilisation clauses and transparency holds true. The higher level of transparency is reflected in their stabilisation practices in terms of the scope and duration of the clause, and the extraction of some form of consideration from investors before they can access the clause.[11]

7.1.4 Sustainable Development and the Misplaced Focus on Social and Environmental Laws.

The exact meaning and legal status of sustainable development has been a subject of debate. While there are those who still argue over these issues, the basic premise of the concept and its core element are now largely established. The historical evolution of the concept reviewed in section 5.2.1 showed that the basic premise of sustainable development is that economic growth, social development and environment protection should be integrated in decision-making in order to meet the needs of the present generation without limiting the ability of future generations to do the same. Furthermore, the usage of 'sustainable development' in international legal texts and jurisprudence confirm that it is now a fully established objective of the international community and states are therefore

[9] These countries include Guinea, Sierra Leone, Mongolia, Bolivia, Peru, Ghana, Tanzania, Liberia, and Zambia.
[10] This is especially in Latin America and includes Colombia, Chile, and Peru.
[11] See section 3.4.3.

expected to conduct their affairs in line with this objective.

The discussion in section 5.2 also showed that sustainable development is not synonymous with environmental protection and/or human rights. It is also not a 'compromise term' to refer to environmental or human rights laws in developing countries. It is as much about economic development as it is about environmental protection or social development. Yet, the literature on the impact of stabilisation clauses has been focused mostly on their effect on human rights and environmental laws, even when the authors claim to be considering their impact on sustainable development.

Possible reasons for the focus on human rights and environmental laws were examined in section 5.3.1. First, the fragmented and compartmentalised nature of institutions has led to analyses of the clause focusing on the narrow compartmentalised concerns of the institution undertaking or sponsoring the study.

The second is the reluctance, especially among public international law specialists, to engage with economics or to undertake any economic analyses. Third, the focus reflects a lack of practical and theoretical understanding of the situation in developing countries. This in turn contributes to the fourth reason, which is that the debates concerning the impact of stabilisation clauses have been framed along the lines of themes prioritised by Western sponsors or authors, rather than the priorities of developing countries where stabilisation clauses are used. The final reason is that this approach is reflective of a flawed understanding and interpretation of sustainable development – one that ignores the interdependency and mutually reinforcing nature of its three pillars.

This thesis therefore concludes that the approach whereby the impact of stabilisation clauses is analysed solely in terms of its impact on environmental and/or social laws is misguided. As a result, the analyses and the solutions arising therefrom are of little practical

relevance to developing countries wishing to align their stabilisation practice with sustainable development.

In the real world, economic growth, environmental protection and social growth are interdependent and interlocked, necessitating comprehensive approaches in pursuing them. For this reason, although it is possible to classify certain laws taken to implement sustainable development according to the constituent pillar at which they are aimed, most do not fit into this strict categorisation. Their purpose and effect significantly affects more than one of the pillars of sustainable development. These laws cannot therefore be appropriately labelled as environmental, social or economic laws. They are simply sustainable development laws, even where they are not so explicitly named. The misplaced focus on social and environmental laws has thus ignored these laws even though any constraints imposed on their effectiveness by stabilisation clauses affect sustainable development.

Furthermore, for developing countries, achieving sustainable development depends to a significant extent on the ability to alter their fiscal and economic policies to ensure that available resources are maximised to fund their sustainable development measures. Since the link between these policies and the improvement of human rights and environmental standards is straightforward, any limitation placed on the ability of host states to alter their fiscal policies affects human rights and environmental protection. It is for this reason that this thesis adopted the integrated approach encapsulated in the principle of sustainable development when assessing the impact of stabilisation clauses.

7.1.5 How Do Stabilisation Clauses Constrain Sustainable Development?

Contrary to the focus in the literature, it is not the constraints that stabilisation clauses impose on the legislative competence of host states in the area of human rights and environmental laws that affect sustainable development. Rather, it is the constraints that they impose on host states' abilities to enact and implement fiscal and economic policies or the

fiscal aspects of the laws (including human rights and environmental laws) that underpin sustainable development. By exempting investors from the effect of changes in the law, stabilisation clauses reduce the policy space available to developing countries to alter their fiscal and economic policies in order to mobilise the maximum returns from available resources to finance their sustainable development measures.

The straightforward link between the three pillars of sustainable development means that while the immediate effect of the constraint may be fiscal in nature, it affects the other pillars in a significant way. This is so because the government's ability to enact the fiscal/economic policies, required to complement environmental and social laws, is constrained, as is its ability to generate funds to implement such laws. As a result, many developing countries are unable to use economic and other market-based instruments to protect the environment. Yet such instruments are very useful in addressing some of the major current environmental challenges such as climate change and unsustainable consumption of natural resources. It also affects the ability of governments to progressively enact and implement human rights laws. However, contrary to the focus in the existing literature, this inability is not necessarily because governments have lost their legislative power to enact and implement human rights laws. Rather it is because they cannot *afford* to do so.

The reduction in fiscal policy space means that developing countries may be affected in various ways. Some of these effects, which could be applicable to all countries that grant stabilisation clauses, were examined in chapter 6. First, stabilisation clauses help to reinforce developing countries' reliance on foreign aid by constraining their ability to mobilise the maximum available domestic resources. As exemplified by the case study of Tanzania, stabilisation clauses can be used by investors to undermine reforms aimed at mobilising domestic revenue. In some cases, foreign investors simply rely on stabilisation clauses to

continue to apply the previous fiscal regime. In other cases, the clauses are used as a bargaining tool by foreign investors to extract concessions from the government thereby reducing the efficacy of the law.

Domestic resources are a key facilitator of sustainable development because they are less volatile and more predictable than development aid. Furthermore, in complying with the conditions usually attached to foreign aid and loans, developing countries enact and implement policies that reflect the priorities of donor countries, rather than their own priorities. Thus, by reinforcing reliance on foreign aid, stabilisation clauses reduce the ability of developing countries to define and implement their sustainable development goals in the light of their country specific priorities.

Second, stabilisation clauses have prevented many developing countries from maximising the benefit of the largely unexpected and sustained high prices of mineral resources. This is because investors have been able to rely on stabilisation clauses to delay the enactment of windfall profit taxes. This is despite the fact that, as exemplified by the case study of Tanzania, the successful implementation of such taxes is closely linked to the sustainable development of these countries.

In instances where the governments went ahead to enact such windfall profit tax laws, investors were able to rely on stabilisation clauses to obtain exemption from their applicability or to be compensated for complying with them. Faced with the threat of international arbitration, such countries are forced to delay the enactment or implementation of the laws or to abolish them completely. Where they decide to implement them, they have been constrained to provide exemptions, or risk being sued and be ordered to pay damages by arbitrators. Whatever option taken by the government, the amount of revenue intended to be mobilised to fund sustainable development measures is either significantly reduced or altogether foregone.

Third, for resource-rich developing countries, stabilisation clauses may impose a significant constraint on their ability to reform energy subsidies in order to promote sustainable development. Stabilisation clauses constrain their ability to use economic instruments, such as carbon taxes, to generate revenue to mitigate the immediate and long term impact of such reforms on the poor. They are also constrained from using such instruments to discourage fossil fuel consumption and provide an incentive for investment in low-carbon power generation. This is because as carbon taxes constitute a fiscal measure, they are likely to be covered by tax stabilisation clauses even if they are also aimed at combating complex environmental challenges such as climate change.[12]

Stabilisation clauses also create policy incoherence and distort economic policies, with implications for sustainable development. Where they are granted only to foreign companies, they impose a greater financial burden on domestic investors who must comply with all changes in the law, including tax laws. This creates unequal competition that can significantly curtail the ability of domestic firms to grow and to maximise the benefits of the spill over effect of FDI.

Where, stabilisation clauses are granted to some foreign investors but not to others, it also creates an unfair playing field among foreign investors that may impede, rather than promote, sustainable development in the long run. Where, on the other hand, stabilisation clauses are made available to all investors, it still raises a question of policy coherence. This is because as different companies invest at different times, the stabilised laws will vary from investor to investor according to the time at which they made their investment. The result is a complex situation where different rules apply to different companies even within the same sector. This creates an unnecessary complication for the regulatory agencies that may result

[12] According to the IMF, eliminating subsidies and replacing them with appropriate carbon taxes could cut global greenhouse-gas emissions by 13 per cent and curtail air pollution. IMF, 'Energy Subsidy Reform: Lessons and Implications' (28 January 2013) 18 – 19 <http://www.imf.org/external/np/pp/eng/2013/012813.pdf> accessed 10 May 2013.

in under-regulation or no regulation at all even when the activities of the companies may undermine the sustainable development of these countries.

7.2 SOME IMPLICATIONS FOR CURRENT POLICY

The findings on the impact of stabilisation clauses summarised in the previous sections have some implications for on-going efforts to confront tax avoidance and evasion. It also raises questions about the usefulness of the solutions routinely proffered in the literature to deal with the impact of stabilisation clauses on sustainable development.

7.2.1 Stabilisation Clauses, Tax Avoidance and Evasion

As discussed in chapter 5, in recent times, the role of fiscal and tax policies in promoting sustainable development, including the protection of human rights and the environment, has taken on added significance. As a result, tax evasion and avoidance issues have been brought to the fore by several governments and organisations, including the G8 where the British Prime Minister pledged 'to drive a more serious debate on tax evasion and tax avoidance' because it is an issue 'whose time has come.'[13]

In line with his promise, the recently concluded G8 summit produced the Lough Erne Declaration containing certain principles to deal with tax evasion and avoidance.[14] These principles are particularly useful to developing countries because a major impediment to domestic resource mobilisation in many resource-rich developing countries is tax evasion and avoidance by multinationals in the extractive industry.[15] It is therefore not surprising that the declaration made specific reference to the extractive industry and the need for developing

[13] Prime Minister David Cameron, 'Speech to the World Economic Forum in Davos' (24 January 2013) <http://www.number10.gov.uk/news/prime-minister-david-camerons-speech-to-the-world-economic-forum-in-davos/> accessed 19 April 2013.

[14] G8, 'Lough Erne Declaration' 18 June 2013<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207543/180613_LOUGH_ERNE_DECLARATION.pdf> accessed 15 July 2013.

[15] See section 6.4.2; AFDB, OECD and UNECA, *Africa Economic Outlook 2010: Public Resource Mobilisation and Aid* (AFDB and ors 2010).

countries to have the information and capacity to collect taxes owed to them.[16] The question however is to what extent can developing countries apply the principles contained in the declaration where they have granted stabilisation clauses to the multinationals in the extractive industry?

Dealing with tax evasion and avoidance require governments to enact new tax laws or amend existing laws to close legal loopholes. It is in recognition of this that the Declaration enjoined countries to 'change rules that let companies shift their profits across borders to avoid taxes.…'[17] The findings in this thesis suggests that where stabilisation clauses have been granted to investors, any change in the taxation rules that increase the investors' tax liability may be in breach of the stabilisation clauses. This may require the host country to compensate investors to the extent of the additional tax collected as a result of the change in the rules, thereby making the change in the rules meaningless.

For example, in *Duke Energy v. Peru*, the tax authority relied on a general tax-avoidance provision to make a new tax assessment for the claimant because it found that the merger involving the investor was a 'sham' transaction conducted to avoid tax liability.[18] This new assessment, which increased the tax liability of the claimant, was held to be in breach of stabilisation clauses because it changed the stable interpretation of the law.[19] Peru was therefore ordered to compensate the investor to the extent of the loss suffered as a result of the change in the stable interpretation of the tax rules.[20]

As rightly noted by the Lough Erne Declaration, 'governments have a special responsibility to make proper rules and promote good governance' and 'fair taxes, increased

[16] G8 (n 14) paras 5 - 6.
[17] Ibid para 2.
[18] *Duke Energy v Peru* (n 1). The general tax avoidance rule is Rule VIII of the Peruvian Tax Code (*as amended* 22 September 1996) which authorises the tax authority to apply 'all interpretation methods admitted by Law' and to look into the 'business relations, situations and acts that are actually performed, pursued or established by tax debtors' when determining the 'true nature of a taxable act'.
[19] Ibid [227[- [228]
[20] Ibid [460] – [485]

transparency and open trade are vital drivers of this.'[21] However, the arbitral jurisprudence on stabilisation clauses suggests that the legitimacy, purpose or fairness of changes to tax laws will be immaterial if the changes are implemented contrary to stabilisation clauses.[22] The implication is that developing countries' governments must continue to apply stabilised law and must not change its interpretation or risk paying compensation to investors. This is so even if the laws are being used mischievously by investors to evade or avoid taxes.

Furthermore, there is also significant evidence that in addition to weak tax laws, foreign investors exploit the weak tax structures in developing countries to evade or avoid taxes and royalties.[23] It is perhaps for this reason that the Lough Erne Declaration also pointed out the need for developing countries to have the information and capacity to collect taxes owed to them.[24] To achieve this, developing countries will need to make huge investments in improving the size and capacity of their tax authorities to deal with the increasingly sophisticated tax avoidance techniques employed by multinationals. Since stabilisation clauses reduce the fiscal policy space available to host states, their ability to mobilise the additional revenue required to improve the capacity of their tax authority is constrained. It therefore remains to be seen how the latest efforts being spearheaded by the G8 to deal with tax evasion and avoidance can be applied by developing countries that have granted stabilisation clauses.

It is therefore suggested that if this latest effort by the G8 is to be relevant and beneficial to developing countries which have granted stabilisation clauses, any legal commitments or principles should go further to include provisions that restore the policy space lost to stabilisation clauses. Provisions should be included enabling developing

[21] G8 (n 14) preamble.
[22] *Duke Energy v. Peru* (n1) [344] – [355]; Section 2.7.2.
[23] See, for example, OSISA, *Breaking the Curse: How Transparent Taxation and Fair Taxes can Turn Africa's Mineral Wealth into Development* (OSISA 2009).
[24] G8 (n 14) para 4.

countries to nullify any agreement or parts of such agreements that encourage or facilitate tax avoidance and evasion irrespective of stability guarantees.

In addition, G8 members are home governments to the majority of investors in the extractive industry of developing countries. As such, if they want their current efforts to combat tax evasion and avoidance to be effective, they should match their commitment with action when it has to do with their home companies investing in developing countries. This is particularly so whenever a developing country attempts to review contracts entered under questionable circumstances. It is common to after all, find media reports describing how home governments are applying pressure on the host government to not undertake the review in a way that adversely affects their home companies.[25]

7.2.2 Stabilisation Clauses and Unsustainable Solutions

The findings in this thesis also raise serious doubts about the practical usefulness of what has now become the default recommendation for dealing with the impact of stabilisation clauses. Almost all the literature on the impact of stabilisation clauses concludes by recommending that environmental and social laws (including human rights laws) should be excluded from the scope of stabilisation clauses. This recommendation is proffered even when the particular literature explicitly claims to focus on the impact of the clause on sustainable development.[26]

However, from the findings in this study, it is hard to see how this recommendation can minimise the constraining effect of stabilisation clauses in any significant way. Indeed, the recommendation appears to be based on the flawed understanding and interpretation of

[25] See, for example, reports of how the Canadian government applied pressure on DRC which reportedly contributed to DRC's decision to settle with a Canadian company over the cancellation of illegitimate mining contracts. For details, see, Macho Philipovich, 'Why is Canada Blocking Congo's Debt Forgiveness' *The Dominion* (11 August 2010) <http://www.dominionpaper.ca/articles/3573> accessed 12 September 2013; Matthew McClearn, 'How First Quantum settled with ENRC for compensation over Congolese Mine' *Canadian Business* (05 July 2012) <http://www.canadianbusiness.com/business-strategy/how-first-quantum-settled-with-enrc-for-compensation-over-congolese-mine/> accessed 12 September 2013.

[26] See, for example Audley Sheppard and Antony Crockett, 'Are Stabilisation Clauses a Threat to Sustainable Development' in Marie–Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe, (eds), *Sustainable Development in World Investment Law* (Kluwer Law 2011) 329 – 350.

sustainable development identified in section 5.3.1.5. This is because the reasoning behind this recommendation is that if such laws are not covered by stabilisation clauses, the host state will be 'free' to enact and implement human rights and environmental laws thereby promoting sustainable development.

However, contrary to the above reasoning, in the real world, economic growth, social development and environmental protection are interdependent and mutually reinforcing. Indeed, the analysis in section 5.3.2 and the discussion in chapter 6 including, the case studies, show that laws taken to promote sustainable development are increasingly becoming difficult to label 'social', 'environmental' or 'economic' law as they significantly affect all three pillars and seek to integrate them. As such, a solution that seeks to emphasis the individuality of each pillar rather than contribute to their integration, is not only impracticable but also negates, rather than promotes, sustainable development.

Furthermore, the findings in this thesis, as exemplified by the case studies, show that it is not the constraints stabilisation clauses impose on the legislative competence of host states in the area of human rights and environmental laws that affect sustainable development. It is the constraints that they impose on their ability to enact and implement fiscal and economic policies, or the fiscal aspects of the laws that underpin sustainable development. Indeed, none of the literature proffering this solution contains any evidence from the real world of the problem it is intended to solve. This is because, as Sheppard and Crockett rightly admitted, there does not appear to be any.[27]

The reason behind the absence of such evidence is that the major constraint in improving human rights and environmental standards in developing countries is the lack of financial resources, rather than lack of laws or inability to enact new laws.[28] It is therefore hard to conceive of a situation where host states will enact and implement new human rights

[27] Ibid 335.
[28] See generally chapter 6.

and environmental laws if stabilisation clauses prevent them from mobilising the additional resources usually required to implement such laws. This is why Sheppard and Crockett did not find any reported case law, arbitral award, or even anecdotal evidence that demonstrates that stabilisation clauses affect the enactment of human rights and environmental laws.[29] Yet, they concluded with the same recommendation i.e. that human rights and environmental laws should be excluded from the scope of stabilisation clauses as a way of dealing with the constraints that the clauses impose on sustainable development.[30] In other words, they, like the other authors, are prescribing a drug to cure an ailment that no one, including them, has been able to diagnose.

A second, but less frequent, recommendation in the literature is that economic equilibrium clauses should be granted in place of freezing clauses.[31] The reasoning behind this recommendation is that economic equilibrium clauses are less obstructive to the state's legislative power as they do not prevent the host state from enacting new laws. Rather, they merely ensure that compensation is paid to investors. They are therefore seen as creating a 'win-win' situation because host states can change their laws and apply them to all investors while the investors are protected from the adverse effect of these changes by being compensated.[32]

Again, it is difficult to conceive how this recommendation will be useful in practice in dealing with the actual constraints that stabilisation clauses impose. This is because in practice, the legal effect of an economic equilibrium clause and a freezing clause is the same. The main consequence of a breach of either of them is the payment of compensation to

[29] Sheppard and Crockett (n 26) 339-340
[30] Ibid.
[31] See, for example, Herbert Smith, 'Stabilisation Clauses - Issues and Trends' (2010) 36 Infrastructure and Mining Newsletter, 1; Talal AQ Al-Emadi, 'Stabilization Clauses in International Joint Venture Agreements' (2010) 3 *International Energy Law Review* 54, 57; Lorenzo Cotula, 'Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses' (2008) 1 JWELB 158, 178.
[32] Ibid.

restore the investor to the same economic position as existed before the breach occurred.[33] The stabilisation clause in *Duke v Peru* was a freezing clause while that in *Burlington v Ecuador* was an economic equilibrium clause. Yet in both cases, the tribunals held the host states liable to pay compensation to the investors to restore them to the same financial position they would have been in if the changes in the law had not occurred.

It is therefore hard to see how the economic equilibrium clause can be a 'win' for host states when it imposes a price tag that is roughly equivalent to the price tag of a freezing clause on host governments' regulatory powers. Thus, for example, where a government enacts a windfall profits tax law, an economic equilibrium clause will not prevent the government from collecting the tax from an investor with a stabilisation clause. However, it ensures that the government will have to return the tax to the investor, or otherwise compensate the investor to the extent of the tax collected. This defeats the purpose of the law thereby making it meaningless and a waste of the government's time. Indeed, in the *Burlington* case, the claimant itself argued that Ecuador ignored its requests for the application of the economic equilibrium clause because compliance with the clauses would have been 'incompatible' with Ecuador's aim in imposing the windfall profit tax.[34] The suggestions to developing countries to exclude human right and environmental laws or to grant economic equilibrium clauses as a way of reconciling stabilisation clauses with sustainable development is therefore ill-conceived.

7.3 RECOMMENDATIONS

7.3.1 To Stabilise or Not to Stabilise?

The findings in this thesis show that whatever solutions proposed to deal with the constraints that stabilisations clauses impose on sustainable development, should not simply

[33] See section 2.6.3
[34] *Burlington Resources Inc v Ecuador*, ICSID Case No ARB/08/5, Decision on Liability of 14 December 2012 [356]

be focused on the scope of the stabilisation clauses to be granted. More importantly, they should focus on the way the clauses are granted and how they should allow for more flexibility. Before then, it is even more important for host states to decide whether or not to grant stabilisation clauses.

A key conclusion reached in this study is that contrary to the claims of proponents, stabilisation clauses are not essential in attracting FDI to the extractive sector of developing countries. This conclusion is supported by recent empirical studies that suggest requests for stabilisation clauses are largely rent–seeking behaviour by investors. There is therefore strong justification for countries to move away from granting stabilisation clauses, at least as they are currently drafted. As such, the first question a government must ask itself when stabilisation clauses are requested is not the scope of the clause that should be granted. Rather, it is whether the clause is necessary and legitimately required by the investor.

As discussed in chapter 4, the closest economic justification for stabilisation clauses is the argument that investors pay higher risk premiums for investment projects in developing countries due to the perceived higher risks.[35] For this reason, it is the view of proponents of stabilisation clauses that governments of developing countries can increase their share of rents by making their investment environment less risky thereby lowering risk premiums for foreign investors.[36] It is thus important that when considering whether to grant a stabilisation clause, that the government carries out an assessment to determine whether it is more beneficial and sustainable to contract away potential future tax revenue or to allow investors to pay the higher risk premium where applicable. This is especially so because studies by some economists have shown that foreign investors actually receive excessive

[35] Section 4.3.3; World Bank, *Strategy for African Mining* (World Bank 1992) 17.
[36] Ibid.

returns on their investment in the countries often considered as having higher political risks.[37]

For example, Margaret McMillan and Andrew Waxman conducted an econometrics study on US multinationals operating in extractive industries abroad.[38] They found that the investors were able to obtain particularly generous deals in developing countries with high levels of corruption and weak governance.[39] They also made two other findings relevant to the present discussion.

First, they used contracts in the Chadian oil sector, including the Chad-Cameroon pipeline project, as a case study. They found that these contracts were 'extremely generous' to the foreign investors.[40] Significantly, these are also contracts identified in this thesis as having broad and stringent stabilisation clauses.[41] Thus in effect, the investors were presumably granted stabilisation clauses to reduce their risk premiums, yet the balance of the contracts, in terms of profit-sharing were still tilted heavily towards the investors.

The second finding has to do with the involvement of the World Bank. McMillan and Waxman found that although the World Bank was 'extensively involved' in the negotiations leading to the contracts, their involvement had not been 'very effective' at helping the host state get a better deal.[42] This finding should be a lesson for developing countries who routinely seek to justify the terms of contracts simply because the World Bank was involved and has approved of it. So, the mere fact that the World Bank is involved or recommends that stabilisation clauses should be included in a contract, should not preclude governments

[37] See as examples, Margaret S McMillian and Andrew R Waxman, 'Profit Sharing between Governments and Multinationals in Natural Resource Extraction: Evidence from a Firm-level Panel' (2007) *Brookings Trade Forum* 149; Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It* (OUP 2007) Part 2.
[38] Ibid. The study by McMillian and Waxman used panel data between 1982 and 1999 from the Bureau of Economic Analysis of the US Department of Commerce.
[39] Ibid 159 – 160.
[40] Ibid 166.
[41] See section 4.3.3.
[42]McMillan and Waxman (n37) 166.

from carrying out their own assessment to determine whether or not to grant stabilisation clauses.

In carrying out the assessment, developing countries' governments must realise that their mineral potential represents a major competitive advantage.[43] This in itself is a strong bargaining tool, which they must begin to responsibly utilise in their favour. Governments must also keep in mind the level of intensity of the competition among foreign investors for the extractive resources in their countries. A long queue in the number of potential investors is the best indication that the overall balance between fiscal terms and other considerations is right.[44] In such a case, stabilisation clauses may be unnecessary.

Developing countries need to continue to seek to maintain an attractive investment climate. They should therefore continue to offer legal protection to foreign investors from arbitrary and opportunistic unilateral adjustments to the fiscal regime governing their investment. This is because too frequent changes to the fiscal regime may reduce the overall viability of FDI in a country and consequently reduce its inflow. However, such protection must be given in such a way that it does not unduly constrain the pursuit of their legitimate sustainable development goals. The evidence seen in this study is that stabilisation clauses, as they are currently drafted, do not achieve this balance. Rather, they give foreign investors an extensive bargaining power that can be used to oppose even marginal changes proposed by host states for perfectly legitimate reasons.

Accordingly, while countries may wish to offer protection for investors, such protection must be flexible enough to allow their governments to enact and implement policies, including fiscal policies, required to pursue their sustainable development goals.

[43] See section 3.2 and in particular the fact that reserves in developing countries remain, in principle, 'large enough' and development cost 'low enough'. International Energy Agency, *World Energy Outlook 2008* (IEA 2008)40.

[44] William F Arnold, 'Mongolia Mining Sector Competitiveness and the Use of Stability Agreements' (2004) Report on Mongolia Economic Policy Reform and Competitiveness Project, 5 <http://www.eprc-chemonics.biz/documents/tech_reports/apr15_2004_mining_stability_en.pdf> accessed 22 March 2012.

One way to do this is to draft stabilisation clauses to cover only discriminatory laws. In other words, all new laws, including fiscal laws should apply to all investors as long as the laws are not discriminatory in their application. In this context, laws are not regarded as discriminatory merely because they apply only to companies in the same sector or in 'similar circumstances'.[45] Models of such clauses are already in use in the few OECD countries that grant stabilisation clauses.[46]

While it could be argued that such clauses are possible in these countries due to the relatively low perception of risk, such an argument is countered by the discussion on political risks.[47] Even the Shemberg study was unable to explain the disparity simply on the basis of perception of risk.[48] Rather, she also listed other factors including the type of clause offered historically to the same or other investors and the different levels of training of the drafters.[49] Indeed, during discussions on the study findings, legal experts expressed surprise that developing countries' governments still agree to the extensive forms of stabilisation clauses.[50] In response, several developing countries' negotiators confessed that they agree to such clauses because they were unaware of alternatives.[51] This is all the more reason why policy-makers in developing countries wishing to grant stabilisation clauses should consider this limited form of the clause.

7.3.2 Stabilisation Clause Impact Assessment

The last section recommended that stabilisation clauses be discarded completely or be limited to discriminatory laws. However, since the situation and circumstances in every developing country is not exactly the same, the possibility that stabilisation clauses may be

[45] This is the interpretation of discriminatory laws in *CMS Gas Transmission Co. v Argentina,* ICSID Case No ARB/01/8, Award of 12 May 2005 [293] – [295]
[46] Andrea Shemberg 'Stabilization Clauses and Human Rights (2009) Report, paras 83 – 92.
[47] Section 3.3
[48] Shemberg (n 46) paras 104 - 110.
[49] Ibid.
[50] UNGA, 'Report of the Special Representative of the Secretary- General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, 22 April 2009, UN Doc A/HRC/11/13, para 33.
[51] Ibid.

necessary in some countries cannot be entirely ruled out. This section recommends how stabilisation clauses may be granted in such instances and in a way that will better align the clauses and FDI with the sustainable development objectives of the state.

Where a host state decides that there is a legitimate and verifiable reason to grant stabilisation clauses beyond discriminatory laws, it is proposed that a Stabilisation Clause Impact Assessment (SCIA) be undertaken before such clauses are granted. The purpose of a SCIA will be to ensure that the implications of the proposed stabilisation clauses and their potential impact on the ability of the country to enact and implement laws in furtherance of their legitimate sustainable development objectives are identified, evaluated, and where possible mitigated.

The SCIA should be conducted through a process that allows for the active participation of all the relevant government ministries, agencies and the general public. The basis for the involvement of relevant government ministries and agencies is simple. The findings in this thesis show that the constraints that stabilisation clauses impose on the regulatory ability of states cut across several government ministries and agencies, that in many cases were not consulted before the clauses were granted.[52] It therefore makes sense that to ensure that stabilisation clauses do not impose unintended limitations on the discharge of their functions, their views should be sought and approval obtained.

The determination of the specific bodies to consult can be aided through the application of the practice in Colombia where investors must identify, in their application for stability agreements, the specific laws or sections or laws that they want stabilised.[53] If this requirement is incorporated in a SCIA, the relevant ministries or agencies can be determined according to how the laws proposed to be stabilised by the investor affects the discharge of their functions.

[52] See especially in the case studies in section 6.2.
[53] See generally arts 1-3 Law 963 of 2005.

The second key element of the proposed SCIA is public participation. It is already a settled position, especially at the international level, that environmental issues are best handled with the participation of all concerned citizens.[54] This thesis has shown that stabilisation clauses not only constrain environmental protection, but also social development and economic growth. There is thus a strong justification for citizens to be able to participate in the process leading to the grant of the clause, not just to protect the environment but also to protect development. This is especially so because it is the citizens who suffer if a government is unable to mobilise the maximum available financial resources to pursue the country's sustainable development goals. This is apart from the fact that they are also the ones directly affected by the adverse effects of investment projects. It is therefore important that where stabilisation clauses are to be granted to potentially insulate such contracts for decades and bind the hands of future governments, those affected should have their say on whether the clauses should be granted or not.

Questions may be asked whether the citizens have the technical and legal capacity to participate effectively in the proposed SCIA. However, there is significant evidence in developing countries to show that citizens, acting through civil society organisations and religious groups, have offered both solicited and unsolicited responses to potential and actual stabilisation clauses.[55] In some of these cases, their involvement helped to eliminate stabilisation clauses or to reduce their scope.[56] The involvement of the public is thus likely to help ensure that proposed stabilisation clauses pass the test of transparency, honesty and due process thereby helping to prevent unnecessary or unjustifiable stabilisation clauses from being granted.

[54] See, for example, 'Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters' (Aarhus, Denmark, on 25 June 1998).
[55] See sections 4.3.4.1 and 5.3.2.4.
[56] See, for example, the stabilisation clauses in Tullow PSAs in Uganda and in London Mining' MDA in Sierra Leone discussed in section 4.3.4.1.

Furthermore, the involvement of the public should be an added incentive on the part of the government to negotiate a better deal with fairer and more balanced terms for the country. Indeed, most of the controversies over stabilisation clauses granted in secret did not arise simply because a stabilisation clause was granted. It had more to do with the fact that the terms that were stabilised usually appeared over-generous to the investors while providing little benefit for the host states. On the other hand, in several instances where increased transparency and accountability led to the elimination or reduction in scope of stabilisation clauses, the changes also included adjustments to the contracts to increase the benefits to the host state.[57]

Investors also stand to benefit from the conduct of a SCIA. The analysis in chapter 4 showed that contracts negotiated in secret and under questionable circumstances are inherently unstable.[58] Such contracts fuel public perception of corruption and unfair terms and often lead to demands for cancellation or restructuring by citizens pushing for greater accountability. Ultimately, the government is forced to act or be voted out of office and replaced with candidates who make explicit promises to review the contracts.[59] Thus, from the perspective of investors, obtaining a more durable contract is closely linked to the legitimacy of the process that led to the contract in the first place. A SCIA, incorporating public participation, is therefore useful in clothing contracts with legitimacy.

7.3.3 Flexible and Beneficial Stabilisation Clauses

Where a host state decides to grant stabilisation clauses and has decided to do so transparently and on an accountable basis, it is recommended that it should aim to retain some measure of flexibility to ease the constraints that the clauses impose. In the first place, it is useful to exclude certain types of law from the scope of the stabilisation clauses. However, unlike the common recommendation in the literature, the laws to be excluded

[57] See, for example, Mittal Steel MDA in Liberia
[58] See section 4.3.4.
[59] Ibid.

should not be limited to human rights and environmental laws. Rather, all laws that the host state considers to be fundamental to their sustainable development objectives should be excluded. In other words, each country should decide, in accordance with their particular circumstances and situation, the type of laws that should be excluded. The label attached to such laws is immaterial.

The stabilisation practice in Colombia is again a good example in this regard. In Colombia, stability agreements cannot cover laws relating to social security, taxes of a temporary nature decreed by the national government during periods of emergency, indirect taxes, moderate regulation of the financial sector, the price rate regime for public utilities and acts of a general character of the country's Central Bank.[60]

While the scope of stabilisation clauses granted is important, the rigidity of the clause also plays a significant role in constraining host states from pursuing their legitimate sustainable development objectives.[61] As such, a major concern for host states when drafting stabilisation clauses should be to balance stability with flexibility to allow the government to enact and implement laws to deal with important, but unforeseen, changes. The findings in this thesis show that the most rigid forms of stabilisation clauses are found in Africa. Yet, and as further evidence of the inconsistency in the use of stabilisation clauses, some of the best practices in terms of incorporating flexibility into contracts with stabilisation clauses are also found in Africa.

Lessons can be learnt in this regard from recent stabilisation clauses granted in the Liberian mining sector.[62] Provisions are included for a periodic review of the stabilised taxes and duties every five years. The stabilised taxes and duties may then be adjusted if the review justifies it. In addition, the agreements can also be modified at any time where a 'Profound Change in Circumstances' has occurred. The combination of these two provisions

[60] Art 3 Decree 2950 of 2005 which partially regulates Law 963 of 2005.
[61] See generally section 4.3.3.
[62] See section 4.3.4.2.

may, for example, give governments a stronger legal basis to impose a windfall tax to capture some of the benefits of the recent windfall brought about by high prices of mineral resources.

Aside from excluding specific types of laws and allowing for some measure of flexibility, it is also important that host states seek to extract as much benefit as possible from a stabilisation clause. To do this, governments must first do away with the idea that exists in most of the literature on stabilisation clauses that the inflow of FDI is the reward a host states gets for granting stabilisation clauses. Rather, they should start to see stabilisation clauses as an 'icing on the cake' i.e. an additional incentive or special favour to foreign investors. Such a view of stabilisation clauses is an important step towards the formulation of a stabilisation practice that seeks to extract additional benefit for the host state in return for granting the clause.

In terms of regional practices, this recommendation is particularly relevant to African governments as it is in this region that this problem is prevalent. On the other hand, Latin America offers a good template of how governments can benefit from stabilisation clauses.[63] Thus in exchange for granting stabilisation clauses, it is wise for governments to require investors to furnish some form of consideration, such as the payment of a premium or accepting to be subjected to a higher tax rate.[64] Again, Colombia offers a good template in this regard as stability guarantees are only granted subject to the payment of a premium which is assessed according to the risks to be assumed by Colombia if it enters into the proposed stability agreement.[65]

A final good practice that other countries should learn from Colombia is the granting of stabilisation clauses to both foreign and local investors provided they meet certain

[63] Again, this disparity appears to be linked to the transparent and uniform manner in which stabilisation clauses are granted.
[64] See section 4.3.4.
[65] Articles 48 - 49 Law No 1450 on National Development Plan, 2011.

conditions.[66] Doing so will help to eliminate the unfair competition between domestic and foreign investors identified in section 6.3.4. Consequently, it will strengthen the ability of domestic firms to maximise the benefits of the spill-over effects of FDI thereby facilitating the contributions of FDI to the sustainable development of the country. The fact that many domestic investors applied for stability agreements in Colombia is an indication that even domestic firms desire stability concerning the regulatory regime. There is therefore no reason why stabilisation clauses should not be available to them if they are available to foreign investors.

7.3.4 Applying the 'Police Powers' Doctrine to Interpret Stabilisation Clauses.

The previous recommendations focused on whether stabilisation clauses should be granted, and if so, how? The question therefore remains as to what might be done to ease the constraints imposed by stabilisation clauses already granted. This question is particularly important because of the usually long duration of stabilisation clauses. While some of these issues may be eventually resolved through negotiation, many are likely to end up in international arbitration, as is increasingly becoming the case.

Arbitral tribunals thus have an important role in reconciling existing stabilisation clauses with sustainable development. This is the more so because it is the threat of international arbitration that in most cases discourages governments from enacting or implementing laws to promote sustainable development. And as some commentators have noted, these threats have been effective mainly because of the almost unconditional support given to stabilisation clauses by arbitral tribunals.[67] It is therefore important that arbitral tribunals re-assess the way in which they interpret stabilisation clauses and begin to interpret it in a way that can accommodate host states' legitimate pursuit of sustainable development.

[66] Section 3.4.3.1.
[67] Thomas W Wälde and George Ndi, 'Stabilizing International Investment Commitments: International Law versus Contract Interpretation' (1996) 31 *Texas Intl LJ* 215.

The principle of sustainable development is now an overarching objective of the international community and an evolving norm of customary international law.[68] This is a sufficiently strong reason for tribunals to recognise the principle when giving legal effect to stabilisation clauses. It is admitted that the imprecise and elastic nature of sustainable development may pose a challenge. However, such a challenge can be overcome in most situations through a case-by-case approach which takes into account all the relevant factors. This is similar to the approach taken by arbitral tribunals in deciding whether investors' legitimate expectations of stability arising from an investment treaty have been breached.

For example, in *Duke Energy Electroquil Partners & Electroquil S.A. v Ecuador,* the tribunal noted:

> To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest.[69]

Although this case dealt with a treaty obligation on the fair and equitable treatment standard, it is argued that this line of reasoning can, and should be applied to stabilisation clauses arising from contractual commitments.

[68] See section 5.2.4.
[69] ICSID Case No ARB/04/19, Award of 18 August 2008 [340]

A review of arbitral decisions suggests that the reason why tribunals do not apply this reasoning to contractual guarantees of stability is because they view such guarantees as a 'specific commitment' by host states not to change their laws to the detriment of investors.[70] While this may be true, the fact that a host state gave a 'specific commitment' should not preclude a tribunal from assessing the reasonableness or legitimacy of that 'specific commitment' in the light of the political, socioeconomic, cultural and historical conditions prevailing in the host state when the commitment was made.

The need for tribunals to assess the legitimacy and reasonableness of stabilisation clauses is further justified by the fact that many of these clauses were granted through opaque processes by unelected, unaccountable and/or notoriously corrupt regimes. Investors should not therefore be given a blanket right to a legitimate expectation of stability because of a 'specific commitment'. In other words, they should not be able to rely on stabilisation clauses granted by corrupt dictators to challenge legitimate measures taken by subsequent governments to promote sustainable development. It is therefore proposed here that contrary to the current position being taken by arbitrators, an investor's legitimate expectations should not be validated simply because of a stabilisation clause. Rather the approach prescribed in *Duke Energy v Ecuador* should be applied.

From an international law perspective, such an interpretation of stabilisation clauses will help facilitate the much needed linkage between the international investment law regime and law in the field of sustainable development. Investment remains a primary driver of sustainable development and ensuring that it contributes to sustainable development is a priority for developing countries in particular.[71] However, to succeed in this regards, investment policies must aim to operationalise sustainable development in concrete measures

[70] Sections 2.6.1 and 2.7.3.
[71] UNCTAD, *Investment Policy Framework for Sustainable Development* (UNCTAD 2012) 1 – 9.

and mechanisms.[72] In other words, investment law regimes and sustainable development law regimes must be inextricably linked if FDI is to contribute to sustainable development. Yet, at present, especially at the international level, this is hardly the case as international investment law has yet to significantly reflect sustainable development law and policy.[73]

It is for the above reason that some commentators have argued that decisions of arbitrators always empower investors at the expense of states because the decisions are based on commercial, and not national, considerations.[74] It is also for this reason that several Latin American countries have previously been indifferent or opposed to international arbitration and more recently have been denouncing ICSID.[75] The current approach whereby the sustainable development objectives of laws are regarded as immaterial because of stabilisation clauses reinforces these perceptions and widens, rather than closes, the gap between the international investment law regime and sustainable development law and policy. There is therefore a pressing need for change.

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[72] Ibid.

[73] See Howard Mann, 'International Investment Law and Sustainable Development: Challenges for A New Agenda' (Institute for Sustainable Development and International Relations Conference, Paris, 25 March 2008) <http://www.iddri.org/Evenements/Seminaires-reguliers/080325_sddee_mann.pdf> accessed 24 January 2014.

[74] See as examples, Greg Muttitt, *Crude Designs: The Rip-off of Iraq's Oil Wealth* (PLATFORM 2005) <http://www.platformlondon.org/carbonweb/documents/crude_designs_small.pdf> accessed 16 July 2013; Sarah Anderson and Sara Grusky, 'Challenging Corporate Investor Rule: How the World Bank's Investment Court, Free Trade Agreements, and Bilateral Investment Treaties have Unleashed a New Era of Corporate Power and What to Do About It'(2007) <http://www.ips-dc.org/reports/#139> accessed 16 July 2013.

[75] For an up to date discussion of Latin America and ICSID, see Sergio Puig, 'Emergence and Dynamism in International Organizations: ICSID, Investor-State Arbitration & International Investment Law' (2013) 44 *Georgetown J of Intl Law* 531.

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APPENDICES

Appendix I:
Significant Changes in Fiscal Terms in the Extractive Industries in Selected Developed Countries (2002 – 2012)

Country	Year	Type of Change	Main Sector Affected
Australia	2008	Excise tax on Condensate.	Oil and Gas
Australia (Western Australia)	2011	Royalties increased.	Mining
Australia	2012	Minerals Resources Rent Tax introduced. Petroleum Resource Rent Tax extended to all oil and gas production.	Mining/Oil and Gas
Australia	2012	Minerals Resources Rent Tax introduced. Petroleum Resource Rent Tax extended to all oil and gas production.	Mining/Oil and Gas
Australia(New South Wales)	2011	Royalties increased.	Mining
Canada (Newfoundland)	2007	Royalties increased.	Oil and Gas
Canada (Alberta)	2007	Royalties increased (commenced in 2009).	Oil and Gas
Italy	2008	Tax rate increased.	Oil and Gas
UK	2002	Supplementary charge (Windfall Tax) introduced.	Oil and Gas
UK	2005	Windfall profit tax increased.	Oil and Gas
UK	2011	Windfall tax profit increased.	Oil and Gas
US	2006	Royalties imposed.	Oil and Gas
US (Alaska)	2006	Higher tax rates Petroleum Profits tax introduced to replaced production tax	Oil and Gas
US (Alaska)	2007	Petroleum Profits Tax increased	Oil and Gas
US	2012	Mining Royalty to be introduced	Mining
US	2012	Windfall Profit Tax (currently under review in Congress)	Oil and Gas

Appendix II:
Significant Changes in Fiscal Terms in the Extractive Industries in Selected Developing Countries (2002 – 2012)

Country	Year	Type of Change	Main Sector(s)	Scope
Algeria	2006	Windfall Profit tax (WPT) introduced.	Oil/Gas	New and existing contracts
Bolivia	From 2005	Royalty rates increased/nationalisations.	Oil/Gas	New and existing contracts
Chile	2006	New tax introduced.	Mining	All companies without stability contracts.
Chile	2010	Mining tax increased.	Mining	As with the 2006 changes
Ecuador	From 2006	WPT introduced/royalty rate increased/ nationalisations.	Oil/Gas	New and existing contracts
Equatorial Guinea	2006	Stabilisation Clauses abolished.	Oil/Gas	New and existing contracts
Ghana	From 2011	Tax increased/WPT introduced/ stability agreements under review.	Mining	New and existing contracts
Guinea	2011	Custom duties increased/Review of mining contracts commenced.	Mining	New and existing contracts
Kazakhstan	2003	Stabilisation Clauses repealed from 31 December 2002.	Most sectors	All new contracts
Kazakhstan	2008 - 2010	Fiscal regime overhauled through a new mining code.	Oil/Gas	New and existing (exceptions for some PSCs)
Mongolia	2006	WPT introduced	Mining	New and existing contracts. (*imposed on companies with stability agreements after negotiations)*
Peru	2011	WPT and 'special contribution' introduced/Royalty rate increased.	Mining	New and existing contracts (*Companies with stability agreements to only pay the "special contribution"*
Venezuela	From 2002	Nationalisations/WPT introduced.	Oil/gas	New and existing contracts
Zambia	From 2008	Stabilisation clauses abolished new tax and royalty rate introduced.	Mining	New and existing MDAs

Appendix III:
List of Jurisdictions Reviewed (*Both in terms of stabilisation practices and changes in fiscal regimes*)

Developing Countries

Algeria	Angola	Argentina	Azerbaijan
Bangladesh	Bolivia	Botswana	Brazil
Cameroon	Chad	Chile	China
Colombia	Costa Rica	Democratic Republic of Congo	Ecuador
Egypt	Equatorial Guinea	Ghana	Guatemala
Guinea Bissau	India	Indonesia	Iraq
Ivory Coast	Kazakhstan	Kuwait	Kyrgyzstan
Liberia	Libya	Madagascar	Malawi
Mauritania	Mexico	Mongolia	Mozambique
Namibia	Nepal	Nigeria	Norway
Panama	Papua New Guinea	Paraguay	Peru
Puerto Rico	Russia	Sao Tome and Principe	Saudi Arabia
Sierra Leone	South Africa	Syria	Timor-Leste
Turkey	Uganda	Uzbekistan	Venezuela
Yemen	Zambia		

Developed Countries

Alaska, United States	Alberta, Canada	Canada	Italy
New South Wales, Canada	Newfoundland, Canada	UK	US
Western Australia, Australia			