Stabilisation Clauses

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Contents

Part I – THE PROBLEM

1. State sovereignty
2. Investor risks arising out of sovereignty

Part II – THE SOLUTION

3. Internationalise the contract
4. Role of Stabilisation Clause
5. Validity and Effectiveness of Stabilisation Clause
6. Categories of Stabilisation Clauses
7. Enforcement of Stabilisation Clauses
Part I – THE PROBLEM

1. State sovereignty

2. Investor risks arising out of sovereignty
1. State sovereignty

1.1 Full control of its affairs within its territory

1.2 Sovereign normative authority

1.3 State's power to bind itself by contract is subject to special prerogatives
1.1 Full control of its affairs within its territory

State is sovereign when exercising all the functions of a **sovereign government**, in maintaining law and order, adopting or imposing laws regulating the relations of the inhabitants of the territory to one another and to the Government.

Its government possesses **full control** over its own affairs within a territorial area and in certain circumstances on the acts of its citizens.

State has **full competence** ascribed to an entity in international law, including entering into international agreements limiting its sovereignty.
1.2 Sovereign normative authority

The State’s sovereignty, finds expression in its normative power to create legal norms:

- **Constitution**
  - Constituant authority

- **Legislation**
  - Legislative organ

- **Regulation**
  - Executive organ
1.3 State's power to bind itself by contract is subject to special prerogatives

In the public interest, a contract may be unilaterally modified under the exercise of special prerogatives of State or public authorities.

In Civil law systems, this is often considered under the exercise of the theory of *fait du prince* (*direct interference with an administrative contract in any form*).
2. Investor risks arising out of sovereignty

2.1 State and Investor are not equal on contractual playing field:

2.1.1 State can change the law which may govern the investment contract

2.1.2 State can legislate mandatory norms applicable to investment contract

2.1.3 State can change the normative climate to impact investment
   ◦ Tax and other mandatory charges, duties and royalties
   ◦ Local content and supply obligations
   ◦ Health, safety, environment, labour, capital, security regulations

2.1.4 The application of public law norms (e.g. Imprévision) which temper *pacta sunt servanda* and privilege the public interest

2.2 State can lawfully expropriate the investment
2.2 State can lawfully expropriate the investment

Under customary international law States have the right to expropriate the property of foreign investors provided the taking is

- Undertaken for a public purpose,
- Non-discriminatory,
- Complies with the principles of due process of law, and
- Accompanied by fair compensation for the investor.

This creates specific risks for the investor which cannot be resolved contractually, without more...
II. THE SOLUTION

1. INTERNATIONALISE THE CONTRACT
2. ROLE OF STABILISATION CLAUSE
3. VALIDITY AND EFFECTIVENESS OF STABILISATION CLAUSE
4. CATEGORIES OF STABILISATION CLAUSE
5. ENFORCEMENT OF STABILISATION CLAUSES
3. Internationalise the contract

3.1 Principle - State cannot rely on its internal law to justify a breach of its international obligations.

3.2 Remove contract from the strict confines of municipal law. In order to redress this inequality of bargaining power,
3.1 Principle - State cannot rely on its internal law to justify a breach of its international obligations.

If a State breaches its obligations which arise under public international law, it will engage its international responsibility.

It is no defence to such a breach to argue that the State was following the dictates of its own municipal laws.

The reasons are obvious. Any other situation would permit international law to be evaded by the simple method of domestic legislation.
3.2 Remove contract from the strict confines of municipal law to benefit from this principle.

• Use International Arbitration and a Neutral Seat of Arbitration

• Use a Foreign Governing Law

• Introduce principles of public international law

• Structure investment to benefit from treaty protection:
  ◦ Applicability of BITs
  ◦ ICSID Jurisdiction (with or without BIT)

• Stabilise the legal framework
Use International Arbitration and a Neutral Seat of Arbitration

Submission of the contract to arbitration constitutes an essential tool in the stabilisation of the legal framework:

• Neutralises the jurisdictional power of the State,

• Applies and identifies the laws applicable to the contract.

• Awards may be enforceable in accordance with international treaties (e.g. such as the New York Convention on the Recognition and Enforcement of International Arbitral Awards.)

Use a Foreign Governing Law

Resisted by Host States except for contracts which do not involve matters of public interest such as international loans.
Introduce principles of public international law

Incorporate principles of international law into the *lex contractus*:

« the present agreement will be governed by and must be interpreted according to Libyan law in that these principles can be interpreted in common with international law. In the absence of common ground between the principles of Libyan law and those of international law, it will be governed by and conform to general principles of the law of the country in which the contract is performed. »

(Libyan concession contract concluded with BP, Liamco and Texaco-Calasiatic.)
Structure investment to benefit from treaty protection:

° **Applicability of Bilateral Investment Treaties**

Typical investment guarantees accorded to investors of signatory countries, which cannot be excluded by the Host State, include the obligation to ensure **fair and equitable treatment** to the investment, and an **objective standard for compensation for expropriation**. Investors wishing to benefit from such protections should structure their investment through vehicles incorporated in countries which have signed BITs with the Host State. BITs typically provide for arbitration to enforce such guarantees.

° **ICSID Jurisdiction (with or without BIT)**

Awards of ICSID tribunals are **binding and enforceable** in all States signatories of the ICSID Convention, **as if they were final judgments** of courts of such States (Art. 54 ICSID Convention). To benefit from the ICSID Convention, investors from signatory States and the Host State (also a signatory) must **consent** to ICSID jurisdiction either **contractually**, via a **BIT**, or pursuant to **investment legislation**. (Art. 25 ICSID Convention).
Insufficiency of Treaty Protection

However, such treaty protections (bar certain exceptions) are not always sufficient to give a truly effective guarantee to investors.

- They provide general protections on the international plane which do not guarantee the stability of the freely negotiated contractual framework;

- cf. Umbrella Provisions in certain BITs (breach of contract is treated as a breach of an international obligation). Arbitral tribunals, in their majority, when faced with a “proper” umbrella clause, i.e. one drafted in broad and inclusive terms, seem to be adopting a fairly consistent interpretation which covers all state obligations, including contractual ones. (see e.g. Eureko B.V. v Poland, Partial Award 19 August 2005)
Stabilise the Contract

Acceptance by the State of contractual equality with investor
4. ROLE OF STABILISATION CLAUSE

4.1 Acceptance by State of contractual equality with investor

4.1.1 Prevent unilateral modifications

4.1.2 Prevent change of law directly impacting on contractual provisions

4.1.3 Freeze legislation at time of contract

4.1.4 Preserve Economic Status Quo at time of Contracting
4.1.1 Prevent unilateral modifications

The State can use *certain prerogatives in order to modify unilaterally the legal environment* of the contract.

The Stabilisation clause is calculated to prevent such unilateral action.

States over such security as a form of investment promotion, not always fully appreciate the consequences. Investors should accordingly take care in the design of such mechanisms.
4.1.2 Prevent change of law directly impacting on contractual provisions

Stabilisation provisions are often intended to mitigate the State’s ability to change the content of the governing law.

One technique is to limit the scope of the governing law. The Tunisian Contractual model is 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 regulation, modifications or interpretation which could be conflicting or incompatible with the provisions of this Agreement and/or the Convention shall be applicable”.
4.1.3 Freeze legislation at time of contract

Some Stabilisation clauses « freeze the provisions of a national system of law chosen as the law of the contract in order to prevent the application of the contract of any future alterations of this system » (see Amoco International Finance v. Iran)

4.1.4 Preserve Economic Status Quo at time of Contracting

Certain clauses compensate the party contracting with the State for the damage caused as a result of the contract being rendered either directly or indirectly more costly to perform due to measures taken by the contracting State.
5. VALIDITY AND EFFECTIVENESS OF STABILISATION CLAUSE

5.1 Can a State bind itself to Stabilise by Contract?

5.1.1 Municipal Law – Need for Legislative Support of Stabilisation

5.1.2 International Law – Recognition of limitation of sovereignty.
5.1.1 Municipal Law – Need for Legislative Support of Stabilisation

The State is subject to its own law (on the municipal plane).

- Any undertakings given by the Host State must be given in a form which is consistent with the State’s legal and constitutional framework – e.g. by legislative ratification of the contract containing the stabilisation provision.

- However, assume that every State retains the sovereign power to enact laws which will « trump » or override previous laws (including such ratificatory laws).
5.1.2 International Law – Recognition of limitation of sovereignty.

« Nothing can prevent a State, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the concessionaire irretractable rights »

“in entering into concession contracts with the plaintiffs, the Libyan State did not alienate but exercised its sovereignty”

6. CATEGORIES OF STABILISATION CLAUSE

6.1 Stabilisation clauses *stricto sensu*

6.2 Intangible Stabilisation clause

6.3 Economic Stabilisation clause

6.4 Cf. Renegotiation Clauses
6.1 Stabilisation clause *stricto sensu*

Provision attempting to "freeze" the law applicable to a contractual relationship, which will not change over the life of the project

“This Agreement shall be governed by the law of the Host State as the date of this Agreement. The Host State hereby agrees that legislation enacted after the date of this Agreement shall not apply to his Agreement"
6.2. Intangible Stabilisation clause

Provision attempting to prevent unilateral modifications by the Host State to the contract

“7.2 (iii) except as may be expressly set forth in any Project Agreement, the State Authorities shall not reduce, condition or limit (whether by termination or amendment of the respective Project Agreement, or otherwise) any right, interest or benefit accruing under the Project Agreements to any Project Participant without the prior written consent of all of the MEP Participants“

(BTC Pipeline Host Goverment Agreement between Azerbaijan and various oil companies, 17 October 2000)
6.3. Economic Stabilisation clause

 Provision of « re-balancing » in case of adoption by the Host State of a measure subsequent to the conclusion of the contract which has damaging consequences to the economic benefits

 "19.13.1 In the event that following the execution of this Agreement, and as a result of any new Laws enacted by any Governmental Authority, the Seller incurs an increase or a decrease in its operating expenses, the Parties hereto agree that the Monthly Capacity Payment or the Monthly Energy Payment, as the case may be, will be adjusted by an amount sufficient to compensate the Seller for all such increase or the Buyer for all such decreases …“

(Power Purchase Agreement between Zimbabwe Electricity Supply Authority and Gokwe North Power Company, 1998)
6.4 Cf. Renegociation Clauses

Clause providing the obligation to renegotiate the contract if fundamental elements for the contractual balance change

« In case of changes in existing legislation or regulations applicable to the [contract], which take place after the Effective Date, and which significantly affect the economic interest of this Agreement to the detriment of CONTRACTOR [ … ], the Parties shall negotiate possible modifications to this Agreement designed to restore the economic balance thereof which existed on the Effective Date. The Parties shall use their best efforts to agree on amendments to this Agreement within ninety (90) days from aforesaid notice. »

(Concession Agreement of 2002 for Petroleum Exploration Exploration & Exploitation between Egypt & The Egyptian General Petroleum Corporation & Dover Investments Limited (East Wadi Araba Area Gulf of Suez): source: Barrows Company Inc.)
7. ENFORCEMENT OF STABILISATION CLAUSES

7.1 Absence of Specific Performance of Stabilisation Clause

- Highly unlikely for an Arbitral Tribunal to specifically enforce a contract with a stabilisation provision.

- Likely impact is on the certainty of obtaining damages and on their quantum.

7.2 Survey of Caselaw

The following is an example of caselaw relating to the enforcement of stabilisation clauses.
7.2 Survey of Caselaw

- Metalclad
- Feldman
- Encana v Ecuador
- CMS v Argentina
Metcalcd

- **Metalclad Corp v United Mexican States (2001)**

  A US investor acquired land in Mexico for use as a landfill and obtained assurances from the federal government that all necessary permits had been issued.

  But the local authorities refused to grant permission to begin construction.

  "expropriation includes not only open, deliberate and acknowledge takings of property … but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State“ (§103)

  The Tribunal ICSID concludes that the host government’s actions had deprived Metalclad of the ability to use its property for its intended purpose, sufficient harm to constitute expropriation.

  The Tribunal identified standards to the effect that there must be deprivation, that it had the affect at least a significant part of the investment and that all of it relates to the use of the property or a reasonably expected economic benefit.

  The assurance received by the investor from the host government were definitive, unambiguous and repeated in stating that the government had the authority to authorize construction and operation on the landfill.
Feldman

- *Feldman v Mexico (2002)*

- Marvin Feldman, the owner of a Mexican company in the business of exporting cigarettes, commenced arbitration proceedings in Ottawa against the United Mexican States.

- Feldman alleged that Mexico’s refusal to rebate excise taxes applied to cigarettes exported by his company and to recognize to its company’s right to a rebate of such taxes regarding prospective cigarette exports constituted a breach of Mexico’s obligations under NAFTA.

- In this case, the authorities opposed the investor’s business activities at every step of the way, and assurances relied upon by the claimant were “at best ambiguous and largely formal.”

- The Tribunal found that no expropriation had occurred because some activities of Feldman remained unaffected by the practices at issue.
EnCana v Ecuador

- *EnCana Corporation v Republic of Ecuador (2006)*
  - The claims concern claims for VAT refunds that arise out of the performance of four petroleum agreements in the host country that were entered into by two companies before and after being acquired by EnCana.
  - EnCana argued that Ecuador has changed its interpretation of the Hydrocarbons Law relating to exemption from various taxes imposed on imports (3 years after conclusion of the Agreement).
  - EnCana made claims of indirect and direct expropriation of its investment in relation to the host government failure’s to provide a tax refund.
  - The Tribunal held that unless there is a specific commitment from the host State, “the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment…
  - Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised"
  - ICSID Tribunal concluded that the policy of the tax authority on oil refunds never amounted to an actual and effective repudiation of Ecuadorian legal rights.
CMS v Argentina

- **CMS v Argentina (2005)**

CMS, a US company, brought several claims against Argentina, alleging that a number of measures taken by it had an adverse impact on CMS’s investment in a local gas utility company, which led to the violation of the US – Argentina BIT.

- CMS claimed that it made investment relying on the commitments that the government made to foreign investors in the offering memoranda and the relevant laws and regulation which were later breached by it.

- The government froze gas transportation tariffs and forced conversion of private service contracts from dollars to devaluated pesos (one to one rate)

- ICSID Tribunal found that Argentina’s actions had violated other standards of protection contained in the BIT but declined to hold that it was liable for expropriation of the investment.
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