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## The End of Hibernation of Stabilization Clause in Investment Arbitration: Reassessing Its Contribution to Sustainable Development

### Keywords

Arbitration, Investment, Sustainable Development, Contracts, Oil, Gas, and Mineral Law, Petroleum

# THE END OF HIBERNATION OF STABILIZATION CLAUSE IN INVESTMENT ARBITRATION: REASSESSING ITS CONTRIBUTION TO SUSTAINABLE DEVELOPMENT

ALISHER UMIRDINOV\*

## I. INTRODUCTION

An unending quest for legal stability in a host country through balancing an investor's legitimate expectation and enough policy space for a sovereign state to legislate and regulate the formers' activity<sup>1</sup> is endemic in the developing world. The zeal of foreign investors in exploring untapped reserves of host countries and the need for attracting foreign direct investment into potential economic sectors of the economy have forced both foreign investors and host countries to attempt to reach a consensus somewhere. The insertion of a stabilization clause<sup>2</sup> into an investment contract is where the consensus of both parties meets.<sup>3</sup> The once hotly-debated stabilization clause that could often be seen in state contracts between host

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1. Kamal Hossain, *Chapter 14 Preface: Are Stabilization Clauses a Threat to Sustainable Development?*, in *SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW* 329 (Marie-Claire Cordonier Segger et al. eds., 2011).

2. The literature is abundant and continuing to increase. Some of these are as listed below in chronological order. See generally Samuel K. B. Asante, *Stability of Contractual Relations in the Transnational Investment Process*, 28 INT'L & COMP. L.Q. 401 (1979); Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 215 (1996); Margarita T. B. Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 DENV. J. INT'L L. & POL'Y 217 (2002); Bertrand Montembault, *The Stabilisation of State Contracts Using the Example of Oil Contracts: A Return of the Gods of Olympia?*, 6 INT'L BUS. L.J. 593 (2003); A. F. M. Maniruzzaman, *The Pursuit of Stability in International Energy Investment Contracts: A Critical Appraisal of the Emerging Trends*, 1 J. WORLD ENERGY L. & BUS. 121 (2008); Andrea Shemberg, *Stabilization Clauses and Human Rights: A Research Project Conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights* (2008) [hereafter *U.N. IFC report*]; Lorenzo Cotula, *Pushing the Boundaries vs Striking a Balance: The Scope and Interpretation of Stabilization Clauses in Light of the Duke v. Peru Award*, 11 J. WORLD INVESTMENT & TRADE 27 (2010); Peter D. Cameron, *Reflections on Sovereignty over Natural Resources and the Enforcement of Stabilization Clauses*, in *YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY* 2011-2012 311 (Karl P. Sauvant ed., 2013).

3. See Cameron, *supra* note 2, at 334 ("Indeed, in many cases a government's refusal to accept a stabilization clause will be sufficient to persuade a company or lender to withdraw from the proposed investment."). See also *Texaco Overseas Petroleum Co. v. Libyan Arab Republic*, 53 I.L.R. 389, 450-52 (1977); *Revere Copper & Brass, Inc. v. Overseas Private Inv. Corp.*, 56 I.L.R. 258, 276 (1978) (showing how international arbitration tribunals underlined the importance of providing stabilization to investors in order to persuade investors to invest for both developing countries).

states and foreign investors entered a long period of hibernation beginning in the 1980s.<sup>4</sup> Several factors—such as the end of a nationalization wave in the third world, the collapse of the Soviet Union, fierce competition for foreign investment, and tribunals' continuous supportive approach for its validity—might be considered decisive for this temporal pacific period.<sup>5</sup>

After almost twenty years of inaction, in the wake of resource nationalism, the stability clause has again emerged in investment arbitration. However, this time around the problem was not whether the stability clause had legally binding force against states' contractual undertakings, but rather, in defining the legitimate scope of states' discretionary powers vis-à-vis the foreign investor. This paper will argue that a stabilization clause has accomplished its investment protection task excellently. First and foremost, the host countries believed the stability clause to be an indispensable and persuasive tool for attracting necessary foreign investment in risky environments. Second, investors relied on the stabilization clause even more so due to the fact that investment tribunals in the twenty-first century have unanimously considered it valid and legally binding, with compensation necessary upon its breach. Though there are some open-ended questions, which remain to be answered, the stability clause contributed enormously to the "sustainable development" of host states<sup>6</sup> by stabilizing host states' legal regimes and giving confidence to foreign investors who are very vulnerable to political and legal risks.<sup>7</sup> Hence, there is a strong belief, which exists in host states, that legal stabilization tools have given significant contribution to the host state's economy.<sup>8</sup>

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4. The word "hibernation" in this article refers to the disappearance of disputes on stabilization clause in arbitration tribunals' decisions.

5. See *infra* Part II.B.

6. Although the soft law concept of sustainable development is widely recognized by states, no consensus has been reached on its precise meaning. For a detailed discussion on the various definitions of sustainable development, see JENNIFER A. ELLIOTT, AN INTRODUCTION TO SUSTAINABLE DEVELOPMENT 6-14 (Tony Binns ed., 3d ed. 2006). The most frequently cited 1987 Brundtland Report defines it as a "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." GRO HARLEM BRUNDTLAND, REPORT OF THE WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT: OUR COMMON FUTURE, ch. 2, para. 1 (1987). However, this definition is far from clear to help understand the connection between foreign investment and host states' development. For the author and the purposes of this paper, the Monterrey Consensus best illustrates the relationship between foreign investment and development. See Monterrey Consensus of the International Conference on Financing for Development, Monterrey, Mex., Mar. 18-22, 2002, *Report of the International Conference on Financing for Development*, ¶ 20, UN Doc. A/CONF.198/11, quoted in Markus Gehring & Andrew Newcombe, *An Introduction to Sustainable Development in World Investment Law*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW, *supra* note 1, at 9 ("Private international capital flows, particularly foreign direct investment, along with international financial stability, are vital complements to national and international development efforts. Foreign direct investment contributes toward financing sustained economic growth over the long term.").

7. Cameron, *supra* note 2, at 316 (noting that as an instrument "for mitigating political risk," these clauses are currently in wider use compared to any preceding periods).

8. See *Paushok v. Mongolia*, Ad hoc/UNCITRAL, Award on Jurisdiction and Liability, ¶ 226 (Hague 2011), <http://www.italaw.com/documents/PaushokAward.pdf>; *U.N. IFC report*, *supra* note 2, ¶ 21; Camilo A. Rodriguez-Yong & Karol X. Martinez-Muñoz, *The Andean Approach to Stabilisation*

A correctly drafted state contract neither limits a state's bona fide public policy measures, nor does it put investors under the pressure of arbitrary actions of the host state.<sup>9</sup> In particular, this new type of stabilization clause, namely, an economic equilibrium clause or renegotiation clause ("EEC") leaves enough room for both parties to maneuver the stabilization clause according to its own needs.<sup>10</sup> Despite the fact that no known arbitral award intensively dealt with EEC to date,<sup>11</sup> recent cases have begun exploring this new type of stabilization clause. For instance, in a landmark case in 2012, an ICSID tribunal judged the obligatory nature of correction factors in EECs.<sup>12</sup> That investment arbitration jurisprudence has also strengthened EECs' role in mega-projects.

This paper is organized as follows. After a short introduction in Section II, Section II will present an overview of the stabilization clause, its rationale, validity, and effect, its long hibernation period, and what factors led it to end this phenomenon. Section III will deal with an emergence of a completely new generation of stabilization clauses, namely EECs in practice and also in investment arbitration. The paper will also explore its legal content, analyze two unprecedented empirical surveys on stabilization clauses, and some investment arbitration cases. Section IV will indicate other factors that widely strengthened acceptance of stabilization clauses briefly. By way of an example, the unique legal contribution of Latin American countries—their legal stability agreements,

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*Clauses*, 6 INT'L J. PRIVATE L. 67, 74 (2013) (showing how Columbian and Peruvian Constitutional Courts perceived Legal Stabilization Agreements as a tool for fostering economic development through promoting foreign investment flow into those countries).

9. This has been pointed out in past research several times. See, e.g., Lorenzo Cotula, *Reconciling Regulatory Stability and Evolution of Environmental Standards in Investment Contracts: Towards a Rethink of Stabilization Clauses*, 1 J. WORLD ENERGY L. & BUS. 158, 172-75 (2008); Evaristus Oshionebo, *Stabilization Clauses in Natural Resource Extraction Contracts: Legal, Economic and Social Implications for Developing Countries*, 10 ASPER REV. INT'L BUS. & TRADE L. 1, 30-31 (2010); Antony Crockett, *Stabilization Clauses and Sustainable Development: Drafting for the Future*, in *EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION* 516, 531-37 (Chester Brown & Kate Miles eds., 2011); Antoine P. Martin, *Stability in Contemporary Investment Law: Reconsidering the Role and Shape of Contractual Commitments in Light of Recent Trends*, 10 MANCHESTER J. INT'L ECON. L. 38, 52-58 (2013). For the paper that analyzed the stabilization clause from the perspective of protection of foreign investors' rights, see A. F. M. Maniruzzaman, *Drafting Stabilisation Clauses in International Energy Contracts: Some Pitfalls for the Unwary*, 5 OIL, GAS & ENERGY L. INTELLIGENCE, 1 (2007).

10. See Linnet Mafukidze, *Legislative Drafting Tools for Stabilization Provisions and Economic Balancing Provisions*, 12 EUR. J. L. REFORM 58, 60 (2010).

11. Indeed, this fact is acknowledged and to some extent expected by many writers in the field. Cameron, *supra* note 2, at 342 ("Modern stabilization clauses of whatever variety or combination are much more likely to be tested in disputes about the applicability of fiscal measures to investments rather than ones in which the host country intends to confiscate the entire investment or most of it."); ERKAN MUSTAFA, *INTERNATIONAL ENERGY INVESTMENT LAW: STABILITY THROUGH CONTRACTUAL CLAUSES* 220 (2011) ("[A]s far as this author is aware, equilibrium clause have yet to be tested in arbitral tribunals or in the courts, so it is a bit early to comment on the effectiveness of such clauses.").

12. *Burlington Res., Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012), [http://www.italaw.com/sites/default/files/case-documents/italaw1094\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/italaw1094_0.pdf).

stabilization norms in a domestic law of host states, and international investment treaties' relevant substantive norms will also be surveyed. This paper will also show how investment tribunals abandoned discussing validity of stabilization clauses, moving surprisingly towards the examination of content of stabilization clauses and interpreted them in unprecedented depth. As a reminder, the author wishes to confess that since natural resource foreign investors often employ this tool, the absolute majority of past research related to the stabilization clause is also on natural resource foreign investment. Although the stabilization clause is also widely used in other fields of economic activity,<sup>13</sup> frequent referral to the natural resource sector is unavoidable.

## II. TRADITIONAL STABILIZATION CLAUSES

In this section, the content of traditional stabilization clauses, their validity and effectiveness, and their historical trajectory is examined. The brief history covers issues like the scope of coverage of the stabilization clauses, the rationale behind host states' consent, and the main types of classical forms of a stabilization clause.<sup>14</sup> This section will briefly pay attention to the hotly debated legal issues surrounding the stabilization clause which center on its validity and effectiveness. Next, in subsections B and C, the factors resulting in a long hibernation are presented, followed by the end of hibernation.

### A. Short Overview

As one of the techniques for stabilization of the contractual relationship, a stabilization clause indicates the contractual clauses in private contracts between foreign investors and host states that address the variety of issues with changes in law—from amendment of the host state's laws to changes of interpretation of laws by judicial bodies in the host state during the terms of the contract.<sup>15</sup> It may cover all areas of regulation or limited to certain types of issues.<sup>16</sup> It may take the shape

13. See *U.N. IFC report*, *supra* note 2, ¶¶ 16, 47 (holding that in addition to extractive industry, the stabilization clauses often can be seen in long-term private contracts for public infrastructure and essential services, such as public transportation, water, and power industries).

14. See *infra* Part II.A.

15. See Host Government Agreement Between and Among the Government of Georgia and [the MEP Participants], app. 1, art. 7.2(x), HOU03:648165.19 (Apr. 28, 2000) Georgia defined "Change in Law" as follows:

changes resulting from the amendment, repeal, withdrawal, termination or expiration of Georgian Law, the enactment, promulgation or issuance of Georgian Law, the interpretation or application of Georgian 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 Georgian Law. . .

*Id.* This can be considered one of the most elaborate types of stabilization clause to date. Similar provisions can be found in the Turkish and the Azeri Host Government Agreements as well. See Host Government Agreement Between and Among the Government of the Republic of Turkey and [the MEP Participants], app. 2, HOU03:560379.41 (Nov. 16, 1999).

16. For the detailed survey on taxonomy of stabilization clauses, see Montembault, *supra* note 2,

of a special clause in a contract or it may be concluded as an entirely distinct agreement. Indeed, a recent investment treaty arbitration case defined it (in the context of Mongolia) as “an agreement between a State and an investor for the purpose of stabilizing (freezing), at least to a certain extent and for a certain period of time, the taxes payable by an investor and/or other legislative, regulatory or administrative measures affecting it.”<sup>17</sup> The beginnings of the usage of a stabilization clause by Anglo-American lawyers<sup>18</sup> can be tracked to the 1930s in private contracts or concessions between U.S. firms operating in Latin America.<sup>19</sup> Nowadays, it is very widely used by foreign investors in not only the developing world, but in some Organization for Economic Co-operation and Development (“OECD”) countries as well.<sup>20</sup>

A recent U.N. International Finance Corporation (“IFC”) study of the stabilization clause argued that not many OECD countries consent to the adoption of stabilization clauses in their contracts with foreign investors because of their internal constitutional orders, which do not let a former government conclude the agreements that bind the next government.<sup>21</sup> For instance, developed market economies do not see themselves to be bound by contract with a foreign investor, since it is opposite from their constitutional framework.<sup>22</sup> Then why do developing and transitional countries widely consent to insertion of a stability clause in private contracts? Scholars enumerate several reasons, such as fragile and weak legal systems of most of the developing world,<sup>23</sup> high political risk,<sup>24</sup> investors’ and

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at 617-40.

17. *Sergeu Paushok v. Mongolia*, Ad hoc/UNCITRAL, Award on Jurisdiction and Liability, ¶ 97 (2011), <http://www.italaw.com/documents/PaushokAward.pdf>.

18. See Montembault, *supra* note 2, at 595.

19. Arbitration Tribunal: Award in the Matter of an Arbitration between Kuwait and the American Independent Oil Company, 21 I.L.M. 976, 1051-52 (1982) (G. Fitzmaurice, Arb., opinion).

20. See Daniel E. Vieleville & Baiju Simal Vasani, *Sovereignty over Natural Resources Versus Rights Under Investment Contracts: Which One Prevails?*, 5 TRANSNAT’L DISPUTE MGMT., 11 (2008) (“most foreign investors today demand the inclusion of contractual guaranties aimed at maintaining the legal status in force at the time the investor made its investment.”); Montembault, *supra* note 2, at 595 (“At the dawn of the 21st Century, stabilisation clauses are more than ever becoming an essential legal tool in the management of political risks which far from having disappeared, seem rather to sometimes extend to areas formerly viewed as stable.”).

21. ERKAN, *supra* note 11, at 110-11 (noting that several countries adopted English common law as part their of national laws have invalidating effect of stabilization clause, since “the state cannot be prevent. . . from performing functions essential to its existence.”).

22. See PETER CAMERON, INTERNATIONAL ENERGY INVESTMENT LAW: THE PURSUIT OF STABILITY 15-17 (2010) (describing how western market economies such as UK gave investors somehow soft-law methods of assurances).

23. See Waelde & Ndi, *supra* note 2, at 223; DELOITTE, STABILISATION CLAUSES IN INTERNATIONAL PETROLEUM CONTRACTS: ILLUSION OR SAFEGUARD? 5 (2014) (“[T]he IOCs demand for stabilisation clauses in the developing countries is premised on suggestions that rule of law is either not firmly entrenched or simply does not operate in the way the IOCs would expect. It is further suggested that Latin America, Africa and the Middle East are also laden with deep and long-lasting legacies of anti-colonialist sentiments or populist suspicion of foreign investment.”).

24. See Waelde & Ndi, *supra* note 2, at 223; Paul E. Comeaux & N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA*

lenders' concerns;<sup>25</sup> a relative weakness of developing countries in terms of bargaining power,<sup>26</sup> lack of financial resources or technological knowledge,<sup>27</sup> and competition for foreign investment.<sup>28</sup> In sum, Abdullah Faruque aptly notes the purpose of a stabilization clause is to seek to provide protection from political risk,<sup>29</sup> ensure legal certainty, and encourage foreign investment.<sup>30</sup>

By virtue of its name, a stabilization clause is an invention of investors to stabilize host state's actions, which have a negative impact on the economics of a project; however, its content and shape is no more constant, unified, and static. As state contracts are concluded in a *quid pro quo* basis, such typology is not absolute<sup>31</sup> and it is constantly evolving. When the states' political and legal regime has in the past been subject to frequent changes or volatility, then it is reasonable for such states to agree to stabilization clauses in order to attract foreign direct investment ("FDI").<sup>32</sup> A stabilization clause would require the host state not to alter its general legal regime for the area addressed in the clause.<sup>33</sup> For instance, taxation, "the principal threat to contract stability,"<sup>34</sup> is one of the most common areas and key issues that a stabilization clause will address.<sup>35</sup> Labor, free transferability, property, export-import provisions, or even far-reaching general

& *OPIC Investment Insurance*, 15 N.Y.L. SCH. J. INT'L. & COMP. L. 1, 2 (1994); Kyla Tienhaara, *Unilateral Commitments to Investment Protection: Does the Promise of Stability Restrict Environmental Policy Development?*, 17 Y.B. INT'L ENVTL. L. 139, 146 (2008).

25. See Asante, *supra* note 2, at 409; PETER D. CAMERON, ASS'N OF INT'L PETROLEUM NEGOTIATORS, *STABILISATION IN INVESTMENT CONTRACTS AND CHANGES OF RULES IN HOST COUNTRIES: TOOLS FOR OIL & GAS INVESTORS* pt. 1.1 (2006); A. F. M. Maniruzzaman, *Some Reflections on Stabilisation Techniques in International Petroleum, Gas and Mineral Agreements*, 4 INT'L ENERGY L. & TAX'N REV. 96, 96 (2005); Waelde & Ndi, *supra* note 2, at 228-29 (noting that "stabilization of the fiscal, foreign exchange, and repatriation terms is an essential requirement for lenders"); *U.N. IFC report*, *supra* note 2, ¶ 18.

26. See Tienhaara, *supra* note 24, at 147.

27. See Roland Brown, *The Relationship between the State and the Multinational Corporation in the Exploitation of Resources*, 33 INT'L & COMP. L.Q. 218, 220 (1984).

28. Ali Khalil Al-Hadiithi, *Guarantees and Incentives of Investment in the Third World and Iraq*, 1 no. 2 DUBAI INT'L ARB. CTR. J.: J. ARB. IN THE MIDDLE EAST 5, 5 (2004) (holding that budget constraints of many developing countries pushed to participate in wild race to attract bigger share of FDI through investment guarantees and incentives).

29. See Abdullah Faruque, *Validity and Efficacy of Stabilisation Clauses: Legal Protection vs. Functional Value*, 23 J. INT'L ARB. 317, 321-22 (2006). For clarification, the paper adopts the definition of political risk, which was given by Comeaux and Kinsella, as "the risk that the laws of a country will unexpectedly change to the investor's detriment after the investor has invested capital in the country, thereby reducing the value of the individual's investment." Comeaux & Kinsella, *supra* note 24, at 1. Government instability, changes in monetary and fiscal policy, and volatility of local tax and regulation systems, such as environmental and human rights issues, it seems, are the risks that today's investors are most acutely faced with. See ERKAN, *supra* note 11, at 51.

30. Faruque, *supra* note 29, at 321-23.

31. See Waelde & Ndi, *supra* note 2, at 256.

32. RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 75 (2008).

33. *Id.*

34. See Cameron, *supra* note 2, at 342.

35. See CAMERON, *supra* note 22, at 70; Waelde & Ndi, *supra* note 2, at 220.



legislative and contractual framework are other potential areas that may be covered by a stabilization clause.<sup>36</sup>

Turning to taxonomy of stabilization clauses, until the onset of hibernation of stabilization clauses, the types mentioned below were the most widespread forms.

### 1. Freezing Clause

Such clauses aim to neutralize the project from application of newly adopted laws to the contract.<sup>37</sup> They are the strictest (stabilization clause in *Stricto Sensu*) and once the most popular forms of stabilization clauses in investment projects.<sup>38</sup> The harshly criticized contract of Mittal Steel Holdings NV with Liberia included such a clause:<sup>39</sup>

For the avoidance of doubt, any amendments, additions, revisions, modifications or other changes to the Tax Corpus made after the Amendment Effective Date shall not be applicable to the CONCESSIONAIRE.<sup>40</sup>

### 2. Intangible Clause

Described as a “prohibition on unilateral changes,” this type of stabilization clause aims to prevent one party, obviously the host states, from making unilateral changes and requires consent of both parties upon making any modification to the contract.<sup>41</sup> It has a more consensual juridical nature<sup>42</sup> as it provides both parties with procedural mechanism for discussion.<sup>43</sup> One of the typical versions of an intangible clause is as follows:

This contract shall not be annulled, amended, or modified in any respect, except by the mutual consent in writing of the parties hereto.<sup>44</sup> According to Faruque, its main difference from the freezing clause is that

while the former [freezing clause] intends to protect investors from host state legislative intervention in the contract through changes in the applicable law or the enactment of new legislation, the latter [intangible

36. Wolfgang Peter, *Stabilization Clauses in State Contracts*, 1998 INT’L BUS. L.J. 875, 878-82.

37. Abdullah Al Faruque, *Typologies, Efficacy and Political Economy of Stabilisation Clauses: A Critical Appraisal*, 4 OIL, GAS & ENERGY DISP. MGMT. 2007, at 6.

38. See CAMERON, *supra* note 22, at 70; U.N. IFC report, *supra* note 2, ¶ 22.

39. See generally GLOBAL WITNESS, HEAVY MITTAL? A STATE WITHIN A STATE: THE INEQUITABLE MINERAL DEVELOPMENT AGREEMENT BETWEEN THE GOVERNMENT OF LIBERIA AND MITTAL STEEL HOLDINGS NV (2006).

40. Mineral Development Agreement, Liber.-Mittal Steel Holdings NV, at 18, Aug. 17, 2005. See also Amendment Dated Dec. 28, 2006 to Mineral Development Agreement, Liber.-Mittal Steel Holdings N.V., at 24, Dec. 28, 2006, cited in CAMERON, *supra* note 22, at 71.

41. CAMERON, *supra* note 22, at 74.

42. Faruque, *supra* note 29, at 319.

43. CAMERON, *supra* note 22, at 74.

44. Production Sharing Contract of Indonesia, Pertamina-Overseas Petroleum & Inv. Corp.-Treasure Bay Enters. Ltd., art. 17.2, Dec. 31, 1994, cited in Faruque, *supra* note 29, at 319.

clause] aims to protect them from the host state's exercise of administrative power to change or modify the contract unilaterally.<sup>45</sup>

Still, there is an intense debate, though much reduced in recent years, on the validity and effect of a stabilization clause.<sup>46</sup> In short, no international tribunal has ruled that a stabilization clause is invalid or will have no legal effect.<sup>47</sup> Conversely, there is strong support that a typical stabilization clause in a contract should not be understood as a renunciation on the part of the host state of its right to expropriate.<sup>48</sup> However, one thing should be clear—in the context of freezing clauses and intangible clauses, which were the main targets of academic debate until 2000—dissatisfaction of both sides was sustained and the debate has not ended.<sup>49</sup> It was clear that industry, host states, and lawyers had to work on better, enforceable, and less-conflicting rules with regards to the sovereignty of host states.<sup>50</sup>

45. Faruque, *supra* note 29, at 319-20.

46. On this perspective, see Jean-Marc Loncle & Damien Philibert-Pollez, *Stabilisation Clauses in Investments Contracts*, 2009 INT'L BUS. L.J. 267, 290 ("The issue of the validity of the State's commitment is no longer doubted, and the main difficulty that could be raised is that of the unenforceability of such a clause against a State carrying out lawful nationalisations having regard to international law."). The legal effect of stabilization clauses was also discussed in many research papers. See Timothy B. Hansen, *The Legal Effect Given Stabilization Clauses in Economic Development Agreement*, 28 VA. J. INT'L L. 1015, 1015 (1988); Faruque, *supra* note 29, at 325-32; A. F. M. Maniruzzaman, *Damages for Breach of Stabilisation Clauses in International Investment Law: Where Do We Stand Today?*, 11 INT'L ENERGY L. & TAX'N REV. 246, 247 (2007); Cotula, *supra* note 9, at 165-67; Maniruzzaman, *supra* note 2, at 139-47.

47. DOLZER & SCHREUER, *supra* note 32, at 75.

48. *Id.*; Montebault, *supra* note 2, at 612 ("the controversy raised by the validity of these mechanisms seems largely appeased"); Vielleville & Vasani, *supra* note 20, at 21 (mentioning the consensus reached by states on this point:

[w]hile some States continue to ignore limits to their sovereignty and the consequences of adopting unilateral measures in contravention of the acquired obligations and some investors ignore the adverse actions of the State while economic profit is still to be made, the fact remains that the New International Economic Order of today is a finely tuned balance between the rights of developing nations, the desires of developed nations and the protections granted to individual investors from around the globe.  
(emphasis added).

49. As Brown mentioned, remarkably, almost thirty years ago in the context of mineral investments,

[t]he bleak experience of past conflict shows that, if instability is to be avoided, it is not enough to preach to host governments the sanctity of contract. What is needed is a new approach to fiscal terms which will be more sensitive to the variations in the output of particular projects.

Brown, *supra* note 27, at 222.

50. For the author, the inflexibility of the freezing clause and its inability to meet the needs of dynamic development of host state's municipal matters made it hated in third world countries. This is because states need to legislate according to their people's needs and a collision of interests is unavoidable in a gigantic investment projects (at least for the host country) which generates large amounts of budgetary monies. Therefore, lawyers began to consider it unenforceable and they started to look for the new and more compatible design of stabilization clause. For instance, see Peter, *supra* note 36, at 888-89.

### B. Start of Hibernation

After the *Kuwait v. Aminoil* arbitration, the stabilization clause rightly “disappeared” as a headache for arbitrators.<sup>51</sup> This disappearance is the case for at least most of the published cases, as it is known that some of the arbitration decisions are not published and are still kept secret.<sup>52</sup> Indeed, in the early 1980s, scholars begun to debate the changing atmosphere of international investment transactions. Roland Brown says that, “[t]he traumatic events of the late 1960s and early 1970s swept away what remained of such archaic arrangements and broke the link with the colonial past. In consequence, there is a perceptible change in the attitude of many Third World countries.”<sup>53</sup>

Several factors served as the key reasons for the hibernation of the stabilization clause from the first part of the 1980s. First of all, there was the end of the nationalization wave in the third world.<sup>54</sup> Outright nationalization of big investment projects in this era by host developing country tremendously decreased.<sup>55</sup> Secondly, there was the dramatic collapse of the Soviet Union and heated competition for foreign investment in post-soviet countries.<sup>56</sup> Many developing countries liberalized important industries, which they had previously eagerly protected, and let the FDI enter.<sup>57</sup> The third factor, as seen in previous sections, is tribunals’ continuous supportive approach for its validity and to some extent its effect that may also be considered as decisive factors for this temporal pacific period. In fact, the boom of adoption of stabilization clause in investment

51. CAMERON, *supra* note 22, at 90-92.

52. Regarding this point, while introducing an unpublished award involving stabilization clause under English law in 2007 between a foreign investor and an African state, Cameron notes that “The publicity that surrounds many treaty based cases is usually absent from such cases since they will tend to be brought under contract and heard privately.” *Id.* at 90-92. In addition to above mentioned points, although ICSID Rules have improved transparency of their terms and recently UNCITRAL adopted its final rules on transparency of investment arbitration, still as Bernasconi-Osterwalder rightly pointed out, “other rules that have evolved from private commercial arbitration allow arbitration proceedings to remain private and confidential.” Nathalie Bernasconi-Osterwalder, *Transparency and Amicus Curiae in ICSID Arbitrations*, in *SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW*, *supra* note 1, at 195.

53. Brown, *supra* note 27, at 220.

54. Michael S. Minor, *The Demise of Expropriation as an Instrument of LDC Policy, 1980-1992*, 25 J. INT’L BUS. STUD. 177, 177-78 (1994).

55. Christopher Hajzler, *Expropriation of Foreign Direct Investments: Sectoral Patterns from 1993 to 2006*, 148 REV. WORLD ECON. 119, 128-29 (2012). A chart from Hajzler’s paper shows that expropriation immediately fell down from the start of the 1980s, and it has never seen a revival until 2005. *Id.* at 129. A graph in Minor’s previous paper also supports this phenomenon within its own scope (until 1992). Minor, *supra* note 54, at 180 tbl.1.

56. Waelde & Ndi, *supra* note 2, at 217-18 (arguing that in CIS, in the early 1990s, foreign investment was seen as the single great opportunity still left for international companies, and governments in this region also responded to the requirements of investors as their countries were seen as high political risk countries).

57. U.N. Conference on Trade and Development, *Incentives: UNCTAD Series on Issues in International Investment Agreements*, 1, U.N. Doc. UNCTAD/ITE/IIT/2003/5 (2004) [hereinafter UNCTAD]; MUTHUCUMARASWAMY SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 25-26 (3d ed. 2010).

contracts occurred in praxis.<sup>58</sup>

### C. *The End of Hibernation*

However, several factors have brought stabilization clauses back to wider attention. But this time, in very different circumstances and in a very different form. The first biggest factor is the expected re-emergence of Resource Nationalism, where the rule of law was tested by ideological sentiments.<sup>59</sup> In particular, the rocketing of oil and gas prices and a strong need for natural resources from emerging economies led to the phenomenon of increased resource nationalism.<sup>60</sup> Resource nationalism can be defined as “determination to gain the maximum national advantage from the exploitation of national resources.”<sup>61</sup> Its features can be seen as a nationalization of FDI in extractive industry,<sup>62</sup> contract renegotiation or abrogation,<sup>63</sup> and rise of taxation burden to international oil companies.<sup>64</sup>

In addition to the above-mentioned factor, acceleration of investor-state arbitration,<sup>65</sup> an enrichment of developing countries with capital, necessary skill, and technology;<sup>66</sup> the rise of service companies in extractive industries;<sup>67</sup> the re-consideration of the very contractual clauses which can be seen very unfair<sup>68</sup> or

58. This is because the 1990s saw a drastic fall in petroleum prices in the global market. In such a situation, the bargaining strength of host countries become very low and this phenomenon also lead to favorable contractual terms and investor leverage. See ERKAN, *supra* note 11, at 124-25.

59. There is burgeoning scholarship on resource nationalism. See, e.g., F. Robert Buchanan & Syed Tariq Anwar, *Resource Nationalism and the Changing Business Model for Global Oil*, 10 J. WORLD INV. & TRADE 241, 243 (2009); Cameron, *supra* note 2; George Joffé et al., *Expropriation of Oil and Gas Investments: Historical, Legal and Economic Perspectives in a New Age of Resource Nationalism*, 2 J. WORLD ENERGY L. & BUS. 3, 3 (2009); Thomas Wälde, *Renegotiating Acquired Rights in the Oil and Gas Industries: Industry and Political Cycles Meet the Rule of Law*, 1 J. WORLD ENERGY L. & BUS. 55, 55 (2008).

60. A. F. M. Maniruzzaman, *The Issue of Resource Nationalism: Risk Engineering and Dispute Management in the Oil and Gas Industry*, 5 TEX. J. OIL, GAS, & ENERGY L., 79, 81 (2009).

61. Joffé et al., *supra* note 59, at 4.

62. Halina Ward, *Resource Nationalism and Sustainable Development: A Primer and Key Issues* 8 (Int'l Inst. for Env't & Dev., Working Paper, 2009).

63. For instance, substantial renegotiation took part in Russia, Venezuela, Algeria, Bolivia and Ecuador. See CAMERON, *supra* note 22, at 10-11.

64. Peter Cameron & Graham Kellas, Wood Mackenzie & Ctr. for Energy, Petroleum & Mineral Law & Policy, *Contract and Fiscal Stability: Rhetoric and Reality* 6-7 (2008).

65. AKIRA KOTERA, KOKUSAI TOSHU KYOTEI : CHUSAI NI YORU HOTEKI HOGO [International Investment Agreements: Legal Protection Through Arbitration], 10 (2010).

66. ERKAN, *supra* note 11, at 154 (“In today’s business world, all technologies in the petroleum industry are buyable. The companies that produce petroleum technology organize big international trade shows every year. Most petroleum producer countries have enough money to buy such technologies because of high price of oil False.”)

67. *The Unsung Masters of the Oil Industry: Oil Firms You Have Never Heard of are Booming*, ECONOMIST, July 21, 2012, Business, <http://www.economist.com/node/21559358>.

68. Brown, *supra* note 27, at 221. Bribing public officials through sham transactions and getting more favorable contractual dealings under influential persons of the country is not rare in the investment world. See *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award (2013).

onerous<sup>69</sup> from the view point of new government;<sup>70</sup> and financial crises<sup>71</sup> can also be seen as the instigating causes for the appearance of the stabilization clause in investment arbitration.

### III. AN EMERGENCE OF NEW GENERATION: ECONOMIC EQUILIBRIUM CLAUSE

This section turns the readers' attention to the new generation of stabilization clause: the EEC. After reviewing its definition, taxonomy, and specific features in Section III subsection A, this paper will query what the main factors behind the shift from traditional clauses to EEC were in subsection B. Subsection C provides a discussion of two unprecedented pieces of research on EEC, which furthers the understanding of the validity and effectiveness of this type of stabilization promise. Lastly, the *Burlington v. Ecuador* case—the first of its kind, which tested the validity, and effectiveness of EEC in the ICSID Tribunal—is examined in subsection D.

#### A. Definition, Taxonomy, and Specifics

In the end, with a minor exception, the stabilization clause experiences a transformation from a freezing clause to EEC.<sup>72</sup> At this point, a brief survey of pertinent contractual practices of EEC is useful. As an example of EEC, Kurdistan Model Product Sharing Agreement Article 43(3) states as follows:

If, any time after the Effective Date, there is any change in the legal, fiscal and/or economic framework under the Kurdistan Region Law or other Law applicable in or to the Kurdistan Region which detrimentally affects the CONTRACTOR, the terms and conditions of the Contract shall be altered so as to restore the CONTRACTOR to the same overall economic position as that which CONTRACTOR would have been in, had no such change in the legal, fiscal and/or economic framework occurred.<sup>73</sup>

In other words, following a change in law, EEC requires the parties to enter into negotiations in order to restore the original balance of the contract. In this definition, Cameron referred to EECs as “balancing clauses.”<sup>74</sup> Having said that, EECs also differ a lot and its definition depends on each expert's (academic,

69. DELOITTE, *supra* note 23, at 10 (“A disproportionately favourable deal for the investor can be counterproductive as it may spark political push-back in the host state resulting in instability that distorts the project returns which the IOC was keen ensure . . . .”); SORNARAJAH, *supra* note 57, at 76-7.

70. See ERKAN, *supra* note 11, at 172-73; SORNARAJAH, *supra* note 57, at 75-6.

71. Some of Argentine-involved cases directly link to the financial crises of that country. See for the detailed discussion, José Alvarez & Kathryn Khamsi, *The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, in YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 2008-2009 388-90 (Karl P. Sauvant ed., 2009).

72. Al Faruque, *supra* note 37, at 45. According to the some research, freezing clauses are still in used in the mining industry where commodity prices are not so prone to change as in the oil and gas market. *U.N. IFC report*, *supra* note 2, ¶ 25.

73. CAMERON, *supra* note 22, at 75.

74. *Id.* at 74.

lawyer, or state official) preference.<sup>75</sup>

It was recently stated that an EEC has mainly three types of forms, namely: Stipulated Economic Balancing ("SEB"), Non-specified Economic Balancing ("NSEB"), and Negotiated Economic Balancing ("NEB").<sup>76</sup> The SEB instructs the automatic amendment of the contract in a predetermined fashion;<sup>77</sup> NSEB does not specify the nature of an automatic amendment, neither does it necessitate the mutual agreement of the parties.<sup>78</sup> In the case of NEB, parties are also under an obligation to meet so that they may make necessary amendments to the agreement.<sup>79</sup>

75. For such clear differences in terminology and taxonomy of stabilization clauses, see Frank Alexander, *Comment on Articles on Stabilization by Piero Bernardini, Lorenzo Cotula and AFM Maniruzzaman*, 2 J. WORLD ENERGY L. & BUS. 243, 245-46 (2009). See also U.N. IFC report, *supra* note 2, at 9 (taking a rather different approach on classification of EEC through dividing them into two group, namely "Full Economic Equilibrium Clauses" and "Limited Economic Equilibrium Clauses").

76. Maniruzzaman, *supra* note 2, at 127 (citing Frank C. Alexander, Jr., *The Three Pillars of Security of Investment Under PSCs and Other Host Government Contracts*, in *Fifty-Fourth Annual Institute on Oil and Gas Law* (2003)).

77. 2002 Model PSC of Ecuador is typical type of SEB.

In case of modifications to the tax regime, including the creation of new taxes, or the labor participation, or its interpretation, that have consequences on the economics of this Contract, a corresponding factor will be included in the production share percentages to absorb the increase or decrease in the tax burden or in the labor participation of the previously indicated contractor. This correction factor will be calculated between the Parties and approved by the Ministry of Energy and Mines.

Maniruzzaman, *supra* note 2, at 125 (quoting BARROWS CO., MODEL PRODUCTION SHARING CONTRACT OF OCTOBER 2002 FOR THE EXPLORATION OF HYDROCARBONS & THE EXPLOITATION OF CRUDE OIL (2002)) (emphasis omitted).

78. An example of an NSEB can be seen with the Agreement Dated 19 April 1999 on the Exploration, Development and Production Sharing for the Block Including the Padar Area and the Adjacent Prospective Structures in the Azerbaijan Republic Between the State Oil Company of Azerbaijan and Kura Valley Development Company Ltd. and Socar Oil Affiliate, art. 24.2 (1999) (Azer.).

In the event that any Governmental Authority invokes any present or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Agreement or adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, or administrative practice, the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then SOCAR shall indemnify the Contractor (and its assignees) for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom. SOCAR shall within the limits of its authority use its reasonable lawful endeavors to ensure that the appropriate Governmental

Authorities will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between all such treaty, intergovernmental agreement, law, decree or administrative order and this Agreement.

See Maniruzzaman, *supra* note 2, at 125-26.

79. Such kind of EEC can be found in the current model PSC of India.

If any change in or to any Indian law, rule or regulation imposed by any central, state or local authority dealing with income tax or any other corporate tax, export/import tax, customs duty or tax imposed on petroleum or dependent upon the value of petroleum results in a material change to the economic benefits accruing to any of the Parties after the Effective Date, the

Even though categories of EECs seem to be simple, in practice they may converge and there may be many carve-outs according to the drafting of parties and also according to the national legislation.<sup>80</sup> For example, a lack of compliance by the contractor and protection of health, safety, and the environment are often thought of as valid exceptions in terms of the scope of economic equilibrium of the contract and in such a case, investors should not expect the re-establishment of their original position.<sup>81</sup> Therefore, it is practically difficult to find a unified model of an EEC in the world and practice may differ according to the project field, parties' needs, and geography. However, all three models of EEC have one cohesive important point, "they do not seek to prevent a change in the law by the host state but rather to seek to address the economic impact of such a change on the bargain originally struck and to establish a framework in more or less detail for its preservation."<sup>82</sup>

Here, there is a need to acknowledge the fact that renegotiation is the inherent procedure for every EEC.<sup>83</sup> This is due to the fact that, since the economic equilibrium of contract cannot be achieved without re-negotiation, this procedural mechanism therefore remains the core element of EEC necessary for keeping the project alive.<sup>84</sup> Seth Stodder and Ryan Orr have already noted that "despite carefully negotiated and varied contractual guarantees and protections, therefore, approximately half of all long-term infrastructure investment contracts end up being renegotiated with a repositioning of the parties that introduces materially significant changes to the terms of the original contractual agreement."<sup>85</sup>

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Parties to this Contract shall consult promptly to make necessary revisions and adjustments to the Contract in order to maintain such expected economic benefits to each of the Parties as of Effective Date.

*Id.* at 126 (emphasis omitted) (quoting CURRENT INDIAN MODEL PRODUCTION SHARING CONTRACT art. 16.7).

80. It is mentioned somewhere that EEC can exist even with freezing form of stabilization in one petroleum contract. See Cameron, *supra* note 2, at 328.

81. See Maniruzzaman, *supra* note 2, at 127.

82. CAMERON, *supra* note 22, at 75.

83. As Salacuse noted, "[r]enegotiation is one of the most important theaters in which parties to existing agreements play out the continuing struggle of life against form." Jeswald W. Salacuse, *Renegotiating Existing Agreements: How to Deal With "Life Struggling Against Form"*, 17 NEGOTIATION J. 311, 312 (2001). Regarding renegotiation, see also Jeswald W. Salacuse, *Renegotiating International Project Agreements*, 24 FORDHAM INT'L L.J. 1319 (2000); John Y. Gotanda, *Renegotiation and Adaptation Clauses in International Investment Contracts, Revisited*, 36 VAND. J. TRANSNAT'L L. 1461 (2003); Asante, *supra* note 2, at 416 (stating that "[r]enegotiation is thus a main feature of modern, large-scale and long-term investment contracts in natural resources").

84. Marina De Kwant, *Emerging Oil and Gas Economies: Mitigating Legal, Political and Economic Risks of Foreign Investors in the Russian Federation (Part A)*, 14 INT'L TRADE & BUS. L. REV. 174, 207 (2011) (noting that renegotiation clauses have a similar function to typical stabilization clauses).

85. ERKAN, *supra* note 11, at 157 (citing Seth. M.M. Stodder & Ryan. J. Orr, *Understanding Renegotiation and Dispute Resolution Experience in Foreign Infrastructure Investment: Proceedings of the 2<sup>nd</sup> General Counsels' Roundtable February 10-11, 2006, Stanford University, California*, 7 J. WORLD INVESTMENT & TRADE 805 (2006).

Obviously, failure of renegotiation may be reinforced by one of following two ways: "a method of indemnity in favour of the party affected by the intervening change of the legal environment of the oil contract, or a clause allowing arbitrators to be substituted for the parties in order to revise the terms of the oil contract."<sup>86</sup> And such detailed reinforced renegotiation may lead to the effective solution of the problem.<sup>87</sup>

### B. Rationale of EEC

Especially after 2000, numerous articles of academics, reports from industries, and client alerts of lawyers started to emphasize the importance of EECs as well as the decline of traditional ones.<sup>88</sup> Why is that? Traditional stabilization clauses long struggled to keep the certainty and predictability of business between parties; however, their inherent deficiency in adapting to new situations barred them from being the preferred type of stabilization clauses.<sup>89</sup> Furthermore, freezing and intangible clauses directly collide with state legislative sovereignty, often contradicting host state's constitutional framework and fettering both parties' ability to renegotiate new terms.<sup>90</sup> As Asante rightly pointed out in the late 1970s:

A major source of conflict between the host governments of developing countries and transnational corporations derives from the preoccupation of transnational corporations with stability and predictability in contractual relations on the one hand, and the persistent demands of host governments for a more flexible contractual regime on the other.<sup>91</sup>

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86. Montebault, *supra* note 2, at 636; Piero Bernardini, *Stabilization and Adaptation in Oil and Gas Investments*, 1 J. WORLD ENERGY L. & BUS. 98 (2008) (emphasizing the importance of referral of necessary mandate to the arbitrator). But, the solution of dispute by third party is not limited to the arbitrator. Although these are relatively rare, it may also be an expert in this field. See Alexander, *supra* note 75, at 252 n.17 (quoting The Jamaica 2005 Model Production Sharing Agreement art. 15.7 (2005)) ("If any dispute shall arise between the parties as to the calculation of the Tax Stabilization Adjustment then the matter in dispute shall be referred to an Expert appointed pursuant to clause 32.6 whose determination shall be final and binding on the parties.").

87. See Montebault, *supra* note 2, at 640. Cameron offers a rather different explanation to the inclusion of renegotiation clause in stabilization clause. He contends that accompanying such clauses in stabilization mechanism of contract can also be considered "as a response by investors to an inevitable political risk and as a way of limiting its impact on the projected investment." Cameron, *supra* note 2, at 324.

88. In the early 2000s, Montebault informed academic society saying a striking fact that a strict stabilization mechanism offered to oil companies is in the minority. Montebault, *supra* note 2, at 612.

89. Talking about extractive industry's perception from its long bitter history with host states, Cameron states that "it would be odd for a foreign investor to consider it feasible to seek a wider constraint on the host country or indeed to intend that by choosing this form of [freezing clause]." Cameron, *supra* note 2, at 323.

90. Asante argued that sticking to stabilization clause through "a blind insistence on the application of *pacta sunt servanda* to such transnational contracts betrays a lack of sophisticated appreciation of the nature and origin of such transactions, the inherent instability in such long-term arrangements, and the formidable difficulties posed by their administration." Asante, *supra* note 2, at 407.

91. *Id.* at 404. See also ERKAN, *supra* note 11, at 185.



Evidently, traditional stabilization clauses could not only efficiently tackle those emerging legal problems in practice, but it should be also noted that the classic types of stabilization clauses are very open to ideological criticism.<sup>92</sup> In short, traditional stabilization clauses could not meet parties' expectation, since they give priority to investor rights upon any change.<sup>93</sup>

Therefore, the EEC has emerged as a "consensus point," meeting the needs of both parties.<sup>94</sup> Additional motives behind the fact that made EEC the preferred stabilization clause other than the freezing provisions are, first, in case of breach of contract by a host country, compensation is the most reliable remedy, rather than the restitution that a freezing clause obviously requires.<sup>95</sup> Second, the EEC will be seen a type of stabilization provisions that does not interfere with legislative power of the state. Third, among other types of stabilization clauses, enforceability of EECs remains the highest;<sup>96</sup> and fourth, it contains two vital elements of "long-term investment contracts, namely, stability and flexibility."<sup>97</sup> Finally, like a double-edged sword, an EEC not only applies to the host state, but also equally applies to the foreign investors.<sup>98</sup> It means not only the private party, but also the state party can require re-negotiation or adjustment of terms of contract when the balance of contract the said party sought is lost. In addition to these enumerated factors, one can add the special character of contracts that often adopt the stabilization clause. For instance, petroleum (oil and gas) contracts are inherently unstable contracts.<sup>99</sup> Due to the constant market fluctuation and unstable pricing,

92. For the discussion on how the rigid intangible clause in the LNG Law of Nigeria eventually was declared unconstitutional by the Federal High Court of Nigeria see Bayo Adaralegbe, *Stabilizing Fiscal Regimes in Long-Term Contracts: Recent Developments from Nigeria*, 1 J. WORLD ENERGY L. & BUS. 239, 242 (2008).

93. It seems that from the end of 1970s, its inability and need for new more flexible mechanism was beginning to be felt by industry. See Brown, *supra* note 27, at 224.

94. For more detailed study, see Zeyad A. Alqurashi, *International Oil and Gas Arbitration 3 OIL, GAS & ENERGY L.* 227-28 (2005).

95. Although the word 'compensation' is used, parties may negotiate not only compensation, but also other means for their satisfaction. According to the U.N. IFC report, it "can take many forms, such as adjusted tariffs, extension of the concession, tax reductions, monetary compensation, or other." U.N. IFC report, *supra* note 2, ¶ 22.

96. Examples are abundant. See, e.g., Maniruzzaman, *supra* note 60, at 97-100; Cotula, *supra* note 2, at 28 (arguing that EECs are much more flexible and versatile compared to traditional clauses). Montembault also agrees on this point by saying that, "[b]y its simplicity, this mechanism can provide the oil company with a relatively efficient protection which could in addition be usefully buttressed by recourse to an expertise procedure to determine the total adjustment in the event the parties are unable to agree it." Montembault, *supra* note 2, at 625.

97. ERKAN, *supra* note 11, at 220.

98. Maniruzzaman, *supra* note 2, at 136-37.

99. In the petroleum industry context, Nakhle argues that:

fiscal regimes cannot be expected to be set in stone. Circumstances are constantly changing in any basin. A certain degree of flexibility has to be allowed in any tax system if it is to respond to differing conditions, such as maturity, and to evolve as a result of major changes in the external environment.

Carole Nakhle, *Petroleum Fiscal Regimes: Evolution and Challenges*, in THE TAXATION OF PETROLEUM AND MINERALS: PRINCIPLES, PROBLEMS AND PRACTICE 89, 115 (Philip Daniel et al. eds.,

both states and investors changed their minds to favor a more pragmatic approach, and they began to focus on more project equilibrium rather than on legal stability.<sup>100</sup>

Of course, there are other views regarding such observations. For example, Alexander denies that an EEC should be considered a “new approach,” referring to contracts of the late 1980s, which included EECs.<sup>101</sup> Moreover, he did not accept the priority of EEC over traditional clauses either. According to him, it is,

misleading, as it implies that Economic Balancing provisions are a sort of panacea according to which, in the event that the [host country] unilaterally revises the relationship after the effective date of the [government petroleum contract], international arbitration may be avoided. To the contrary, there are no guarantees that the parties will, by way of such a “renegotiation”, agree upon the specifics of how the [government petroleum contract] shall be amended – particularly in the case of Non-Specified Economic Balancing and Negotiated Economic Balancing. Even in the case of Specified Economic Balancing, the [host country] may refuse to implement the provision (particularly if the [host country] has, subsequent to the effective date, enacted a law that abrogates any prior “stabilization provisions”).<sup>102</sup>

Additionally, in one of his recent works, a leading scholar on stabilization clauses, Peter D. Cameron contended that there is no real shift to the EEC.<sup>103</sup>

Those counterarguments are right to some extent. The emergence of EECs should not be taken as a panacea; however, there is sound research output that shows the substantial decline of traditional clauses, and also facts where the latter apparently failed to respond to a crisis between a foreign investor and a host state.<sup>104</sup>

### C. Two Important Empirical Surveys

“Data! data! data! . . . I cant make bricks without clay”— Sherlock Holmes<sup>105</sup>

With this in mind, what then were the reactions of industries, academics, host

2010).

100. DOLZER & SCHREUER, *supra* note 32, at 77.

101. Alexander, *supra* note 75, at 246.

102. *Id.* at 252.

103. Cameron, *supra* note 2, at 343 (noting that every contract stabilization clauses have inherent flexibility and actual contractual shift is much more complex).

104. . See, e.g., Asante, *supra* note 2, at 412 (providing an excellent case study on how traditional stabilization clause could not give parties enough chance to negotiate); Peter Slinn, *Foreign Investment Contracts: Host Country's Concerns*, 2 THIRD WORLD LEGAL STUD. 37, 44 (1983) (arguing that, in the example of the Bougainville re-negotiation (Zambia) in 1970s, a “flexible fiscal regime of this kind, if introduced at the outset of a project, helps to avoid pressure for re-negotiation if the investor’s rate of return subsequently appears to reach (for the host country) unacceptably high levels”).

105. ERKAN, *supra* note 11, at 221 (quoting 12 Arthur Doyle, *The Adventure of the Copper Beeches*, in SHERLOCK HOLMES: THE COMPLETE NOVELS AND STORIES, 429, 437 (1986)).

states, and their state-owned enterprises toward EECs? Did they accept the EEC's validity and effectiveness? Or to put it differently, do they currently believe in its validity and effectiveness? Do they feel that they are bound by such undertakings? Notwithstanding the mountains of qualitative study on stabilization clauses,<sup>106</sup> until recently there has been a lack of empirical investigations on the practice of modern stabilization clauses. Finally, at the end of the first decade of twenty-first century, two important empirical researches have been conducted successfully, answering those questions that were in flux.

An important research project, *Stabilization Clauses and Human Rights*, was conducted in 2008 by Andrea Shemberg for the IFC and the U.N. Special Representative to the Secretary General on Business and Human Rights, Professor John Ruggie.<sup>107</sup> This study addressed the following question: "Can stabilization clauses create obstacles to applying new social and environmental legislation to investment projects in the host state; and if so, to what extent?"<sup>108</sup> As emphasized in the report, it is likely

...the first empirical study on modern stabilization practice covering a wide range of industries and regions of the world. Such studies are rare due to the confidential nature of most investment contracts. There is no public repository of private contracts that would allow practitioners, host states, investors, civil society, and academics to view modern practice for all sectors.<sup>109</sup>

The report was based on mainly three sources:

- 1) a collection of [seventy-six] modern contracts and [twelve] modern contract models;
- 2) a literature review and a review of reported contract and international state-investor disputes that may be relevant to understanding the legal enforceability of such clauses; and
- 3) [I]nterviews with negotiators, lenders, lawyers who negotiate investment contracts or litigate disputes for states and investors, and with nongovernmental organization members who have conducted research on stabilization clauses.<sup>110</sup>

Mustafa Erkan's publication in 2010, *International Energy Investment Law: Stability through Contractual Clauses*, a second piece of research that overlaps in timing with the U.N. IFC, also asks the question of how contractual tools, such as stabilization clauses, renegotiation clauses, choice of law, and alternative dispute resolution will help energy investors avoid such political risk and continue the viability of projects.<sup>111</sup> As regards methodology, in addition to in-depth literature

106. Most of the works cited in this paper are indeed qualitative ones, which concentrated either on case analysis or survey of stabilization clauses in model contracts and municipal legislations.

107. *U.N. IFC report*, *supra* note 2.

108. *Id.* at viii.

109. *Id.* at viii-ix.

110. *Id.* at ix.

111. ERKAN, *supra* note 11. The main objective of this book, as the author mentions is:

review, the author developed his ideas based on large questionnaire results and interviews with various specialist lawyers in the energy field.<sup>112</sup> In the case of the former, the author received survey answers from 112 respondents who are persons and organizations known to be active in the petroleum industry, and examined political risks, expropriation, and the effectiveness of contractual clauses.<sup>113</sup> In the case of the latter, Erkan tried to bring specialists' often rare experience and quasi trade secrets to readers.<sup>114</sup>

Regarding the findings of both Shemberg's and Erkan's unprecedented works, they both conclude that stabilization clauses, especially the EEC, are widely used among foreign investors and host countries.<sup>115</sup> First of all, the U.N. IFC report clarified that some OECD countries are currently parties to some contracts, which include some EECs, even though they are limited ones.<sup>116</sup> The data in the report "provide[d] some potential models as well as indication of underlying principles that are useful for future efforts to design stabilization clauses aimed at protecting investors against arbitrary or discriminatory changes in law, while also preserving the host state's legislative capacity to introduce necessary environmental and social laws."<sup>117</sup> Furthermore, the U.N. IFC report made several well-founded recommendations for host states in order to reach much fairer outcomes.<sup>118</sup> But the most important thing is that while the U.N. IFC report implicitly mentions an EEC as the most preferred type of stabilization clause, it never questioned its validity.<sup>119</sup> This shows that both developed and developing countries believe in the validity of the EEC, even though its real effect was still unclear at the time that the report was written.

Turning to the findings of Erkan, there are other outcomes to be faced. For instance, the author reached some surprising results: while 77.8% of international oil companies believe that a stabilization clause has a legal and functional value in

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to determine the effectiveness of contractual clauses related to the management of the political risks faced by international petroleum investors during the life span of their projects, concentrating how effective contractual clauses work to protect against risks associated with expropriation and avoid investment disputes that can lead to expropriation.

*Id.* at 9.

112. *Id.* at 13-14.

113. *Id.* at 15.

114. *Id.* at 13.

115. *Id.* at 220; *U.N. IFC report, supra* note 2, at 18-19 tbls.6.1 & 6.2.

116. *See U.N. IFC supra* note 2, at 18-19 tbls.6.1 & 6.2.

117. *Id.* ¶ 137.

118. *Id.* ¶¶ 138-49 (the recommendations were: "[i]dentifying [g]ood [p]ractice, . . . [t]he [h]uman [r]ights [u]ndertaking, . . . [l]imited [e]conomic [e]quilibrium [c]lauses in the OECD [s]amples, . . . [o]ther [i]deas for [t]ailoring [s]tabilization for [f]airness in [r]isk [a]llocation, [and] . . . [t]ransparency of [c]ontracts").

119. *See id.* at v, ¶ 135 (demonstrating that, from the very beginning the U.N. IFC report described stabilization clause as "a widely used risk-management device in investment contracts," but used the word "validity" once in a different context.). *See id.* ¶ 109 (illustrating that although the report discusses the legality issue of freezing clauses briefly, obviously it was discussing constitutional frameworks in municipal legal systems, such as in common law and civil law countries, and did not go beyond it).

intentional petroleum contracts, 76.9% of national oil companies also believe so as well.<sup>120</sup> After clarifying the limit of validity and effectiveness of traditional stabilization clauses and in the context of the necessity for negotiation clauses that aim at avoiding or minimizing potential conflicts in international energy projects, Erkan's research reveals that in the petroleum industry, during windfall profits, the majority of respondents (almost 70%) agree that the petroleum investment contract should be renegotiated and fundamental change of circumstances requires such change.<sup>121</sup> Renegotiation clauses can stand together with stabilization clauses in one contract and their importance is they abstain from challenging the sovereignty of a host state.<sup>122</sup> The book shows that the great majority of international oil companies (97%) are also willing to renegotiate their original contract.<sup>123</sup> Regarding the efficiency of EECs, Erkan found only 8.5%, where renegotiation requests ended with unsuccessful attempts and cases were referred to arbitration.<sup>124</sup> This also shows how renegotiation-plus stabilization clauses have been successfully protecting the contracts' equilibrium and ultimately the lifespan of the project.

What is common in both works is that they both mentioned—implicitly or explicitly—that investors could rely on stabilization clauses when they face political risks in the form of changes in the law.<sup>125</sup> Moreover, both noted that it was not clear how the EEC would be dealt with in investment arbitration, as no publicized arbitration had ever dealt with that issue.<sup>126</sup> Surprisingly, right after Erkan's work was published, the long expected *Burlington v. Ecuador* award was delivered. In this case, the tribunal upheld both the validity and effectiveness of the EEC,<sup>127</sup> something which will be discussed below.

#### *D. Testing EEC in Investment Arbitration: Burlington v. Ecuador*

As already noted, many reports and academics have shown that no arbitration decision has ever dealt publicly with a new type of stabilization clause. Thanks to the re-emergence of resource nationalism and acceleration of ISDS, there is a chance to follow-up on how arbitration has dealt with an interpretation of EEC in the wake of expropriation action of Ecuador, one of the resource rich countries in Latin America. At this stage, it may be helpful to briefly recall the facts of this case and main findings of the award.

120. Such a positive attitude towards stabilization clauses is not so surprising, since many NOCs in the world are themselves started to participate as foreign investor in many overseas projects. ERKAN, *supra* note 11, at 122-23. See also JAMES A. BAKER III INST. FOR PUB. POLICY OF RICE UNIV., THE CHANGING ROLE OF NATIONAL OIL COMPANIES IN INTERNATIONAL ENERGY MARKETS 4 (2007).

121. ERKAN, *supra* note 11, at 218.

122. *Id.* at 199.

123. *Id.* at 218.

124. *Id.* at 217-18.

125. See U.N. IFC report, *supra* note 2, ¶ 132.

126. See *id.* ¶¶ 128-31; ERKAN, *supra* note 11, at 220.

127. *Burlington Res., Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability (Dec. 14, 2012), [http://www.italaw.com/sites/default/files/case-documents/italaw1094\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/italaw1094_0.pdf).

## 1. Background

Burlington Oriente, a subsidiary of the claimant Burlington Resource Inc. ("Burlington"), entered into Product Sharing Contracts ("PSCs") with Ecuador to explore and exploit oil reserves in several blocks inside the country.<sup>128</sup> Under these agreements, the contractor assumed the entire risk of exploitation in return for a share of the produced oil.<sup>129</sup> As international oil prices soared in 2005, Ecuador attempted to renegotiate the terms of the PSCs with Burlington.<sup>130</sup> When those renegotiations failed, Ecuador had to restore the economic equilibrium of the contracts by implementing a package of measures.<sup>131</sup>

First, on April 19, 2006, the Congress of Ecuador empowered its government to impose a windfall tax on Burlington's excess profits through Law 42.<sup>132</sup> According to this, investors had to pay the sum of 50% of their profit, if the market price of oil surpasses the price of oil at the time the contracts were executed.<sup>133</sup> Second, Decree 662 increased the tax rate of Law 42 from 50% to 99% on October 18, 2007.<sup>134</sup> Burlington paid both taxes under protest.<sup>135</sup> Foreign investors, including Burlington, "requested PetroEcuador [national oil company] to apply a correction factor to its oil participation share" that would soften the impact of Law 42 at 99%, reportedly following the tax modification clauses of the PSCs several times.<sup>136</sup> However, Ecuador ignored these requests.

When Burlington refused to pay the taxes in 2008, Ecuador initiated proceedings to confiscate and auction the production share of investor so as to collect the overdue payment.<sup>137</sup> Burlington subsequently suspended operations on the grounds that the investment had become unprofitable.<sup>138</sup> In response, Ecuador took the possession of Burlington's blocks and eventually terminated the PSCs.<sup>139</sup> In turn, Burlington brought the case to the ICSID tribunal under the U.S.-Ecuador BIT.<sup>140</sup> On December 14, 2012, an ICSID tribunal ruled that Ecuador expropriated an U.S. oil and gas company's investment in violation of the U.S.-Ecuador BIT.<sup>141</sup> The quantum of damages was left for future decision.

## 2. Key Contractual Stabilizing Terms

Firstly, look at the key terms of the parties' contract on stabilization. The

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128. *Id.* ¶ 14.

129. *Id.* ¶ 9.

130. *Id.* ¶ 28.

131. *Id.* ¶ 29.

132. *Id.* ¶ 30 (citing L. 42, Apr. 19, 2006 (Ecuador)).

133. *Id.* ¶ 32.

134. *Id.* ¶ 35 (citing Decree 662, Oct. 18, 2007 (Ecuador)).

135. *Id.* ¶ 36.

136. *Id.*

137. *Id.* ¶¶ 52-63.

138. *Id.* ¶ 62.

139. *Id.* ¶ 65.

140. *Id.* ¶ 67.

141. *Id.* ¶ 546.

2012 Award enumerated them as follows, in three paragraphs.<sup>142</sup>

a. The tax modification clause of the PSC for Block 7 (the exploration area for petroleum production).

The tax modification clause included in clause 11.12 of the PSC for Block 7 provides as follows:

Modification to the tax system: 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 economics 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. This correction factor will be calculated between the Parties and will be subject to the procedure set forth in Article thirty-one (31) of the Regulations for Application of the Law Reforming the Hydrocarbons Law...

This clause must be interpreted in conjunction with clauses 8.6 and 15.2 of the Contract. Clause 8.6 states:

Economic stability: In the event that, by the action of the Ecuadorian State or PetroEcuador, any of the events described below were to occur and have an impact on the economy of this Contract, a correction factor will be applied to the production sharing percentages in order to absorb the increase or decrease in the economic burden: a) Modification of the tax system as described in clause [11.12] . . .

Clause 15.2 in turn provides that:

Contract amendments: There shall be negotiation and execution of contract amendments, with prior agreement of the Parties, particularly in the following cases: [ . . . ] c) When the tax system [ . . . ] applicable to this type of Contract in the country is modified, in order to restore the economy of the Contract in accordance with clause [11.12 . . .].<sup>143</sup>

PSC for the Block 21 (the exploration area for petroleum production) also included identically the same clause as for Block 7. Apart from the latter, PSC for Block 21 also included below mentioned sentence in its “tax modification clause”: “[t]his adjustment will be approved by the Administrative Board on the basis of a study that the Contractor will present to that effect.”<sup>144</sup> In other words, the procedural mechanism of PSC for Block 21 was much more sophisticated.

### 3. The Main Controversy

The parties failed to agree on the definition of the economy of contracts, and Ecuador denied the rights of a foreign investor to reap all windfall profits coming

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142. *Id.* ¶¶ 316-19.

143. *Id.* ¶¶ 317-19.

144. *Id.* ¶ 328.

from Blocks 7 and 21.<sup>145</sup> Secondly, the parties failed to agree on whether the tax modification clauses, which require the application of an amendment in case the economy of the contracts is affected, are obligatory or not.<sup>146</sup>

#### 4. Tribunal Decision

First of all, after paying an attention to the length of contracts, cross-examination and timing of a similar Tarapoa contract,<sup>147</sup> the tribunal controversially decided the economy of Block 7 and Block 21 as follows:

This language creates a link between the economic benefits the contractor may draw from the contract and the price of oil. If the price of oil exceeds USD 17 per barrel, the additional revenues are apportioned between Ecuador and the contractor on a 50/50 basis. This apportionment does not affect the contractor's participation share in terms of oil volumes, but it does affect the economic benefits the contractor may draw from that share by conferring on the State half of the revenues stemming from oil prices in excess of USD 17 per barrel. No such Tarapoa-like clause was included in the PSCs for Blocks 7 and 21. This is particularly enlightening if one remembers that the PSC for Block 21 and the Tarapoa Contract were negotiated at the same time.<sup>148</sup>

The tribunal later goes on to state:

[f]irst, while the Tarapoa Contract parties accepted a clause linking the distribution of oil revenues to the price of oil, the Block 7 and 21 contract parties did *not* accept such a clause. Second, the possibility of linking the distribution of oil revenues to oil prices was specifically discussed during the negotiations for the Block 7 and 21 PSCs. *On the basis of these premises, it is safe to conclude that the non-inclusion of a Tarapoa-like clause in the PSCs for Blocks 7 and 21 was not the product of inadvertence but a deliberate choice of the contracting parties.*<sup>149</sup>

By way of conclusion, the Tribunal determined that the parties never included an adjustment clause into both PSCs in order to re-balance the revenue in case of sudden jump in oil prices. Although Ecuador succeeded in negotiating for an equal share of windfall profit in the Tarapoa contract, it seems that investors preferred to leave this point somehow vague in Blocks 7 and 21, predicting increase of oil price and subsequently greater profit. Taking these facts into account,<sup>150</sup> the Tribunal decided the economy of contracts that empowers investors to get oil revenue

145. *See id.* ¶ 262.

146. *Id.*

147. *See id.* ¶¶ 276-95.

148. *Id.* ¶ 295.

149. *Id.* ¶ 299 (first emphasis in original, second emphasis added).

150. In order to reach a conclusion, the Burlington Tribunal paid attention to three main facts: the length (sophistication) of contracts; similar timing with other Tarapao contract and rejection of contractors (investors) to include a clause, which lets parties to equally share the oil revenues. *See id.* ¶¶ 275-300.



without any regard to price of oil or internal rate of return and left the host country with empty handed, harshly penalizing for its defeat in contract negotiation.<sup>151</sup>

Secondly, after determining what economy of PSCs is, the Tribunal reached the conclusion that modification clauses are indeed tax stabilization clauses.<sup>152</sup> Not surprisingly, the tribunal interpreted two-layered tax modification clause as follows:

[f]irst, all the three provisions transcribed above contain mandatory language calling for the parties to apply a correction factor in order to absorb the impact of a tax increase or decrease on the economy of the Contract. Under clause 11.12, a correction factor will be included if there is a modification to the tax system which has an impact on the economy of the Contract; under clause 8.6, a correction factor will apply if there is a modification to the tax system which has an impact on the economy of the Contract; under clause 15.2, if there is a modification to the tax system, the parties shall negotiate and execute a contract amendment with a view to re-establishing the economy of the Contract. Those formulations show that the application of a correction factor is not optional. In the event of a modification to the tax system impacting the economy of the Contract, there must be a correction.<sup>153</sup> . . . Second, pursuant to the relevant clauses, the purpose of the correction factor is “to absorb the impact of the increase or decrease in the tax” and “to restore the economy of the Contract.” The purpose is to avoid that tax increases or decreases alter the economic foundation upon which the parties entered into the contract. This purpose would be defeated if a party could simply refuse to apply a correction factor in the event of a tax increase or decrease. Hence, the purpose of the tax modification clause suggests that the parties intended the application of a correction factor to be mandatory.<sup>154</sup>

According to above-mentioned reasons the Tribunal held as follows:

For the foregoing reasons, the Tribunal deems that the application of a correction factor is mandatory when a tax affects the economy of the PSCs for Blocks 7 or 21. This 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 modification level.<sup>155</sup>

If we remind ourselves about the types of EECs discussed in the previous section,<sup>156</sup> one can understand Burlington PSC as a SEB type of EEC. Burlington’s PSC also included a precise procedural mechanism for contract

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151. *Id.*

152. *See id.* ¶¶ 317-35.

153. *Id.* ¶ 321.

154. *Id.* ¶ 324.

155. *Id.* ¶ 334.

156. *See supra* Part III.A.

amendment, namely a contract amendment and an administrative board. Moreover, not only negotiation, but also the execution of a negotiated contract amendment is designed as mandatory. This is exactly what Thomas Waelde and George Ndi predicted about twenty years ago: “the revitalized, extensive, and increasingly novel stabilization commitments” resurfaced in arbitration.<sup>157</sup> Obviously, the investor in this case took very careful measures when it entered into contracts with Ecuador.

In sum, the Tribunal clearly determined that the above-mentioned EEC is not merely a renegotiation clause, but that it is indeed a type of stabilization clause, which included mandatory correction factors, since all words used in the clause refer to the mandatory nature of contractual language.<sup>158</sup> Expectedly, the award indeed confirmed the renegotiation-plus provision as a stabilization clause. A brilliantly crafted stabilization clause gave in the end what investors anticipated: “*the parties remain under an obligation to apply a correction factor that will counterbalance the effects of a tax change on the economy of the contract.*”<sup>159</sup>

### 5. Assessment

What are the main implications of the Burlington decision for the EEC? The first is an obligatory nature of the tax stabilization clause. Nonetheless, some may express doubt on the effectiveness of renegotiation provision in an EEC since its simplest version is not “an agreement to agree,” but rather “an agreement to negotiate;” however, the Burlington case successfully proved how a well-crafted contractual EEC could defeat the host state’s groundless arguments. Accordingly, the Tribunal found the two-layered EEC (application of correction factor and its calculation process) of the Burlington PSC as mandatory and the host state liable. Dissenting opinions of arbitrator Vicuña are also consistent with this point.<sup>160</sup> While a prudent and profit-seeking investor (Burlington) intentionally left “economy of contract” open in order to maximize the future profit, it nevertheless took an opposite policy regarding EEC. Therefore, one can find very detailed mechanisms of tax modification negotiation from Burlington’s PSC.

The Tribunal also must be credited for its determination for giving full effect to the EEC in PSC of Blocks 7 and 21—Ecuador has to absorb all tax effects to the PSCs and restore the equilibrium of contract to pre-tax level.<sup>161</sup> The author

157. See Waelde & Ndi, *supra* note 2, at 218.

158. However, arbitrator Brigitte Stern found the identical clause not to be a stabilization clause, but a renegotiation clause in another case. Occidental Petroleum Corp. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Dissenting Opinion, ¶ 12 (Sept. 20, 2012), <http://www.italaw.com/sites/default/files/case-documents/italaw1096.pdf>.

159. Burlington Res., Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability ¶ 323 (Dec. 14, 2012), [http://www.italaw.com/sites/default/files/case-documents/italaw1094\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/italaw1094_0.pdf) (emphasis added).

160. *Id.* ¶¶ 219-21.

161. Such kind of reading of compensation for breach of stabilization clause reminds us of the classic Chorzow Factory case between Germany and Poland. The Factory at Chorzów (Ger. v. Pol.), 1928 P.C.I.J. (ser. A) No. 13, ¶ 181 (Sept. 13). For an elaborate discussion of this case, see BORZU SABAH, COMPENSATION AND RESTITUTION IN INVESTOR-STATE ARBITRATION: PRINCIPLES AND

believes that, in general, the Tribunal rightly read the legal meaning of the stabilization clause, deciding that a correction factor should be calculated with the consent of both parties in order to avoid from arbitrary calculation of tax effect. No doubt, such an investment treaty decision provides investors with more confidence towards the already inserted EEC for mega projects.

The second implication of this case is the lack of articulation of key contractual provisions, which are subordinated to the stabilization clause. We should remember that Ecuador did not lose because of a harsh EEC. The problem lies not with an existence of EEC, but with other subordinate clauses, which were incumbent upon parties. But when Ecuador recklessly conceded to leave a terminology “economy of contract” without any articulation and unresponsive fiscal regime, it was this that cost Ecuador severely, as it was totally deprived from windfall profit tax in subsequent years.<sup>162</sup> To put it briefly, what Waelde and Ndi were worried about, did in fact occur:

[a] negotiator will also seek to maintain such advantages for as long as possible, even through all the vicissitudes the future might bring to the relationship. At the same time, an industry team will seek to keep all options for itself as open as possible. Such options will include early termination rights, watered-down exploration and development commitments, *ambiguity with respect to all obligations*, and *absolute clarity and precision with respect to its rights and entitlements*.<sup>163</sup>

Specific definitions of key contractual clauses, such as “economy of contract,” play very important roles during dispute settlement, since vague definitions are “prone to conflicting interpretations in different contexts.”<sup>164</sup> The Burlington case reveals just how important contract drafting is as the initial step of contracting.<sup>165</sup>

The final point from this case is the limitation of the Burlington award. It is important to keep in mind that even though the Burlington award clarified and confirmed the legal meaning of the modern stabilization clause, it is still a treaty-based arbitration.<sup>166</sup> Additionally, the calculation of host state’s damages to the investment was left for forthcoming decisions of the Tribunal with the important point that it will be calculated not based on breach of EEC, but rather the treaty provision—which the Tribunal based its jurisdiction on— on prohibition of unlawful expropriation.<sup>167</sup> This is because no known published international award

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PRACTICE 47-53 (2011).

162. See Burlington Res., Inc., ICSID Case No. ARB/08/5, ¶ 546.

163. Waelde & Ndi, *supra* note 2, at 226 (emphasis added).

164. Maniruzzaman, *supra* note 2, at 129.

165. See Burlington Res., Inc., ICSID Case No. ARB/08/5, ¶ 19 (O. Vicuña, Arb., dissenting) (arguing the necessity of applying the doctrine of *rebus sic stantibus* regarding the interpretation of “economy of contract”).

166. See *id.* ¶ 12; Burlington Res., Inc., ICSID Case No. ARB/08/5, at 133 n.639, ¶ 245.

167. Burlington Res., Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Jurisdiction, ¶¶ 248-49, 342 (June 2, 2010), <http://www.italaw.com/sites/default/files/case-documents/ita0106.pdf>.

has dealt with the quantification of damages for the breach of EEC,<sup>168</sup> as present treaty-based award cannot show the real effect of EEC. It is clear from the Tribunal's decision that even Law 42's second effect (a 99% tax increase) has not been considered as the breach of expropriation while there was a high probability of getting compensation under the breach of stabilization clause if the case were judged on contract-based arbitration.<sup>169</sup>

#### IV. OTHER FACTORS FOR FORTIFICATION OF STABILIZATION CLAUSES

Even though this paper's main focus is the EEC and its contribution to the stability of investment projects, increase in the flow of FDI to the developing world, and eventually sustainable development, understanding current stabilization clauses only within the scope of EEC is also not appropriate. This is because there are other types and elements of stabilization clauses, some of which have become extremely important in recent years. This section will pay attention to their function as a stabilization clause. In this respect, substantive rules of BITs (Section IV.A.), municipal laws which regulate foreign investment activity in the host country in particular (Section IV.B.), and Latin American legal stability agreements are discussed (Section IV.C.).

##### A. BITs' Substantive Treatments

BITs' substantive treatments have a significant potential to contribute towards the reinforcement of legal value of stabilization clauses.<sup>170</sup> For example, the prohibition of expropriation and fair and equitable treatment ("FET"), national and most favored nation treatment, and umbrella clauses<sup>171</sup> are leading examples of them. Since, the role of FET became truly important with its absolute nature,<sup>172</sup> many scholars and practitioners view BIT as one new generation of stabilization.<sup>173</sup>

168. See Maniruzzaman, *supra* note 46, at 250.

169. For a short discussion of expropriatory taxation, see Arno E. Gildemeister, Case Comment, *Burlington Resources, Inc. v. Republic of Ecuador: How Much is Too Much: When is Taxation Tantamount to Expropriation?*, 29 ICSID REV. 315, 317 (2014).

170. For a detailed analysis on the impact of BIT on contracts, see 4 JAN OLE VOSS, *STUDIES ON THE LAW OF TREATIES: THE IMPACT OF INVESTMENT TREATIES ON CONTRACTS BETWEEN HOST STATES AND FOREIGN INVESTORS* ch. 2, 5 (2011).

171. Investors may rely it on, though its jurisprudence is currently far from being clear. See Alexander, *supra* note 75, at 248 n.8. Regarding this point, Waelde and Ndi left an important solution. According to them,

The state's treaty obligation—e.g., to "observe any obligations it has entered into with an investor"—may not directly apply to a particular state/investment contract. Nevertheless, if both parties have negotiated a stabilization clause before the known background of such a treaty obligation, then one should assume that the treaty's obligation to respect contractual commitment reinforces the contractual mirror-image.

Waelde & Ndi, *supra* note 2, at 254 (emphasis added); see also Al Faruque, *supra* note 37, at 39 (stating that umbrella clause merely codifies the principle of *pacta sunt servanda* as a law of treaty and it does not raise stabilization clause in state contract to the level of BIT).

172. JESWALD W. SALACUSE, *THE LAW OF INVESTMENT TREATIES* 131 (2010).

173. See CAMERON, *supra* note 25, at 70-72; Martin, *supra* note 9, at 58 ("Tribunals' interpretation of the Fair and Equitable standard of treatment is however leaving room for justified expectations and

In particular, one of the famous elements of this opaque treatment is the protection of a “legitimate expectation” of a foreign investor, with stabilization commitment lending itself to the protection and scope of this element.<sup>174</sup> Here, it is necessary to mention two main points regarding the relationship between FET and stabilization clauses.

First of all, numerous BIT-based tribunals upheld the validity of the stabilization clauses and characterized them as a legitimate expectation of the foreign investor. For instance, in *EnCana v. Ecuador* the Tribunal noted that, “[i]n the absence of 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.”<sup>175</sup> Additionally, *Parkerings v. Lithuania*<sup>176</sup> and *Total v. Argentine*<sup>177</sup> also mentioned the importance of stabilization commitment in the light of FET. This means that when foreign investors bring the breach of contract claim to the BIT for arbitration, then the stabilization clause can stand for the breach of legitimate expectation of foreign investor.<sup>178</sup>

The second point is related to somehow misleading beliefs in the real legal power of FET. After extensively surveying FET breaches in investment arbitration, Moshe Hirsch notes an important point that:

such a conclusion does not reflect and is not supported by existing investment jurisprudence; nor does it reflect the appropriate balance between the interests of host states for regulatory flexibility and legal predictability. This jurisprudence is not inclined to accept that the FET clauses lead to outcomes similar to those flowing from stabilization clauses; and indicates that legislative or regulatory changes alone are insufficient for generating an obligation to compensate foreign investors harmed by such regulatory changes.<sup>179</sup>

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predictability, offering a new role to stability commitments designed as treaty standards indicators.”).

174. Michele Potestà, *Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept*, 28 ICSID REV. 88, 114 (2013).

175. *EnCana Corp. v. Republic of Ecuador*, LCIA Case No. UN3481, Award, ¶ 173 (Feb. 3, 2006), <http://ita.law.uvic.ca/documents/EncanaAwardEnglish.pdf> (emphasis added).

176. *Parkerings-Compagniet AS v. Republic of Lith.*, ICSID Case No. ARB/05/8, Award, ¶ 332 (Sept. 11, 2007), <http://www.italaw.com/sites/default/files/case-documents/ita0619.pdf>.

177. The Total Tribunal concluded that:

[i]n the absence of some “promise” by the host State or a specific provision in the bilateral investment treaty itself, the legal regime in force in the host country at the time of making the investment is not automatically subject to a “guarantee” of stability merely because the host country entered into a bilateral investment treaty with the country of the foreign investor.

*Total S.A. v. Arg. Republic*, ICSID Case No. ARD/04/01, Decision on Liability, ¶¶ 17, 118-19, 164, 309 (Dec. 27, 2010), [http://www.italaw.com/documents/TotalvArgentina\\_DecisionOnLiability.pdf](http://www.italaw.com/documents/TotalvArgentina_DecisionOnLiability.pdf).

178. On this point, see generally Moshe Hirsch, *Between Fair and Equitable Treatment and Stabilization Clause: Stable Legal Environment and Regulatory Change in International Investment Law*, 12 J. WORLD INVESTMENT & TRADE 783 (2011).

179. *Id.* at 792. Cameron had also mentioned the same point several years before. See CAMERON, *supra* note 25, at 74.

Hirsch's observation is very important, as it concludes that the stabilization clause is still highly important<sup>180</sup> and that no BIT's clauses could replace it.<sup>181</sup>

### *B. Municipal Laws Regulating Foreign Investment*

The next type of stabilization clause is the stabilization clause in municipal laws.<sup>182</sup> Many developing countries adopted "foreign investment laws," "foreign investment codes," or "joint venture laws" that in effect create a special legal regime for foreign investment.<sup>183</sup> This legal regime defines the types of investments that foreigners are permitted to make, the incentives they may obtain, the controls to which they are subject, and the governmental agencies that have special responsibility for promoting and regulating foreign investment.<sup>184</sup> For instance, article 3(4) of Investor Protection Law of Uzbekistan provides as follows:

If the subsequent legislation of the Republic of Uzbekistan makes worse investment conditions, than legislation current on the date of investment is applied to foreign investments within ten years of the date of investment. The foreign investor has the right at his own discretion to apply those provisions of a new legislation which make better conditions of his investment.<sup>185</sup>

Still, municipal stabilization clauses do not offer absolute effective stability<sup>186</sup>

180. But the importance of BIT tools lies in the absence of contract-based-stabilization clause, where investors may turn to BIT and rely on its principles and treatments. This may be a crucial for small-scale investors where it is difficult to get enough contractual protection in the form of stabilization clause, because of weak bargaining power. In this regard, Hirsch says "[I]arge investors are generally in a better position to obtain such assurances from the host government than small ones that often have no direct contact with governmental agencies. Still, it is noteworthy that small investors involved in non-contractual relations are protected by other rules deriving from FET clauses." Hirsch, *supra* note 177, at 803.

181. Of course, BITs also may adopt similar provisions that functions like stabilization clause to some extent. In such cases, host countries shall refrain from taking some regulatory changes. For instance see how Italian model BIT contains partial stabilization clause prohibiting retroactive application of changes in the law in Article XII (3): "After the date when the investment has been made, any substantial modification in that legislation of the Contracting Party regulating directly or indirectly the investment shall not be applied retroactively and the investments made under this Agreement shall therefore be protected." See U.N. CONFERENCE ON TRADE AND DEVELOPMENT, STATE CONTRACTS: UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS, at 27, 48, U.N. Doc UNCTAD/ITE/IIT/2004/11, U.N. Sales No. E.05.II.D.5 (2004).

182. For thorough study of stabilization clause in the municipal laws, see A. F. M. Maniruzzaman, *National Laws Providing for Stability of International Investment Contracts: A Comparative Perspective*, 8 J. WORLD INVESTMENT & TRADE 233 (2007).

183. SALACUSE, *supra* note 172, at 191.

184. *Id.*

185. Law on Guarantees and Measures of Protection of Foreign Investors' Rights, L. No. 611-I (1998), [http://old.uzgeolcom.uz/docs/laws/3law\\_of\\_the\\_republic\\_of\\_uzbekistan\\_on\\_guarantees.doc](http://old.uzgeolcom.uz/docs/laws/3law_of_the_republic_of_uzbekistan_on_guarantees.doc).

186. Maniruzzaman, *supra* note 182, at 238.

The provision for a stability agreement with the State authorities bolsters the foreign investor's legitimate expectation of stability. IOCs should try to make most of the stability agreement they enter into with the host State authorities. However, a mere promise in the State legislation for stabilization is not enough of a guarantee for the foreign investor in view

though they are nonetheless widely used and some investors heavily rely on them in the onset of their business, because they provide investors with necessary financial holiday.<sup>187</sup> Such tax incentive-stabilization clauses are indispensable to attracting small-scale investors into the country and, in turn, host governments often use them as a “strategic weapon to their own benefit”<sup>188</sup> based on conditionality.<sup>189</sup> These clauses, although with some exception and more narrowly tailored scope, guarantee some tax breaks to the foreign investors for some period and also stabilize the laws to the investors.

There is also an inter-relationship between various stabilization clauses between domestic law and state contracts. In other words, a stabilization clause in domestic law contributes to the articulation of a stabilization clause.<sup>190</sup> This can be clearly seen in *Burlington v. Ecuador*. The Tribunal stated that:

[i]ndeed, as Ecuador itself noted, the PSCs reproduced some of the provisions of the Hydrocarbons Law on which Burlington relies. Thus, these legal provisions may shed light on the meaning of the contract by the very reason that they were to be replicated in the PSCs. Specifically, the Hydrocarbons Law may serve to establish the meaning of the “economy” of the contracts in the tax modification clauses.<sup>191</sup>

### C. Legal Stability Agreements

The third type of stabilization guarantee is not just one article of law or contract, but the entire legal scheme on agreement of legal stability (“LSA”).<sup>192</sup> This innovation is largely a Latin American invention. The statutory regulation may be considered one of the main characteristics of LSA.<sup>193</sup> Through this tool, Latin American countries could give a strong protective and reliable pledge to foreign investors. Indeed, there are several well-documented research projects that

of the State’s right to exercise its sovereign authority in certain circumstances.

*Id.*

187. UNCTAD, *supra* note 57, at 5.

188. Maniruzzaman, *supra* note 182, at 240.

189. Host countries may promise tax incentives and also stability of them for a certain period to foreign investors, who make investment to the particular underdeveloped region or infant industry of that host country. See UNCTAD, *supra* note 57, at 55.

190. See Waelde & Ndi, *supra* note 2, at 240 (aptly noting that, “. . . the fact that general legislation extant at the time of an investment guaranteed contractual and tax stability could well be a factor in ascertaining when compensation is due and in determining the quantum of compensation if the state subsequently revokes or ignores those same legislative promises of stability.”).

191. *Burlington Res., Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability ¶ 308

(Dec. 14, 2012), [http://www.italaw.com/sites/default/files/case-documents/italaw1094\\_0.pdf](http://www.italaw.com/sites/default/files/case-documents/italaw1094_0.pdf).

192. There are many papers on LSA. For short comparative study of them, see Vielleville & Vasani, *supra* note 20, at 13-21; see also Álvaro Pereira, *Legal Stability Contracts in Colombia: An Appropriate Incentive for Investments?*, 12 RICH. J. GLOBAL L. & BUS. 237 (2013). For the latest study on the Andean experience, see Rodríguez-Yong & Martínez-Muñoz, *supra* note 8.

193. See Rodríguez-Yong & Martínez-Muñoz, *supra* note 8, at 71-72. Decreto No. 662, 29 Augusto 1991, El Peruano, Diario Oficial, 2 Sept. 1991 (Peru), translated in 5 Inter-Am. Legal Materials 158 (1992).

show how, for example, Chile, Columbia, and Peru became successful in attracting targeted FDI thanks to the LSA.<sup>194</sup> Legal stability agreements are also adopted in Ecuador, Venezuela, and Panama according to their legislation.<sup>195</sup> Moreover, not only Latin American countries are currently using this mechanism of stability, but we can observe other countries also relying on this protective tool, such as in Asia and Africa.<sup>196</sup>

LSA has already started to become the target of investment arbitration from 2008. In the first published award on stabilization clause after the *Kuwait v. Aminoil* dispute, was the *Duke Energy v. Republic of Peru*,<sup>197</sup> which was a contract-based dispute under the auspices of ICSID.<sup>198</sup> The Tribunal had to deal with “sham transaction” of the claimant in order to receive tax benefits in the process of privatization reforms of energy industry in the 1990s.<sup>199</sup> In 2000, after a change of government and the beginning of a re-examination of privatization policy and, subsequently, tax law was retroactively applied to the investor.<sup>200</sup> In article 5 of the relevant LSA (DEI Bermuda), legal stability was defined as follows:

This Legal Stability Agreement shall have an effective term of ten (10) years as from the date of its execution. As a consequence, it may not be amended unilaterally by any of the parties during this period, even in the event that Peruvian law is amended, or if the amendments are more beneficial or detrimental to any of the parties than those set forth in this Agreement.<sup>201</sup>

However, the Tribunal’s decision came, surprisingly so, with a wide interpretation and a novel way of understanding the scope of stabilization of contract, and it found liability of host state:

The guarantee of tax stabilisation applied not only to laws, *but also to stable interpretations or applications of the law*. It may also be invoked to protect the investor in the absence of a prior stable interpretation to the extent that ‘*stabilized laws will not be interpreted or applied in a*

194. See Pereira, *supra* note 192, at 269.

195. See Maria Paula Silva, *Legal Stability in Colombia: An Invitation to Invest*, 16 CEPMLP ANN. REV. (2013), [http://www.dundee.ac.uk/cepmlp/gateway/files.php?file=cepmlp\\_car16\\_69\\_452126627.pdf](http://www.dundee.ac.uk/cepmlp/gateway/files.php?file=cepmlp_car16_69_452126627.pdf); Vielleville & Vasani, *supra* note 20, at 14.

196. Paushok v. Mongolia, Ad hoc/UNCITRAL, Award on Jurisdiction and Liability, ¶¶ 97, 473 (Hague 2011), <http://www.italaw.com/documents/PaushokAward.pdf> (explaining the negotiation between the host country and investor for tax stabilization agreement). In Africa, Ghana also seems to give such protection. See Oshionebo, *supra* note 9, at 8.

197. See generally *Duke Energy Int'l Peru Invs. No. 1, Ltd. v. Republic of Peru*, ICSID Case No. ARB/03/28, Award (Aug. 18, 2008), [http://arbitrationlaw.com/files/free\\_pdfs/dukevperuaward2008.pdf](http://arbitrationlaw.com/files/free_pdfs/dukevperuaward2008.pdf).

198. *Id.*

199. *Id.* ¶ 324.

200. See generally *id.*

201. *Id.* ¶ 187.



*patently unreasonable or arbitrary manner.*<sup>202</sup>

The Duke Energy Tribunal focused not only on the validity of agreement, but also its real content, which sheds light on the unexplored aspects of the stabilization clause. It went beyond the traditional interpretation position (illegality of regulatory change) and found host state's regulatory action illegal regarding the change of interpretation of taxation law (illegality of interpretative change). The Tribunal actually went further and clearly indicated the possibility of illegality of arbitrary interpretation when there is no older interpretation (illegality of arbitrary change). This new development in legal interpretation points to the possibility that retroactive changes of interpretation of tax laws might be a breach of the stabilization clause. The Duke Energy Tribunal truly expanded the protection scope compared to the traditional *Kuwait v. Aminoil* judgment's restrictive interpretation.<sup>203</sup>

## V. CONCLUSION

In conclusion, not only the validity of the stabilization clause, but also its effect, has been strongly recognized by all actors in the field. One of the main factors for this is the changing of its form—from rigid and unpractical freezing clause to a more versatile and practical option, namely, EECs. EECs found wide-range support from all actors of the field: host states, NGOs, investment arbitration, and academics. The *Burlington* Tribunal has also contributed enormously to strengthening the EEC's role in investment projects. Through its flexibility, it could find a consensus point between the host country that jealously protects its sovereignty and the investor that seeks to keep the equilibrium of their contract.

Furthermore, post-2000, cases are rare and it is not easy to deduct general conclusions. However, those cases, which are available, are invaluable, as they brought the practice of states and investors in the natural resource sector to our attention and raised the level of transparency. From those cases, we can say that freezing clauses are no longer practiced in the petroleum industry. EEC is now dominant and highlights a very big transformation in the case of state sovereignty pertaining to taxation.<sup>204</sup> Compared to the 1960s or 1970s, states are more capable of keeping their taxation power and they successfully replacing freezing clauses

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202. Subsequent 2011 Ad Hoc committee also dismissed Peru's application for partial annulment. See *Duke Energy International Peru Investments No. 1, Ltd. v. Republic of Peru*, ICSID Case No. ARB/03/28, Decision of the *Ad Hoc* Committee, ¶ 201 (Mar. 1, 2011) (first emphasis added).

203. Excellent critical analyses of present case can be found from Cotula, *supra* note 2; Peter D. Cameron, *Stability of Contract in the International Energy Industry*, 27 J. ENERGY & NAT. RESOURCES L. 305 (2009).

204. However, we should also not forget the fact that through creating legal enclave in one jurisdiction, especially providing tax stabilization clauses, host states' flexibility on tax policy will be limited and the administrative burden of monitoring and enforcing by tax authority will be increased. See INT'L MONETARY FUND, GUIDE ON RESOURCE REVENUE TRANSPARENCY (2007); Mafukidze, *supra* note 10, at 88.

with a more flexible EEC.<sup>205</sup>

It is also true human rights advocates' and environmentalists' concerns are to some extent valid as pertains to the constraining power of the stabilization clause.<sup>206</sup> Nevertheless, today it has not been proven that the stabilization clause has a negative impact on the environmental regulation.<sup>207</sup> Most of the criticisms are only hypothesis and nobody has ever shown any real facts proving its negative impact.<sup>208</sup> As a matter of fact, the opposite may be true<sup>209</sup> and the author strongly believes that there is enough room for its improvement and recalibration so as to meet the best interests of both parties.<sup>210</sup>

Finally, we need to also take into account the limits of modern stabilization clauses. Initially, notwithstanding the significant effect of EECs in stabilizing host state commitments and providing investor with enforceable remedies, an EEC has its own limits and obviously it cannot stop host states from nationalizing investment assets or unilaterally terminating contracts.<sup>211</sup> As many scholars and

205. Thomas Wälde & George Ndi, *Fiscal Regime Stability and Issues of State Sovereignty*, in THE TAXATION OF MINERAL ENTERPRISES 63, 68-69 (James Otto ed., 1995).

206. U.N. IFC report informs that "in a number of cases the stabilization clauses are in fact drafted in a way that may allow the investor to avoid compliance with, or seek compensation for compliance with, laws designed to promote environmental, social, or human rights goals." U.N. IFC report, *supra* note 2, ¶ 135.

207. Those two authors argue that, "[w]e are not aware of any instance where a stabilization clause has in fact operated as a constraint to bona fide law reform in relation to environmental or social matters." Audley Sheppard & Antony Crockett, *Are Stabilization Clauses a Threat to Sustainable Development?*, in SUSTAINABLE DEVELOPMENT IN WORLD INVESTMENT LAW, *supra* note 2, at 335; CAMERON, *supra* note 25, at 407 ("Although stabilization measures in investment contracts have been the target of critical scrutiny by third parties (and by many host states and scholars in the past), it does not appear that they have been an obstacle to the development of more exact and enforceable environmental standards and access to justice.").

208. In 2006, Cameron noted that regarding creeping expropriations, "environmental, health and safety obligations although this is still a relatively untested area." CAMERON, *supra* note 25, at 14.

209. In this regard, reallocation of shares in the Sakhalin-2 Gas Project due to environmental concerns between investors and Russian Government is very telling. See Nowell David Beckett Bamberger, *In the Wake of Sakhalin II: How Non-Governmental Administration of Natural Resources Could Strengthen Russia's Energy Sector*, 16 PAC. RIM L. & POL'Y J. 669 *passim* (2007) (explaining the complete story of Russian far east Sakhalin-2 Gas Project and how Russian government selectively manipulated its environmental laws in order to get more share from the that project).

210. We should not also forget that the host states maintain a strong armory of negotiation in the later phase of the project. See CAMERON, *supra* note 25, at 23-24. In this regard, Hay notes that host states have "a wide variety of mechanisms available to interfere with rights in private property." R. Hay, *Protecting Assets from Political Risk*, 3 P.C.B. 152, 153-154 (1997), *cited in* ERKAN, *supra* note 11, at 24 n.18.

211. Elisabeth Eljuri & Clovis Treviño, *Political Risk Management in Light of Venezuela's Partial Nationalisation of the Oilfield Services Sector*, 28 J. ENERGY & NAT. RESOURCES L. 375, 389 (2010). On this point, notwithstanding the generally positive outlook of the author towards EEC as a contractual risk reduction tool, see how stabilization clauses of petroleum contracts in Venezuela failed to prevent the forced sale of investor assets. Thomas J. Pate, Note, *Evaluating Stabilization Clauses in Venezuela's Strategic Association Agreements for Heavy-Crude Extraction in the Orinoco Belt: The Return of a Forgotten Contractual Risk Reduction Mechanism for the Petroleum Industry*, 40 U. MIAMI INTER-AM. L. REV 347, 350, 358-59 (2009).

practitioners argue, an EEC is not enough to stabilize the investment project<sup>212</sup> and investors need other kinds of additional tools.<sup>213</sup> Therefore, the stabilization clause is only one part of the tools for stabilizing contracts—of course, one of the most important ones, and needs therefore to be considered in its own capacity. Additional tools might include investment insurance by prominent insurance institutions like Multilateral Investment Guarantee Agency (“MIGA”); reliance on BITs and so on.<sup>214</sup>

But, this is not the entire story. We need to keep track of innovating new and more appropriate designs for each country and projects. As a matter of fact, we also have to keep an eye on the current contractual practice, since arbitral awards and theoretical analysis that were cited in this article mainly dealt with practice of late 1990s.<sup>215</sup> Having said this, a novel and also more suitable design of stabilization clause cannot be achieved without the endeavors of all actors in the field, namely, the host and home country and epistemic communities of world investment. This challenge is left for future research to consider.

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212. ERKAN, *supra* note 11, at 139-40 (noting that one of Respondent to the questionnaire suggested that, reality is different from the perception and leading author to recommend reasonableness of investors in their expectation in stabilization clause).

213. *Stabilisation Clauses—Issues and Trends*, ENERGY, INFRASTRUCTURE, & MINING NEWSLETTER (Herbert Smith in Ass’n with Gleiss Lutz & Stibbe, Minato-ku, Tokyo), June 2010, <http://documents.lexology.com/35f7c716-7a61-4687-ba7b-ec21a8737911.pdf> (noting that although stabilization clauses are important for investment protection, they are also often imperfect).

214. For other alternatives of legal protection, *see generally* Comeaux & Kinsella, *supra* note 24.

215. Waelde & Ndi, *supra* note 2, at 219 (describing the time lag between actual contractual practice and arbitral awards/theoretical writings on stabilization clauses).

