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Margarita T.B. Coale

STABILIZATION CLAUSES IN INTERNATIONAL PETROLEUM TRANSACTIONS

MARGARITA T.B. COALE*

*Weil, Gotshal & Manges, L.L.P., Dallas, Texas. Visiting Professor of Law and International Studies, Universidad de Monterrey, Monterrey, Nuevo Leon, Mexico. The opinions in this paper are those of the author, not of Weil, Gotshal & Manges or any of its clients.

I. INTRODUCTION

During this century, petroleum[1] has been one of the most important commodities in the modern world, referred to as "critical to national strategies and crucial to international politics."[2] As the modern petroleum industry emerged in developing countries, where ownership of petroleum almost universally belongs to the state,[3] international oil companies with the necessary capital and expertise controlled petroleum exploration and exploitation.[4] Even though almost all petroleum producing countries today have state-owned oil companies, this situation has not changed substantially.[5] This reality demands that the international oil company and the state reach some agreement about the development of those resources.[6]

Exploration and exploitation of petroleum resources places the international oil company in a uniquely complex business arrangement with a foreign country. This arrangement links the government, who owns the resources, with the companies, who have the technology, capital and equipment necessary for development, in a sector where the

1. For the purposes of this paper the term "petroleum" will be used as a synonym for both oil and gas.

2. ZHIGUO GAO, INTERNATIONAL PETROLEUM CONTRACTS: CURRENT TRENDS AND NEW DIRECTIONS 1 (1994).

3. BERNARD TAVERNE, AN INTRODUCTION TO THE REGULATION OF THE PETROLEUM INDUSTRY 11 (1994). The exceptions to this rule, where ownership of underground petroleum belongs to the owner of the land, usually occur in developed countries such as the United States and the Netherlands. *Id.*

4. *See* GAO, *supra* note 2, at 1. *See generally* Ernest E. Smith & John S. Dzienkowski, *A Fifty-Year Perspective on World Petroleum Arrangements*, 24 TEX. INT'L L. J. 13 (1989) (surveying international petroleum arrangements since the beginning of this century).

5. *See* Smith & Dzienkowski, *supra* note 4, at 35. *See also* Oil.com, *at* http://www.wn.com/?t=oilcom/left/production.txt (last visited Oct. 14, 2000) (sampling current worldwide petroleum explorations).

6. The term "agreement" in this context can mean many things, including production sharing agreements, licenses, concessions, service contracts, participation agreements and joint operating agreements. *See* R. Daniel Vock, *Petroleum Development Agreements: Form and Drafting*, J. ENERGY & NAT. RESOURCES L. 251, 251 (1990) (describing the complexity of agreements generated in the petroleum industry). *See also* SAMIR MANKABADY, ENERGY LAW 25-73 (1990); Smith & Dzienkowski, *supra* note 4, at 35.

stakes, risks and possible profit margins all can be very high.[7] The questions of how to contribute to this "partnership" and how to allocate the profits are fundamental issues in the arrangement among the foreign country and the international oil company.[8]

Since these petroleum agreements require a large initial outlay of capital, and long-term investment in projects including exploration, appraisal and development[9] that must be recouped from earnings, these investments expose the international oil company to substantial risk for an extended period.[10] Simultaneously, because petroleum prices are unpredictable, an apparently profitable agreement for the country can look undesirable after it is entered, especially if the international oil company's work proves highly productive.[11] These factors combine to encourage the foreign government to seek adjustments to long-term agreements in response to both political pressure and changed circumstances.[12] On the other hand, the international oil company tries to avoid the renegotiation of the agreement, the effect of subsequent changes to the country's law, or even outright nationalization of the company's assets.[13]

Over time, companies have tried to deal with the risks involved in petroleum transactions either by: spreading risk; insuring against risk; defending against the risk; structuring and managing risk; or creating contractual mechanisms for risk management.[14] When a company tries to "spread the risk" it usually tries to form joint ventures to create a united and stronger front against an interventionist host country.[15] A company can also try to "insure against the risk" by buying an insurance policy to protect the company from contractual changes in the agreed upon financial regime, including foreign exchange guarantees.[16]

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7. *See* Christopher T. Curtis, *The Legal Security of Economic Development Agreements*, 29 HARV. INT'L L. J. 317, 317-18 (1988). *See also* GAO, *supra* note 2, at 1.

8. *See* GAO, *supra* note 2, at 1.

9. *See* Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L. J. 215, 227 (1996).

10. *See* Curtis, *supra* note 7, at 318. As a general rule, petroleum projects involve ten years or more of exploration in areas such as geological surveys, drilling, and appraisal. WORLD MINERAL EXPLORATION: TRENDS AND ECONOMIC ISSUES 2-11 (John E. Tilton et al. eds., 1988).

11. *See* Waelde & Ndi, *supra* note 9, at 227.

12. *Id.* at 233

13. *Id.*

14. *Id.* at 233-34.

15. *See* Ivan K. Fong & John Kent Walker, *International High-Technology Joint Ventures: An Antitrust and Antidumping Analysis*, 7 INT'L TAX & BUS. LAW. 57, 61 (Winter 1999). *See also* Joel Davidow, *Special Antitrust Issues Raised by International Joint Ventures*, 54 ANTITRUST L.J. 1031, 1037 (1985). *See generally* Roger L.M. Dunbar, *International Renegotiations: The Case of the Dominican Republic and Falconbridge*, 15 NAT. RESOURCES F. 258, 263-68 (1991).

16. *See* Jorg-Dietrich Wirmistich, *Coverage of Political Risk by National Agencies:*

"Defending against the risk" is a strategy that requires the foreign company to try to use economic, financial, and political persuasion and leverage to discourage governments from abrogating investment agreements.[17] Companies have also tried to "structure and manage" through actions that include association with the host state, low visibility in the project, and flexibility in investment to be able to adapt to changing pressures and expectations.[18] Finally, the oil company can try to reduce risk by contract through clauses that provide for international arbitration, choice of law, and offshore accounts, as well as with stabilization clauses.[19]

Out of this broad field of risk management devices,[20] this article focuses on the use of stabilization clauses to protect the international oil company. Part II defines and describes the types of stabilization clauses. It also reviews the risks stabilization clauses are intended to reduce, including financial and non-financial concerns. Part III reviews the criteria used to apply and interpret stabilization clauses, both under municipal law and principles of international law, and Part IV surveys how those criteria have been applied to stabilization clauses in eight arbitrations. Part V concludes with some general observations about the treatment of stabilization clauses in those arbitrations.

II. STABILIZATION CLAUSES DEFINED

An international oil company may try to minimize risk through contract provisions.[21] Many risks are difficult or impossible to control by contract, such as commercial (price volatility), financial (interest rate volatility), geological (no deposit found), technical (failure of the installations to perform as planned), managerial (labor problems) and natural disasters.[22] Stabilization clauses address one specific type of risk that a contract can affect: political risk.[23] This part will describe

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The German Investment Scheme, *in* PROMOTION OF DIRECT INVESTMENT IN DEVELOPING COUNTRIES 123 (1986). *See also* John C. Kinna, *Investing in Developing Countries: Minimization of Political Risk*, 1 J. ENERGY & NAT. RESOURCES L. 89 (1983). *See generally* Douglas A. Paul, *New Developments in Private Political Risk Insurance and Trade Finance*, 21 INT'L LAW. 709 (1987).

17. *See* Kinna, *supra* note 16, at 95-99. *See also* Jurgen Voss, *The Protection and Promotion of Foreign Direct Investment in Developing Countries: Interests, Interdependencies, Intricacies*, 31 INT'L & COMP. L.Q. 686, 686-88 (1982).

18. *See* Waelde & Ndi, *supra* note 9, at 234.

19. *Id.*

20. *See* GAO, *supra* note 2, at 201-240. *See generally* Taverne, *supra* note 3.

21. *See* Waelde & Ndi, *supra* note 9, at 221.

22. *Id.*

23. *See* Curtis, *supra* note 7, at 346. *See also* Eli Lauterpacht, *Issues of Compensation and Nationality in the Taking of Energy Investments*, 8 J. ENERGY & NAT. RESOURCES L. 241, 243-44 (1990). Stabilization clauses are only one type of provision used by foreign companies in an attempt to protect their investment. Arbitration and choice of law

that risk and then review the types of stabilization clauses available.

A. Risks

A central question about the security of a petroleum transaction is the nature and degree of risk to which the investment is exposed.[24] Long-term resource and energy projects such as oil and gas exploration and mining have a serious need for stability that goes beyond short-term projects.[25] Key financial requirements of these investors include rapid investment recovery through accelerated depreciation and amortization, long loss carry-forward periods, reasonable royalty rates responsive to mineral prices and a flexible system of income or cash-flow based taxation triggered only after investment recovery.[26]

To avoid financial uncertainty about these requirements, companies frequently ask for assurances of stability of the status quo.[27] Sometimes these promises are made as administrative orders or regulations, however they are more frequently made through legislation or in specific contract provisions.[28]

Other non-financial concerns are also important to foreign companies.[29] The greatest worry, of course, is that the foreign country would expropriate or nationalize the company's operation.[30] This can occur directly, through legislation, or indirectly, through interference with the investors' freedom to control the enterprise and make a profit.[31]

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clauses are also frequently used. *See* N. Stephen Kinsella & Paul E. Comeaux, *Political Risk and Petroleum Investment in Russia*, CURRENTS 48 (Summer 1993)[hereinafter *Political Risk in Russia*]. *See also* N. Stephen Kinsella & Paul E. Comeaux, *Reducing the Political Risk of Investing in Russia and Other C.I.S. Republics: International Arbitration and Stabilization Clauses*, RUSSIAN OIL & GAS GUIDE 21 (April 1993)[hereinafter *Reducing Risk in Russia*].

24. *See* Lauterpacht, *supra* note 23, at 242.

25. *See* Waelde & Ndi, *supra* note 9, at 266.

26. *Id.* at 224.

27. *Id.* at 226.

28. *See* PETER FISCHER & THOMAS W. WAELDE, COLLECTION OF INTERNATIONAL CONCESSIONS AND RELATED INSTRUMENTS 195, 481 (1981). Since resource projects are usually funded to a considerable extent by external loan financing, these financiers have as their core concern the ability of the company to repay its debt. Accordingly, stabilization of the fiscal and foreign exchange regimes are essential requirements that lenders want to see in concession agreements. *See generally* Grover R. Castle, *Project Finance: The Alternative That Can Leverage Borrowing Power*, 5 NAT. RESOURCES F. 196 (1981); Z. Mikdashi, *Oil Funding and International Financial Arrangements*, 9 NAT. RESOURCES F. 283 (1985).

29. *See* Waelde & Ndi, *supra* note 9, at 230.

30. *See* Lauterpacht, *supra* note 23, at 242-43. *See* C.F. Amerasinghe, *Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice*, 41 INT'L & COMP. L.Q. 22 (1992) for a thorough discussion of compensation for expropriation .

31. Lauterpacht, *supra* note 23, at 242-43.

Similarly, companies want protection from changes in labor law that could result in increased employment costs, government intervention in production decisions,[32] unexpected increases in energy and infrastructure usage costs,[33] changes to accounting rules which would result in increased taxes, unexpected obligations to provide infrastructure, or mandated local service and supply contracts.[34] Currently, the issue of most concern in this area is the imposition of new environmental obligations by subsequent regulation, or by administrative or judicial rulings interpreting existing law.[35]

B. Types of Stabilization Clauses

A concession agreement differs from a standard contract in that one of the parties is a sovereign state.[36] A state has sovereign power over property and can change its laws. To reduce the tension between these powers and the imposition of a contractual limitation on them, an oil company can ask the country for specific assurances that can be enforced under international law.[37]

Stabilization clauses "specifically seek to secure the agreement against future government action or changes in law," either legislative or regulatory.[38] More specifically, a stabilization clause is a specific commitment by the foreign country not to alter the terms of the agreement, by legislation or any other means, without the consent of the other contracting party.[39]

Stabilization clauses can be divided into a number of categories.[40]

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32. Examples would include orders to reduce production or damaging the asset base of the investment through mandated overproduction.

33. Examples include railroad and pipeline charges.

34. *See* Waelde & Ndi, *supra* note 9, at 230.

35. *Id.* at 230-31.

36. *See e.g.* Saudi Arabia v. Arabian American Oil Company (ARAMCO), 27 I.L.R. 117 (1963) (an arbitration relating to the interpretation of a concession agreement between the government of Saudi Arabia and the Standard Oil Company of California). *See also* Michael E. Dickstein, Revitalizing the International Law Governing Concession Agreements 6 Int'l Tax & Bus. Law 54, 54 n.1, 68 (1988); Paul E. Comeaux & N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance*, 15 N.Y.L. SCH. J. INT'L & COMP. L. 1, 16 (1994)[hereinafter *Developing Countries*].

37. *See* Comeaux & Kinsella, *Developing Countries*, *supra* note 36, at 18; Curtis, *supra* note 7, at 345-46.

38. Curtis, *supra* note 7, at 346.

39. *See* Michelle Flores, *A Practical Approach to Allocating Environmental Liability and Stabilizing Foreign Investment in the Energy Sectors of Developing Countries*, 12 COLO. J. INT'L L. & POL'Y 141, 159-61 (2001).

40. *See* KEITH W. BLINN, ET AL., INTERNATIONAL PETROLEUM EXPLORATION AND

By agreeing to a stabilization clause, the foreign government purports to alienate its right to unilaterally change the rights promised to and relied upon by the foreign oil company.[41] A clause that provides the government may not unilaterally modify or terminate the contract has been called an "intangibility clause."[42] Another variety, usually called a "stabilization clause stricto sensu," states that the governing law of the contract shall be that of the contracting state at the time the contract was executed, thereby preventing the application of subsequent changes in the contracting state's law.[43] Another type of stabilization clause provides that the agreement shall be performed consistently with "good will" or in "good faith," thus precluding unilateral modification or termination.[44] For example, since international law does not prohibit expropriation but does require some type of compensation, a stabilization clause can help give the company some type of protection in the event of appropriation.[45] These clauses may appear in either a broad form or a narrow form that stabilizes only limited aspects of the contract, such as the applicable tax regime.[46]

III. APPLICATION AND INTERPRETATION OF STABILIZATION CLAUSES

When a dispute arises between a foreign oil company and its host state over a concession agreement, the choice of law governing the dispute, especially as it relates to the validity of a stabilization clause, is very important. Because the interpretation of a stabilization clause in an international agreement can involve strands of arguments from international public law, national law, and possibly an international *lex mercatoria,* the resulting issues are arguably some of the most complex in international business law.[47]

Traditionally, most disputes related to concession agreements were

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EXPLOITATION AGREEMENTS: LEGAL, ECONOMIC AND POLICY ASPECTS 284, 302 (1986) (remarking that there are three different types of stabilization clauses). Curtis, *supra* note 7, at 346 (stating that there are four different types of stabilization clauses).

41. Coneaux & Kinsella, *Developing Countries, supra* note 36, at 23. *See also* Curtis, *supra* note 7, at 321.

42. *See* Curtis, *supra* note 7, at 347.

43. *See id.* at 346-47.

44. Curtis, *supra* note 7, at 346-47.

45. STEPEHN M. SCHWEBEL, JUSTICE IN INTERNATIONAL LAW 401-15 (1994) (discussing the UN Declaration on Permanent Sovereignty over Natural Resources). There is general recognition that states have the right to nationalize, "expropriate or requisition these natural resources as long as the owner is paid appropriate compensation." G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 15, U.N. Doc. A/5217 (1962) [hereinafter General Assembly Resolution]. *See also* Amerasinghe, *supra* note 30, at 32-36 (discussing the impact of UN Resolutions on the understanding of what is "appropriate" compensation).

46. SCHWEBEL, *supra* note 45; General Assembly Resolution *supra* note 45; Amerasinghe *supra* note 45, at 33. *See also* BLINN, *supra* note 40, at 302-04.

47. *See* Waelde & Ndi, *supra* note 9, at 237.

thought to be controlled by the domestic law of the nation granting the concession.[48] More recently, a theory has developed in which the contract is considered to be "internationalized" because it contains a stabilization clause, and is thus not subject to the law of the host nation.[49] The question of whether municipal law governs the contract or whether the contract has been internationalized has caused much dispute between developed and developing countries.[50]

Developing nations – generally the states granting the concession – argue that their national law governs the concession and that international law should not apply because the cancellation of a contract with a private party is a prerogative implicit in the concept of national sovereignty.[51] When the government's actions do not constitute a breach of contract under that state's law, even if they are inconsistent with the contract, then the government has the right to modify its contract with or without compensation to the private contracting party.[52] Thus, if a stabilization clause in an international petroleum agreement is subject to municipal law, it will likely be declared invalid.[53]

Proponents of a nation's right to "permanent sovereignty" are found in the views of several "formidable commentators" and pronouncements from the U.N. General Assembly supporting the notion of permanent sovereignty.[54] This idea is embodied in the following pronouncement: "[t]he description of this sovereignty as *permanent* signifies that the territorial State never loses its legal capacity to change the status or the method of exploitation of those resources, regardless of any arrangement that may have been made."[55]

The proposition that municipal law governs an international petroleum concession, however, has not had much support unless there is no ambiguous or specifically contradictory provision in the contract.[56] Developed countries – whose corporations tend to be the private contracting parties – insist that sovereign states must follow their contractual promises and that international law governs disputes about those promises, so a breaching party must either specifically perform its

48. *See* Michael E. Dickstein, *Revitalizing the International Law Governing Concession Agreements*, 6 INT'L TAX & BUS. LAW. 54, 54 (1988).

49. Dickstein, *supra* note 48, at 54.

50. *Id.* at 55.

51. *Id.*

52. Dickstein, *supra* note 48, at 55. *See also* E. NWOGUGU, THE LEGAL PROBLEMS OF FOREIGN INVESTMENT IN DEVELOPING COUNTRIES 188-89 (1965).

53. *See* Waelde & Ndi, *supra* note 9, at 239.

54. *See* Dickstein, *supra* note 48, at 62-63.

55. *See* Edouardo Jiménez de Aréchaga, *State Responsibility for the Nationalization of Foreign Owned Property*, 11 N.Y.U. J. INT'L L. & POL. 179-180 (1978).

56. *See* Waelde & Ndi, *supra* note 9, at 238.

obligations or pay monetary compensation equal to the full prospective value of the contract.[57]

International law is not per se applicable to every concession agreement.[58] To gain such protection the oil company must seek to "internationalize" the contract.[59] The doctrine of internationalization, also called transnationalization, delocalization, or denationalization, is intended to ensure a form of binding dispute resolution which is not under the control of the state party.[60]

An express choice of law provision may settle the question.[61] When there is no express choice of law provision, three different theories have been commonly used to prevent the application of the law of the foreign state.[62] These are the vacuum theory, the internationalization theory and the theory of *lex mercatoria*.[63]

The internationalization theory states that some contracts are by their very nature internationalized and thus subject to international law.[64] The rationale is based on the mutual consent of the contracting parties. Mutual consent has been accepted as a universal and well-established principle about the autonomy of the will of the parties to the contract.[65] The internationalization of a concession agreement on this basis had gained adherents over past decades, persuading many arbitrators that a contract becomes internationalized because at the time of negotiation that was what the parties consented to.[66]

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57. Dickstein, *supra* note 48; Kinsella & Comeaux, *Reducing Risk in Russia*, *supra* note 23, at 24.

58. *See* John Crawford & Wesley Johnson, *Arbitrating with Foreign States and Their Instrumentalities*, 5 INT'L FIN. L. REV. 11, 12 (1986).

59. *See* Waelde & Ndi, *supra* note 9, at 241.

60. *Id.*

61. *See* Derek William Bowett, *State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach*, 59 BRIT. Y.B. INT'L L. 49, 50 (1988). Parties can expressly chose to submit their contracts to either general principles of law or international law. *See* Curtis, *supra* note 7, at 331. General principles of law are a set of legal principles or rules shared in substance by the world's major legal system, such as *pacta sunt servanda*. Many scholars consider public international law to be different than those general principles of law. These differences will not be discussed in this paper. For a thorough review of the subject, *see generally* Reese, *The Law Governing International Contracts*, *in* INTERNATIONAL CONTRACTS 3 (H. Smit, N. Galston & S. Levitsky eds. 1981).

62. *See* Bowett, *supra* note 61.

63. *Id.* at 50-53.

64. This was the view adopted by the arbitrator in *Texaco v. Libyan Arab Republic (TOPCO)*, 53 I.L.R. 389 (1977). This case will be further discussed in *infra* Part IV(B)(2).

65. *See* F.V. Garcia-Amador, *State Responsibility in Case of Stabilization Clauses*, 2 J. TRANSNAT'L L. & POL'Y 23, 30 (1993).

66. *Id.* at 30-31. *See also* Bowett, *supra* note 61, at 51.

IV. INTERNATIONAL ARBITRATIONS INTERPRETING STABILIZATION CLAUSES

This part reviews international arbitrations concerning petroleum concessions including a stabilization clause. Although these cases are very complex and have many other interesting features, the focus is solely on the features involving the stabilization clause.

A. *Early Cases*

1. Lena Goldfields, Ltd. v. U.S.S.R.[67]

On February 12, 1930, an almost insolvent English company began arbitration proceedings against a hostile and large foreign state under an ad hoc arbitration clause contained in a written concession agreement signed by both parties.[68] The relationship started when Lena Goldfields was incorporated in 1908 for the express purpose of acquiring seventy percent of the shares of the Russian Lena Goldfields Company, which had been created in 1855 to develop gold mining along the river Lena and its tributaries in Siberia.[69] The relationship went well until July 1918 when the new Soviet government nationalized all mining properties without compensation, including the Lena's Russian interests.[70] In 1925, after two years of difficult negotiations between the Soviet government and Lena Goldfields, the company ratified a concession agreement which gave Lena Goldfields the exclusive right to mine gold and other metals in the Urals and parts of Siberia.[71] The concession period was to run in part for thirty years and in part for fifty years.[72]

In October 1925, Lena Goldfields began operations on its concession.[73] By 1929, however, the Soviet government adopted a number of policies that discouraged concessions agreements with foreign capitalists.[74] As a result, Lena Goldfields was subjected to

67. Lena Goldfields Arbitration, ANNUAL DIGEST OF PUBLIC INTERNATIONAL LAW CASES (H. Lauterpacht ed. 1929-1930). *See also* A. Nussbaum, *The Arbitration between the* Lena Goldfields, Ltd. *and the Soviet Government*, CORNELL L.Q. 31, 42 (1950-51) (reproducing the *Lena* award since the original English version has been lost).

68. *See* V.V. Veeder, *The* Lena Goldfields *Arbitration: the Historical Roots of Three Ideas*, 47 INT'L & COMP. L.Q. 747 (1998) (giving a thorough review of the case and its history).

69. Veeder, *supra* note 68, at 756-57.

70. *Id.* at 757.

71. *Id.* at 758.

72. *Id.*

73. *Id.* at 761.

74. *Id.*

increasingly hostile treatment and was not able to meet the production requirement of the concession agreement.[75] Because the Soviet Union's official harassment caused Lena Goldfields to not be able to carry on its concessions, and because all attempts to negotiate settlement failed, Lena Goldfields referred the matter to arbitration under an arbitration clause within the agreement.[76]

This case is the first arbitration that involved a choice-of-law clause and a stabilization clause.[77] Article 89 of the agreement was the choice of law provision which stated that the "parties base[d] their relations with regard to this agreements on the principle of good will and good faith, as well as on reasonable interpretation of the terms of the Agreement."[78] Article 76 contained the stabilization clause under which the Soviet Government promised to make no alteration in the agreement by order, decree, or other unilateral act, or at all, except with Lena's consent.[79]

As a result of the interaction between the clauses of the agreement, the Court of Arbitration determined for the first time that a contract between a private party and a sovereign state might be internationalized.[80] The tribunal held that the agreement between Lena Goldfields and the Soviet Government, while governed by Russian law in respect to ordinary matters, was subject to the general principles of law insofar as the contractual provisions safeguarding the company's position were concerned.[81] The court did not elaborate, however, on the relevance of Article 76, the stabilization clause of the concession agreement.[82] The significance of this award cannot be discounted because it was the first time an arbitration panel held that other law, besides national law, could govern the contractual relationship between a foreign company and a private party.

2. Sapphire International Petroleum Ltd. v. National Iranian Oil Co. (NIOC)[83]

Sapphire was the next well-known major arbitration involving a stabilization clause.[84] A concession by the Iranian government contained a choice-of-law clause similar to Lena Goldfields' in which

75. Veeder, *supra* note 68, at 762.

76. *Id.* at 762-63.

77. *See* Garcia-Amador, *supra* note 65, at 37.

78. *Id.*

79. *Id.*

80. *Id.*

81. *See* Christopher Greenwood, *State Contracts in International Law-The Libyan Oil Arbitrations*, 53 BRIT. Y.B. INT'L L. 27, 41 (1982).

82. *See* Garcia-Amador, *supra* note 65, at 38.

83. 35 I.L.R. 136 (1967).

84. *See* Garcia-Amador, *supra* note 65, at 38.

parties agreed to carry out the provisions in accordance with principles of good faith and good will.[85] The stabilization clause stated that:

> no general or statutory enactment, no administrative measure or decree of any kind, made either by the government or by any governmental authority in Iran (central or local), including NIOC, can cancel the agreement or affect or change its provisions, or prevent or hinder its performance. No cancellation, amendment or modification can take place except with the agreement of the two parties.[86]

The arbitrator held first that the agreements contained no express choice of law provisions.[87] As a result, he decided that the agreement between the parties should be construed in light of the provisions currently stipulated to in other, similar Iranian agreements.[88] He then stated that the legal security of the investments, responsibilities, and considerable risks of the foreign company, "could not be guaranteed . . . by the outright application of Iranian law, which . . . is within the power of the Iranian state to change."[89] The arbitrator thus found that general principles of law applied to the agreement, rather than Iranian law alone.[90] The arbitrator, however, ignored the stabilization clause of the concession agreement and refused to find that the State of Iran had violated the clause, although the tribunal did find that where a concession is prematurely terminated there is a duty to compensate.[91]

This decision is sometimes cited for the proposition that parties to economic development agreements may specify that their contracts will be governed by general principles of law.[92] There are other explanations, however, for why the arbitrator so ruled. For example, the alleged violations of the agreement did not include any violation of the specific obligations listed in the paragraph where the stabilization clause is found.[93]

3. Saudi Arabia v. Arabian American Oil Co. (Aramco)[94]

In 1954, the government of Saudi Arabia concluded an agreement with Saudi Arabian Maritime Tankers, Ltd. and its owner, Aristotle Onassis, under which the company was given a thirty year right of

85. 35 I.L.R. at 140.
86. 35 I.L.R. at 140.
87. *Id.* at 173.
88. *Id.* at 174-75.
89. *Id.* at 171.
90. *Id.* at 175.
91. *See* Amerasinghe, *supra* note 30, at 37.
92. *See* Curtis, *supra* note 7, at 331-32.
93. *See* Garcia-Amador, *supra* note 65, at 39.
94. 27 I.L.R. 117 (1963).

priority for the transport of Saudi Arabian oil.[95] This concession was in direct conflict with that of the Arabian American Oil Company ("Aramco"). Aramco held an oil concession agreement, granted by Saudi Arabia in 1933, which gave Aramco the exclusive right to transport the oil it extracted from its concession area in Saudi Arabia.[96]

As a result of this conflict, there was an arbitration in 1955 between the Kingdom of Saudi Arabia and Aramco held in Geneva under an ad hoc submission agreement.[97] There was a stabilization clause in the Aramco concession agreement. The tribunal concluded that "[b]y reason of its very sovereignty within its territorial domain, the State possess the legal powers to grant rights [by] which it forbids itself to withdraw before the end of the concession."[98] In 1958, the tribunal ruled in favor of Aramco, stating that the government was bound by its agreement with Aramco.[99] The agreement with Onassis's company thus violated that agreement. The importance of this case is that it was the first after *Sapphire* to recognize the validity of stabilization clauses under international law.[100]

B. Libyan Nationalization Cases

Despite earlier arbitral decisions, the legal status of contracts between states and foreign companies remained "so obscure and controversial" that any new arbitral or judicial decisions created a great deal of interest.[101] Three Libyan cases that arose after the Libyan Government's nationalization of foreign companies' interest under long-term oil concessions created this type of interest.[102]

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95. *See* ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 373 (3d ed. 1999).

96. *Id.* at 373.

97. *Id.*

98. 27 I.L.R. at 168. *See also* Mobil Oil Iran, Inc. v. Islamic Republic of Iran, 16 Iran-U.S. Cl. Trib. Rep. 3 (1987) (Brower J. concurring) ("Contemporary international precedents have concluded that such contractual [stabilization] provisions preclude a sovereign during the stated period from exercising the rights it otherwise possess under international law to take an alien's property for a public purpose, and without discrimination and for a just compensation").

99. 27 I.L.R. at 169.

100. *See* Waelde & Ndi, *supra* note 9, at 246.

101. *See* Greenwood, *supra* note 81, at 27.

102. There has been much academic commentary on these arbitrations and the many issues presented by them. This Article focuses only on how the arbitral tribunal interpreted the stabilization clause. For a thorough review of the procedures and arbitral awards, *see id.* at 27-28; Robert B. von Mehren & P. Nicholas Kourides, *International Arbitrations Between States and Foreign Private Parties: The Libyan Nationalization Cases*, 75 AM. J. INT'L L. 476 (July 1981); Robin C.A. White, *Expropriation of the Libyan Oil Concessions - Two Conflicting International Arbitrations*, 30 INT'L & COMP. L.Q. 1 (1981); Note, *Unilateral Action by Oil-Producing Countries: Possible Contractual Remedies of Foreign Petroleum Companies*, 9 FORDHAM INT'L L. J. 63 (1985-86).

The companies who were parties to these agreements, "in an attempt to ensure contractual stability, had included clauses providing that Libyan legislation was not to affect them without the consent of all parties, as well as elaborate choice of law clauses designed to prevent the contracts from being governed exclusively by Libyan law."[103] Two of the most difficult questions associated with contracts between private parties and a foreign state were raised by these cases: (1) what is the degree to which such parties are able to choose the law governing the agreement; and, (2) whether nationalization can be rendered unlawful through the drafting of these agreements.[104]

The Royal Libyan Government granted the concessions subject to the arbitral cases between 1955 and 1968. Each concession gave the exclusive rights for fifty years to search for, extract and sell oil from specific areas of Libyan territory.[105] All relevant provisions were negotiated in identical terms since they were based upon a model concession set out in a schedule to the Libyan Petroleum Law of 1955.[106]

Three relevant provisions were designed to protect the interest of the oil company.[107] The first was a choice-of-law provision which sought to remove the concession from the realm of Libyan law. Clause 28(7) in its final form stated:

> This concession shall be governed by and interpreted in accordance with the principles of law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.[108]

The second important provision was clause 16, the stabilization clause, which excluded the contract from the ambit of any subsequent changes in Libyan law. Clause 16 in its final version read as follows:

> 1. The Government of Libya will take all steps necessary to ensure that the Company enjoys all the rights conferred by this Concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties.
>
> 2. This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations

103. *See* Greenwood, *supra* note 81, at 27-28.
104. *Id.* at 28.
105. *See* von Mehren & Kourides, *supra* note 102, at 478-79.
106. *Id.* at 478.
107. *See* Greenwood, *supra* note 81, at 28.
108. The history of the concession is reviewed in the Texaco Overseas Petroleum Company and California Asiatic Oil Company v. The Government of the Libyan Arab Republic, 53 I.L.R. 389 (1978). Clause 28(7) is reproduced in 53 I.L.R. 297, at 303.

> in force on the date of execution of the agreement of amendment by which this paragraph 2 was incorporated into this concession agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent.[109]

Finally, clause 28 provided that all disputes would be submitted to arbitration unless the parties arrived at a friendly settlement.[110] The clauses specified that either party had the right to institute arbitration proceedings.[111] Clause 28(3) took into consideration the possibility that one party might seek to frustrate the arbitration clause by refusing to appoint an arbitrator, stating that in that event the President of the International Court of Justice would appoint a sole arbitrator.[112]

Between 1971 and early 1974, the Libyan government nationalized the interest and properties of foreign oil companies in Libya.[113] "Three separate arbitral tribunals adjudicated the lawfulness of these nationalizations and the remedies available to the companies."[114] Even though the awards were generally favorable to the foreign companies, "the arbitrators reached different conclusions despite the close similarity between the cases."[115]

1. BP Exploration Company (Libya) Ltd. v. Government of the Libyan Arab Republic.[116]

The *BP* case involved a single concession originally granted to Nelson Bunker Hunt in 1957.[117] In 1960, Hunt assigned to BP an undivided one-half share of its interest.[118] BP carried out exploration work and found oil in large quantities.[119] BP then acted as operator for Hunt and itself.[120] In 1969, the Royal Government was overthrown and a revolutionary regime was established.[121] The new government

109. 53 I.L.R. at 322.
110. *Id.* at 302.
111. *Id.* at 302.
112. *Id.* at 402-04.
113. *See* Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474, 479 (1992).
114. *Id.* at 479.
115. *See* Greenwood, *supra* note 81, at 28.
116. 53 I.L.R. 297.
117. *Id.* at 298.
118. *See* Greenwood, *supra* note 81, at 29.
119. *Id.*
120. *Id.* There was subsequent litigation between Mr. Hunt and BP in both the United States and England. This litigation is outside the scope of the paper, but for a detailed discussion of the agreements between the parties, *see* B.P. Exploration Co. (Libya) Ltd v. Hunt (No.2) [1979] 1 W.L.R. 783; Hunt v. Coastal States Gas Producing Company, 570 S.W. 2d 503 (1978).
121. B.P. Exploration Co. (Libya) Ltd v. Hunt (No.2) [1979] 1 W.L.R. 783, at 792.

promised to honor the concessions granted by its predecessor.[122] In December of 1971, however, in retaliation for what was regarded as the UK's failure to prevent Iran's occupation of three islands in the Persian Gulf, the Libyan government nationalized BP's entire interest in the concession.[123] Shortly after the nationalization law, BP wrote the Libyan government to request arbitration.[124] After Libya failed to respond, under clause 28(c), BP asked the President of the International Court to appoint a sole arbitrator.[125] Libya took no part in the proceedings and an award was rendered against the country.[126]

The arbitrator determined that the agreement was a contractual relationship belonging to the category of administrative contracts and that by virtue of the stabilization clause, Libya had limited its "freedom to change or terminate the concession by unilateral act unless it could be shown that the changes was truly in the public interest."[127] Thus, while not expressly making reference to the stabilization clause in clause 16 either in the passage of the award or in its final decisions, the arbitrator did hold that nationalization constituted a fundamental breach of the concession and amounted to a total repudiation of the agreement.[128]

2. Texaco Overseas Oil Petroleum Co./California Asiatic Oil Co. v. Government of the Libyan Arab Republic (TOPCO).[129]

The *Texaco / Calasiatic* ("TOPCO") case had a similar background to BP's case. Between 1955 and 1968, Texaco and Calasiatic, both United States corporations, obtained fourteen oil concessions from the Royal Libyan Government.[130] In 1973, the revolutionary government nationalized fifty-one percent of the companies' interest in the concessions.[131] When the companies commenced arbitration proceedings, their remaining forty-nine percent interests were also nationalized.[132] Libya did not respond to the companies' request to submit to arbitration, but when the companies under clause 28(3) asked the President of the International Court of Justice ("ICJ") to appoint a sole arbitrator, the Libyan government opposed such appointment in a

122. *See* Greenwood, *supra* note 81, at 29.
123. *Id.*
124. 53 I.L.R. 389, 390.
125. *Id.* at 399.
126. *Id.*
127. *See* White, *supra* note 102, at 5-6.
128. 53 I.L.R. at 329.
129. 53 I.L.R. 389 (1979).
130. *See* Greenwood, *supra* note 81, at 30.
131. *Id.*
132. 53 I.L.R. at 393-8.

memorandum.[133] Libya objected to the arbitration procedure, stating that the disputes were not subject to arbitration because the nationalizations were acts of sovereignty.[134] After considering the memorandum, the President of the ICJ named a sole arbitrator.[135] A preliminary award was rendered in November of 1975, followed by an award on the merits in January 1977.[136]

The TOPCO arbitrator looked at the whole issue in greater detail and reached different conclusions about why TOPCO was entitled to compensation.[137] He first rejected the notion that the concession agreement is an administrative contract.[138] He then proceeded to examine the nature and implications of the stabilization clause.[139] First, he stated that Clause 16 did not "in principle impair, the sovereignty of the Libyan State" since all its sovereign legislative and regulatory powers are preserved, as this power can be exercised with respect to persons with whom the state has no contractual obligations.[140] On this point he held that:

> the recognition by international law of the right to nationalize is not sufficient to empower a State to disregard its commitments, because the same law also recognizes the power of a state to commit itself internationally, especially by accepting the inclusion of stabilization clauses in a contract entered into with a foreign private party.[141]

He then turned to the validity of stabilization clauses and reached the following conclusion:

> Thus, in respect of the international law of contracts, a nationalization cannot prevail over an internationalized contract, containing stabilization clauses, entered into between a State and a foreign private company. The situation could be different only if one were to conclude that the exercise by a State of its right to nationalize place that State on a level outside of and superior to the contract and also to the international legal order itself, and constitutes an act of government which is beyond the scope of any judicial redress or any criticism.[142]

The importance of the TOPCO arbitration is: (1) the arbitrator internationalized the contract; and, (2) he interpreted the stabilization

133. *See* von Mehren & Kourides, *supra* note 102, at 489.
134. *Id.* at 489.
135. *Id.*
136. 53 I.L.R. 389 (1979).
137. *See* White, *supra* note 102, at 6.
138. *See id.*
139. *Id.*
140. 17 I.L.M. 1, 24-25 (1978).
141. *Id.*
142. 17 I.L.M. at 25.

clause as a basis to do so. In other words, the arbitrator held that when the contract is internationalized, the parties act as equals and the state host is bound by the guarantees it has offered to the investor.[143]

3. Libyan American Oil Co. (LIAMCO) v. Government of the Libyan Arab Republic.[144]

The last arbitration involving the Libyan nationalizations was the *LIAMCO* case. This case was identical to *TOPCO*, except that the company was one of the smaller independent oil companies whose participation had been encouraged by the Royal Libyan Government.[145] LIAMCO was a Delaware corporation that owned an undivided twenty-five and one-half percent interest in three concessions at the time of the Libyan revolution.[146] Fifty-one percent of the LIAMCO interests were nationalized at the same time the *TOPCO* nationalizations took place.[147] Again, when LIAMCO commenced arbitrations its remaining interests were nationalized.[148] The arbitration proceedings followed the same pattern as the *TOPCO* arbitration, with Libya refusing to participate in the case.[149] The President of the ICJ, at the request of LIAMCO, named a sole arbitrator and the award was given on April 12, 1977.[150]

In analyzing the stabilization clause, the sole arbitrator found that the clause was "justified not only by the said Libyan petroleum legislation, but also by the general principle of the sanctity of contracts recognized also in municipal and international law."[151] He went on to state that since LIAMCO's concession agreements were binding they could not validly be terminated unless there was "mutual consent of the contracting parties, in compliance with the said principle of the sanctity of contracts and particularly with the explicit terms of Clause 16 of the Agreements."[152] The conclusions of the award, however, were not consistent with the views of the arbitrator concerning the validity of the stabilization clauses. It is thus difficult to evaluate how the stabilization clause influenced the award.[153]

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143. *See* White, *supra* note 102, at 11.
144. 62 I.L.R. 140 (1977); 20 I.L.M. 1 (1977).
145. 62 I.L.R. at 155.
146. *Id.* at 155-56.
147. *Id.* at 162.
148. *Id.* at 165.
149. *Id.*
150. *Id.* at 165-220.
151. 62 I.L.R. at 31.
152. *Id.* at 62.
153. *See* Garcia-Amador, *supra* note 65, at 44.

C. *Other Cases Involving Stabilization Clauses*

1. AGIP v. Popular Republic of Congo.[154]

On January 12, 1974, all the oil distribution sector in the Congo was nationalized.[155] This measure affected all companies in the sector, except for AGIP, who a few days earlier negotiated with the government the sale of fifty percent of AGIP's capital.[156] The agreement between AGIP and the government contained several stabilization clauses[157] and an arbitration clause. On April 12, 1975, the President of Congo ordered the nationalization of AGIP.[158] Following this order, the army occupied the company's headquarters and seized all of its assets, files and accounting records.[159]

AGIP filed an application for arbitration.[160] Like the *TOPCO* arbitrator, the tribunal held that stabilization clauses freely accepted by the Government "do not affect the principles of its sovereign legislative and regulatory powers, since it retains both in relations to those, whether national or foreigners, with whom it has not entered into such obligations."[161] Hence, the stabilization clauses were held to be valid and enforceable under international law.[162]

2. Government of the State of Kuwait v. American Independent Oil Co. ("Aminoil")[163]

In 1948, the ruler of Kuwait granted a sixty-year oil concession to Aminoil, a United States corporation.[164] This concession agreement included a stabilization clause that stated:

> The Skaikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11. No alteration shall be

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154. 21 I.L.M. 726 (1982).

155. *See* Garcia-Amador, *supra* note 65, at 44.

156. 21 I.L.M. at 727.

157. In one of the stabilization clauses, the government adopted measures to prevent the application to the Company of future amendments to the law affecting the structure and composition of the Company's bodies. *See* Garcia-Amador, *supra* note 65, at 45.

158. 21 I.L.M. at 729.

159. *See* Christopher Koa, *The International Bank for Reconstruction & Development & Dispute Resolution: Conciliating and Arbitrating with China through the International Center for Settlement of Investment Disputes*, 24 N.Y.U. J. INT'L L. & POL. 439, 459 (1991).

160. *Id.*

161. 21 I.L.M. at 735-36.

162. *See* Waelde & Ndi, *supra* note 9, at 245.

163. 21 I.L.M. 976 (1982).

164. George Delaume, *Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria*, 63 TUL. L. REV. 575, 606 (Feb. 1989).

> made in the terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh or the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, relations or additions to this Agreement.[165]

In 1961, a supplemental agreement was negotiated which amended the 1948 concession.[166] In 1977, after several years of trying to modify the agreement and increase Aminoil's payments, Kuwait enacted a law that terminated the concession agreement.[167] In 1979, the parties agreed to submit their dispute to an ad hoc tribunal.[168]

Aminoil claimed that the concession agreement was wrongfully terminated because there was a stabilization clause and termination of the agreement was a violation of international law.[169] Because the concession agreement was renegotiated several times, the tribunal found that the "stabilization clauses, as no longer possessed their former absolute character."[170] The tribunal, however, did not find that stabilization clauses would not prevent termination, if such clauses were still considered binding. Additionally, the tribunal expressly rejected Kuwait's contention of permanent sovereignty.[171]

V. CONCLUSION

Nations with substantial petroleum reserves, without the financial capacity to develop these resources, continue to rely on foreign oil companies to undertake the financial and technological development, exploration and production of these resources. This is particularly true with the emergence of new independent states in Central and Eastern Europe. Petroleum concession agreements thus continue to be used by private parties and foreign companies.

Stabilization clauses will continue to be used in concession agreements to protect foreign companies from subsequent unilateral actions by the foreign state. To meet this challenge, it is important for companies and host countries to understand how, when and why stabilization clauses have been used in the past and how arbitral awards have treated stabilization clauses. The decisions discussed in this article show that such clauses are taken seriously by arbitrators. The precise language used in the clauses has not been particularly significant; rather, they are generally analyzed from a policy-based perspective that considers the limitation on sovereignty expressed by

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165. 21 I.L.M. at 990-91.
166. *Id.* at 991.
167. *Id.* at 998.
168. *See* Delaume, *supra* note 164, at 607.
169. *Id.*.
170. 21 I.L.M. at 1024.
171. *See* Garcia-Amador, *supra* note 65, at 48.

such a clause in light of all the circumstances surrounding the transaction.