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Victoria R. Nalule

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## WHAT IS THE PROBLEM WITH STABILIZATION CLAUSES IN PETROLEUM AGREEMENTS?

Victoria R. Nalule\*

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### ABSTRACT

International Oil Companies (IOCs) continue to invest in countries which do not have stabilization clauses. Why is this so? What is the essence of these clauses? One of the curiosities of stabilization clauses in petroleum agreements, is that most developed countries will not offer them to investors. So, why do developing countries with stable political, fiscal and regulatory climate offer them? Additionally, history shows that these stabilization clauses have not deterred host governments from expropriating petroleum investments. While governments may be able to make commitments of their own, as a matter of national sovereignty they may not be able to bind the legislative competence of the State into the future. These concerns are the main driver behind this article, which is influenced by the various questions asked by policymakers in the Global South on the importance of stabilization clauses for the sustainable development and management of natural resources.

**Keywords:** Stabilization; sustainable development; natural resources; oil and gas

## 1. INTRODUCTION

Energy investments are typically very expensive ventures requiring large amount of capital which is often beyond the reach of host governments.<sup>1</sup> In this respect, host governments must attract the participation of international companies with the resources and expertise to help them exploit and market their energy resources. International oil and gas companies (IOCs) often demand for inclusion of stabilization clauses into their contracts. The past experiences of IOCs with host governments have played a major role in shaping the current stabilization mechanisms. Particularly the nationalization of IOCs' assets and the failure of the early stabilization clauses to act as a deterrent in the nationalization movements which were experienced in the Middle East and North Africa. This resulted to numerous energy disputes.

One way of avoiding energy disputes is to ensure effective negotiations throughout the project lifecycle. Negotiations can also play a crucial role in resolving energy disputes. Although there are various issues to be taken into consideration with respect to negotiating energy projects and resolving related disputes, this paper will focus on stabilization clauses. Before a discussion on stabilization clauses, it is important to understand what exactly 'Stabilization' means. Professor Peter Cameron in his book, 'International Energy Investment Law: The Pursuit of Stability', asserts:

In the context of an international energy contract, the term stabilization applies to all of the mechanisms, contractual or otherwise, which aim to preserve over the life of the contract the benefit of specific economic and legal conditions which the parties considered to be appropriate at the time they entered into the contract.<sup>2</sup>

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\* Ph.D. (Dundee), Senior Research Fellow, Institute for Oil, Gas, Energy, Environment and Sustainable Development (OGEES Institute).

<sup>1</sup> Damilola Olawuyi, *Extractives Industry Law in Africa* (Springer, 2018) 1-5.

<sup>2</sup> Cameron P. *International energy investment law: the pursuit of stability*. OUP Catalogue. 2010.

Depending on the type of a stabilization clause (including the wording), IOCs may seek protection against unilateral modifications to the contract and against taking the rights of the investor.<sup>3</sup> All these decisions are reached as a result of effective negotiations.

Simply defined, negotiation refers to the process of holding a discussion with the main aim of reaching an agreement. With respect to petroleum projects, the host government and the IOCs must negotiate the terms of the petroleum agreement. There are various issues to be considered when negotiating the petroleum agreement including the fiscal regime, accounting standards, contract termination provision, social impact including land access, compensation and relocations; local content provisions; environmental and health issues and many others. In negotiating petroleum agreements, there are some unique features that must be considered and thought about. These include among others: the cost of exploration and development; the ever-changing market conditions; the possible field size, including the possibility of dry holes; and the difficulty of recovery.

Of interest to this article, is a question as whether stabilization clauses are still relevant the 21<sup>st</sup> century? Should investors focus on other avenues of protecting their investments, for instance through the provisions in national investment laws; arbitration clauses; and international investment agreements? These questions have indeed raised a lot of concern in the 21<sup>st</sup> century, especially among policymakers from developing countries. As such, this short paper attempts to address some of these questions. In so doing, a three-step framework is employed in the form of sections; this being the introduction. Section two explores stabilization clauses and their impact. Section 3 reflects on the key concerns with respect to stabilization clauses, and it also sets out the concluding remarks.

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<sup>3</sup> It is imperative to note that, the way these 'rights' are viewed and interpreted matters. For instance, if the investors' rights as stipulated in the Petroleum Agreement: are viewed as a form of property, then the legal issue will be whether interference by a state with these rights amounts to expropriation? Cameron P. International energy investment law: the pursuit of stability. OUP Catalogue. 2010.. Page 69

## 2. STABILIZATION CLAUSES IN PETROLEUM AGREEMENTS

Stabilization clauses have increasingly become an important subject given their impact on the sovereignty of a State over its natural resources. The resource curse notwithstanding, the discovery of petroleum resources generally ignites national dreams of riches and economic prosperity. Indeed, there are countries that have benefited from these resources, including Norway, the United Kingdom, the United States, The United Arab Emirates and Kuwait, to mention but a few.<sup>4</sup>

Different stakeholders have different expectations from these resources. For instance, the host government is more concerned about revenues; the IOCs are concerned about protecting their investments and making profits. On the other hand, the citizens and host communities are more interested in developmental infrastructure and employment opportunities. Meeting the expectations of all these stakeholders in full may be impossible and as such, in practice, participants must strike a balance.

Historically, stabilization clauses date as far back as the 1930s, when they were introduced in the new oil provinces of the Middle East. These were also used as a defense against expropriation and nationalization, which characterized the 1970s and 1980. Evidence from the arbitration cases related to expropriation indicates that even though stabilization clauses exist in a petroleum agreement, the State can still use its sovereign power to revise its relationship with the investor unilaterally. However, the impact of this is that the State is liable for the payment of damages.<sup>5</sup>

These clauses target risks that have the impact of causing losses to the investors. Such risks include direct expropriation; a gradual loss of investment value by a series of measures over time (creeping expropriation); or the loss of anticipate future opportunities.<sup>6</sup> Stabilization clauses are in essence contractual

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<sup>4</sup> Nalule VR. *Land Law and the Extractive Industries: Challenges and Opportunities in Africa*. Bloomsbury Publishing; 2021 Aug 26.

<sup>5</sup> *Supra* note 1. Page 89

<sup>6</sup> *Supra* note 1

assurance of negotiated terms against future legal or regulatory changes. This is achieved by providing legal and fiscal stability.<sup>7</sup>

Important to note is that, despite the fact that IOCs operate in both the developed and developing countries, these companies do not tend to apply the same standards with respect to negotiating stabilization clauses. For instance, some countries do not offer stabilization guarantees at all. These include among others the UK, Brazil, Colombia, Libya, Norway and Saudi Arabia.<sup>8</sup> Some countries that do not offer stabilization guarantees have, instead, effective legal remedies available to cure for changes in the contract, and under a domestic legal system that is independent from the executive branch. If the principle of national sovereignty is fully applied to this context, then national parliaments should not bind itself with regards to the future, and on that basis countries in the Global South should “pick a leaf” from developed countries such as Norway before considering negotiating stabilization clauses with IOCs. On the other hand, the nature of energy investments in general, and petroleum ones in particular, suggests the need for large sunk costs up front and the danger (to investors) of an ‘obsolescing bargain’ whereby, once those investments are made, the bargaining advantage moves strongly in favor of host governments with respect to any change in contractual terms – hence the demand made by IOCs and others for stabilization.

This tension is discussed below, alongside a survey of the very wide range of stabilization clauses in use within the petroleum sector.

### **2.1 Instability and the quest for stabilization clauses**

The petroleum sector is unpredictable especially with the unstable markets. Additionally, the COVID-19 pandemic has proved that uncertainties in the energy sector can no longer be

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<sup>7</sup> There are states that provide legislative support for the stability provisions of a contract. This can be either of a procedural kind (by legislative approval of the contract itself) or a substantive kind (by incorporating specific stabilization guarantees for investment contracts in domestic law).

<sup>8</sup> The bargaining power of a country plays a major role in negotiating on whether to include stabilisation clauses or not. The bargaining power is often rooted in a state’s character as a capital-exporting country or its extensive control over the domestic energy industry and large domestic resources of fossil fuels.

ignored. For instance, the COVID-19 pandemic has had an impact on all spheres of life. In the energy sector, oil demand and consumption has decreased consequently leading to drastic drop in oil prices to below zero future prices for specific future contracted delivery for a brief period from the 21st April 2020. This led many to question the future of fossil fuels especially in this energy transition era.<sup>9</sup>

The above market uncertainties affect both developed and developing countries. However, for the countries in the global south, they are often viewed by IOCs as being unstable with ineffective rule of law. For these reasons, IOCs often persuade host governments in the global south into accepting stabilization clauses.

The above notwithstanding, it is imperative to note that, legal and fiscal instabilities are not prone to developing countries. For instance, the fiscal instabilities in the UK cannot be ignored. Since the establishment of the UK Continental Shelf tax system in 1975, the regime has been repeatedly reviewed and many amendments applied. There are various factors that may cause the host state to revise the fiscal terms to which they originally agreed with investors. As spotlighted by Dr. Carole Nakhle, these include:<sup>10</sup>

**a. Oil prices:** Typically, when the oil price is high, the government has the upper hand. Governments often change their fiscal terms to respond to oil prices.

**b. Investment:** A significant rise in petroleum investments may encourage the host government to introduce a tax increase. However, an unexpected decline in investment may trigger the opposite response.

**c. Production life cycle:** Whereas governments are kin to attract investments before a discovery, by among others providing a

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<sup>9</sup> Nalule, V.R. Energy Access Challenges in the COVID 19 crisis: Is there a future for Extractives in the Energy Transitions era? Extractives Hub Research Insight, May 2020. Extractives Hub, Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee.

<sup>10</sup> Mansour, Mario, and Carole Nakhle. "Fiscal stabilization in oil and gas contracts—evidence and implications." (2016).

favorable tax regime; often the same government will increase the tax once commercial discoveries are made.

**d.** Regional trend and neighborhood effect: A change in the fiscal regime of one country, can influence neighboring countries to do the same. This is so because most of the countries in the region are competing for the same petroleum investors, so they endeavor to have regionally competitive tax policies.

**e.** Changes in political conditions: Once a new government is ushered into the country, they often change the legal, regulatory and fiscal frameworks. As such, the petroleum fiscal regime designed by the previous administration will invariably be reviewed critically by a successor with a different political persuasion or ideology.

**f.** Deteriorating government finances: When a country is going through an economic crisis, the government will take all measures to raise revenue, including increasing taxes for IOCs. In this respect, a country will make changes to the general fiscal regime, affecting not only the local industry and other sectors but also the IOCs.

The above notwithstanding, the risks associated with transforming locked underground assets (oil and gas) into cash cannot be ignored. The different phases of a petroleum life cycle present various risks. The complexity of petroleum projects has been the basis for including stabilization clauses in developing countries.<sup>11</sup> For instance, during the exploration phase, a lot of capital is invested, and this could cost tens or hundreds of millions of dollar, and yet there is a risk of encountering a dry well.<sup>12</sup> Consequently, if the well proves dry, the exploration costs of the dry hole are written-off. Conversely, if oil is found,

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<sup>11</sup> Nakhle C. *Petroleum taxation: sharing the oil wealth: a study of petroleum taxation yesterday, today and tomorrow*. Routledge; 2008 Apr 29.

<sup>12</sup> The costs vary depending on some key factors such as the location of the possible oil reserves-whether it is near land or in deep water; how large the oil field is expected to be etc. The most common method used in exploration is geophysical and seismic surveys. However, in the distant past, early explorers relied on looking at surface rock formations for clues about the rocks below- a hit and miss approach.



then the company may then proceed to the testing phase. A well is considered commercially viable if it can produce enough oil or gas to justify the costs of drilling and placing it on production. As such exploration activities are not only expensive but also high risks, hence IOCs will device all means to protect their investments and minimize the related risks. In the appraisal stage, the risks are also inevitable. The appraisal phase follows discovery, which necessitates the need to appraise the reservoir in order to ascertain its size, structure and quality. Although the odds of success are higher at this stage, there are aspects of risk especially in instances where the technology required to produce oil or gas are too expensive; or where there is not enough oil or gas to be commercially attractive. After the development and production phases, the last phase is abandonment. This point is reached where production levels fall to a level which ceases to cover operating costs. Abandonment costs cover the plugging of wells, removal of well equipment, production tanks and associated installations.

The above briefly outlines the complexity of petroleum projects and the risks associated with these projects. These risks may differ depending on the region or country in question. Often, politically unstable countries present greater risks for IOCs. In order to mitigate some of these risks and protect their investments, the IOCs often negotiate to have stabilization clauses inserted into the petroleum agreements. The next sub-section discusses the different types of stabilization clauses.

## **2.2. Types of stabilization clauses**

There are stabilization clauses of a fiscal nature and stabilization clauses of a legal (or regulatory) nature. Fiscal stabilization clauses relate to government revenue: taxes, royalties, duties to mention but a few. Legal stabilization clauses on the other hand, cover laws and regulations of a non-fiscal character, such as the statutes that govern operations at the project site on a day-to-day basis (mining laws, labour laws, environmental laws, etc.). The inclusion of stabilization clauses dates as far back as the early 1930s. There are various types of stabilization clauses as will be discussed below. However, the impact or purpose of these clauses is the same: that is to offer assurance that the investment terms at its core on the date of signature will remain the same over the life of the agreement. Stabilization clauses are

drafted differently, some clauses focus on the fiscal impacts, while other clauses include the right to monetize; the right to develop a petroleum discovery to be commercial; an exchange regime and the governance of the project itself.<sup>13</sup>

### **1. Freezing clauses**

In the legal profession, these are also referred to as stabilization clause *stricto sensu*. Freezing clauses are to the effect that, the governing laws – general and special – applicable to operations under a contract between a company and a sovereign state should be those of the state at the time the contract was executed. When applied strictly, these clauses prohibit the host state from changing its laws, by effectively freezing the laws which were in force on the date that the contract came into effect, hence shielding the IOC from any changes in legislation occurring after this date. Freezing clauses may be used in different ways. Besides being applied strictly, they may also be used to prevent the host state from applying changes in the host state’s law made after the effective date of the contract to the specific investment contract. Alternatively, the contract may be granted an enclave status by making it exempt from any legal changes occurring in the wider legal regime of the host state. These clauses are not often acceptable to the host governments, since it is unconstitutional to completely restrain the sovereign authority of the host state to amend its laws. In this respect, host governments prefer to limit the applicability of the freezing clauses to a few aspects of the contract (taxes for instance). As such, freezing clauses have increasingly been replaced with the ‘Economic Equilibrium’ clauses.

### **2. Economic equilibrium/ Economic stabilisation clauses**

These seek to re-establish the economic position-the economic equilibrium- of the contract following changes in law which have an economic impact on the bargain struck between the host state and its contractual partner. They provide protection through a renegotiation mechanism. Whereas the investors are supposed to comply with the new laws, they are entitled to

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<sup>13</sup> The right to monetize may include the right to export products and sell interests in the investment. For a detailed discussion see, Cameron P. International energy investment law: the pursuit of stability. OUP Catalogue. 2010.

compensation so that they remain in the same economic situation they would have been in had the laws not changed. These function as indemnity clauses which provide balance to the economic equilibrium of the contract by ensuring that appropriate remedies are available to the investor if the host state's actions adversely affect the underlying economics of the relevant project. The common form of remedy is compensation, this can take such forms as: adjusted tariffs, extension of the concession, tax reductions, or monetary compensation

With economic equilibrium clauses, the parties must define the 'Trigger Event', which can either be widely defined (for example, 'any change in law') or narrowly defined (for example, 'any change in tax law'). However, these clauses do not apply to issues that are considered to be of public interest including health, safety, environment or security or other issues.

Economic balancing/equilibrium is more complex to administer than freezing-style mechanisms. Besides offering different terms to different countries, the fact that the policy tools subject to stabilization are not identified, implies that the parties must know the outcome at any point in time. Often the IOCs have an information advantage, thus limiting effective and fair implementation of economic equilibrium clauses. It would therefore be prudent for the host government to have the same model for stabilization clauses for all IOCs.<sup>14</sup> Albeit, this also presents challenges as the clauses are often negotiated in different years.

### **3. Rebalancing of benefits**

These clauses are similar to economic equilibrium. They typically envisage automatic adjustments or renegotiation of contract terms in the event the specified circumstances occur. They stipulate that if the host state adopts a measure subsequent to the conclusion of the contract that is likely to have damaging consequences to the economic benefits of the original bargain for one or both parties, a re-balancing must take place. It has been observed that although most stabilization clauses cover tax policy parameters, there those that extend coverage to exogenous shocks – which presumably relate to market

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<sup>14</sup> Supra note 9.

conditions but can be anything that affects the return on investment.

#### **4. Hybrid clauses**

These seek to combine the unambiguous nature of freezing clauses with provisions commonly found in economic equilibrium clauses.

#### **5. Allocation of burden clauses**

These seek to allocate the fiscal and related burdens created by a unilateral change in the law. It is common for the resultant burden to be borne by the National Oil Company or the State.

#### **6. Prohibition on unilateral changes**

This is also referred to as an ‘intangibility clause’. It prohibits unilateral changes to the investment agreement and requires the consent of both parties before any changes may be made. Unlike the freezing clauses which freeze the law, this type of clause only freezes the contract. It tries to limit the state’s capacity by requiring mutual consent to contract changes.<sup>15</sup>

#### **7. Good will clause**

This is similar to the ‘intangibility clauses’, although the scope of their application might differ. Basically, as the name suggests, the ‘good will’ clause is to the effect that the parties shall perform the contract with ‘good will’ or ‘good faith’, hence the clause precludes unilateral modification or termination of the contract.

#### **8. Combined stabilization clauses**

It is common for a regime or PSC to contain a combination of all the different types of stabilization clauses. Scholars have identified the example below from Azerbaijan’s Shah Deniz contract:<sup>16</sup>

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<sup>15</sup> Examples of these type of clauses can be found in different PSCs. For instance, Article 18.2: Mayfair Production Sharing Agreement between the Ministry of Oil and Natural Resources and Yemen Mayfair Petroleum Corporation (Al Zaydah, Block 22, Tihama Area), dated 29 July 1992. This provision is to the effect that the petroleum agreement may be altered or amended only by the mutual agreement of the Parties.

<sup>16</sup> Cameron P. International energy investment law: the pursuit of stability. OUP Catalogue. 2010. Page 81

*The rights and interests accruing to Contractor (or its assignees) under this agreement....shall not be amended, modified or reduced without the prior consent of Contractor (intangibility). In the event that any Governmental Authority invokes any present or future law, treaty, inter-governmental agreement, decree or ministerial 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 change in tax legislation, regulations or administrative practice, or jurisdictional changes pertaining to the Contract Area, the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties [balancing], and if the rights or interests of Contractor have been adversely affected, the SOCAR (the NOC) shall indemnify contractor for any disbenefit, deterioration in economic circumstances, loss or damages that ensue there from [allocation].*

Moving forward, the author notes that, all the stabilization clauses are incompatible with the State's permanent sovereign power to enact and amend laws. The sovereignty of the State should not be limited to contractual mechanisms: and yet these clauses in effect can be described as the limits of non-alienation of State prerogatives, or as self-limitation of its legislative competences.<sup>17</sup> Additionally, these clauses are as a result of negotiations between the host country and the IOCs. As such, it is common to find that a host government has negotiated different stabilization clauses with different companies. Consequently, this leads to administrative complexity- as the government will have to apply to each project the law existing at the time of concluding the contract. Consequently, the tax authority ends up administering different tax procedures and forms, which could become quite complex with the accumulation of contracts.<sup>18</sup>

### **2.2.1. Examples of Stabilization Clauses**

Stabilization mechanisms can be in different forms. Some are provided for in a law (for instance foreign investment laws).

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<sup>17</sup> Supra note 9

<sup>18</sup> *ibid*

However, the common form of stabilization clause is found in petroleum agreements, or it may be ‘contractualized’ by way of a law referencing the petroleum contract. Regardless of the form the stabilization mechanism takes, the stabilization clause must be properly entered into by the state; and it must be enforceable in the domestic law of the host State. There are different stabilization clauses in different countries; the example below is from Liberia:

*“For the avoidance of doubt, any amendments, additions, revisions, modifications or other changes on the Tax Corpus made after the Amendment Effective Date shall not be applicable to the CONCESSIONAIRE. Furthermore, any future amendment, additions, revisions, modifications or other changes to any Law (other than the Tax Corpus) applicable to the CONCESSIONAIRE or the Operations that would have the effect of imposing an additional or higher tax, duty, custom, royalty or similar charge on the CONCESSIONAIRE will not apply to the CONCESSIONAIRE to the extent it would require the CONCESSIONAIRE to pay such tax, duty, royalty or charge”.*<sup>19</sup>

The example above, relates to freezing clauses. However, it is important to note that there is no universally accepted form of stabilization clauses. These differ in content and wording depending on the country concerned. Additionally, the breadth of protection offered by the stabilization clauses also differs depending on how they are drafted. In the next table, I further highlight the provisions offering for stabilization clauses in other African countries.

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<sup>19</sup> This is an example of a freezing stabilisation clause.

**Table 3 Summary of other Stabilization clauses<sup>20</sup>**

<b>Country</b>	<b>Legislation/Contract</b>	<b>Provision for Stabilization</b>
Uganda	Uganda Model Contract 1999 Model Production Sharing Contract	Article 31
	The Petroleum (Exploration, Development and Production) Act, 2013	Part XVII Section 190 (Transitional provision)
	Production Sharing Agreement for Petroleum Exploration Development and Production in The Republic of Uganda by and between The Government Of The Republic of Uganda and Tullow Uganda Limited in respect of Exploration Area 1, Feb 2012	Article 33
Tanzania	The Petroleum (Exploration and Production) Act 1980 The United Republic of Tanzania No. 27 Of 1980	Second Schedule Section 95 (Transitional provision)
	Model Production Sharing Agreement Between The Government of The United Republic of Tanzania and Tanzania Petroleum Development Corporation and Abc Oil Company November 2004	Article 30(b)
	Petroleum Act 2008	Section 56 (Transitional Provision)

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<sup>20</sup> Extracted from, Mansour, M. and Nakhle, C., 2016. Fiscal stabilization in oil and gas contracts—evidence and implications.

Sierra Leone	Petroleum Exploration and Production Act 2001	Section 66(2) (Transitional provision)
	Petroleum Agreement between Government of Sierra Leone and Oranto Petroleum Limited (2003)	Article 26
	Model Petroleum agreement (2011 (Open Oil estimate))	Article 26
Papua New Guinea	No. 33 of 2000. Resource Contracts Fiscal Stabilization Act 2000	Section 2
Mozambique	Petroleum Law N° 3 /2001 of 21 February	Article 26 (Transitional Provision), Article 27 (dispute resolution)
	Law no. 21/2014	Article 68 (Transitional Provision), Article 69 (dispute resolution)
	Exploration and Production Concession Contract between the Government of the Republic of Mozambique and ENI East Africa S.p.A and Empresa Nacional di Hidrocarbonetos, E.P. for Area 4 Offshore of the Rovuma Block Republic of Mozambique 2006	Article 27.12 27.14

As illustrated in the table above, there is no internationally recognized format or content for stabilization clauses. However, there are some common aspects especially in fiscal stabilization which include stability covering all taxes and levies on the sector. This can be provided expressly by referring to the taxes themselves (as the case in Uganda, which limits the coverage to income tax); or implicitly by reference to various (arguably, economically equivalent) notions of ‘benefit’.<sup>21</sup>

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<sup>21</sup> Supra note 9



Most stabilization clauses are also broadly drafted, and as such they offer the investors appropriate protection, especially considering the fact that some of the terms used in these clauses are ambiguous. Although some of these terms might have different legal interpretations and impact, economically, they refer to the share of the parties from the oil rent.<sup>22</sup> Some of these broad terms include notions such as ‘economic balance’, ‘original situation of the parties’ ‘economic benefits’, ‘commercial and fiscal benefits’, and ‘balance in the interest of the parties. There is therefore an urgent need for host governments to narrow down on these ambiguous notions.

It would be good practice for the host State to limit the coverage and timeframe for these stabilization clauses. Where possible, it is the opinion of the author that host States in the 21<sup>st</sup> century should not accept these stabilization clauses. Most of these developing countries are politically stable with an effective rule of law. In this respect, they should be able to protect all kinds of investments (including petroleum), through their national investment laws; regional energy laws such as the 2003 Economic Community of West African States (ECOWAS) Energy Protocol; bilateral investment treaties and multilateral investment treaties. All these are avenues for protecting IOCs from nationalization and expropriations, which were the main trigger for stabilization clauses in the early 1970s.

Further, it is no secret that IOCs continue to invest in countries which don’t have stabilization clauses. One of the curiosities of Stabilization Clauses in Petroleum Agreements, is that most developed countries will not offer them to investors. So, why do developing countries with stable political, fiscal and regulatory climate offer them? Additionally, history shows that these stabilization clauses have not deterred host governments from expropriating petroleum investments. While governments may be able to

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<sup>22</sup> Daniel P, Sunley EM. Contractual assurances of fiscal stability. In *The Taxation of Petroleum and Minerals* 2010 Apr 15 (pp. 421-440). Routledge.

make commitments of their own, they cannot bind the legislative competence of the State into the future. As such, IOCs should embrace other mechanisms of protecting their investments. On the other hand, the host governments should be more concerned about establishing a competitive and stable legal, regulatory, and fiscal regime.

### **3. MAXIMIZING THE VALUE OF STABILIZATION CLAUSES TO PROMOTE SUSTAINABLE RESOURCE DEVELOPMENT: RECOMMENDATIONS AND CONCLUSION**

It is clear that stabilization clauses in effect limit the normal prerogatives of any legislature and government, such as their right to enact and issue protective environmental, labor and other regulatory laws. These clauses make the tax, financial and commercial concessions, environmental regulations, as well as other contractual provisions, permanent for a 20, if not a 40 to 60-year period—depending on the petroleum project lifecycle. In essence, stabilization clauses ensure that the terms and conditions of a contract (and their effects) are ‘frozen’ from the time of signature over the life of the contract.<sup>23</sup> Although the State has the sovereign power to revise its relationship with the foreign investor unilaterally, the consequence of a stabilization mechanism is that the government has to compensate an oil company for any change in a nation’s laws, rules or regulations that adversely affect a company or its operations.

A stabilization clause is a contractual risk-mitigating device to protect investments from variations in the legal environment. This would include risks deriving from a possible exercise of host state sovereignty such as: expropriation, the obsolescence bargain, or any other change which the government might utilize in order to impose new requirements on investors.<sup>24</sup> In summary, fiscal stability only favors the IOCs, as it is only applicable in instances of tax increment but not tax reductions.

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<sup>23</sup> Dias ND. Stability in International Contracts for Hydrocarbons Exploration and Some of the Associated General Principles of Law: From Myth to Reality. *Oil, Gas & Energy Law*. 2010 Nov 1;8(4).

<sup>24</sup> *Supra* note 9

Societies are constantly progressing economically, socially and politically. In this respect, a government should be able to respond to these changes by among others enacting new laws or amending outdated laws. With stabilization clauses, however, the State's right and ability to modernize its legal system is limited by IOCs. As such, host governments in developing countries often find themselves in a position where they must negotiate with IOCs before modifying their tax regimes and safety standards. Since these clauses are not found in developed countries such as Canada or Norway, they have been described as "contractual colonialism," the modern world's legal answer to a discredited system.<sup>25</sup>

Taking stock of the above, it becomes imperative for host governments to strengthen their legal and regulatory frameworks; ensure rule of law; political stability; embrace arbitration and other mechanisms of protecting energy investments including both multilateral and regional energy protocols such as the 2003 ECOWAS Energy Protocol in West Africa. All these avenues of protecting foreign investments will not be fully discussed in this short paper. Rather, the message is for host governments in the developing world to strengthen their rule of law and be mindful about negotiating stabilization clauses.

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<sup>25</sup> Radon J. How to negotiate an oil agreement. Escaping the resource curse. 2007 May 22:89-113.