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Anchoring Stabilizing Clauses in International Petroleum Contracts

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Abstract

Periods of high gas prices, as recently witnessed, herald repudiation of international petroleum contracts as host governments seek a greater share of the profits under various legitimate and flimsy theories, raising the question of the utility of stabilization clauses in such agreements.

Stabilization clauses were introduced to reduce political risk and preserve the fiscal regime in international petroleum contracts. While practitioners and clients derive comfort from stabilization clauses based largely on international arbitrations precedents, this article notes that such comfort may be misplaced absent the requisite international anchor, which could be missing in international petroleum, and accordingly stresses the need for such anchor, proposes drafting, client management, and litigations considerations for the practitioner.

I. Introduction

The popularity of the stabilization clause as a risk-management tool can create a false sense of security and undermine a party's ability to timely initiate negotiations and explore dispute resolution alternatives when faced with a governmental measure that alters the fiscal landscape. What is insufficiently stressed in many publications trumpeting the benefits of the stabilization clause is that its apparent effectiveness and validation by arbitration tribunals is contextual and rooted in an international anchor in the arbitration clause. An international anchor postulates arbitral venue outside the host county, even if the host country's law governed, and/or stipulates that the governing law be the law of another nation with a developed judicial system, rather than that of the host nation, or provides a treaty protection. Absent an international anchor, the stabilization clause provides little more than psychological comfort, as the wronged party must litigate in the host nation with the attendant perils.

This article provides a brief historical context of stabilization clauses, their origin, and purpose; explores arbitral decisions and their import; and underlines the need to position the stabilization clause within the framework of the arbitration clause and other provi-

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sions, such as the governing law. Critically, the arbitration clause should provide the requisite international anchor; otherwise, counsel should consider other options to internationalize the agreement.

Given divergent international arbitral rulings on whether a State entity, such as a national oil company (NOC), is an agent of the State and whether its actions are attributable to the State, this article suggests that, to the extent practical, the State should become a party for the limited purpose of stabilization, rendering issues of agency and estoppel—which are often relied on absent a direct contractual privity with the state—superfluous. When internationalizing the clause contractually in the arbitration clause, particularly through the governing law or place of arbitration, counsel should explore internationalizing by treaty.

II. Rationale for Stabilization Clauses in Production Sharing Agreements

By the time an international oil company (IOC) invests in a resource rich nation, it has conducted significant due diligence to review the fiscal, tax, and legal regimes in the host nation, as much as the geologic and geophysical data. It is well aware of the risks in exploring and exploiting oil and gas resources. The currently available commercial and legal regime informs the IOC's fiscal model and the potential profitability of its massive, capital intensive, high-risk, long-term investment, which could run into billions[1] and span decades yet will not yield any returns for years. Once the investment is made, the IOC cannot pull out when a dispute arises, given the scale of its committed resources; it is essentially at the mercy of the host nation.[2]

Host nations richly endowed with mineral resources, on the other hand, tend to be developing economies, often beset with political and economic crises and potentially laden with a history of coups and counter-coups. They dangle fiscal incentives to attract the IOCs to provide needed capital, expertise, and management required for successful exploitation of their mineral resources.[3]

The structure of the relationship has evolved over time: from concession agreements in the early years, when title to oil and gas was conveyed to IOCs for forty to sixty years or more, with the host country retaining a royalty interest, to the current production sharing agreements in which the State or a State entity—a NOC tasked with stewardship, and sometimes regulation, of the country's mineral resources—retains title to the mineral resources and engages the IOC as a "contractor" to explore and produce oil and gas on its

1. The Shell-operated Bonga platform off the coast of Nigeria is estimated at $3.6 billion. *See* Rigzone.com, Shell's Bonga Field Begins Offshore Nigeria, http://www.rigzone.com/news/article.asp?a_id=27260 (last visited Jan. 15, 2009); Chevron's Frade project off the coast of Brazil is estimated at $3 billion. *See* Russell Gold, *Chevron Project Offers Glimpse of Oil's Future*, WALL ST. J. ONLINE, Oct. 30, 2008, http://online.wsj.com/article/SB122531663876381697.html?mod=dist_smartbrief.

2. Margarita T.B. Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 DENV. J. INT'L L. & POL'Y 217, 220 (2002). *See also* Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 216, 220 (1996).

3. MARTIN M. OLISA, NIGERIAN PETROLEUM LAW AND PRACTICE 191-92 (2d ed. 1997). He observes that *when oil exploration and production activities slowed down in Nigeria in the 1960s and 70s, owing to high tax and royalty rates, the Nigerian government introduced a new tax and royalty regime to encourage exploration and production, boosting profit margins. Id.*

behalf.[4] The IOC essentially bears all the risks as the NOC is mostly a carried interest but is rewarded with a share of the profits.[5] The NOC's share of profits and the bonuses, taxes and royalties paid to the State can result in up to, and sometimes more than, a 90 percent take for the State.[6] The long duration of these contracts makes them susceptible to political or economic influences unforeseeable when the contract was concluded, but with adverse impact on the economics of the contract.[7]

Against this backdrop, an IOC expectedly seeks reassurance that the host nation shares its belief in the sanctity of contracts: that the fiscal incentives offered and promises made will outlive the contracting political leaders and last for the duration of the production sharing agreement—hence, the need for a stabilization clause in the production sharing agreement.[8] Host nations (which are mostly developing nations) usually agree to this clause to reassure IOCs and encourage investment and development of their mineral resources. It is obvious that without such assurance, the IOC remains at the mercy of the host government once the investment is made,[9] and nothing precludes the host government from exploiting the shift in bargaining power and seeking favorably to renegotiate the agreement under some legitimate or flimsy legal concept.[10]

A. Origin of Stabilization Clauses

One commentator has traced the origin of stabilization clauses to "the period between World War I and World War II when U.S. companies began to include them in concessionary contracts because of Latin American nationalizations . . . to preserve concessions for the full term of the contract."[11] While stabilization clauses were robustly debated in the 1970s and 1980s[12], their utility and future remain fertile grounds for discussion today, as "stability of the terms underlying the decision to commit risk capital or those agreed upon [remains] the constant theme of international petroleum investment."[13]

Debate over the nature and application of stabilization clauses remain relevant, with the cycle of soaring oil and gas prices accompanied by host governments' repudiation of fiscal regimes in production sharing agreements and increasing resource nationalization as demonstrated by the following. In Russia, the government of Vladimir Putin acquired Gazprom and revoked a permit for a Shell oil and gas project.[14] In Chad, the government

4. R. Doak Bishop, *International Arbitration of Petroleum Disputes: The Development of a Lex Petrolea*, Rocky Mountain Mineral Law Foundation International Energy and Minerals Arbitration Mineral Law Series 2-18, 18 (2002).

5. *Id.*

6. *Id.*

7. Klaus Peter Bergen, *Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrator*, 36 Vand. J. Transnat'l L. 1347, 1348 (2004).

8. The production agreement may be termed a "production sharing contract" (PSC) or a "production sharing agreement" (PSA), but the two retain the same features and have little real distinction.

9. 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 (2008).

10. Waelde & Ndi, *supra* note 2, at 225.

11. Bishop, *supra* note 4, at 23.

12. Waelde & Ndi, *supra* note 2, at 216.

13. Thomas W. Waelde, *International Energy Investment*, 17 Energy L.J. 191, 214 (1996).

14. Alexia Brunet & Juan Agustin Lentine, *Arbitration of International Oil, Gas, and Energy Disputes in Latin America*, 27 Nw. J. Int'l L. & Bus. 591, 622 (2007).

demanded that international operators Chevron, Exxon Mobil, and Petronas renegotiate their revenue share.[15] In Venezuela, President Hugo Chavez took control over the formerly independent Petroleos de Venezuela (PDVSA)[16] and ordered the IOCs to turn over their majority interest to PDVSA or face complete nationalization of their interests in the oil-rich Orinoco River Basin, forcing out ExxonMobil and ConocoPhillips. In Bolivia, President Evo Moralez mobilized the army into Bolivian gas fields and nationalized Bolivia's industry.[17] In Ecuador, the government assumed control of the holdings of the U.S. oil company Occidental,[18] and in Nigeria, the government's attempts to renegotiate PSCs concluded in the 1990s.[19]

The apparent perception that IOCs have reaped a windfall in the climate of high energy prices and unfairly benefited from the production sharing agreement seems to undergird these efforts, exacerbated by poverty, political ideology, corruption, restive constituent groups, and dismal economic conditions in some of the host countries.[20] Thus, a consequence of high prices is that "producer governments looked at the terms offered in the 1990s and in many cases concluded they had been overly generous. The obsolescing bargain was alive and well, and fueled pressures on the IOCs."[21] Forgotten amidst the clawback by the host nations is the colossal risk undertaken by the IOCs in exploring new frontiers, the risks of a dry hole and unrecoverable, massive costs, not to mention the high volatility in the oil prices as shown recently by the crude oil prices soaring to $147 per barrel in July 2008 and falling to $55 per barrel in November 2008.[22]

B. Definition and Features of Stabilization Clauses

Stabilization clauses have been described as an effort to protect the private investor by "restricting the legislative or administrative power of the State, as sovereign in its country and legislator in its own legal system, to amend the contractual regulation or even to annul the agreement"[23] and are negotiated with the State or a State entity entrusted with administering petroleum resources in the public interest.[24] Guaranteeing the stability of key conditions of the agreement that bear on the return to the investment, such as the fiscal regime, is the goal.[25] Hence, stabilization clauses are considered a bulwark against future changes in law or regulation as the host government contracts away its sovereign right to

15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. *See* IHS.com, Nigeria Floats the Idea of Renegotiating Contracts, http://energy.ihs.com/News/WW-News/news-2007/Nigeria-floats-the-idea-of-renegotiating-contracts.htm. (last visited Feb. 4, 2009) (citing 23 International Oil Letter 43 (2007)).
20. *See* Waelde & Ndi, *supra* note 2, at 226.
21. Paul Stevens, *National Oil Companies and International Oil Companies in the Middle East: Under the Shadow of Government and the Resource Nationalism Cycle*, 1 J. World Energy L. & Bus. 23 (2008).
22. *See* New York Mercantile Exchange Homepage, http://www.nymex.com/index.aspx (last visited Feb. 4, 2009).
23. Piero Bernadini, *Stabilization and Adaptation in Oil and Gas Investments*, 1 J. World Energy L. & Bus. 100 (2008).
24. *See id.* at 98; *see also* Waelde & Ndi, *supra* note 2, at 218 (observing that recent stabilization clauses have been negotiated with state entities rather than with the State).
25. Bernadini, *supra* note 23, at 100.

later introduce laws in derogation of those existing when the contract with an IOC was consummated.

Commentators distinguish stabilization clauses into two key categories: (1) traditional freezing clauses that provide that the law in effect when the contract was executed governs the contract and bars the host government from later enacting any law inconsistent with the contract,[26] and (2) modern hybrid-stabilization clauses with adaptation mechanisms where the state undertakes to compensate an IOC should subsequent legislation increase its financial burden.[27] Examples of the former traditional clause include:

1. The 1968 Production Sharing Contract between Pertamina and Agip SpA, which provided in art. XVI.i.2 that "[t]his contract shall not be annulled, amended or modified in any respect except by the mutual consent in writing of the Parties hereto;"[28] and

2. Article 25 of the 1937 concession agreement between Petroleum Concessions, Ltd. and the Sultan of Muscat and Oman, providing that:

> The Sultan shall not by general or special legislation or by administrative measures or by any act whatever annul this Agreement . . . No alterations shall be made in the terms of this Agreement . . . except in the event of the Sultan and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations . . . .[29]

In the modern, hybrid stabilization clause prevalent in recent agreements, governmental intervention triggers an adaption of the agreement to restore the agreement to its original equilibrium; thus, upon disruption of the status quo, the parties are obliged to negotiate in good faith to restore the original balance.[30] Only if they fail to reach an agreement can the matter be referred to arbitration.[31]

The hybrid-stabilization clause (which is the focus of this article as the freezing species is hardly in vogue, except in older agreements) generally contains the following four principal features, as illustrated by the samples shown in section I below:

1. They define a change of circumstance that will trigger renegotiation, which can be defined in general or specific economic terms;

2. They indicate the effect of the change on the contract;

3. They outline the objective and procedure of the renegotiation; and

4. They provide for a solution if renegotiation fails.[32]

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26. Waelde & Ndi, *supra* note 2, at 260.

27. *Id.* at 264.

28. Bernardini, *supra* note 23, at 100, n. 9.

29. *Cited in* ERNEST E. SMITH, JOHN S. DZIENKOWSKI, OWEN L. ANDERSON, GARY B. CONINE, JOHN S. LOWE, & BRUCE M. KRAMER, INTERNATIONAL PETROLEUM TRANSACTIONS 414 (2d ed. 2000).

30. *See* Bernadini, *supra* note 23, at 102-103.

31. *Id.*

32. *Id.* at 103. He further observes that an implicit, common feature of the hybrid-stabilization clauses is that the triggering event for renegotiation not be within the control of the party invoking it. *Id.*

III. Sample (Hybrid) Stabilization Clauses

A. Art. 34.12 (Equilibrium of the Agreement) of the Qatar Model exploration and production sharing agreement of 1994:

Whereas the financial position of the Contractor has been based, under the agreement, on the laws and regulations in force at the Effective Date, it is agreed that, if any future law, decree or regulation affects Contractor's financial position, and in particular if the customs duties exceed . . . percent during the term of the Agreement, both Parties shall enter into negotiations, in good faith, in order to reach an equitable solution that maintains the economic equilibrium of this Agreement.

Failing to reach agreement on such equitable solution, the matter may be referred by either party to arbitration pursuant to art. 31.[33]

B. Clause 26 ("Review/Re-Negotiation of Contract and Fiscal Terms") of the Nigeria/Sao Tome & Principe Joint Development Authority Model Production Sharing Contract of 2004:

26.1 The Parties agree that the commercial terms and conditions of this contract are based on the existing fiscal terms in accordance with the provisions of the Petroleum Regulations dated the 4th of April, 2003. If such fiscal terms are changed, the Parties agree subject to Clause 26.3, to review the terms and conditions of this contract affected by such changes to align such terms and conditions with the fiscal terms.

26.2 The terms of this contract have been negotiated and agreed having due regard to the terms of the Tax Regulations dated the 4th of April, 2003.

26.3 If at any time or from time to time, there is a change in legislation or regulations which materially affect the commercial benefit afforded the Contractor under this Contract, the parties will consult each other and shall agree to such amendments to this contract as are necessary to restore as near as practicable such commercial benefits which existed under the contract as of [ ] the effective date.[34]

The clear import of these stabilization clauses, as can be seen from the first and third paragraphs above, is equilibrium restoration: a return to the IOC's economic expectations when the contract was executed. Nonetheless, they could be improved by providing a time limit for renegotiation and what should trigger referral to arbitration.

33. *Id.* at 102.

34. *Nigeria/Sao Tome & Principe*, Joint Development Authority Model Production Sharing Contract of 2004, cl. 26, ***available at*** http://web.austin.utexas.edu/chenry/oil/2006/PSA2004model/NST-JDA%20Model%20PSC%202004.pdf. (Referral to arbitration is provided in Clause 24, "CONCILIATION AND ARBITRATION" of the Production Sharing Contract.).

C. The Kurdistan Regional Government of Iraq Model Production Sharing Contract: Fiscal Stability

43.2 The obligations of the CONTRACTOR resulting from this Contract shall not be aggravated by the GOVERNMENT and the general and overall equilibrium between the Parties under this Contract shall not be affected in a substantial and lasting manner.

43.3 The GOVERNMENT guarantees to the CONTRACTOR for the entire duration of this Contract, that it will maintain the stability of the fiscal and economic conditions of this Contract, as they result from this Contract and as they result from the laws and regulations in force on the date of signature of this Contract. The CONTRACTOR has entered into this Contract on the basis of the legal, fiscal and economic framework prevailing at the Effective Date. If, at 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 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.

43.4 If the CONTRACTOR believes that its economic position has been detrimentally affected as provided in Article 43.3, upon the CONTRACTOR's written request, the Parties shall meet to agree on any necessary measures or making any appropriate amendments to the terms of this Contract with a view to re-establishing the economic equilibrium between the Parties and restoring the CONTRACTOR to the position it was in prior to the occurrence of the change having such detrimental effect. Should the Parties be unable to agree on the merit of amending this Contract and/or on any amendments to be made to this Contract within ninety (90) days of CONTRACTOR's request (or such other period as may be agreed by the Parties) the CONTRACTOR may refer the matter in dispute to arbitration as provided in Article 42.1.

43.5 Without prejudice to the generality of the foregoing, the CONTRACTOR shall be entitled to request the benefit of any future changes to the petroleum legislation or any other legislation complementing, amending or replacing it.

43.6 The Parties agree to cooperate in all possible ways with a view to fully achieving the objectives of this Contract. The GOVERNMENT shall facilitate the performance of the Petroleum Operations by promptly granting to the CONTRACTOR any necessary authorization, permit, license or access right and making available any existing facilities and services with a view to the Parties obtaining maximum mutual benefit from the contract.[35]

35. *Reproduced in* James Barnes, Sample Granting Instruments for 2007 (2007).

1. *Enforceability of Stabilization Clauses*

International arbitral tribunals generally maintain that stabilization clauses are valid and binding.[36] Balancing the sanctity of sovereignty against the sanctity of contracts, international arbitral tribunals have harmonized the two, reasoning that entry into a contract is an exercise of sovereignty. Therefore, a State may not invoke the cloak of sovereignty to disavow earlier commercial contractual commitments.

This situation is illustrated in *Texaco v. Libya*,[37] relating to Libya's nationalization of interests in a concession in a purported exercise of sovereignty. The sole arbitrator rejected the notion that the oil concession was an administrative contract subject to Libyan regulatory powers, and, after considering whether the concession was a binding contract, he found in the affirmative.[38]

The arbitrator then turned to the stabilization clause, which was of the freezing variety, and provided that:

> This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the agreement of amendment by which this paragraph (2) was incorporated into the concession agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its Consent.[39]

The arbitrator held that the stabilization clause did not impair Libyan sovereignty, stating, "Not only has the Libyan State freely undertaken commitments but also the fact that this clause stabilizes the petroleum legislation and regulations as of the date of the execution of the agreement does not affect in principle the legislative and regulatory sovereignty of Libya."[40] He thereby concluded that "nationalization cannot prevail over an internationalized contract, containing stabilization clauses, entered into between a State and a foreign private company."[41]

Further, in *AGIP Co. v. Congo*,[42] arising out of yet another nationalization notwithstanding a stabilization clause, the arbitral tribunal reaffirmed the reasoning in *Texaco*. It held that:

> These stabilization clauses, freely accepted by the Government, do not affect the principle of its sovereign legislative and regulatory powers, since it retains both in relation to those, whether nationals or foreigners, with whom it has not entered into such obligations, and that, in the present case, changes in the legislative and regulatory arrangements stipulated in the agreement simply cannot be invoked against the other contracting party.[43]

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36. *See* Texaco Overseas Petroleum Co. & Cal. Asiatic Oil Co. v. Gov't of the Libyan Arab Republic, 17 I.L.M. 1 (Jan. 18, 1977); *see also* AGIP Co. v. Congo, 21 I.L.M. 726, 735-36 (Nov. 30, 1979).
37. *Texaco*, 17 I.L.M. at 1.
38. *Id.* at 10-11.
39. *Id.* at 24.
40. *Id.*
41. *Id.* at 25.
42. AGIP Company v. People's Republic of the Congo, 21 I.L.M. 726 (Nov. 30, 1979).
43. *Id.* at 735-36.

In another significant arbitration decision the same year, *Government of the State of Kuwait v. American Independent Oil Co.* ("*Aminoil*"),[44] the tribunal reviewed article seventeen of the parties' 1948 Concession Agreement, which contained the following stabilization clause:

> The Shaikh 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 made in the terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and th[e] Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement.[45]

The parties reached a supplemental agreement in 1961, which provided as follows:

> If, as a result of changes in the terms of concessions now in existence or as a result of the result of concessions granted hereafter, an increase in benefits to Governments in the Middle East should come generally to . . . them, the Company shall consult with the Ruler whether in the light of all relevant circumstances, including the conditions in which operations are carried out, and taking into account all payments made, any alterations in the terms of the agreements between the Ruler and the Company would be equitable to the parties.[46]

While article seventeen was a freezing clause, the 1961 supplement was adaptive and contemplated re-negotiation in the face of changed circumstances. Nonetheless, by Decree Law No. 24 of Sept. 19, 1977, the Kuwaiti government terminated the concession, ostensibly frustrated because Aminoil would not concede to the government's revised re-negotiated terms, resulting in the arbitration proceedings.[47] Kuwait raised a number of defenses, contending, among others things, that the stabilization clause was invalid because imposed upon by Britain when it was a British colony; and, even if it was valid, it was nonetheless annulled by the Kuwait Constitution of 1962, which conferred ownership of all mineral resources on the State.[48]

It further argued that permanent sovereignty over natural resources under international law prohibited a State from providing a guarantee against the exercise of public authority over its mineral resources.[49] While the tribunal rejected Kuwait's arguments, it nonetheless noted that stabilization clauses no longer possessed an "absolute character"[50] and are not a bar to nationalization: "The case of nationalisation is certainly not expressly provided against by the [ ]stabilisation clauses of the Concession."[51] Thus, nationalization was not inconsistent with stabilization so long the nationalization was not confiscatory in nature and compensation is paid.[52]

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44. Kuwait v. Am. Indep. Oil Co., 21 I.L.M. 976 (Sept. 1982).
45. *Id.* at 1049.
46. *Id.* at 992.
47. *Id.* at 998.
48. *Id.* at 1021.
49. *Id.*
50. *Id.* at 1024.
51. *Id.* at 1023.
52. *Id.* at 1024.

Accordingly, there is consensus that a sovereign state can enter into binding contractual agreements with IOCs, thereby reducing their political risk. Nonetheless, this consensus should not lead to a hasty conclusion that a stabilization clause is inherently valid and enforceable. First, it must be noted that "no published international arbitration awards have dealt with" the modern hybrid stabilization clause.[53] Second, the earlier line of arbitral rulings related to expropriations under traditional stabilization rubric rather than "lesser forms of regulatory change;"[54] third, inquiry is still required to determine the legality of the stabilization under local law,[55] and whether the host government had proper authority to enter into the agreement.[56] Fourth, and significantly, international arbitral decisions validating stability clauses relied on an anchor that conferred jurisdiction in international arbitration, such as international governing law or an investment treaty. An IOC should, therefore, ensure that it stipulates international law as the governing law, stipulate for venue outside the host nation, and secure protection under an investment treaty, where the governing law will be international law.

2. *Ensuring Functional Utility of Stabilization Clauses*

While traditional stabilization clauses have been deemed enforceable under a line of expropriation cases, as noted above, the modern adaptive clauses have yet to be tested. Meanwhile, a review of the modern clauses reveals the following potential weaknesses should they be challenged.

First, modern clauses are contracted not with the State itself but with a State entity, such as the NOC. One commentator observes that negotiating the stabilization clause with the NOC is "not in practice a complicating factor and may make it easier to reach an agreement[,]"[57] and concludes that from a judgment recovery perspective, "the NOC as signatory to the contract might improve the likelihood of the IOC obtaining specific performance and not just lump sum damages from a tribunal."[58] It is unclear how widespread this view is shared, but it is not uncommon for production sharing and ancillary agreements to be executed by a State entity only, ostensibly because as the commentator noted above, it is "easier."[59] A better explanation why a State entity only, the NOC, executes the production sharing agreement with IOCs is likely dependent on how the applicable upstream petroleum regime is set up (i.e., the upstream petroleum regime provides for the NOC to receive a license from the host county and for the NOC then to contract with IOCs).

While proceeding against an NOC could affect specific performance as posited above, it is submitted that the specter of a binding international arbitral ruling against the State itself, in addition to the NOC, coupled with the adverse publicity, reputation, and impact

53. *See* Bishop, *supra* note 4, at 2-25.
54. *See* Cotula, *supra* note 9, at 164.
55. *Id.*
56. *See* Waelde & Ndi, *supra* note 2, at 242.
57. Peter D. Cameron, Association of International Petroleum Negotiators, Stabilization in Investment Contracts and Change of Rules in Host Countries: Tools for Oil and Gas Investors 17 (2006), http://lba.legis.state.ak.us/sga/doc_log/2006-07-05_aipn_stabilization-cameron_final.pdf.
58. *Id.* at 18.
59. *Id.* at 17.

on foreign investments, could be more effective in ensuring compliance with contract terms. Also, when the dispute centers on broader regulatory issues that could nonetheless impinge on the fiscal regime or radically alter the base agreement, such as tax or environmental regulations, an arbitral ruling against the State likely binds State entities who would not be party to a limited action against a State entity, such as a NOC.

In addition, to the extent that NOCs or other State entities take their orders from the State, it is doubtful that an adverse ruling will catalyze specific performance. Moreover, even after prevailing against the State entity, such as a NOC, an IOC may still have to bring an action against the State. Further, the State entity is unlikely to have deeper pockets or attachable assets more than the State.

Finally, the import of negotiating a stabilization clause, it must be recalled, is precisely to maintain economic balance and to keep IOCs whole should a government enact new laws or regulations inconsistent with the terms of the contract. Contracting with the State entity adds to the mix questions of agency, that is, whether the State entity was acting at the behest of the State, as well as whether the State entity is an alter ego and thereby acting in the capacity of the government, especially when the State entity has quasi-regulatory functions. Accordingly, to the extent practical, IOCs should endeavor to make the State a party to the agreement for the limited purpose of stabilization, thereby restraining the exercise of sovereign power and providing basis for a contract claim against the State in seeking to be made whole. Without adding the State to the agreement, the IOC faces the following two uncertainties in proceeding solely against the State entity.

First, unlike an action against the State, assuming requisite jurisdictional basis, arbitral decisions in actions against a State entity, such as a NOC, mainly in expropriation and creeping expropriation cases, have been a mixed bag. Commentators and arbitral panels have advanced different theories for imputing the actions of the NOC to the State under commercial international arbitration, such as the principles of "piercing the corporate veil." They have outlined four methods for holding the State responsible: (1) estoppel, (2) functional identity with the state, (3) evasion of obligations, and (4) responsibility for acts of public authorities.[60]

Under the first theory, estoppel, the "entity is considered to represent the state if 'it appears from the practice of the States concerned or from other circumstances that their intention was to consider that person [or entity] as representing the state for such purposes and to dispense with full power.'"[61] Under the second theory, functional identity, the "state is responsible for the acts of the state enterprise if the state enterprise is performing functions exclusively reserved to the state."[62] Under the third theory, "evasion of obligations or abuse of rights," the inquiry is whether "the state uses the form of . . . [the] entity. . . to evade its own obligations;" while the fourth theory, "responsibility for acts of public authorities," considers "whether [the] state entity can avoid performance under the doctrine of force majeure . . . [for] acts taken by the state such as administrative acts and laws."[63] Distilled to its essence, the foregoing four-prong test essentially revolves around

60. R. Doak Bishop, Sashe D. Dimitroff & Craig S. Miles, *Strategic Options Available When Catastrophe Strikes the Major International Energy Project*, 36 TEX. INT'L L.J. 635, 679 (2001).

61. *Id.*

62. *Id.*

63. *Id.*

identity and control: whether the state entity is identified with, controlled by, and acts on behalf of the State.

Focusing on control, the arbitral tribunal in *Maffezini v. Kingdom of Spain* applied a two-part test in determining whether an entity was a State organ whose actions were imputable to the State: structural control and functional control.[64] Under the structural test, the Court evaluated the structure of the entity and whether it appeared distinct from the State, while the functional test was used to examine the functional status of the entity to determine if it was entrusted with governmental functions and to determine which acts could be attributed to the State.[65] Accordingly, the presumption that the State entities have separate juridical existence can be maintained only if the same legislative or administrative measures apply indiscriminately to them as to private entities.

Second, there is hardly a uniform, gold standard for determining when to attribute the acts of a State entity to the State as arbitral decisions remain inconsistent, are not binding precedent, and are at best persuasive evidence.[66] Therefore, depending on the circumstances, there remains the risk that the actions of a State entity may not be attributed to the State, as illustrated below. Where a separately incorporated and juridictionally distinct NOC is tasked with commercial functions while another State agency has regulatory oversight, arguing that the NOC is an agent of the host government may not win the day. The foregoing risks are attenuated when the State itself is a party to the agreement, for the limited purpose of stabilization.

3. *Divergent Decisions of Arbitral Panels on Attributing Actions of State Entities to the States*

The following cases highlight the divergent views of arbitral tribunals in determining whether a state entity's actions under a contract can be imputed to the state itself, albeit in the context of bilateral investment treaty (BIT) disputes.

In *Eureko B.V. v. Republic of Poland*, a dispute arising out of the Netherlands-Poland BIT, one of the issues raised was whether the Polish State Treasury, a State entity, breached the BIT by privatizing Poland's insurance group, PZU.[67] The tribunal held in the affirmative, attributing the agency's action to the State, reasoning that the State breached the BIT clauses relating to fair and equitable treatment and prohibiting expropriation.[68]

Further, in *Wintershall A.G. v. Government of Qatar*, the tribunal determined that a company wholly owned by the Government of Qatar was the government's agent because the government appointed the board of directors of the company and was therefore bound to arbitrate a dispute under the agent's arbitration clause.[69] *In Impregilo S.p.A. v. Islamic*

64. Maffezini v. Kingdom of Spain (Arg. v. Spain), ICSID Case No. ARB/97/7 (Jan. 25, 2000), 5 ICSID (W. Bank) 396 (2002), 40 I.L.M. 1129, 1137 (2001), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566_En&caseId=C163.

65. *Id.* at 1136-38.

66. Abul F. M. Maniruzzaman, *The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration?*, 14 AM. U. INT'L. L. REV. 657, 730 (1999).

67. Eureko B.V. v. Poland (Neth. v. Poland), Partial Award, (Ad Hoc Arbitral Tribunal ICSID Aug. 19, 2005), *available at* http://ita.law.uvic.ca/annulment_judicialreview_if_content.htm.

68. *Id.*

69. Wintershall A.G. v. Gov't of Qatar, 28 I.L.M. 795, 811-12 (Ad Hoc Arbitral Tribunal ICSID 1989).

Republic of Pakistan, a dispute arising from the most favored-nation provision of the Italy-Pakistan BIT and involving an independent State entity, Pakistan's Water and Power Development Authority (WAPDA),[70] the tribunal's examination of the relationship between WAPDA and Pakistan revealed strict control of the former by the latter: the Pakistani government appointed WAPDA's Board and could dismiss it at will, service to WAPDA was deemed service to Pakistan and its employees were deemed civil servants, and Pakistan further exercised financial control over WAPDA.[71] Nonetheless, it reasoned that because WAPDA was a jurisdictionally-distinct entity, the government of Pakistan, which was not in privity of contract with Italy, was not liable for WAPDA's contracts:

> Given that the Contracts at issue were concluded between the Claimant and WAPDA, and not between the Claimant and Pakistan; that under the law of Pakistan, which governs both the Contracts and the status and capacity of WAPDA for the purposes of the Contracts, WAPDA is a legal entity distinct from the State of Pakistan; and given that Article 9 of the BIT does not cover breaches of contracts concluded by such an entity, it must follow that this Tribunal has no jurisdiction under the BIT to entertain Impregilo's claims based on alleged breaches of the Contracts.[72]

Accordingly, a host nation could be expected to argue that the dispute arising from the PSC or PSA are under a contract to which it is not a party. Making the State a party for the limited purpose of stabilization renders the argument moot.

4. *Implications for the Practitioner:*

a. Communicate Early and Often with the State and/or State Entity

Counsel should endeavor during contract negotiations to ensure that both parties understand the operative drivers and framework to reduce dispute down the road and further provide evidentiary support should a dispute ensue. Renegotiation, where contemplated by the stabilization clause, will likely be difficult if the host government has little appreciation of industry norms and of the risks and costs that the IOC incurs, not only in the brief boom periods but over the life of the project. Accordingly, the IOC should proactively educate the host country and/or its entity during negotiations and long after, to the extent practicable, so they appreciate that the fiscal models are competitive within the oil and gas industry.

b. Client Management

As the cliché goes, a little knowledge can be dangerous. So is too much knowledge. IOC contract advisors and savvy managers sometime see little need to consult with counsel as they believe they can read and construe the agreements as well as anyone. Based on a plain language construction of the stabilization clause and without correlation to the arbitration clause and governing law; unaware that the governing law is important to the enforceability of the stabilization provision, they may take misplaced solace in the stabili-

70. Impregilo S.p.A. v. Islamic Republic of Pakistan (Italy v. Pak.), ICSID Case No. ARB/03/3 (Apr. 22, 2005), *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC642_En&caseId=C224.

71. *Id.* at ¶ 209.

72. *Id.* at ¶ 216.

zation clause when a dispute bubbles. Managing client relationships and "pre-emptive lawyering" is critical to assure proper understanding of the contract and evaluation of the IOCs position should a dispute with a State entity arise.

The popularity of stabilization clauses can engender a false sense of security and result in a failure to realize the IOC's potentially weak position when the host government introduces measures that unilaterally modify the fiscal regime without expropriating. When a practitioner realizes that the agreement cannot be internationalized—through governing law or investment treaty protection—it then behooves him or her to educate the client and manage expectations early, so alternatives are timely explored before positions are hardened and passions become inflamed, impeding a negotiated resolution. The time to communicate with the client is not when a dispute has flared up, but early and often.

c. Bind the State, not Just the State Entity, to the Stabilization Clause

Divergent international arbitral rulings, such as those shown above, underscore the need to expressly, directly, and unequivocally bind the state, as practical, to the stabilization clause. This necessity is highlighted by *SPP (Middle East) Ltd. (H.K.) and Southern Pacific Properties Ltd. (H.K.) v. Arab Republic of Egypt*,[73] where Southern Pacific Properties Ltd. (SPP), the Egyptian Minister of Tourism, and the Egyptian General Organization for Tourism and Hotels (EGOTH) executed a "Heads of Agreement" for a tourist village on the Pyramids Plateau and another one at Ras-El-Hekma, which was followed by a second agreement between SPP and EGOTH and to which was appended the Minister of Tourism's signature with the following: "approved, agreed and ratified by the Minister of Tourism, His Excellency, Mr. Ibrahim Naguib on the Twelfth day of December 1974."[74]

SPP initiated ICC arbitration against Egypt and EGOTH after the projects were scrapped, and the government of Egypt objected to the ICC jurisdiction, defending on grounds that it was not a party to the later agreement and arguing that the Minister signed the agreement in his capacity as Chairman of the General Assembly of EGOTH (acting as shareholder representative, rather than as Minister) or, alternatively, in a supervisory capacity over EGOTH as a public organization under the Ministry of Tourism.[75] The ICC Tribunal rejected both arguments and affirmed its jurisdiction, reasoning that, "By the Minister signing not only 'approved' but also 'agreed' (which clearly means the undertaking of an obligation of its own) the Government also became a contractual party to the December Agreement."[76] On Egypt's application to the Paris Court of Appeal, the award was set aside, with the court reasoning that the notation "'approved, agreed and ratified' must be understood in accordance with Egyptian law, which confers supervision of tourist sites upon the Ministry of Tourism" and account for his intervention "apart from any will to become a party to the contract."[77] The Cour de Cassation, the French Supreme Court, upheld the court of appeals decision.[78]

A corollary to the foregoing is that an international tribunal is unlikely to be swayed by contract by implication: for the State to be bound, the intention must be direct and ex-

73. SPP (Middle East) Ltd. (H.K.) & S. Pac. Props. Ltd. v. Arab Republic of Egypt, 22 I.L.M 752 (1983).
74. *Id.* at 756-57.
75. *Id.* at 765.
76. *Id.* at 767,
77. Cour d'appel [CA] [regional court of appeal] Paris, July 12, 1984, 23 I.L.M 1048, 1056 (Fr.).
78. *See* Cour de cassation [highest court of original jurisdiction], Jan. 6, 1987, 26 I.L.M. 1004 (Fr.).

press. Accordingly, where the State seems to assent to a stabilization clause, it must be clear whether it is doing so in a supervising, regulatory role, essentially taking-no-exception to the parties' contractual relationship, or binding itself as counterparty to the contract.

An illustrative case is *Svenska Petroleum Exploration AB v. Lithuania*, an English High Court decision relating to an ICC arbitration award.[79] Essentially, the case arose out of a joint venture between a Swedish petroleum company and a previously state-owned Lithuanian petroleum company for oil exploitation in Lithuania and the arbitration provision contained within the agreement.[80] The agreement further provided that "The Government of . . . Lithuania hereby approves the above agreement and acknowledges itself to be legally and contractually bound as if the Government were a signatory to the Agreement."[81]

When a dispute arose regarding contract performance, the Swedish company included the Government of Lithuania in its suit, and the latter asserted the defense of sovereign immunity, claiming that the arbitration clause bound only the two joint venturers.[82] The tribunal disagreed, finding in favor of the claimant, and the English Court agreed with the tribunal, reasoning that the Government of Lithuania had waived sovereign immunity and was bound by the arbitration clause.[83] Contrary to the practice of IOCs contracting solely with NOCs, Counsel should endeavor to bind the State to the stabilization clause as part of the effort to internationalize the agreement, thereby avoiding uncertainty over whether the NOC is an agent of the State and providing basis for a potential claim against the State.

d. Review Applicable Arbitration Law

Where governing law is stipulated to be the domestic law of the host country, or arbitration must occur in the host country, counsel should analyze local law to ascertain whether and how it characterizes arbitration and whether it provides for international arbitration. Nigeria, for example, adopted the UNCITRAL Model Law on International Commercial Arbitration by enacting the Arbitration and Conciliation Act, Chapter 19 of the Laws of the Federation of Nigeria, 1990, which applies to both domestic and international arbitrations, with venue in Nigeria.[84] The Arbitration and Conciliation Act provides that arbitration is international if:

i. the parties have, at the time of the agreement, their places of business in different countries;

ii. the place of arbitration is different from the place of business of the parties;

iii. the place of performance of a substantial part of the commercial relationship is different from the places of business of the parties;

79. Svenska Petroleum Exploration A.B. v. Lithuania, [2005] 1 EWHC (Comm) 2437, (2006) 1 All E.R. 731 (Eng.).
80. *Id.*
81. *Id.* at ¶ 13.
82. *Id.* at ¶ 27.
83. *Id.* at ¶ 31.
84. Arbitration and Conciliation Act, (1990) Cap. 19 § 57 (Nig.).

iv. the place with which the subject matter of the dispute is most closely connected is different from the places of business of the parties; or

v. the parties have agreed that any dispute will be treated as an international arbitration.[85]

Under the Nigerian Arbitration and Conciliation Act, any arbitration that is not international is domestic and must follow the arbitration rules in the First Schedule to the Arbitration and Conciliation Act.[86]

Like Nigeria, Malaysia similarly adopted the UNCITRAL Model Law on International Commercial Arbitration, defining international arbitration as where:

a. one of the parties to an arbitration agreement, at the time of the conclusion of that agreement, has its place of business in any State other than Malaysia;

b. one of the following is situated in any State other than Malaysia in which the parties have their places of business:

i. the seat of arbitration if determined in, or pursuant to, an arbitration agreement;

ii. any place where a substantial part of the obligations of any commercial or other relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or

c. the parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one State.[87]

As in the Nigeria rules, any arbitration that is not international is domestic. Under both nations' arbitration rules, the key determinant of whether arbitration is international hinges on the parties having a place of business in different countries. One must therefore review the applicable arbitration regime and local law to determine whether contemplated arbitration is likely domestic or international (after due consideration of the parties' residence and domicile), where a substantial part of the contract was to be performed, etc.

The implication of the foregoing is that the practitioner should review local law, as applicable, to determine whether arbitration is local and its attendant implications. If it provides for potential international arbitration, counsel should endeavor to appreciate whether it provides the requisite international bridge. Absent such international nexus, IOC could be unwittingly stuck in domestic arbitration, with domestic governing law and venue, rife with the risks discussed below.

e. Seek Waiver of Soverign Immunity

Consistent with the effort to bind the State to the stabilization clause, making it a contracting party as noted above, counsel should seek waiver of sovereign immunity in the production sharing agreement, if limited to the stabilization clause, to effect enforcement

85. *Id.*

86. *Id.* at § 15(1).

87. Arbitration Act, § 2(a)-(c) (2005) (Malay.), http://www.eurasialegalnetwork.com/library/pdfs/nl_ArbitrationAct2005.pdf (last visited Feb. 4, 2009).

and execution. An example of such waiver is contained in the Kurdistan Model Form, which provides as follows in article 41:

> The GOVERNMENT and any Public Company which may be a CONTRACTOR entity at any time hereby fully and irrevocably waives any claim to immunity for itself or any of its assets.
>
> This waiver includes any claim to immunity from:
>
> a. any expert determination, mediation, or arbitration proceedings commenced pursuant to article 42 of this Contract;
>
> b. any judicial, administrative or other proceedings to aid the expert determination, mediation, or arbitration proceedings commenced pursuant to Article 42 of this Contract;
>
> c. any effort to confirm, enforce or execute any decision, settlement, award, judgment, service of process, execution order or attachment (including pre judgment attachment) that results from an expert determination, mediation, arbitration or any judicial, administrative or other proceedings commenced pursuant to this Contract.[88]

The express waiver likely renders moot future disputes regarding enforcement and execution of an arbitral award against the host country.

f. Limit Court Interference

Where the NOC insists on domestic governing law and venue during contract negotiations, IOC counsel should consider specifying in the arbitration clause appropriate limits to local court interference. As noted in the example of Nigeria below, local laws may allow robust judicial interference, with the resulting temptation of gamesmanship by a party.

g. Place of Arbitration

Location is critical not only in real estate but also in arbitration. Counsel should seriously consider the level of confidence in the local courts, the likelihood of entering interim orders in aid of arbitration, the potential for frustrating arbitration, and the enforcement of any awards.

In fine, counsel should draft with the end in mind, aware of the potential for litigation, and should consult local and arbitration counsel early to ensure that the stabilization clause has a desirable anchor for meaningful enforcement, such as international governing law and venue. If counsel is unable to secure preferred language in the production sharing agreement, then a bilateral investment treaty (BIT) remains an internationalizing option.

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88. *See* Model Form Production Sharing Contract of the Kurdistan Regional Government of Iraq, http://74.125.47.132/search?q=cache:eS2Y0xwr54IJ:www.krg.org/grafik/uploaded/KRG_Model_PSC_20071112__2008_07_17_h15m59s45.pdf+%22Production+Sharing+Contract%22+%22Kurdistan+Regional+Government+of+Iraq%22+%22contractor+entity%22&hl=en&ct=clnk&cd=1&gl=us&client=firefox-a (last visited Feb. 4, 2009).

h. Consider a Bilateral Investment Treaty (BIT)

Assuming contracting options are unavailing, counsel should explore options for a BIT to confer the requisite international jurisdictional nexus. Where no such treaty exists between the IOC's home State and the foreign country, counsel should consider corporate restructuring and migration to benefit from a BIT, and while they vary widely, generally offer the following protections: (i) fair and equitable treatment of the investments and an obligation not to impair investments by protected nationals; (ii) physical security and protection not less than that accorded either to investments of a contracting state's own nationals or to investments of nationals of a third State; (iii) an "umbrella clause" under which a contracting state agrees to observe any investment obligations with nationals of another contracting State; (iv) a prohibition on expropriation, except where: (1) the measures are taken in the public interest and under due process of law; (2) the measures are not discriminatory or contrary to any undertaking by the contracting State; and (3) the measures are accompanied by just compensation; (v) free transfer of payments relating to investments; (vi) a most-favored nation provision under which the host State may not treat a foreigner's investments less favorably than that of an investor from a third State; and (vii) an agreement that disputes between a Contracting Party and a national of the other Contracting Party are to be resolved by international arbitration, such as ICSID.[89]

While some countries have protested against a perceived "abuse" of bilateral investment treaties when companies "forum shop", incorporating in a treaty nation solely to take advantage of a BIT protection, arbitral tribunals have rejected such claims; accordingly, an IOC may "forum shop" for investment treaty protection.[90] In *Aguas Del Tunari, S.A. v. Republic of Bolivia*,[91] for example, the holding of Aguas del Tunari was migrated from the Bahamas to Luxembourg, whose shares were in turn held by a Netherlands entity, thereby availing Aguas Del Tunari of the Netherlands-Bolivian BIT, and providing access to the International Centre for Settlement of Investment Disputes (ICSID).

The Republic of Bolivia objected to the ICSID Tribunal's exercise of jurisdiction, claiming that it "never consented to the availability of ICSID jurisdiction for an entity . . . with migratory ownership interests"[92] and that a migrated entity was outside the "circle of beneficiaries" of the Netherlands-Bolivian BIT.[93] The thrust of Bolivia's argument was that the corporate restructuring created mere shells for the purpose of gaining ICSID jurisdiction and that Aguas Del Tunari was not a Bolivian entity "controlled directly or indirectly" by nationals of the Netherlands, as required by the BIT. The tribunal disagreed, reasoning that there is no real distinction between a company that is "controlled directly or indirectly" by another company and one that is "subject to the direct or indirect control" of another; share ownership sufficed to establish control.[94]

89. *See* United Nations Conference on Trade and Development, http://www.unctad.org/Templates/StartPage.asp?intItemID=2068 (last visited Feb. 11, 2009).

90. Venezuela, for example, railed against oil companies' alleged abuse of its BIT with Netherlands and announced that it would renegotiate the treaty. *See Venezuela to Renegotiate Dutch Investment Treaty*, REUTERS, April 30, 2008, http://www.reuters.com/article/idUSN3053796020080430.

91. Aguas del Tunari, S.A. v. Bolivia, ICSID Case No.ARB/02/3 (Oct. 21, 2005), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC629_En&caseId=C210.

92. *Id.* at ¶ 196.

93. *Id.* at ¶ 199.

94. *Id.* at ¶¶ 312, 317, 323.

V. Risks of Domestic Resolution of a Stabilization Dispute

Absent an international nexus, either contractually as described above, or through a treaty, an IOC is stuck with domestic arbitration with the attendant risks:

A. Local Courts Could Frustrate Arbitration

Domestic arbitration in the host country and under domestic law is generally rife with risk and determines which local courts would exercise supervisory jurisdiction over the arbitral tribunal, whether local courts would issue an injunction or order remedies in aid of arbitration, as well as recognize and enforce an award. The risks of a foreign-owned IOC litigating in a host country become more acute in disputes relating to stabilization clauses where arbitration may never even take off.

Nothing precludes the State entity and/or the State from challenging the jurisdiction of the arbitral panel before the local courts and preempting arbitration or filing a declaratory judgment to challenge the validity of the stabilization clause.

B. Delayed Justice, Denied Justice

Assuming a challenge to the arbitrability of an issue or other court involvement, and depending on the specific country, the courts could be manipulated and a ruling could be light years away. Even after an initial judicial decision is rendered, the State could commence appeals, which could also take years to resolve. That the wheels of justice grind painfully slowly in some countries, frustrating arbitration, was recently highlighted in the landmark decision by an English High Court in *IPCO (Nig.) Ltd. v. Nigerian Nat'l Petroleum Corp.*, relating to a contract between IPCO and the Nigerian National Petroleum Corporation (NNPC) to design and build a petroleum export terminal in Nigeria.[95]

A dispute arose and was referred to international arbitration in Nigeria, under Nigerian law, and under supervision of Nigerian courts.[96] IPCO received an award in October 2004 of $152 million and sought an order of enforcement in England.[97] On November 15, 2004, NNPC appealed against the award in Nigerian courts. On November 22, 2004, IPCO filed a Notice of Preliminary Objection to NNPC's Original Motion. The English High Court granted an order to IPCO, but adjourned enforcement of the award pending resolution of the Nigerian appeal.[98] IPCO applied for a variation of the order adjourning enforcement of the award, and the court agreed, allowing immediate partial enforcement of the award (approximately $52.5 million) as subsequent developments in Nigeria had meant that any appeal against the award now lay some five or ten years in the future:

> In the light of all this it is apparent that even a decision at first instance on the Preliminary Objection may now be very many years away. The potential delay involved in any of the possible outcomes of the appeal is five years together with however long it takes for the matter first to be resolved in the Court of Appeal. On a best

95. IPCO (Nig.) Ltd. v. Nigerian Nat'l Petroleum Corp., [2008] EWHC (Comm) 797, 2008 WL 1771454 (appeal taken from Nig.) (U.K.).
96. *Id.*
97. *Id.*
98. *Id.*

case analysis at the conclusion of that period either Okeke J would deliver her ruling, assuming she is still available to do so, or Auta J or another judge would proceed to re-hear the Preliminary Objection de novo. However if the decision of the Court of Appeal is that Auta J should hear and determine the merits of the transfer application, the timescale for achieving resolution at first instance of the Preliminary Objection might be more than twice five years, since Auta J's decision on the merits of the transfer application, when reached, would itself be susceptible to two further appeals.

I have of course been dealing only with the timescale for achievement of a ruling at first instance on the Preliminary Objection. The prospects as to what might occur after such a determination are equally dismaying. The appeal process might take of the order of eight to nine years.[99]

C. Local Law May Permit Unrestrained Judicial Interference

As noted above, there may be no bar under local law for challenging the arbitrability of a stabilization clause before local courts. The Malaysian Arbitration Act, for example, provides in section 4.1 that "[a]ny dispute which the parties have agreed to submit to arbitration under an arbitration agreement may be determined by arbitration UNLESS THE ARBITRATION AGREEMENT IS CONTRARY TO PUBLIC POLICY."[100] What constitutes "public policy" appears to be subjective.

A court could reasonably conclude that an agreement that precludes the state from revising its tax or environmental laws or exercising greater control over its natural resources is contrary to public policy, notwithstanding the potential detriment to the IOC in altering the fiscal regime.

Further, the Nigerian Arbitration Act arguably grants courts broad supervisory authority over arbitration, including the right to intervene, providing as follows:

> 4 (1) A court before which an action which is the subject of an arbitration agreement is brought shall, if any party so request not later than when submitting his first statement on the substance of the dispute, order or stay of proceedings and refer the parties to arbitration.
>
> (2) Where an action referred to in subsection (1) of this section has been brought before a court, arbitral proceedings may nevertheless be commenced or continued, and an award may be made by the arbitral tribunal while the matter is pending before the court.[101]

Compare, however, with section 5 below:

> 5 (1) If any party to an arbitration agreement commences any action in any court with respect to any matter which is the subject of an arbitration agreement any party to the arbitration agreement may, at any time after appearance and before delivering any pleadings or taking any other steps in the proceedings, apply to the court to stay the proceedings.

99. *Id.* at ¶¶ 51-52.
100. Arbitration Act § 4(1) (Malay.) (emphasis added).
101. Arbitration and Conciliation Act (1990) Cap. 19 § 4(1) (Nig.).

(2) A court to which an application is made under subsection (1) of this section may, if it is satisfied-

(a) that there is no sufficient reason why the matter should not be referred to arbitration in accordance with the arbitration agreement; and

(b) that the applicant was at the time when the action was commenced and still remains ready and willing to do all things necessary to the proper conduct of the arbitration, make an order staying the proceedings.[102]

D. Local Laws May Be Poorly Drafted, Developed, or Inconsistent

The above-cited provisions of Nigeria's Arbitration & Conciliation Act show some of the inconsistencies one may encounter arbitrating a dispute in a host country. Unlike section four of the Act, section five does not compel referral to arbitration when a matter subject to an arbitration agreement is brought before the court—the court "may" but is not required to refer to arbitration.

Furthermore, even if the IOC prevails in the domestic arbitration, the tribunal's ruling could be set aside by local courts. Section twenty-nine of Nigeria's Arbitration Act, for example, provides that the court may annul an award if it "contains decisions on matters which are beyond the scope of submission to arbitration."[103] Determining whether the issue was arbitrable in the first place remains a subjective decision for the courts, and affords a robust opportunity to frustrate arbitration.

Thus, a domestically arbitrated matter could be prone to judicial preemption, as the State or State entity could raise before local courts thorny issues such as the authority of the host government to enter into such commitments without the approval of the legislature, whether a previous government could limit the authority of successive governments, and whether the government properly waived sovereign immunity. Unlike in international arbitration where courts basically stand aside, local laws may allow extensive judicial review and supervision. In exercising this role, the courts, unrestrained by decisions of international arbitral tribunals, could frustrate arbitration and may deem the matter unarbitrable.

In fine, while international arbitral tribunals have affirmed the validity of stabilization clauses, reasoning that the contracting State waived sovereign immunity, it is unlikely that local courts in host countries, which are not bound by arbitral decisions, will follow the same reasoning. While the host nation and NOC will naturally prefer local law, the reality is that in developing nations plagued by weak institutions, the judiciary is hardly impervious to the endemic, corroding corruption. Local laws are emergent and appointed judges lack the luxury of lifetime appointments. The same outcry against the perceived greed of IOCs in boom times and which may spur governmental contract repudiation could also infect judicial reasoning. While international arbitral tribunals such as *Aminoil* rejected arguments that stabilization clauses were negotiated unfairly and were essentially imposed, such arguments could have some resonance in local courts, which could contend

102. *Id.* § 5.
103. *Id.* § 29.

that it was a contract of adhesion or was reached with an unauthorized representative, particularly when contracted with a dictator.

With much room for mischief in the local courts, the practitioner should therefore endeavor contractually to internationalize the arbitration by providing for dispute referral to an internationally recognized arbitral forum and by providing for international, rather than domestic governing law and venue. Even if the State itself did not execute the stabilization clause, a tribunal may nonetheless deem the NOC an agent of the state whose acts are attributable to the state. Also, the practitioner should ensure that a BIT provides the requisite bridge to international jurisdiction if contractual options are unavailing.

VI. Conclusion

The popularity and prevalence of stabilization clauses hardly means that they are an effective prophylactic in an agreement with a host country. While stabilization clauses have grown in popularity and remain a useful tool for political risk management, the practitioner must not take their efficacy for granted; their effectiveness depends on other contractual provisions, such as governing law, place of arbitration, and availability of investment treaty protection. Without a properly drafted arbitration clause providing an international anchor contractually through express approval by the State (in addition to the State entity, such as an NOC), international governing law and venue, and absent recourse to a BIT, the utility of a stabilization clause is suspect as the IOC likely becomes trapped in the maze and nightmare of domestic arbitration and litigation.