CONTRACT LAW AND NEGOTIATIONS - The contemporary practice and usage of contractual tools in the sphere of Investor State Contracts

PROSPER MUYATWA (2019) LLM (Salford, Manchester) LLB (University of Zambia, Lusaka) ASCZ AHCZ ACIArb

Contents

1. Introduction

The contemporary practice and usage of contractual tools in the sphere of Investor State Contracts (hereafter "ISCs") has lately directed its anxieties towards risks associated with Sovereignty.

This preoccupation has given birth to ingenious and industrious tendencies by foreign investors to drag these otherwise predominantly domestic agreements into the realm of protection under International Law.

On this backdrop, this paper will in the first part briefly analyze the peculiar position of the State and the luminous risks attached to ISCs. The second part will explore the most pertinent sections found in ISCs. The height of our discussion should critically assess and evaluate the said clauses. The third and final part of this note proposes to explore the connection of such clauses to International Law.

1.1 SOVEREIGNTY

The conventional system of statehood is rapidly being eroded by the concept of globalization. However, the preservation of the age-old supremacy and exclusivity of state power remains dense and unshaken. Due to this special character of the state there are risks attached to any Investor State Contract.

1.2 RISKS OF ISCs

Investor State Contracts by their nature pose unique risks to the foreign investor. Some are of a commercial nature while others are technical such as the promulgation of new environmental laws that entail technological reorganization and recapitalization. We also have risks associated with natural disasters and geological formations. This paper will discuss the risks associated with the state's exercise of its sovereign powers. Over the past two decades' investors have formulated devices to cure or at the least mitigate risks associated with state functions.

2. OVERVIEW OF ISC DEVICES

From Super Pit Mine in Kalgoorlie[1] to the Firestone Rubber Plantation in Liberia. A stroll along the famous Rodeo Drive[2] or checking into the magnificent Anfield[3] for a Liverpool game will quickly reveal to you the

[1] Super Pit is a large gold mine located in Kalgoorlie Western Australia

[2] Rodeo Drive is a chic up market strip in Los Angeles United States and is one of the streets housing the most number of designer shops in the world

[3] Anfield is home to Liverpool Football Club one of the world's largest football clubs

amount of raw materials extracted from, or pumped into these luxuries. Significant amounts of capital are invested over long periods of time to sustain these ventures. For this reason, innovation and industry was inevitable in crafting ISCs.

There are numerous clauses that most investors use to limit risks associated with sovereign legislative functions. These are Renegotiation, Stabilization, Umbrella and Applicable Laws clauses. Other scholars might argue that an Arbitration and the attendant Adaptation clauses are devices equally deployed for the same purpose. Force Majeure whether sitting in the ISC itself or a Hardship clause encased in a Bilateral Investment Treaty may also be classified as such device. The writer will however limit the overview by sampling the most prominent of devices to demonstrate the efficacy of all.

2.1 Stabilization

This tool as opposed to Renegotiation, envisages a prearranged legal framework so that in the event amendments to the domestic laws were effected the investor's contractual texture remains unscathed. This may either be achieved by way of a freezing effect or an agreement in advance to adjust or adapt a contract. The international law principles of good faith play a huge role here. It follows that the less emphasized tools such as Adaptation and Adjustment must seldom be discussed in the absence of Stabilization. They are in effect a subset of Stabilization. The Force Majeure clause is also another form of pre-agreed legal framework more in the lines of a stabilization clause. It is for this reason that the author will also propose that Force Majeure is a type of Stabilization. The import and mischief is usually to freeze obligations and rights in the event of a natural disaster. Its relevance in our discussion kicks in where disasters occur because of sovereign whims and caprices such as strikes, lockouts, coups or even war.

2.2 Renegotiation

Renegotiation is a pre-arranged right of an investor to re-engage the contracting state into talks at any time during the subsistence of a contract. It is a clause that ensures economic equilibrium is maintained in a contract even after new laws that tend to tip the balance were introduced by the contracting state. This tool is useful usually when the compliance no longer makes economic sense. It is usually the legal consequence of

Hardship. It is also frequently called upon when an investment that was initially highly risky turns out lucrative. The state will always drive for more and more participation by even making amendments to the law. The downside to this tool has always been that rarely do parties ever reach agreement. It is simply an agreement to chat. Renegotiation seeks to make a contract flexible and dynamic throughout the duration. A hardship clause is an international contract law principle that emphasizes the maintenance of commercial equilibrium. Notwithstanding some commentaries elevating it to the status of an independent tool one cannot speak about hardship without Renegotiation.

2.3 Umbrella

An Umbrella Clause is one of the many reciprocal sections of general application in Bilateral Investment Treaties (hereinafter "BITs") which have been specifically referred to in the ISC. BITs are made between countries and in those treaties, are found clauses of a reciprocal nature which investors rely upon to gunner compliance by a state to an agreement. More connected to this head though of universal application is the concept of Arbitration. This tool is the most versatile and using Umbrella Clauses investors can seek redress under international tribunals. Closely connected to this tool is the concept of Applicable Laws where investors have sought to oust the domestic law and courts first. Secondly investors have managed to connect the host country to its obligations under the relevant BIT and in so doing cleverly subject the host country to Arbitration.

3. EVALUATION OF ISC DEVICES

Having quickly given a recap of the main tools of ISCs we will now review and assess the efficacy of these tools in their quest to remedy the attendant risks.

3.1. STABILIZATION CLAUSES

This device can classically be analyzed by an examination of the three Libya nationalization arbitral awards handed down in the BP arbitration,[4] TOPCO/CALASIATIC arbitration[5] and the LIAMCO arbitration.[6] The standard clauses

[4] BP Exploration Co. (Libya) Ltd. V. The Government of the Libyan Arab Republic. 53 ILR 297 (1979).
[5] Texaco Overseas Petroleum Co./California Asiatic Oil Co. v. The Government of the Libyan Arab Republic. 53 ILR 389 (1979).
[6] Libyan American Oil Co. v. The Government of the Libyan Arab Republic. 20 ILM 1 (1981).

enshrined in the three concessions provided for, what the author would submit, amounted to a combo of Stabilization/Renegotiation clauses.[7] The provisions' intention was to forbid the amendment, "freezing", of any contractual rights and obligations created thereunder in the absence of "mutual consent",[8] for the duration of the concessions. Libya reneged about four years after Colonel Muammar el-Qaddafi took over and the four-oil exploration and producing companies were nationalized.

The latter took the matters to arbitration for determination and further to hearings the tribunals found for the companies. The Libyan Government in some instances never attended the hearings neither did they make any submissions. In other cases, Libya with impunity simply disregarded and ignored whatever award was rendered. The arbitral form and procedure adopted by respective Counsel also proved to have an impact on the award as well which would explain why LIAMCO's awards took far much longer than the other two. The Libyan Government also resorted to intimidating tactics and would sometimes take punitive measures on the other investment establishments connected to the Applicants' countries of origin.

All these factors go to show that Stabilization clauses are quite inefficient and ineffective where the state is a party. The authority that a Government wields within its territorial precincts to enact laws and legislation that enhance its citizenry's lives cannot possibly be effectively fettered by some private and pre-agreed contractual arrangement. This argument is further augmented by the mandate or lack of it, given to any regime at any moment in time. The social contract[9] also dictates that the mandate to rule may be withdrawn at any time and replaced by another, exercising a mind of its own.

The prevalence of chronic poverty and destitution in the emergent economies has lately given birth to a ferocious

[7] Popularly known as Clauses 16 and 28 of the standard clauses of the Deeds of Concession pursuant to The Libyan Petroleum Law (Law No. 25 of 1955)
[8] Ibid
[9] Freeman, MDA Lloyds Introduction to Jurisprudence (Ninth Edition) para 2-022, Sweet $ Maxwell, 2014.

cancer called corruption. Many a regime changes in Africa and the world at large have fallen due to the fight against this scourge, whether real, perceived or otherwise. This is the reason why most successive governments will almost always undo what their predecessors would have done. This would so often include contracts even of an international dimension.

The net effect is that the Stabilization device is only as good and efficient as it is crafted coupled by the continued good faith of the government of the time. This device should always be definitive enough to address aspects of jurisdiction, applicable law, procedure and to ensure that the contract is couched in such a way that it is brought into the realm of international law. You will in the meantime recall that the state is always seated in a stronger bargaining position than the investor. It is for that reason that the investor will need to examine its BATNA.[10] The ARAMCO arbitration Chrystal clearly recognized the "dignity" and "prerogative" of any sovereign state.[11] Investors must be meticulous in their drafting to ensure internationalization of ISCs.

Stabilization clauses possess another very grave handicap, that is the dialectics between national and international obligations. While matters of national security, tax and safety on one hand must strictly be observed for the good of a nation, the international pressure groups on the other hand are now obsessed with issues of human rights, green technology and conservation and health. This in turn tends to place such tools as Stabilization clauses in very embarrassing light. This is because long term pre-arranged legal frameworks together with their lack of dynamism and inflexibility will oftentimes cross both the domestic and the international good governance principles. It remains to the Investor to craft these clauses with clarity and boldness.

[10] Best Alternative to Negotiated Contract.
[11] The State of Saudi Arabia v. The Arabian American Oil Co. 27 ILR 117. 155-56 (1963)

3.2. RENEGOTIATION CLAUSES

Renegotiation is unique in that it can be contrasted from Stabilization because of its dynamic and flexible nature. The main challenges faced in most Renegotiation clauses is the issue of jurisdiction. Any tribunal presented with a dispute relating to such clause should almost always provoke certain questions. These would be the question relating to jurisdiction to hear the matter, to adapt, trigger events, consequences of failure to negotiate and so forth. This kind of clause prescribes negotiation where the contractual equilibrium has been lost.

The cases of Aminoil v. Kuwait and Lasmo v. Vietnam make interesting comparison. The former case was held to be vague and therefore the tribunal refused to intervene. The Lasmo clauses were to the contrary couched in bold and effective terms so that the tribunal upheld their content. The style of drafting was thus the central issue raised by these tribunals. The absence of key elements will usually result in the tribunal's refusal to adjudicate. The standards required for Renegotiation to chrystalise must first be achieved before the process could commence and these are known as trigger events. Specific parameters of obligations and rights, legal consequences and the extent of the jurisdiction of the tribunal are all necessary to form a solid case for Renegotiation.

Renegotiation is usually the result of Hardship as described under international law and Force Majeure under any given ISC. Where an unforeseen calamity occurs during the life of an ISC Renegotiation is usually the best open remedy for parties. Renegotiation has its drawbacks in the sense that the tool prescribes only the act of renegotiating and not the outcome of negotiations. There is no obligation to come to an agreement and a difference of standpoints does not necessarily trigger renegotiations. Another disadvantage if not properly and adequately couched is the adaptation factor in the light of the principle of sanctity of contracts. Tribunals have therefore found it very difficult to adapt contracts for want of jurisdiction.

Finally, an interesting angle about these kinds of clauses can best be illustrated in the Anaconda v. Chile case.[12] In this case two companies Anaconda and Kennecott dominated mining in Chile prior to the era of "Chileanization". During this period the Chilean government drove hard bargains with the companies which resulted in the increase of government ownership and participation in the ventures. The reasons for the companies' composure were quite interesting and they fully unravel the pitfalls associated with Renegotiation. Firstly, the government proposals to participate represented the "lesser evil", The alternative was nationalization. Secondly, Anaconda's investment in Chile was about the most lucrative as such they could not afford to opt out. This attitude of appeasement did not pay back however as later in 1971 the Allende regime nationalized the mines.

3.3. UMBRELLA CLAUSES

The starting point to any international treaty based discussion may be The Vienna Convention on the Law of Treaties 1969. The convention prescribes the following as being appropriate remedies under international law: Inquiry; Mediation; Conciliation, arbitration or judicial proceedings".[13] The International Court of Justice only has jurisdiction of a binding nature in contentious issues between States. They also produce reasoned non-binding Advisory Opinions. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States stipulates that where parties enter an arbitration agreement the award shall be binding.[14] Nonetheless, enforcement is only subject to contracting states. From the foregoing, it is apparent that all forms of dispute resolution under international law are by their nature voluntary. This is particularly vexing where one party is a state and the other a private entity. For that reason, enforcement of any of the traditional ISC devices has for some time now proved very problematic.

[12] Kolo a and Walde T W Journal: Renegotiation and Contract Adaptation in International Investment Projects
[13] Articles 65(3) and 66(b), Vienna Convention on the Law of Treaties
[14] Article 53(1) Convention on the Settlement of Investment Disputes between States and Nationals of Other States

As described earlier on, Umbrella clauses are in fact sections in a BIT that are specifically referred to and relied upon in an ISC. The breach whatsoever howsoever of any provision in the ISC should be deemed a breach of the BIT. BITs are contracts between two states setting reciprocal standards. The innovation behind ISCs and specifically Umbrella clauses was the ability to subject a state party to arbitration through the back door. However, a review of the numerous cases that have been decided by international tribunals has shown a tendency of inconsistency. Their propensity to internationalize each ISC is by far the greatest of weaknesses as states have vehemently thwarted all attempts to oust domestic laws.

We will illustrate the intrinsic problems by way of comparison of two landmark cases. The brief facts of the two cases that is SGS v. Pakistan,[15] and SGS v. Philippines[16] are similar. Both disputes arose due to services rendered by SGS and not fully paid up by the host country. In both cases SGS sought to rely respectively on the Swiss-Pakistan BIT and the Swiss-Philippines BIT and their argument was that due to the Umbrella clauses contained therein the terms of their contracts were elevated to the level of Treaty claims. In the first case the tribunal took a narrow view and held that over and above the contracts, the parties needed a "special agreement" outside their contract to trigger Treaty protection. The second SGS case took a different twist and sustained SGS for the simple reason that in this case the clause was crafted much clearer than the preceding SGS case. A comparison of the two cases will show that the central distinguishing factor was the style of drafting in both contracts and the respective BITs. Arbitrations as opposed to courts are not restricted in their applications of the law as done to courts in several jurisdictions.

A better understanding of Umbrella clauses can best be attained in part 6 of this paper.

[15] SGS Societe Generale de Surveillance S.A. v. Islamic Republic of Pakistan 8 ICSID Report 406 (2005)
[16] SGS Societe Generale de Surveillance S.A. v. Republic of Philippines 12 ICSID Report 245 (2007)

4. RELATIONSHIP WITH INTERNATIONAL LAW

The Public International Law (hereafter "PIL") is made up of several sources: The Classical International Law that is General Principles of Law;[17] the General Treaties and Multilateral Conventions;[18] Bilateral Treaties;[19] State Customs;[20] Judicial and Arbitral Awards;[21] and Writings of Internationally Recognized Scholars. We will restrict our scope to the relevant four in our context of International Investment Law. Our focus shall still explore its linkage to National Laws.

4.1. CLASSICAL INTERNATIONAL LAW

This facet of the law relates to those principles generally applicable to inter-state relations such as good faith. The impact of this type of law on international investment law has been perceived by certain scholars to have been quite limited. This is because the classical international law principles are principally connected to the conduct of states inter se and international organizations such as the African Union and the United Nations. The other reason is that being residual principles their applicability is usually an instance of last resort. Once an ISC is executed parties will almost always rely on the provisions canvassed therein in line with some chosen law. States have also tended to guard the exclusivity of their respective laws very jealously. It follows that while ISC devices owe their foundation to classical international principles the latter have limited influence on the former.

4.2. BILATERAL INVESTMENT TREATIES

Like any other international law sources the reliance on Treaties by international investors through Umbrella clauses is undermined by the lack of any supreme authority over a state. The act of ratification is a somewhat voluntary act so that some states have gotten away with none compliance. It is an international custom for states to be diplomatic unto each other and this usurps an investor's right to assert a claim. The reciprocal standards set in BITs have created a

[17] Article 38(1) of the Statute of the International Court of Justice.
[18] Ibid
[19] Ibid
[20] Ibid
[21] Ibid

favourable environment for the execution and enforcement of not only Umbrella clauses but Renegotiation and Stabilization clauses alike. Under International Law, there is no means by which an investor may bring a State before a tribunal and that is the marked disadvantage. To that end Umbrella clauses contained in BITs have had tremendous influence on most of the ISC related arbitrations so far decided.

4.3. JUDICIAL AND ARBITRAL AWARDS

Breach of a treaty obligation is usually accompanied by arbitration and investors' protection in that respect is enhanced. Provisions and rules concerned with the domestication of arbitral awards by Contracting States have been posited in numerous treaties.[22]The decisions of these tribunals invariably influenced the development of ISC jurisprudence in the Twentieth Century.

4.4. STATE CUSTOMS

The preoccupation of most industrialized countries following the nationalization fiasco by emergent states of the second half of Twentieth century has been the protection of their nationals' investment. The tendency by the latter has been to extend the definition of investment in BITs, at the same time widening the scope of customary international law through vehicles such as regional integration and globalization. These milestones have in turn produced customs such as adequate compensation upon expropriation. The intermingling of some binding customs with BITs have seen the increasing practice of integration by way of codification through BITs.[23] This has greatly enhanced and boosted devices already in play of the likes of Umbrella, Renegotiation and Stabilization clauses.

[22] Article III of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
[23] This view is an observation purely made at the instance of the author.

5. CONCLUSION

Renegotiation seeks to maintain economic equilibrium by way of a pre-arranged agreement to re-engage in negotiations. Stabilization on the other hand seeks to maintain a status quo of the conditions about which an ISC was concluded. These devices are weakened by the notion of democracy where governments change hands every so often, corruption and the whims and caprices of rulers. These devices are usually ineffective if not properly crafted. Umbrella clauses have emerged quite strong in the last century. Due to the connection to BITs their efficacy has grown in strength over the years. The art of incorporating arbitration clauses in BITs is the reason why today many states have been brought before international tribunals to answer claims by private companies. The innovation and industry has succeeded in broadening the internationalization of ISCs.

Territorial exclusivity of sovereign states and the lack of an international authority to “whip” sovereigns into place has been the biggest hindrance to foreign investment protection. International customs and norms should continue to be created and developed into binding values that in turn are codified under BITs. One such force that is becoming even more effective is globalization and the fear of isolation and sanctions.

Primary Sources

Convention on the Settlement of Investment Disputes between States and Nationals of Other States.
Statute of the International Court of Justice.
New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
Vienna Convention on the Law of Treaties.

Secondary Sources

Books

Freeman, MDA Lloyds Introduction to Jurisprudence (Ninth Edition) para 2-022, Sweet $ Maxwell, 2014.

Journals

Kolo a and Walde T W Journal: Renegotiation and Contract Adaptation in International Investment Projects

Table of Cases

BP Exploration Co. (Libya) Ltd. V. The Government of the Libyan Arab Republic. 53 ILR 297 (1979).

Libyan American Oil Co. v. The Government of the Libyan Arab Republic. 20 ILM 1 (1981).

Texaco Overseas Petroleum Co./California Asiatic Oil Co. v. The Government of the Libyan Arab Republic. 53 ILR 389 (1979).

The State of Saudi Arabia v. The Arabian American Oil Co. 27 ILR 117. 155-56 (1963).

SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan 8 ICSID Report 406 (2005).

SGS Société Générale de Surveillance S.A. v. Republic of Philippines 12 ICSID Report 245 (2007).