



# IGF-OECD BEPS in Mining Program

## Stabilization Clauses, Investment Treaties and Their Impacts on BEPS Mitigation

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# Issues to Consider

- Stabilization clauses
- Investment Treaties and Arbitration
- How they fit together: Do they limit the ability of governments to address BEPS issues?
- Government policy issues
- Corporate action issues
- Limitations on government actions to address BEPS: Some key cases
- Exceptions to limitations: Options for further review
- Conclusions



# Stabilization Clauses

- Stabilization clause: stabilize the legal regime applicable to an investment at the time it was made
- Two types
  - Freezing clauses
  - Economic equilibrium clauses: government covers full cost of company complying with new law, if there is a cost
- Found in laws (investment, mining) and contracts
- Application in extractive sector almost exclusively to developing countries
  - Unconstitutional in most states
  - But applied under international law processes



# Stabilization Clauses

- Scope of stabilization clause:
- Full stabilization: all laws that applying to the mine
- Fiscal stabilization
  - All of fiscal regime
  - Part of the fiscal regime covered by a contract but not generally applicable law
  - Specified aspects of fiscal regime
- Time period
  - Full life of mine
  - Specified period of time from date of commencement or date of commercial production



# Stabilization Clauses

- Territorial scope of stabilization clauses:
- General description is country neutral, but, in practice:
  - in natural resource exploitation contracts, only developing countries are subject to stabilization clauses
  - Prof. John Ruggie's (UN Guiding Principles on Business and Human Rights) legal research team, with IFC, surveyed natural resources contracts
  - Almost exclusively stabilization clauses were in relation to developing countries, and more broadly so in Africa than other regions
  - And many developing countries urged by WB and OECD to put such clauses in their domestic laws

(Shemberg, Andrea "Stabilization Clauses and Human Rights", 11 March 2008,

[http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitlep\\_StabilizationClausesandHumanRights/\\$FILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitlep_StabilizationClausesandHumanRights/$FILE/Stabilization+Paper.pdf))



# Investment Treaties and Arbitration

- Investment Treaties: 3000+ treaties
  - Mostly bilateral (BITs)
  - Increasingly in regional agreements and free trade agreements
  - Establish rules for government treatment of foreign investors
  - Establish remedies in the form of mandatory international arbitration based on the rules
  - Each arbitration tribunal can determine for itself what the law means and how it should be applied, each one independent



# How Stabilization Clauses and Investment Treaties Fit Together

- Limitations on government actions to address BEPS
- Key legal provisions for us:
  - Fair and equitable treatment
  - Protection against expropriation
- Wide scope of interpretation in relation to making changes in laws



# How Stabilization Clauses and Investment Treaties Fit Together

- Fair and equitable treatment: Two key cases
- Tecmed v. Mexico, 2003
- *...this provision ...requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. ...*



# How Stabilization Clauses and Investment Treaties Fit Together

- Fair and equitable treatment: Two key cases
- *Parkerings v. Lithuania*, 2007

*It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.*



# How Stabilization Clauses and Investment Treaties Fit Together

- Expropriation: Two key cases
- Metalclad v. Mexico, 2000, NAFTA case

*103. Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.*



# How Stabilization Clauses and Investment Treaties Fit Together

- Expropriation: Two key cases
- Methanex v. United States, 2005, NAFTA case

*But as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment, is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.*



# How Stabilization Clauses and Investment Treaties Fit Together

- Key point:
  - Many expropriation and FET cases take different approaches
  - But even the one's most supportive of the state right to regulate have caveats, “unless the state has given an undertaking not to do so...”
  - Only developing countries “obliged” to do so
  - FET: all cases raise issue of “legitimate expectations of the investor”
    - Any written promise by a government, and many unwritten statements, can create this legitimate expectation
- So what does that mean in practice?



# Limitations on Government Actions to Address BEPS:

- Limitations on government actions to address BEPS:
  1. The tribunals will reflect on the right to regulate
    - Including that the government has agreed clearly to limit their right to regulate
    - And the investor relied on that limitation
    - Whether or not it is not valid under domestic law is irrelevant under international law cases
  2. Tribunals will read the stabilization clauses very literally:
    - give the investor exactly what it says
    - no more, but no less



## Limitations on Government Actions to Address BEPS:

- Sample cases:
- Enron v. Argentina, 2007

*261. This Tribunal notes, however, that the stabilization requirement does not mean the freezing of the legal system or the disappearance of the regulatory power of the State. As noted by the tribunal in CMS: It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects.*



# Limitations on Government Actions to Address BEPS:

- Sample cases:
- Enron v. Argentina, 2007
- 262 *What seems to be essential, however, is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding to invest.*



## Limitations on Government Actions to Address BEPS:

- Sample cases:
- Enron v. Argentina

264. Argentina in the early 1990s constructed a regulatory framework for the gas sector *containing specific guarantees to attract foreign capital to an economy historically unstable and volatile*. As part of this regulatory framework, *Argentina guaranteed that tariffs would be calculated in US dollars, converted into pesos for billing purposes, adjusted semi-annually in accordance with the US PPI and sufficient to cover costs and a reasonable rate of return. It further guaranteed that tariffs would not be subject to freezing or price controls without compensation. Foreign investors were specifically targeted to invest in the privatization of public utilities in the gas sector. Substantial foreign investment was undertaken on the strength of such guarantees, including the investment made by Enron in TGS.*



# Limitations on Government Actions to Address BEPS:

- Sample cases:
- Bogdanov v Moldova, 2013

*183. Indeed, the protection of legitimate expectations must now be considered as firmly rooted in arbitral practice, and "a reversal of assurances by the host state which have led to legitimate expectations will be considered as a violation of the principle of fair and equitable treatment"*



# Limitations on Government Actions to Address BEPS:

- Sample cases:
- Bogdanov v Moldova, 2013

186. On the other hand, as pointed out by *the Parkerings* tribunal quoted by claimants above, "it is each state's undeniable right and privilege to exercise its sovereign legislative power ... *Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about an amendment brought to the regulatory framework existing at the time an investor made his investment*"

187. *In other words, if the Republic of Moldova has enacted new legislation deteriorating the conditions of Claimants and if such legislation falls within the scope of the stabilisation clause, then this would, at least prima facie, amount to a breach of the fair and equitable standard of the Treaty. But if such new legislation falls outside the scope of the stabilisation clause, its enactment by the Republic will not have deprived Claimants of any legitimate expectations created by the assurances in that clause.*



# Limitations on Government Actions to Address BEPS:

- Sample cases:
- Bogdanov v Moldova

188. *The question, therefore, is what exactly the Republic promised by issuing the stabilisation clause.* According to the wording of the clause itself, it covers new laws "deteriorating the conditions of Free Zone residents activities with regard to the customs and tax regimes stipulated by the present law". *Since the tax regime stipulated by Law 625 only concerns value added tax, the stabilisation clause in fact only relates to the specific customs and VAT privileges for residents of the Free Zones which are stipulated in Law 625.* It created a legitimate expectation that the rules in Law 625 exempting them from customs duties and VAT would remain unchanged, but it did not extend to legislation in other fields.



## Exceptions to Limitations

- Public policy, “ordre public international”
  - Broad recognition today that addressing BEPS issues is a matter of international public order
- Implementation of international agreements/standards
  - Also ensures measures are not arbitrary or discriminatory
- Implement obligations of investors
- More research on applying these exceptions needed
  - Next stage of this work



## Options to Consider: Contracts

- If stabilization is included, very specific language, should be used:
  - What is covered
  - How long
- Alternative approach:
  - Include a government obligation against arbitrary and discriminatory treatment of investors (Ruggie recommendation, Principles of Responsible Contracting, Annex to Guiding Principles)



# Options to Consider: In Contracts and Treaties

- Counter-balance investor rights with express recognition of obligation of investor not to use BEPS practices
  - And include right of government to prevent this
- Include “right to regulate” language in text
  - Recognition that governments maintain the right to regulate in the public interest without paying compensation
- Express right to implement international best practice/standards provision in relation to operations, taxation, accountability
- Include obligations for EITI to apply to covered projects
- Some treaties exclude taxation or limit access to dispute settlement for tax issues (Occidental v. Ecuador compared to Encana v. Ecuador)



## Preliminary Conclusions

- Stabilization clauses have impact under international law, whether or not they are legal under domestic law
  - They will, therefore, impact international legal processes
- Investment treaty arbitration can reinforce application of stabilization clauses
- Impact will depend on
  - clarity and scope of drafting in contracts
  - Clarity and scope of drafting in related investment treaties
  - Changing perceptions of international public policy on BEPS